

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

EVENT DATE/TIME: OCTOBER 30, 2019 / 2:00PM GMT

## OVERVIEW:

Co. reported 3Q19 reported operating income of \$88.5m and diluted EPS of \$1.17.



OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

## CORPORATE PARTICIPANTS

**Amanda H. Butler** *Lincoln Electric Holdings, Inc. - VP of IR & Communications*

**Christopher L. Mapes** *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

**Vincent K. Petrella** *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Brian Edward Bollenbacher** *Longbow Research LLC - Research Analyst*

**Joseph O'Dea** *Vertical Research Partners, LLC - Principal*

**Mircea Dobre** *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

**Nathan Hardie Jones** *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

**Robert Cameron Wertheimer** *Melius Research LLC - Founding Partner, Director of Research & Research Analyst of Global Machinery and Cannabis*

**Robert Stephen Barger** *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

**Saree Emily Boroditsky** *Jefferies LLC, Research Division - Equity Analyst*

**Walter Scott Liptak** *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

## PRESENTATION

### Operator

Greetings, and welcome to the Lincoln Electric 2019 Third Quarter Financial Results Conference Call. (Operator Instructions) And this call is being recorded.

It is now my pleasure to introduce your host, Amanda Butler, Vice President of Investor Relations and Communications. You may begin.

---

**Amanda H. Butler** - *Lincoln Electric Holdings, Inc. - VP of IR & Communications*

Thank you, Latif, and good morning, everyone. Welcome to Lincoln Electric's 2019 Third Quarter Conference Call. We released our financial results earlier today, and you can find our release as an attachment to this call's slide presentation as well as on the Lincoln Electric website at [lincolnelectric.com](http://lincolnelectric.com) in the Investor Relations section.

Joining me on the call today is Chris Mapes, Lincoln's Chairman, President and Chief Executive Officer; as well as our Chief Financial Officer, Vince Petrella. Chris will begin the discussion with an overview of third quarter results, and Vince will cover the quarter performance in more detail. Following our prepared remarks, we're happy to 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 discussed financial measures that do not conform to U.S. GAAP. And a reconciliation of non-GAAP measures to the most comparable GAAP measure is found in the financial tables in our earnings release, which, again, is available in the Investor Relations section of our website on [lincolnelectric.com](http://lincolnelectric.com).

And with that, I'll turn the call over to Chris Mapes.



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

Thank you, Amanda. Good morning, everyone. As we move to Slide 3, we continued to generate strong cash flows, solid cash conversion and top quartile returns despite weaker market conditions in the third quarter. Lower capital spending and slowing global industrial production rates challenged volumes. This was most pronounced in our automation portfolio where lower sales and unfavorable product line mix significantly impacted profitability, decremental margin and earnings performance. Excluding automation and acquisitions, we generated a low 20% decremental margin in the remainder of the business as positive price cost and cost management actions helped mitigate the unfavorable impact of automotive sector weakness and a broader deceleration in global industrial production.

Moving to Slide 4. Third quarter results were below our expectations due to weakening organic sales. Broad global deceleration demand resulted in a 4.1% reduction in volumes. This decline was from 3 primary areas. First, incremental compression in capital spending along with some challenging projects impacted our automation portfolio and acquisitions. Second, ongoing manufacturing weakness in International Welding led by declines in Asia Pacific and Europe as well as a broad reduction in global industrial production impacted consumable demand in our welding segments. While price declined 60 basis points in the quarter, price cost was positive in all segments, and Americas Welding 1.2% lower price reflected the removal of U.S. tariff surcharges.

On a global product basis, we incurred low single-digit percent volume declines in both consumables and standard equipment, and automation declined at a low double-digit percent rate in the quarter.

Looking at end market trends, the incremental slowdown in global industrial production in the quarter shifted approximately 60% of our revenue exposure to end markets that are compressing. This compares to approximately 1/3 of our revenue exposed to headwinds in the second quarter.

The automotive/transportation sector compressed at a double-digit percent rate, which was a significant deceleration. General fabrication declined mid-single digits, it's first decline this year. Heavy industry and energy demand continued to grow as shipbuilding and maintenance and repair activity rose substantially in the quarter, and all energy and applications accelerated except pipeline, which has been primarily hampered by project delays and interruptions.

Moving to Slide 5. Although automation order rates improved sequentially in Q2 -- from Q2, we expect fourth quarter demand to remain below prior year levels. Given weak global manufacturing data, uncertainty in the market outlook and cautious customer sentiment, we are expecting continued softness through the fourth quarter. We will also continue to face challenging price comparisons in Americas Welding through the first half of 2020 until we anniversary the removal of the U.S. tariff surcharges.

We have operated successfully through economic cycles with strong cash flow generation, cash conversion and returns. And we've already implemented further cost-reduction actions to mitigate the impact of the cycle. As standard, we are continuing to invest in our capital projects and our growth initiatives to ensure that we remain well positioned to capture growth as we move through the cycle. For customers and analysts visiting us at the upcoming FABTECH trade show, you'll see a number of new solutions that we're launching there including 2 that we released a few days ago, such as our new Power MIG 360 Multi-Process light industrial welder, which we view as the industry's new best-in-class all-in-one performance welder. We also launched our new PIPEFAB solution for pipeline and vessel applications. Having redesigned this new solution from the ground up, we view this as a game changer. PIPEFAB uses our latest technologies to improve weld performance, quality and customer productivity. These 2 equipment solutions reinforce our 52% equipment vitality index, a measure of the percent of sales from new products launched in the last 5 years.

Additionally, we just launched our new state-of-the-art advanced technology solution center in Germany, which gives us an unprecedented commercial presence in the European market. This new tech center allows us to feature our latest technologies in welding consumables, equipment and automation and how they work together to deliver world-class solutions to customers.

And now, I'll pass the call to Vince to cover the quarter in more detail. Vince?



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

**Vincent K. Petrella** - Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer

Thank you, Chris. Moving to Slide 6. Our consolidated third quarter sales declined 90 basis points as a 5.4% benefit from acquisitions was offset by 4.1% lower volumes, a 60 basis point decline in price and a 1.6% unfavorable impact from foreign exchange. Our third quarter gross profit margin decreased 150 basis points to 32.6% as positive price cost including a \$1.6 million LIFO credit was offset by weaker operating leverage and unfavorable mix.

Automation products and acquisitions represented the bulk of the year-over-year margin decline. Our SG&A expense was essentially flat in dollar terms as lower incentive compensation expense and favorable foreign exchange offset added SG&A from acquisitions. SG&A as a percent of sales increased 20 basis points to 20.3%. Reported operating income decreased 12.1% to \$88.5 million or 12.1% of sales. Operating income results included approximately \$3.1 million in special item charges related to rationalization and asset impairments from our International Welding integration activities and amortization of step-up of acquired inventories. Excluding these special items, adjusted operating income declined 12.2% to \$91.6 million or 12.5% of sales, a 170 basis point decline versus the prior year. Acquisitions and the automation businesses had a 150 basis point unfavorable impact to the adjusted operating profit margin. Excluding acquisitions on our automation product lines, the third quarter decremental margin would have been 23%.

Our third quarter effective tax rate was 21.1% compared with 26.3% in the prior year period. Excluding special items, our third quarter tax rate was 22.4%. This compares with 23.3% in the prior year period. We now expect our fourth quarter 2019 effective tax rate to be in the low to mid-20% range, subject to the future mix of earnings and the timing and extent of discrete tax items.

Third quarter diluted earnings per share increased 9.3% to \$1.17 compared with \$1.07 in the prior year. Excluding special items, adjusted diluted earnings per share decreased 9.9% to \$1.09, reflecting the impact of lower organic sales. Unfavorable foreign exchange translation reduced EPS by \$0.02 per share.

Now moving to the geographical segments on Slide 7. Americas Welding segment's third quarter adjusted EBIT dollars [declined 17%] to \$74.1 million. The adjusted EBIT margin declined 280 basis points to 15.6% as positive price costs, LIFO benefits and cost management actions were offset by lower volumes, primarily in the automation portfolio. Excluding the weakness in our automation business, the segment's adjusted EBIT margins would have decreased 80 basis points versus the prior year or 39% decremental margin.

Looking at the top line. Americas Welding reported a 5.7% decline in organic sales against a challenging prior year comparison of 14.9% organic sales growth. Americas Welding volumes declined 4.5%, largely due to a mid-teens percent decline in the automation portfolio. Additionally, broader weakness and general industrial production impacted consumable volumes at a low single-digit percent rate. Our standard equipment volumes increased modestly on demand for our new product solutions. The segment's 1.2% lower price reflects the removal of surcharges in the U.S. business. We do expect pricing to be lower through the remainder of the year and through the first half of 2020 until we anniversary these surcharges. Americas Welding sales also benefited 3.8% from the 3 automation acquisitions that have been previously announced.

Moving to Slide 8. The International Welding segment's adjusted EBIT decreased 5% to \$10.2 million, and the adjusted EBIT margin declined 10 basis points to 4.9%. Price cost management and benefits from rationalization and integration activities helped mitigate the impact of lower volumes. Organic sales decreased 5.9% as a 6.2% decline in volumes was partially offset by 30 basis points of positive price. Volume weakness was predominantly in Asia Pacific from slowing regional automotive and heavy fabrication sector demand. European volumes are largely flat in the quarter despite weakening macroeconomic conditions in France and Germany on easier prior year comparisons.

Moving to the Harris Products Group. Third quarter adjusted EBIT increased 27.2% to \$11 million. Adjusted EBIT margin increased 160 basis points to 13.2% on favorable mix, accretive acquisitions and productivity improvements. Volumes increased 4.7% on continued solid demand in the OEM channel and in aluminum products. Harris also recognized a 6.5% sales improvement from the acquisition of Worthington Industries' soldering business.

Moving to Slide 10. Cash flows from operations increased 21% to \$129 million, reflecting improved working capital and lower tax payments, which helped to generate a 165% cash conversion ratio. Our working capital ratio increased due to lower sales.



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

Moving to Slide 11. We maintained a balanced approach to capital allocation, deploying \$136 million in the quarter. We paid a \$29 million dividend to shareholders, reflecting the 21% higher dividend payout rate, and we also repurchased \$61 million in shares.

We invested in the business with \$17 million in capital expenditures and \$29 million in acquisitions. For the balance of the year, we continue to prioritize growth investments and the return of cash to shareholders through a higher dividend payout rate and share repurchases.

And with that, I would like to turn the call over for questions. Latif?

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) Our first question comes from the line of Rob Wertheimer of Melius Research.

**Robert Cameron Wertheimer** - *Melius Research LLC - Founding Partner, Director of Research & Research Analyst of Global Machinery and Cannabis*

I just wanted to chat about incremental margins for a second. I mean, obviously, you have one of the more flexible operating systems out there and then incrementals weren't great this quarter. And just to -- did the decline catch you by surprise or is it just normal? I mean, obviously, a quarter is only a quarter, it is just normal time to sort of accelerate changes.

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Rob, I'd start by saying that, that's why we -- I provided some decremental information ex automation because the automation performance was certainly distortive to our normal decremental margin performance. Without that, I would tell you that the Americas was a little higher than what our historical performance has been in that segment, and overall businesses is more in line with our decremental experience ex automation. So automation's performance was particularly weak in the quarter. The slowdown in order activity and the deferral of projects, and most importantly, the mix of what we delivered in the quarter really impacted our consolidated results, and certainly the Americas.

**Robert Cameron Wertheimer** - *Melius Research LLC - Founding Partner, Director of Research & Research Analyst of Global Machinery and Cannabis*

Okay. And then, if I can, just on pricing, you're giving back some of the surcharges which, I guess, we've long known was going to happen. When you sort of look cycle to cycle, did you keep as much pricing through those surcharges as you think? Or is pricing perhaps eroding a little bit more than you would've guessed? And I'll stop there.

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Thanks, Rob. Now the pricing impact is really in almost totality the surcharge removal. So I would tell you that our pricing in the business ex surcharges is relatively stable, and we actually took a little bit of price in some of our business segments outside of the Americas. So the -- that whole decline is really associated with the removal of those tariffs. Now we haven't put in a significant additional price increases in the Americas, so it's really that flow-through that you see on the surcharges.

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

Yes, Rob, and I would just add that in our application of those surcharges where most of them are occurring here in our Americas segment, we were very transparent with our customers as to the cost of the surcharge, and they would be able to see that very clearly in our communications



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

and our transaction with them. So the removal of that once we -- once those -- these have been exempted or dropped is something that's very clear and transparent with our customer base.

---

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

So again, just to finish this off Rob, we took 30 basis points of price in International on declining volumes of over 6%, and we took 100 basis points in the Harris Products Group. And so the Americas, because of surcharge, came down 120 basis points.

---

**Operator**

Our next question comes from the line of Saree Boroditsky of Jefferies.

---

**Saree Emily Boroditsky** - *Jefferies LLC, Research Division - Equity Analyst*

So you previously expected volumes to be flat to low single digits in the second half of the year. Could you just provide more color on what end markets or regions have really deteriorated since your previous commentary?

---

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

Well, that's really the challenge that occurred for us in looking at our third quarter performance. As we exited Q2, we thought that we had seen some signals from the market that we were going to see a flattening marketplace in Q3, and unfortunately, we continued to see the compression within the business. Part of the acceleration to that compression is, I mentioned in the earlier comments, we had a portion of that, that came from Europe; a portion of that, that came from China. And on an industry segment basis, we saw an acceleration in the compression in the automotive segment. A portion of that certainly could be aligned with some of the challenges in the U.S. market relative to the strike that occurred, but that would only be one of those elements. The compression across that segment was much more broad. But automotive was certainly the other segment that we saw that compression. And then my final comment, Saree, on the segment side would be, for the first time this year, we actually saw general fabrication compressed for us in the marketplace. So those 2 industry segments and then globally, certainly, the compression that we saw in China and in Europe would be the areas that I would focus on.

---

**Saree Emily Boroditsky** - *Jefferies LLC, Research Division - Equity Analyst*

That's helpful. And then you highlighted the weakness obviously in APAC and International. I was wondering if you would comment on what you saw in exports in Americas segment and any color by end markets?

---

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. So the exports were flat on a year-over-year basis, which was very encouraging. And our export business is largely equipments. And so we do think that some of our newer product introductions were taken well in the international markets. So we were flattish in exports out of the U.S.

---

**Operator**

Our next question comes from Nathan Jones of Stifel.



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

**Nathan Hardie Jones** - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Chris, I think when you -- in your prepared comments that you talked about a difficult or problematic automation project. Was there an impairment to the margin on a project there or something that didn't chip in the quarter that made automation weaker than it otherwise would have been?

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

Well, I'd say -- first of all, couple of quick comments on automation. First, I got to tell you, I've got great confidence in the long-term secular trends and the strategy we're deploying in our automation business. We absolutely are confident that globally the challenge in finding the qualified welder and the desire to drive productivity that our approach to automation is the right approach, and we're going to continue to drive that business and seek acquisitions to continue to expand upon that business. But in the quarter, certainly, beyond coming off a very challenging comparable prior year, we certainly had a couple of projects that were more difficult for us. And those projects did materialize in Q3 and we recognized some of those challenges there. But I'm cautious because we could certainly have a challenging project in our future. And as I said in my prepared remarks, although our automation business has sequentially improved from Q2 into Q3, I don't believe our Q4 results will meet our prior year results. We still expect to see a challenged situation on a year-over-year basis for our automation business in Q4. But we'll work through those issues and have great confidence in our strategy there as we continue to build our automation portfolio.

**Nathan Hardie Jones** - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Okay. But -- so that challenging project or few projects did impact the automation margins or the automation shipments during the quarter. So kind of fundamentally the demand is maybe not as bad as the results indicate?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

No. The demand is down year-over-year mid-teens. So from a revenue perspective ex acquisitions the order or the orders that translated into sales in the quarter were down significantly, but just piling on, we had some unusually large underperforming projects in the quarter that also contributed to a poor result in our automation portfolio. So it was also the top line. And finally, just to pile on some more, we had a poor mix as well. So our highest margin part of the portfolio was a good part of the decline on a year-over-year basis. So the richness of the mix was weak on top of being down mid-teens of sales volumes. So we had a weak quarter in automation for sure.

**Nathan Hardie Jones** - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Perfect. Still I'm there on automation. You guys talked about really the price down in the Americas being only the removal of the surcharges. And Lincoln has got a very good record historically of hanging on to price in deflationary environments. What is your outlook going forward for the pricing environment? Do you think you can hold pricing here ex anything that moves around with tire or some things like that? Or do you think that the market's going to require you to give some pricing back?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. I think, where we sit today, because of the requirement to anniversary the tariffs, you will continue to see in the fourth quarter some pricing declines in the Americas. I don't believe that we're in an environment now where a lot of price can be taken when we have mid- to high single-digit volume pressure on the business, and with a little bit of softening in our major input costs being steel, as we talked about, we did take some LIFO credits that will likely continue into the fourth quarter. So we get a little bit of assistance there. But I don't think we're in an environment enough of a strong volume environment and inflation that would be pushing through a whole lot of price here in the next quarter or so.



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

**Nathan Hardie Jones** - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

But it sounds like you don't think you're going to have to give any back either outside of what you've already done on the surcharges?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

No. I think this kind of a volume environment, it's not mid, may be trending in the high single digits won't be enough for the market to lose a lot of discipline.

**Operator**

Our next question comes from the line of Mig Dobre of Baird.

**Mircea Dobre** - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

So to be honest with you guys, this quarter is a bit of a head scratcher for me, especially as it pertains to automation. And maybe you can kind of set me straight on a few items here. My understanding has always been that the automation business carried a little bit of lower margin than the overall segment. So maybe you can set me straight on that. I'm also curious as to how you think about incremental and decremental margins, the normal incremental and decremental, on dollars of volume swings in automation?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Right. I'll answer the first one. Last year's third quarter, we actually achieved an automation of mid-teens operating profit margin. So we were a little -- we had a particularly good quarter last year's third quarter, richen the mix of the total corporation. And then this year, Mig, that operating profit margin's essentially been cut in half because of the factors that we've talked about earlier. So we went from mid-teens to mid-single digits on a year-over-year basis and that certainly exasperates our comparisons, and we talked about those in response to a previous question. Again, volumes down mid-teens, mix weak, some loss projects. And so we certainly don't expect to continue to perform in the automation portfolio at a single-digit type of operating profit margin, and we would expect to migrate back up over the longer term to something that approximates the group average. But we do have a tough year-over-year comparison in the third quarter related to a very strong outperformance in the prior year versus the strong underperformance in the current year.

As far as decrementals are concerned, I think this business will likely have, over the longer term, a little bit more of a decremental margin impact on the downside because the costs are largely more fixed than some of our other businesses. It's mostly SG&A type of engineering and white collar workforce that can't be flexed as easily as the rest of our businesses in the U.S. And so I think you're going to see a little bit more decremental on the downside in this business. And again, that -- it will move around depending upon the mix, but it will be higher than what we have experienced traditionally as a corporation and as an Americas segment, which has roughly been in the mid-20s type of region.

**Mircea Dobre** - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

Okay. So the decrementals, and I'm presuming, incrementals for automation are going to be higher than this 25%?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Right. It'll be a little bit more volatility than what our core business is.





## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

**Mircea Dobre** - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

And with that, I am still trying to understand what was the extraordinary or onetime, however you want to call it, impact in this automation business in the quarter? I mean, if you're sort of looking at what would've been normal versus these projects, is it that we're talking \$4 million, \$5 million, can you quantify that?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

I really can't. I would tell you though that I wouldn't expect us to replicate this quarter often. Like I said in some pretty detailed comments about it, there are a lot of headwinds in this quarter that I do not expect to occur in sequence as we roll through the rest of 2019 and into 2020.

**Mircea Dobre** - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

Well, I'm sorry, I'm still unclear because you said that the fourth quarter is challenging as well. So have we kind of taken our pain in the third quarter? Or are we setting up for a rough fourth quarter?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

No, very consistent. Mig, what we're saying is that we're still going to be down year-over-year in the automation business. We were down mid-teens. We believe -- based on our order rates we see, Chris pointed out that they are improving sequentially, but still not enough to wipe out that 15% type of year-over-year decline. I don't expect these projects to be replicated in the fourth quarter, and I also expect that our mix should improve a bit. So as far as automation is concerned, this should be a trough, and we should see some improvement, and then we have the rest of the business to worry about obviously.

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

Yes, Mig, as you know, with the automation business with us sequentially improving from Q2 to Q3, and as Vince said, we expect improvement from Q3 to Q4, although not operating at prior year levels, but when we have those sequential improvements, it also makes it very difficult for us to be more aggressive in necessarily addressing some areas of the cost structure. So that is part of that conflict that we had that certainly materialized in Q3. And as Vince said, we're hopeful that quite frankly we're seeing a troughing of the automation business as it relates to our Q3 performance. And we'll continue to drive that strategy within the business as we move through the rest of the year.

**Mircea Dobre** - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

I see. Then my follow-up, I want to ask a question on International. If I understand correctly, Europe volumes were flat, which is good. I am looking at flat margins as well, maybe down a little bit on a year-over-year basis. And I guess my question is this, if we're finally to the point that we're seeing some stability in Europe overall, given everything that you've done with Air Liquide and your business over there, at what point in time should we start seeing in some real margin expansion, especially as we think about your framework for double-digit margin for this segment?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. So it was very encouraging to see that the top line did stabilize in the face of what we would describe as an accelerating softness in the industrial environment in Europe. So I think it's going to be challenging, Mig, and as the softness continues in our major markets in Europe to see a margin expansion at this time. So we really, from my perspective, need to see a stabilization in the macro environment there and start to see some growth in the top line aided by those tailwinds when they do come. I think we are continuing though on the cost side to compress out costs in that region, that's not completely behind us. So you'll -- we'll have some opportunity as we move through 2020 to -- even with challenging top line environment,



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

start to see some leverage come through that business, provided again that the -- we don't have another step-down in macros and industrial activity in the European region.

---

**Operator**

Our next question comes from Walter Liptak of Seaport Global.

---

**Walter Scott Liptak** - *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

Let me start with just some follow-ons from the last discussion with Mig. You said that the EU was flat, but the market is deteriorating. Why do you think you guys were flat? Was it a market share win back? Or was there like a channel fill that had to happen? Why is it stabilizing?

---

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

Well, certainly one of the things that we've been focused on in our business in Europe is that as we've been moving through the integration, we've been very focused in ensuring that our customer delivery metrics and our ability to serve the marketplace were improving. And we've been managing and tracking those expectations and that data for the last several months. Matter of fact, we actually had a communication with our customers in the marketplace in the third quarter, sharing with them the improvements we've made and the confidence that we have walled and our ability to serve the marketplace there in Europe. So I certainly believe that as a catalyst for some of that improvement. I don't want to go as far as to say that flattening, although we know the market has deteriorated there, especially the automotive market is a market share when you know we don't think about market share from a quarter-to-quarter basis. But certainly, the symbolization is a positive sign, and we're going to continue to work at making the improvements in finding growth in that market there in Europe. It certainly was positive to be there for the grand opening of our new technical center outside of Frankfurt. We launched that last week and believe that also can be a way for us to bring our solutions and technologies closer to our customers there in the region.

---

**Walter Scott Liptak** - *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

Okay. Okay. And it sounds like, based on Vince's comment, that there is most restructuring that still needs to be done with Air Liquide Welding. What do you think of the costs and timing for that?

---

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

We are not in a position at this point to make any kind of estimates on what we might have in terms of actions or costs, but we're continuing to look at opportunities to compress the head count down there to match our new volume levels at this present time.

---

**Walter Scott Liptak** - *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

Okay. All right. And then, on your prepared remarks, you guys talked about cost cutting, but then it was more kind of variable costs, lower work hours, less overtime, watching spending. Are you guys contemplating some bigger cost actions, maybe outside of the Air Liquide Welding business to mitigate? Or is it that -- is it more variable costs coming out?

---

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

Well, I think as we look at what we're going to be able to actually impact through the rest of 2019 that we're really looking strongly at these variable cost actions that we can go out and address with the lack of clarity we see for the business moving into Q4 and expecting Q4 to look a lot like Q3. Certainly, if we're not trouging and not seeing the improvements that we expect to see in the business moving into 2020, then we'd be looking



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

at taking broader actions to try to mitigate some of the negative impacts from the marketplace. But as it relates to the rest of 2019, I think the actions we've talked about is the path that we will go. And then again, once we get more clarity into what type of demand market we think we'll be participating in moving into 2020 will determine whether we need to take further actions to be able to mitigate the impact.

---

**Walter Scott Liptak** - *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

Okay. All right. And then last one for me is on the decrementals. So that -- I wasn't sure I understood. Is the 23%, it sounds like that was worse than expected because of North America and the outsized decrementals there, like is 23% what we should be thinking about kind of into the future until revenue stabilizes? Or are you going to be able to improve that and get lower decrementals?

---

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. So the 23% is what is in line with what we have historically experienced through downturns in volumes, Walt. And that is ex our automation businesses and acquisitions. So obviously, it was a lot higher, but we wanted to give you a read-through on our core business. And it is in this soft environment in line with our historical performance from a decremental perspective, and we wanted to take out the one very poor quarter from a performance perspective in the automation business. We'll see how that shakes out in the fourth quarter, but it was just a with and without calculation to give you an idea of the core business performance from a decremental perspective. And that is, again, in line with our historical performance from that perspective.

---

**Operator**

Our next question comes from Chris Dankert of Longbow Research.

---

**Brian Edward Bollenbacher** - *Longbow Research LLC - Research Analyst*

This is Brian on for Chris. Just around the Europe sales, I know you guys identified about \$100 million to \$110 million in some pruning. Have you been able to identify any further there? Or is that still kind of the rate we are looking at?

---

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

No. That's about what we're looking at around those numbers.

---

**Brian Edward Bollenbacher** - *Longbow Research LLC - Research Analyst*

All right. And then kind of jumping over to the China growth rates, were those kind of in line with the Asia down double digits? And is stabilization expected during 4Q or does the trade macro uncertainty causes softness to kind of spill over into early 2020?

---

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

Look, I think that softness is going to continue into 2020 until we start to get more clarity around trade and a couple of the other tariff issues that are impacting imported equipment into that marketplace. And those -- the China declines would have been greater than the average declines for International or Asia Pac. It certainly was a very challenging quarter for them, and we expect another challenging quarter for them in Q4.



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Right. Brian, just as a reminder, we had our big step-down in China in the second quarter. So now we've had the third quarter that was around the same sort of year-over-year declines. And so I would think we've got -- as long as the environment is consistent with what we've seen in the last 2 quarters, we're going to have difficult comparisons for a couple of more quarters where we're going to see in the fourth quarter and the first quarter of next year some big declines because of the tough comparisons based on the current trends and operating environment that we see now.

---

**Operator**

(Operator Instructions) Our next question comes from the line of Joe O'Dea of Vertical Research.

---

**Joseph O'Dea** - *Vertical Research Partners, LLC - Principal*

Related to some comments on that last question, just kind of interested in your perspective on kind of the demand transition that's underway, and I think, seeing maybe a little bit of flattening in Europe, talking about China, a couple of tough quarters, but if that's stabilizing at current demand levels, you get a couple more. North America, maybe some recent trends in terms of a downshift when you talk about general fab. I'm just curious, putting that all together, kind of what your view is of the demand transition and kind of how you can put any perspective on how that's likely to continue maybe into 2020 by regions? When we can expect some overall stabilization across LECO?

---

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. Look, I think that's a really tough read-through. When we look at what happened in the third quarter, we did see some greater deterioration as the quarter unfolded. I think based on what we've seen in October, we're going to likely see the same kind of trending and environment that we experienced certainly in the third quarter. I think 2020 is just -- for at least me, is just too far off based on the kind of dynamics that we see going on in the marketplace right now. And there's just too much uncertainty, at least from our perspective, on that outlook. But the most I could give from what we're seeing in the trends throughout our business is we're going to see more of the same in the fourth quarter. And then 2020 is something we're going to have to have an updated view on once we get through the fourth quarter when we talk to you, again, in February.

---

**Joseph O'Dea** - *Vertical Research Partners, LLC - Principal*

Okay. And then on costs, I mean, you touched on it a little bit with some steel costs coming down, but can you frame it at all in terms of what kind of steel inflation you saw kind of subsequent to tariffs? And then to what degree that's come off? And I guess, any sort of insight on -- are there further opportunities that you have through negotiations to drive that lower?

---

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

So look, we recognize that when the demands are compressing out in the broad industrial marketplace out there, our teams will continue to work with our supply base, but we don't see that as an enormous opportunity as we're moving through the rest of the fourth quarter, or certainly, a visibility that we have right now moving into Q1.

I think our teams have done an excellent job in the past of managing that price cost dynamic here within Lincoln Electric and continue to manage it very closely, but I certainly don't see that as any greater opportunity for us as I think about Q4 as we're moving into 2020. I'd also just like to amplify Vince's comments. So look at -- especially coming out of Q2 where we thought we were going to see a more favorable volume environment in Q3 and then that didn't materialize and we saw that volume compression again in the quarter and are expecting that volume compression in the fourth quarter, it's just very challenging for us right now to give confidence in where we think we might be moving as it relates to 2020. We'll certainly be working with our customers and looking at industry and macro data and trying to determine what that will be, and certainly will provide an update when we're back together in February.



## OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call

**Operator**

Our next question comes from Steve Barger of KeyBanc Capital Markets.

**Robert Stephen Barger** - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

I was on and off the call, but I just wanted to go back to the conversation that I heard on the automation. I know that there were impacts in 3Q and order inquiry came down. But what is the general view towards how people are thinking about investing in automation as we go into an environment where organic growth is down in the back half and maybe into 2020 for your customers?

**Christopher L. Mapes** - *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*

So look, I still believe, Steve, very strongly in the long-term secular trends. So that's the long-term piece, the need to identify ways to mitigate the challenges in finding the qualified welder and the productivity that can be advanced through the automation and the quality that can be advanced through the automation. So the long-term secular trends, I'm very confident with. I think we are going to see some challenges associated with customer behavior as we're exiting Q4. And I think we might see that in our automation business, and we might see that in our core business because I can't imagine that they have much greater clarity than what we have today here at Lincoln Electric, which means they may pause associated with looking at some of those projects or looking at how they may bring some of their demands into their business as they exit 2019. Positive that quite frankly automation was improved sequentially Q2 to Q3 and likely Q3 to Q4, although Q4 will still be materially down from where we saw it participate off of a record 2018 quarter for us in automation. But I think we're going to continue to see some challenges around the capital spend and would like to see more clarity and certainty in the marketplace, and we'll just have to manage through this portion of the automation cycle here over the next couple of quarters.

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. I would describe it, Steve, as a little bit sense of -- a greater sense of cautiousness, and certainly, in the capital equipment spending arena amongst our customers in the most recent quarter.

**Robert Stephen Barger** - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Yes. And you guys have been, I think, foreshadowing a tougher 4Q and the first part of 2020, but just to that point, thinking about what we've heard from various machinery names through earnings so far, orders are down year-over-year, backlogs are contracting. So without getting too far into guidance, we should be thinking that Americas and International revenue will be down similar to what we're expecting in the back half here into the first part of 2020, is that a fair statement?

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

You must not have been on the call when I answered that one, but I think it's too early for us to comment on 2020. I think we're comfortable that we're going to see a replication or continuing softness on a year-over-year basis in the fourth quarter. I think it's safe to say, Steve, that the -- based on the order levels and the trends that we have today, that our comparisons in the first half are going to obviously be a lot more difficult.

**Operator**

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



**OCTOBER 30, 2019 / 2:00PM, LECO - Q3 2019 Lincoln Electric Holdings Inc Earnings Call**

**Vincent K. Petrella** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

And thank you. Thanks, everyone, for joining us on the call today. Look forward to discussing our fourth quarter with you in February and also the progression of our strategic programs for the future. So thank you very much again. Have a nice day.

---

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

---

**DISCLAIMER**

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019, Thomson Reuters. All Rights Reserved.

