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LECO - Q3 2016 Lincoln Electric Holdings Inc Earnings Call

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**David Stratton** *Great Lakes Review - Analyst*

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## PRESENTATION

### Operator

Greetings and welcome to Lincoln Electric's 2016 third-quarter financial results conference call. At this time, all participants are in a listen-only mode and this call is being recorded.

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

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

Thank you Liz, and good morning, everyone. Welcome to Lincoln Electric's 2016 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, Chief Executive Officer, as well as our Chief Financial Officer, Vince Petrella. Chris will begin the discussion with an overview of the quarter and Vince will cover the quarter's performance in more detail. Following our prepared remarks, we are 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 discuss financial measures that do not conform to US GAAP. A reconciliation of non-GAAP measures to the most comparable GAAP measures is found in the financial tables in our earnings release, which is available in the Investor Relations section of our website at [LincolnElectric.com](http://LincolnElectric.com).

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

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

Thank you Amanda. Good morning everyone. We're pleased to report another quarter of solid margin and cash flow performance, reflecting good execution of our 2020 strategy initiatives focused on enriching our mix and improving cash flow generation and returns. The quarter's results also benefited from the flexibility of our incentive management system, which helps align costs with current market conditions. While markets remain challenged in the third quarter, our sales performance improved through the quarter on easier year-over-year comparisons and improved demand trends in portions of the business.

Third-quarter sales declined 7% primarily due to 7.8% lower volumes, excluding Venezuela. Operating income margin remains strong at 14.4%, representing a 70 basis point decline versus the prior year's adjusted margin of 15.1%. Favorable sales mix and lower costs, including lower incentive pay accruals, mitigated compressing volumes. Additionally, productivity and lean initiatives as well as the residual benefits of our 2015 cost reduction actions supported margin performance.

EPS was \$0.89 in the quarter, which held steady versus prior year's adjusted EPS. EPS performance included benefits from our commercial and operational initiatives as well as a discrete tax item and share repurchases.

Cash flows from operations were strong in the quarter and cash conversion was above 100% of adjusted net income in the quarter and for the first nine months of 2016. We also returned over 100% of free cash flow to shareholders through our higher dividend payout rate and share repurchases.

For the first nine months, we purchased \$289 million of shares and continue to target \$400 million of share buybacks this year.

Additionally, earlier this week, we announced a 9.4% increase in our dividend payout rate to \$1.40 per diluted share for next year. This marks the Company's 21st year of consecutive payout increases.

Looking at topline performance in more detail on Slide 4, we achieved pockets of growth across the business. The Harris Products Group segment maintained solid growth in the retail channel among existing and new big-box store customers on the strong adoption, sell-through and inventory stocking of our new merchandising sets. This contributed 8.3% higher volumes in the quarter for the Harris Products Group.

Our automation portfolio grew in the quarter as we continued to expand our capabilities in these solutions. And we continue to see growth within Southern and Eastern Europe, in India, and across portions of Southeast Asia.

Additionally, we are seeing demand trends improve for our equipment solutions across all of our reportable segments, while consumable volumes continue to be challenged, primarily in the Americas welding segment.

On an in-sector basis, automotive, pipeline, and maintenance and repair applications posted relatively steady year-over-year performance. However, this was outweighed by sluggish industrial demand and ongoing compression in oil and gas and related US exports. Both areas contracted by approximately 30% in the quarter and heavy fabrication declined approximately 20% in the quarter, notably in the Americas segment.

Moving to our key activities in the quarter on Slide 5, we remain focused on supporting consumer-oriented demand by expanding the Harris Group's retail program. We are seeing improved project pacing in automation, and we are successfully serving customers with new products, promotions, and are expanding our market presence as we scale solutions globally and convert new customers with our application expertise. These efforts are driving improved sales performance and are helping to enrich our mix and margin performance during a challenging portion of the cycle.

We are confident in our market position and will continue to benefit from our incentive management system, which will flex and align business costs as needed. Additionally, the organization continues to aggressively deploy lean initiatives to enhance productivity.

As we finish the year, we expect to see a continued narrowing of the year-over-year rate of decline in sales due to easing topline comparisons and recent market momentum. We remain cautious on fourth-quarter margin performance due to challenging year-over-year comparisons.

In the interim, we are focused on serving our customers and driving innovation. We invite our investors and analysts to visit us at the upcoming FABTECH show in mid-November to see our solutions and how we are continuing to invest to achieve our 2020 vision and strategy and drive shareholder value.

And now I will pass the call to Vince to discuss our third-quarter results and uses of cash in more detail.

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

Thank you Chris.

Looking at our third-quarter income statement highlights on Slide 6, our consolidated sales decreased 12% compared with the prior year. Volumes decreased 12.8%, and price declined slightly by 70 basis points. Acquisitions contributed 2.1% to the top line. Excluding results from our Venezuelan operation in the prior year, third-quarter 2016 sales decreased 7%, primarily from a 7.8% lower volume.

Our third-quarter gross profit margin increased to 35.2% compared with 30.8% in the prior year. The prior-year gross profit included a \$22.2 million non-cash charge related to a Venezuelan currency remeasurement loss. Excluding this charge, third-quarter 2015 gross profit margins were 34.3%. Our gross profit margin improvement was primarily due to favorable mix in the Americas Welding and Harris Products Group segments, and the benefits of our 2015 and 2016 cost reduction actions.

In the quarter, we incurred a \$0.5 million LIFO charge compared with a \$4.1 million LIFO credit in the prior-year period.

Our SG&A expense declined 8%, or \$10.3 million, primarily due to lower incentive pay accruals and favorable foreign exchange. SG&A as a percentage of sales increased 90 basis points to 20.8%, reflecting the unfavorable impact of lower volumes.

We achieved operating income of \$81.8 million, or 14.4% of sales, in the quarter. This compares with an operating loss of \$84 million in the prior year, due to \$181 million of pretax special charges related to a pension annuity contract purchase, Venezuelan currency remeasurement losses, and rationalization and asset impairment charges.

On an adjusted basis, 2015 third-quarter operating margin was \$97.1 million or 15.1% of sales. Our decremental margin in the current quarter was 19.7%, or approximately 30% when excluding Venezuela and special items in the prior year.

Interest expense was \$3.8 million in the quarter from interest accrued on borrowings. This compares with prior-year interest expense of \$5.8 million, which included a \$2.9 million adjustment in the estimated contingent consideration accrual for a majority-owned subsidiary.

As announced in our earnings release, we closed our new \$350 million private placement yesterday with a weighted average effective interest rate of 3.1%. We expect our fourth-quarter interest expense to be approximately \$6 million on these higher borrowings.

Our third-quarter effective tax rate was what 25.2%, which included a \$4 million, or \$0.06 per share, benefit from a discrete tax item. For the fourth quarter, we expect our effective tax rate to be in the high 20% range. This range is subject to the future mix of earnings and the utilization of US tax credits.



Third-quarter 2016 diluted earnings per share were \$0.89. This compares with a loss per share of \$0.82 in the prior-year period, due to the special items that I previously discussed. Excluding special items, third-quarter 2015 adjusted EPS was \$0.89. Our share repurchase program did contribute an \$0.08 benefit to adjusted EPS in the quarter.

Now, moving to our reportable segments on Slide 7, our Americas Welding segment adjusted EBIT margin held relatively steady at 17.1% versus the prior year, due to favorable sales mix, lower incentive and compensation costs, and the benefits from cost reduction actions. Sales, excluding Venezuelan results in the prior year, declined 10% on 11.1% lower volumes and 1.3% lower price. These declines were partially offset by a 2.9% increase in sales from our acquisitions.

Year-over-year sales performance improved as the quarter unfolded and into October on easier comparisons. However, end markets continue to be broadly challenging in the quarter. Modest growth in the automotive transportation sector, and some improving trends in pipeline applications, continued to be offset by further compression in oil and gas applications, heavy fabrication, and in US exports.

In our International Welding segment, adjusted EBIT margin declined 220 basis points to 4.7% due to unfavorable fixed cost absorption from 4.9% lower volumes, and ongoing investments in management and commercial resources. Lower volumes reflected ongoing declines in oil and gas applications across northern Europe and in China, while Southern and Eastern Europe continued to grow, as did India and portions of Southeast Asia.

The Harris Products Group's third-quarter adjusted EBIT margin increased 230 basis points to 12.1% on favorable mix and improved raw material costs trends. Volumes grew 8.3% from a continued strong double-digit increase in the retail channel, and pricing increased 3.5% on favorable year-over-year metal cost changes.

Now, moving to Slide 10, cash flow from operations increased 6% to \$111 million in the quarter. Operating working capital was 17.7% at September 30, which was slightly unfavorable versus prior year and sequentially, but performing well given the challenging market conditions. Cash conversion remained solid in the quarter and for the first nine months of 2016 at 161% and 115% respectively.

Capital expenditure pacing increased to approximately \$15 million in the quarter or \$39 million in the first nine months. We now estimate full-year CapEx spending to be in the range of \$55 million to \$60 million this year.

During the third quarter, we paid a cash dividend to shareholders of \$22 million, reflecting the 10% higher dividend payout rate in 2016. We also spent \$86 million repurchasing 1.4 million shares for treasury.

Through September, we have repurchased 5 million shares, or approximately 8% of our outstanding share count. We continue to target the \$400 million of share buybacks in 2016.

Our net debt position at September 30 was \$287 million. With the closing of yesterday's private placement, our total long-term debt will approximate \$700 million with a weighted average interest rate of 3.3% and an average term of 18 years.

Now, I would like to turn the call over to questions. Liz?

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Joe O'Dea, Vertical Research.

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

Good morning. I think, on Slide 4, where you show some of the trends by different markets and showing strongest performance in automation solutions, and that wasn't in that group last quarter, but could you just talk about whether that's auto-focused, whether it was more project related within the quarter or were there some underlying trends of broadening out where you are serving automation and what's happening in those markets?

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

Yes, when we think about automation, we are continuing to seek solutions that expand welding automation and cutting across all of our various segments within the business. We were excited about continued improvement in automation, had a strong quarter for us in the third quarter, although, as we have discussed at times, that business that now is at about \$450 million on an annualized basis for us is still a little bit of -- still a little choppy because of large projects that might be moving through the business.

And as I think about the automation business, in the third quarter, I would not want to imply that the density of automotive business was any greater than what we see as a normalized trend for that business. And again, we continue to seek out segments globally where we can provide productivity improvements through the advancement of our automation strategy and automation solutions with our customers.

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

Great. And then Chris, I think some of your earlier comments talking about you seeing pockets of improving demand trends through the course of the quarter, and then other comments talking about continuing to see some weakness in oil and gas. But could you maybe talk about those areas where it's most notable, where there would have been improvements over the course of the quarter and whether that's continued into October? And similarly, is it kind of further kind of deterioration in oil and gas, or was it more being a steady state, but you're still just working off of those weak markets?

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

I would make a couple of comments. First, I would say we certainly identified some areas around the world globally where we are executing on those strategies and we are seeing some improvements in those markets -- India, some areas of Southeast Asia.

As it relates to oil and gas, from my perspective, I believe our international business, especially our European business and within that portions that are serving the offshore portion of oil and gas, continue to be very challenged in the third quarter.

But probably most importantly, when we talk about the improvement within the demand trends, we are really thinking about the way we've been managing through this broad cycle over the last several quarters. I think we have been pretty consistent in identifying this as a longer compressing marketplace for welding. And we have been managing through that cycle over the last several quarters. Although the third quarter started out a little shallow for us in the July period, we saw improvement, especially in our Americas segment, as we moved through the quarter. And as we stated, we saw improvement in those demand trends on a year-over-year basis moving from the first quarter of this year to the second quarter to now completing our third quarter. As we look at the fourth quarter, we believe that trend is going to continue. I would expect us to look at the improvements on a topline basis year-over-year in the fourth quarter probably moving towards low single digits on a year-over-year basis, but still probably not showing growth yet in the fourth quarter. But as we are thinking about the business moving into 2017, we believe that we will continue to make those improvements and would expect to see very small, modest growth as we are looking at 2017.

So we believe we've continued to manage through the cycle and, again, would still see some compression in the fourth quarter, but that narrowing, and then looking for us to see very modest growth and seeing improvement as we move towards 2017.

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

That's really helpful. Thank you.

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**Operator**

Mig Dobre, Baird.

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

Good morning guys. Maybe a question on bonus accruals. I was kind of looking back, and I saw that, in 2015, you had a nice tailwind of about \$30 million. I think, year-to-date, at least as of last quarter, you were running a tailwind of about \$11 million.

So, Chris, maybe taking your comment as to what -- the way you are sort of framing 2017 at this point, how should we think about the reset on a bonus accrual side for 2017, if that's kind of your outlook for the year?

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

That's a very good question. And I'm actually going to let Vince answer the bonus accrual portion of that question for you.

But I think one thing that I should provide you guidance on is that, as we think about the business in 2017, one of the things that we've done here in our Americas business is we brought forward a new 401(k) program that we are launching January 1. With the launch of that program, we will be re-instituting our 401(k) match for those employees. And as we are evaluating where we think the business will migrate in 2017, I would expect to also probably bring back the global reduction of salaries that our employees had sometime within 2017.

I'll also share with you, because of the productivity that we've been driving throughout the business this year, we believe we are going to be able to accomplish that without it being a drag on our year-over-year performance as we move into 2017 for those two items.

And I'll let Vince share with you the analysis relative to the bonus accrual.

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

Yes, so the bonus accrual is predominantly affected by the profit-sharing bonus that we have in place in our US operations. So, that accrual is driven by the relative profitability of our biggest, most profitable business unit to the enterprise. So, the reduction in the bonus accrual is largely directly attributable to the lower EBIT and operating profit earnings of the business and is accrued at a fixed percentage of those earnings.

As a reasonable proxy for how much our total incentive accruals are relative to operating profit, you can use a factor of somewhere around the mid to high 20s% from a percentage perspective. So, the reductions, again, in incentive accruals are largely tied to and relative to the lower operating profit of the business.

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

Okay, that's really helpful. Thank you. And then maybe my follow-up is on the pricing side. I'm trying to reconcile in the back of my mind the price degradation that we saw this quarter in Americas Welding with sort of demand trends going forward, and with any potential LIFO charges that you might have to take either in the fourth quarter or maybe basically going into early 2017. How do we think about that and what that means for margins specifically?

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

Okay, so the Americas pricing decline was 1.3%, excluding Venezuela, in the quarter. That is up a little bit from what the year-to-date rate was. I would attribute that to some greater promotional activities going on in the equipment side of the business, Mig, as well as some slight easing of pricing on the consumables side.

And as far as LIFO is concerned and input costs, we have seen moderation in those costs during the course of the quarter. We did, though, take an approximate \$0.5 million charge in the quarter. And I would expect that we will have something similar based on our current estimates of costs at the end of the year at inventory levels that will be taken in the fourth quarter of 2016.

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

Great. Thank you.

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**Operator**

David Stratton, Great Lakes Review.

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**David Stratton** - *Great Lakes Review - Analyst*

Thanks for taking the question. Just on automotive briefly in a previous question, I was just wondering what the outlook is like, especially considering a major automaker idling a few plants coming up, and how that impacts you, or if it impacts you.

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

Look, I probably won't talk about anyone specific facility. With the global nature of our business, one particular facility isn't really the way we think about the space.

Just as we mentioned in the second quarter, look, Automotive had begun to tail down slightly from the run rates that we saw in 2015, but we would acknowledge that, look, those are off of very high run rates when we look at vehicle production still here, especially in the North American market.

I'll also share with you we are still excited about the automotive segment and space. We have got some new applications that we've been driving into that marketplace. So, we are excited not only about the fact that, look, although the volumes, the demand volumes, might be down slightly this year versus prior year, and may be uncertain as to exactly the extent of where those demand volumes will flatten out looking at 2017, we have some technologies that we have pointed towards that marketplace. We are excited about those solutions and how it might assist those OEMs. So still believe that is a very solid market for us, very important market for us, as we move forward.

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**David Stratton** - *Great Lakes Review - Analyst*

All right. Thank you. And then can you elaborate a little bit on your retail initiatives and the size of that business, and margins compared to the overall?

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

Look, the retail business for us is a business that's encompassed primarily within our Harris business, although we have pieces of retail operations globally in international as well as portions in the international business -- I'm sorry, the Americas segment.

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Look, an important piece of it, it was very solid for us in the quarter as we had part of that channel that we are seeing increased demand and had some increased stocking orders that occurred in the third quarter. I'm not sure that those will repeat as we are moving forward into the fourth and the first quarter at the same level. But at the end of the day, we've been continuing to support that channel with some resets over the last six, 12, 18 months, and we are seeing some of the benefits of those marketing programs there.

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

And I would bracket the size of the business at less than 3% of our consolidated revenue run rate. And the profitability is in line with the Group's profitability from a margin perspective.

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**David Stratton** - *Great Lakes Review - Analyst*

Thank you very much.

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**Operator**

Saree Boroditsky, Deutsche Bank.

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**Saree Boroditsky** - *Deutsche Bank - Analyst*

Thank you. Just going back to the question on bonus accrual, I believe this was pretty light in the fourth quarter last year. I wanted to see if you could kind of quantify for us the headwind going into the fourth quarter this year.

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

Could you elaborate a little bit on that question in terms of the bonus accrual?

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**Saree Boroditsky** - *Deutsche Bank - Analyst*

I believe it was a little light in the fourth quarter last year, so the year-over-year comparison.

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

Okay. So, in the prior year, we did have a lighter bonus accrual because we adjusted our estimates based on the amounts that we paid out in the early part of December as compared with our final performance for the end of the year. There is not a way to make an estimate of that this year, although we hope to narrow that difference and make a better estimate of what our final operating profit achievement is for the full year. So it's a function of making an estimate and paying out the bonus and then how it ultimately is -- unfolds when the year is closed up in February of the next year.

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**Saree Boroditsky** - *Deutsche Bank - Analyst*

Thanks. That's helpful. And then I was just wondering if you could provide any detail on how you are thinking about capital allocation in 2017, especially as it comes to share repurchases?

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

Sure. So, we've been on a multi-year execution of an established capital allocation plan that culminated in the past two years of targeted spending of approximately \$400 million per year on share buyback activity in order to reach a targeted gross debt to EBITDA ratio of between 1.5 and 2 times debt to EBITDA. By the end of this year, with the completion of this program, the final spending of \$111 million or so on share buybacks in the fourth quarter, we will be within that range. And so as we move into the next year, 2017, we will move to what I refer to as a maintenance mode on our capital structure and our spending on a share buyback. We will continue to target spending in CapEx in line with what you've seen in the last couple of years.

But as far as share buybacks are concerned, we will now be more opportunistic in buying back shares. At this point, we are not in a position to establish a target, but we will likely at least buy back at least the number of shares and spend that will avoid dilution on employee benefit programs. So, the number will likely come down next year substantially from the \$400 million and moving into a more maintenance mode and what I would refer to as opportunistic purchases in the marketplace.

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**Saree Boroditsky** - *Deutsche Bank - Analyst*

Thanks for taking my questions. I'll get back in queue.

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**Operator**

Chase Jacobson, William Blair.

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**Chase Jacobson** - *William Blair & Company - Analyst*

Hi, good morning. Nice quarter. So, Chris, I know you guys don't give guidance, but you did say that you expect 2017 to be up kind of low single digits as this rate of decline kind of decelerates here. Can you maybe just, on a couple of the bigger end markets, whether it's automotive or commercial construction or heavy fab, kind of give us some sense of your confidence as to how you get to that low single-digit growth kind of given the outlook for those markets?

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

Yes. I think my comments should be construed around the fact that our confidence that we've been managing through this longer-term compressing market during this particular cycle. And if you take a look at, over the last five or six, seven, eight quarters for the Company where we could see that compression and where we believe that compression peaked out and now that we've made improvements in that on a year-over-year basis moving through Q1, Q2 and now Q3 of this year. So part of that expectation is certainly from the realization that we will have some easier comparisons on a prior-year basis as we migrate into 2017.

The second piece, though, that I would point towards is the confidence that we will be able to continue to grow our automation business as well as drive some of the new technologies we've been migrating into the market over the last six to 12 months.

So, as we think about that 2017, which, again, we believe we still will see a compressing environment, I would expect it to be low single digits in the fourth quarter and, again, only beginning to look at 2017 and expecting that we would show very modest growth. So, there is not a large catalyst there that we are pointing toward that's going to drive us to have confidence in there being a more robust market in any one segment. But the confidence that what we see with the business and where we have seen this business trending as we move into 2017, either late in the first quarter or the second quarter, we should begin to see where we are driving growth within the portfolio again.

**Chase Jacobson** - *William Blair & Company - Analyst*

Okay. And then, Vince, I think, on the mix, you said Automation was a big part of that favorable mix benefit in the quarter. How much was Automation up year-over-year? And was there anything else in the mix that we should be aware of?

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

There was actually an improvement sequentially from the first half of the year as far as Automation is concerned, and also a greater proportion of the portfolio sales across the Americas.

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**Chase Jacobson** - *William Blair & Company - Analyst*

Okay. And does that continue -- should we expect that to continue or do you think -- I know you talked about it being lumpy a little bit --

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

Yes, we've seen a strengthening in automation revenue run rate into the third quarter and expect to finish the year relatively strong in automation as compared to the first half of the year.

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**Chase Jacobson** - *William Blair & Company - Analyst*

Okay, thank you.

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**Operator**

Stanley Elliott, Stifel.

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**Stanley Elliott** - *Stifel Nicolaus - Analyst*

Hey guys. Good morning. Thank you for taking my question, a quick question. With all of the changes you've made to the portfolio, it really deflects the cost structure, etc. How do we think about decremental margins under kind of this new commercial organization with a larger percentage going into higher margin, higher growth automation?

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

Stanley, I wouldn't say that decrementals have changed significantly based on that mix. We really haven't seen the impact of a meaningful downturn in automation that would be reflected in our decrementals. But my expectation is that, with some puts and takes, some positive changes in terms of mix and improvements in the structural cost elements of our business globally, and then perhaps some greater cyclicality that might be introduced in certain elements like automation, that we should still be in line with what guidance I have provided in the past in terms of decrementals.

So, I would reiterate that I think we will be in the high 20s% decrementals in this type of an environment, at least moving into the fourth quarter, and then next year, if we do have some improvement in the top line, I think we will shift around obviously and see some incrementals that are over 20%.

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**Stanley Elliott** - *Stifel Nicolaus - Analyst*

And so the incremental piece would be kind of running around that same sort of decremental number. Is that what I heard?

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

Yes.

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**Stanley Elliott** - *Stifel Nicolaus - Analyst*

Okay. And then secondly, terming out or getting the capital structure to where you want from a leverage perspective, how you are all thinking about M&A right now? Is that an opportunity to take it above that targeted range, or does this mean that you have the portfolio that you want in place? Thanks.

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

Thanks for that question. We certainly will, for the right opportunity, of course fitting our strategy and at the right price, we will acquire any property that we think furthers our strategic growth initiatives and our 2020 vision. So, we would move that number up for the right opportunity. We would certainly, in that case, likely take our share buyback activity down to a lower amount, and perhaps abstain from buying shares for some time while we pay down that debt that we take on to move above 2 times, and then try to bring ourselves back into that line as time goes on. But there is no reason that we would impede our strategic growth initiatives with a 2 times debt to EBITDA limit.

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**Stanley Elliott** - *Stifel Nicolaus - Analyst*

Great guys. Thank you very much and best of luck.

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**Operator**

Steve Barger, KeyBanc.

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**Steve Barger** - *KeyBanc Capital Markets - Analyst*

Thanks. Good morning. I wanted to go back to the 2017 comment. When you think about the comps and the commercial projects you have in the pipeline, do you consider positive revenue growth in the first quarter or the first half an easy hurdle, or is this more of the longer compression and your comment or your expectation would be more towards the back half and full year?

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

Yes, as we think about 2017, as I said earlier, it's a lot more around where we are seeing the business continue to trend as we have been moving through this compressing market. We are just coming off a third quarter where I am very happy with the performance of the Company, but as I said, we started out pretty shallow in July and then showed improvement as we were moving through the quarter.

So, look, we still feel, I still feel, that we should find modest growth as we are moving into 2017. It will be very modest. It should occur in the first half, but probably don't have the ability to identify that exacting point in time, but very confident and very positive in the way I believe we've migrated through this piece of the cycle over the last several quarters in managing our cost structure and keeping our cash generation and margin performance at this level.



**Steve Barger** - KeyBanc Capital Markets - Analyst

Got it. I guess, to the point about July being weak, has October trended to whatever you expected?

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

You know, we saw improvements as we were migrating out of July, and we certainly continue to see those run rates as we've had the first few days here in October.

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**Steve Barger** - KeyBanc Capital Markets - Analyst

Okay. So --

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

I'll just add, Steve, that October's results to date are validating our belief that we will continue to narrow in our year-over-year declines in volumes as compared with the third quarter.

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**Steve Barger** - KeyBanc Capital Markets - Analyst

Understood. I wanted to go back to the comment about seeing increased promotional activity on the equipment side. It just made me think about a lot of industrial companies have been consolidating plants and shrinking headcount over the past year or more. How are you thinking about idle or used welding machines in the marketplace affecting equipment sales for 2017, and do you think pricing gets worse or more aggressive?

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

I don't believe that, on the aggregate at the macro level, that impacts it any. There are certainly our product areas where, quite frankly, there's a potential ability for there to be used equipment in the marketplace, that might impact small markets or pieces of product portfolio, but not at the aggregate level when we are thinking about pricing for equipment.

The promotional activity that we drove was really an opportunity for us to partner with our channel partners to be able to drive some initiatives out in the marketplace and pull some of those products back through our channel partners. So, it's a great way for us to utilize some of our technologies from an e-business perspective to share those competencies with the marketplace, allow our channel partners to participate with us. And certainly, we did some of that activity in the third quarter. We will continue to do that activity as we think about the business moving forward.

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**Steve Barger** - KeyBanc Capital Markets - Analyst

Did competitors kind of match that, or have you seen a step up in activity from other companies?

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

You know what? I'm not sure I can answer that. I can't tell you that any of it is necessarily at my desk. But as we've shared with you before, we are pretty resonant in the way we're trying to drive the strategy within the business. And we think the things we're doing are very good for the health of our business long-term and we will continue those actions here at Lincoln.

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**Steve Barger** - *KeyBanc Capital Markets - Analyst*

Got it. And last question for me, you also mentioned some easing of price on consumables. Is that a function of steel prices coming down as the quarter progressed, or any more commentary on that?

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

I wouldn't be able to add anything other than I think it's a number of different factors that would affect that. Certainly, when volumes are soft and input costs are flattening, you're going to see a little bit more of that type of activity in this type of marketplace.

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**Steve Barger** - *KeyBanc Capital Markets - Analyst*

Understood. Thank you for the time.

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**Operator**

Walter Liptak, Seaport Global.

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**Walter Liptak** - *Seaport Global Securities - Analyst*

Hi, thanks. Good morning guys. I wanted to ask about your comments on 2017, which sound great. But I wonder if you can talk a little bit about what you're seeing internationally, where the declines have already decelerated, in Europe and Asia. If you had to guess which segment would turn first, Americas or international, where you get volume growth, what would you expect?

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

Well, again, when we think about the volume comments that I made, I'm talking about the Company in total. And I'm not going to probably get down into the specifics by segment or by product area relative to where we think those improvements are going to occur as we move into the first half of 2017. I just felt that it was important that, as we are talking about the business and managing through this longer cycle, that we see that we begin to believe we will find very small, modest growth as we are moving into 2017 within Lincoln Electric in total. And where we are actually going to see that developed by region or segment is very difficult for us to predict at this point.

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**Walter Liptak** - *Seaport Global Securities - Analyst*

Okay. All right, fair enough. And kind of a follow-on to that, Vince, you called out in Europe, or I guess international, those margins being a little bit weaker sequentially, some extra management costs, and I think investments. I wonder if you can provide some color. Are those cost reduction or is it kind of growth-focused investments?

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

No, they are clearly growth-focused investments we have made, additional investments in talented people to drive the strategies that we have laid out in our international and European marketplace to grow the business and expand our presence in certain markets that we think have opportunities for us to grow our share.



**Walter Liptak** - *Seaport Global Securities - Analyst*

Okay, great. All right. Thanks guys.

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**Operator**

Eli Lustgarten, Longbow.

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**Eli Lustgarten** - *Longbow Research - Analyst*

Thank you. Good morning everyone. Look, just a couple of follow-on questions because we've covered a lot of ground. One, can we talk a little bit about the fourth quarter and into next year, you've talked a number of times that we are going to be anniversaring a lot of the cost reductions and a lot of programs going. We do have normal seasonality that begins (inaudible) which I assume will still be there in the quarter. And I want to make sure we don't run into what happened a year ago at FABTECH where you did a call here and also we got this big announcement two weeks later at the meeting. And some of us won't ever forget that, I suspect. But just to get some idea of how the cost reduction, the end of programs, are going to have some new program starting, or how would it impact the income statement looking out for these changes that are beginning to go through? You have higher costs. You have higher costs. You have costs coming back in, as you indicated, into next year, the anniversary of the programs that you have. How should we think about that (multiple speakers) function?

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

Eli, thank you for that question. As far as 2017 is concerned, the additional cost savings initiatives that we've implemented in the second half of 2016 will largely be offset by some of the costs that are being placed back into the model relative to retirement costs as well as pay reductions. So we expect to next year reinstate the costs related to our suspended 401(k) matching program and restore some pay decreases that have been running through our cost savings in 2016. So, we expect to be able to fully offset those increases from the anniversaring of the cost savings initiatives that were implemented in 2015 as well as new cost savings initiatives that were implemented in 2016.

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**Eli Lustgarten** - *Longbow Research - Analyst*

And as you look out, I know the optimism and better demand, every manufacturer, everybody is in this sort of turmoil with the politics that's going on that we have to go through and how people are looking at out into next year, and now in automotive markets beginning to flatten out and worrying, are we seeing any behavior change by any of the manufacturers -- customers (inaudible) basis from what they've been doing all year, at least indicating that things are slowing or flattening or being pushed out? Do we get some of that going on in automotive?

And on the other side of it, is there anybody who's been spending by necessity as opposed to any needs beginning to talk about maybe spending a few dollars for a change after not spending for a couple of years in some of your markets?

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

No, I'm not aware of any.

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**Eli Lustgarten** - *Longbow Research - Analyst*

Nothing? Everything is -- all right, thank you very much.

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

I'm not aware of any of those trends.

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**Eli Lustgarten** - *Longbow Research - Analyst*

All right. Thank you very much.

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**Operator**

Liam Burke, Wunderlich.

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

Thank you. Good morning Chris. Good morning Vince. Chris, you talked about system sales being up, consumables being light in the Americas. How has the export market been looking at sort of mixed international markets here?

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

Well, the export market continues to be challenged for us. It's been a challenging environment for us over the last few quarters, so that continues to be challenging. We are hoping that, with some technologies that we have been developing that we think have some global applications, we may have a couple of solutions that might assist us in making some improvements in export as we move forward. That will take a few quarters for us to be able to get those into those particular markets. Exports continue to be challenging.

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

Okay. And then on international, on the systems integration side of the business, you talked about the Americas showing sequential improvement. How about internationally?

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

Internationally, we still see improvement in that area of the business. That was a global trend for us, so we still see improvements across the portfolio in that area.

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

Great. Thanks Chris.

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**Operator**

Justin Bergner, Gabelli.

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**Justin Bergner** - *Gabelli & Co. - Analyst*

Good morning Chris. Good morning Vince. Just one quick clarification question. With respect to the minus low single-digit sort of view on the fourth quarter and modest positive view on 2017, that's organic volumes? Just to clarify, that's not revenue?



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

Thank you for that question, Justin. That's what we are referring to and looking to is volume. So organic volumes. So no acquisition, no foreign exchange.

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**Justin Bergner** - *Gabelli & Co. - Analyst*

Okay, thank you. And then one other question. The acceleration of the Harris Products volume, I think it was about, oh, 1% in the second quarter, and then it jumped to 8% this quarter. I mean how much of that was this sell-in phenomenon versus improvement that you think can be sustained? Any sort of qualification would be helpful there. Thanks.

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

I would estimate the sell-in affect as about a third to a half of that increase in volumes in the quarter.

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**Justin Bergner** - *Gabelli & Co. - Analyst*

Okay. So the mid-single-digit rate is sort of the run rate that Harris is enjoying and hopefully can sustain over the next couple of quarters?

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

Correct.

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**Justin Bergner** - *Gabelli & Co. - Analyst*

Okay. Thanks. Nice quarter.

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**Operator**

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

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

Thank you Liz, and I thank everyone for joining us on the call today and for your continued interest and support in Lincoln Electric. We look forward to talking to you as a result of the fourth-quarter performance in February of next year. Thank you.

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**Operator**

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

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