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LECO - Q1 2017 Lincoln Electric Holdings Inc Earnings Call

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OVERVIEW:

Co. reported 1Q17 sales of $580.9m, operating income of $81.5m and diluted EPS of $0.84.

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PRESENTATION

Operator

Greetings, and welcome to Lincoln Electric's 2017 First Quarter Financial Results Conference Call. (Operator Instructions) And this call is being recorded. It is now my pleasure to introduce your host, Amanda Butler, Director of Investor Relations. Thank you. You may begin.

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

Thank you, Brian, and good morning, everyone. Welcome to Lincoln Electric's 2017 First 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 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 the quarter, and Vince will cover the quarter performance in more detail. And 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 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 at lincolnelectric.com.

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

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

Thank you, Amanda. Good morning, everyone. We had a strong start to the year with improving demand in many of our end markets. Excluding Venezuela, we achieved 6.4% sales growth, with approximately 4% volume growth and 2% price contribution. Higher volumes with favorable mix and operational efficiency helped mitigate rising raw material costs in the quarter. Our adjusted operating income margin expanded 90 basis points to 14.6%, representing a 33% incremental margin. Our organization's execution of our 2020 Strategy initiatives delivered solid profitability performance. The design and investment in unique solutions, leading application expertise, 600-plus technical sales team, 1000-plus automation team and our focus on operational excellence continues to drive value in the business throughout the cycle.

These strengths generated an 11% increase in EPS to $0.84 in the quarter. Excluding transaction costs associated with the proposed acquisition of Air Liquide Welding, adjusted EPS increased 16% to $0.88. We generated strong cash flows from operations in the quarter and achieved 110% cash conversion of adjusted net income.

Looking at market conditions in more detail on Slide 4, we continue to capture pockets of growth across the business. When excluding Venezuela results in the prior year, volumes increased by nearly 4% and grew across all categories on a consolidated basis in the business.

Consumables achieved modest growth in all segments after several quarters of compression. And equipment systems, including automation, continue to show strong volume performance, especially in North America and in Asia Pacific. This demand spurred U.S. export sales up over 10% in the quarter.

Looking at performance by end-market, we estimate that approximately 80% of our revenue is exposed to end markets which were trending steady to up in the first quarter, with only portions of energy and shipbuilding remaining globally challenged. While these results are encouraging, we recognize that easier year-over-year comparisons account for a portion of the growth rate, and we'll like to see a few more months of consistent growth to ensure that end markets are trending. On a positive note, April month-to-date volumes continue to track favorably.

Before I pass the call to Vince to cover the quarter in more detail, I would like to touch upon our recent announcement that we are in exclusive negotiations to acquire Air Liquide Welding's businesses. While we are still progressing through the consultation and information process with relevant works councils in Europe, we are excited about the prospect of bringing together 2 leading welding and cutting organizations. We believe the complementary nature of the businesses will not only offer operating and supply chain efficiencies, but we'll better positioned to capture growth opportunities. Together, we will be able to offer a more comprehensive product portfolio, broader application expertise and expand channels to markets within Europe.

In the interim, we are focused on servicing our customers and continue to invest to achieve our 2020 vision and strategy to drive shareholder value.

And now, I'll pass the call to Vince, to discuss our first quarter results and uses of cash in more detail.

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

Thank you, Chris. Looking at our first quarter income statement highlights on Slide 5. Our consolidated sales increased 5.5% compared with the prior year on contributions from volumes, price and acquisitions. Volumes rose 2.9%, price increased by 2.1% and acquisitions contributed 60 basis points to the top line.

Excluding results from our Venezuelan operation in the prior year, first quarter 2017 sales increased 6.4%, primarily from 3.9% higher volumes and the 2.1% price increases.

Our first quarter gross profit margin increased 80 basis points to 35.1% compared with 34.3% in the prior year. The improvement was primarily due to higher volumes across the business and favorable mix. In the quarter, we incurred a $1.7 million LIFO charge in our Americas Welding segment due to rising raw material costs.

Our SG&A expense increased 8% or $8.6 million, primarily due to higher incentive compensation accruals and the acquisition transaction costs related for the proposed acquisition of Air Liquide Welding.

Excluding those acquisition-related costs, SG&A expense increased 4% or $5 million, and SG&A as a percentage of sales declined 30 basis points to 20.4%.

Operating income increased 8% to $81.5 million or 14% of sales. On an adjusted basis, operating income increased 13% to $85.1 million or 14.6% of sales, a 90 basis point improvement versus the prior year period.

Our incremental margins were 33% in the quarter, or 30% excluding Venezuela and special items. Interest expense was $6.1 million in the quarter from interest accrued on borrowings. This compares with prior year interest expense of $3.8 million. We continue to expect annual interest expense of approximately $24 million in 2017.

Our first quarter effective tax rate was 28.3%, which was higher than the prior year's rate, reflecting geographical mix of earnings. We expect our full year average 2017 effective tax rate to be in the high 20% range. This range is subject to the future mix of earnings, the utilization of U.S. tax credits and the timing of stock option exercises.

The tax benefits from stock option exercises are now recognized as an income tax adjustment on the income statement following the adoption of a new accounting standard in the first quarter. The impact from this accounting change was a benefit of $1.3 million or $0.02 per share in the first quarter. First quarter 2017 diluted earnings per share increased 11% to $0.84 per share, and excluding special items, EPS increased 16% to $0.88 per share, reflecting higher volumes and the favorable mix. Our 2016 share repurchase activity contributed a $0.05 per share benefit to adjusted EPS in the quarter.

Now moving to our reportable segments on Slide 6. Our Americas Welding segment adjusted EBIT margin increased 90 basis points to 16.9% on higher volumes. Sales, excluding Venezuelan results from the prior year, increased 8.3% on 5.6% higher volumes, 1.6% higher price and 90 basis points from acquisitions.

Sales performance also benefited from easier year-over-year comparisons. Demand trends improved through the quarter, with notable strength in automotive and construction applications, automation and U.S. export sales. These areas of growth were partially offset by ongoing weakness in portions of the oil and gas sector, which have not fully stabilized in the Americas segment.

In our International Welding segment, adjusted EBIT margin increased 240 basis points to 7.2% on favorable mix and a 2.7% increase in volumes. Volume and price improvements came predominantly from the Asia Pacific region, where we see continued strong demand for our solutions. European region sales were up modestly in the quarter.

The Harris Products Group's first quarter adjusted EBIT margin increased 80 basis points to 11.9% on favorable mix and improved raw material cost trends. Volumes declined 2.9% from challenging comparisons in the retail channel, but the segment did achieve growth in other areas of their business, notably in international regions. Price increased 4% on favorable year-over-year metal cost changes.

Moving to Slide 9. Our cash flow from operations increased significantly year-over-year to $76 million in the quarter. The increase reflects improved company operating performance and lower pension contributions due to the freeze of our fully funded defined benefit pension plan on December 31, 2016.

Our operating working capital ratio improved 190 basis points to 17.1% compared with 19% in the prior year's same quarter. Our cash conversion remains strong in the quarter at 110%. Capital expenditures increased to approximately $12 million in the quarter. We are maintaining our full year CapEx spend expectation at $65 million to $75 million.

During the first quarter, we paid a cash dividend to shareholders of $23 million, reflecting the 9% higher dividend payout rate in 2017. And finally, our net debt position at March 31, 2017, was $234 million.

Now I would like to turn the call over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from the line of Mircea Dobre with Robert W. Baird.

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

Lots to talk about, but I guess I'll just start with this. When you're looking at your business, not only year-over-year but sequentially, can you talk a little bit about how progression has been in terms of demand versus normal seasonality? And maybe a little bit more color into what you're seeing into April versus what -- again, seasonally would -- how your business would build versus 1Q?

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

Sure, Mig. This is Chris. And, look, I think that the quarter in Q1 continued to show the improvements that we've talked about in the business over the last 3 or 4 quarters. At the end of the day, we saw the rate of compression narrowing as we were exiting 2016, and expected that as we moved into 2017, we would start to see growth within the portfolio. And certainly have seen that and probably seen that a little -- slightly earlier than may be we had expected. I think there are a couple of elements though to the volume trend lines that we are certainly cautious with as we look at the business. One is that, globally, we are seeing raw material input prices that are hitting -- those costs that are hitting the business on a global basis. In a couple of major markets, we're seeing multiple raw material cost increases into the business. That's creating some choppiness associated with potentially some demand trends in those markets. As you all know certainly, the second quarter, normally, would be an accelerating quarter from a trend perspective. Welding generally has. The second quarter is a very strong quarter. And we are seeing the continued favorable trends from the first quarter move into early April, although it certainly is still very early in the quarter. But with the multitude of end markets that we're seeing that are up over prior year, it gives us more confidence that with these trends, that we'll see that continued improvement at least as we're moving into Q2. But as I said, some of the raw material input cost increases that we're seeing on a global basis, maybe making a little bit of the order book and some of the patterns of demand a little cloudier than we would normally see at this point in the cycle.

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

I appreciate that Chris. And also, maybe a quick question on mix here. At least versus our expectations, it surprised positively in the quarter. And I'm wondering, how you are thinking about this mix going forward? Especially, at this point in the cycle, should we continue to see equipment outperform consumables? At what point does that flip back to consumables outperforming?

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

Well look, we've -- we had very strong equipment performance in Q1 across the portfolio. I believe that's because of the continued advancement of the technologies that we're providing into the marketplace. Some of the new products that we brought in over the last couple of years continue

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to perform very well. But I don't believe that one quarter is going to give us guidance to move away from what we see as the normal trends associated with the welding business, and would expect to see the increased migration of demands in consumables, and I'm certainly not expecting that mix to continue at that rate, as we're thinking about the rest of 2017.

Operator

Our next question will come from the line of Joe O'Dea with Vertical Research.

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

First on oil and gas. Could you just flush out a little bit in terms of the key areas that we focus on there, which you might have been seeing upstream, midstream, downstream, onshore versus offshore. It sounded like, when you said you haven't seen total stabilization yet, that, that was an offshore comment. But just to understand the various drivers there.

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

Actually, Joe, it was the other way around. We -- in the Americas, we still had a down quarter year-over-year, whereas internationally, we were up in the oil and gas space. In the aggregate, from a global perspective, the company was up in oil and gas end markets in the single digits on a year-over-year basis, so we are seeing a little bit faster rebound internationally than what we've seen in the Americas. As far as the subcategories of oil and gas, we would tell you that both upstream and

downstream are the stronger elements of those components, and midstream is still down on a year-over-year basis globally.

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

And then -- similarly, just on mining a little bit. I think the past couple of quarters, noting MRO activity up. Could you talk about how much of that is mining related, and what you've seen in those markets? Were there stabilization or some acceleration over the past couple of quarters?

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

Right. So our maintenance and repair business was up strongly, and actually led the way from a percentage increase perspective, as far as our end-market segments that we look at. So a very strong improvement, predominantly in the international markets, but it was, certainly, one of the leaders of our year-over-year improvements. Other well performing categories that I mentioned in my formal comments were automotive and construction end markets as well as some other energy markets that were strong in the quarter. So certainly, more in the green than what we've seen for quite some time from an end market segment. But by no means are all markets are positively trending on a year-over-year basis. But those are some of the highlights in the quarter.

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

And then, just a last one on price cost. I think you were putting in place some price increases earlier in the first quarter, that I believe were in place by March 1st. It doesn't sound like those drove any kind of meaningful pull forward in demand, and things remain pretty good in April. Could you talk about the incremental cost increases that you've seen since then? How substantial are those relative to what you were previously pricing in? How much of a headwind are recent cost increases?

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

Yes, so I -- and again in my formal comments, I mentioned the LIFO charge that we took in the first quarter, that only applies to half of our business that's on LIFO accounting in the Americas. You can expect to have equivalent or greater cost increases from raw material pricing. That's been put into the book yield thus far. I would tell you that not all of the cost increases are in the quarter, we are going to continue to see cost increases roll through our global businesses as we enter into the second quarter and into the third quarter. I think, if you look at our margin performance and our price increase of 2.1% in the first quarter, we've done a good job of passing along those cost increases from a global perspective. But my message today is that we'll see more increases in cost as we continue throughout the year, and the 2.1% pricing improvement in the first quarter will be increasing, certainly, in the second and third quarter of 2017.

Operator

Our next question will come from the line of Jim Giannakouros with Oppenheimer.

James Giannakouros - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Just to better understand the puts and takes of your incremental margin progression. You said 30 -- call it low 30s incremental margins. That's a little bit higher than what we were modeling, and certainly, I think, what you guys were thinking about this time in the last quarter or 3 months ago. What was the source of upside? Was it volume? Was it a price cost dynamic that was a benefit? Because if I recall, Vince, you kind of guided us to -- if we were to be in the high single-digit type of volume area, then that would drive 25% to 30% incremental. So not to be nitpicky, but just trying to get a better beat on better-than-expected incrementals.

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

Yes, certainly, our price cost realization was good in the quarter. Our volumes were a little bit higher than what we were talking about in the prior quarter. And looking forward into the first quarter, we were talking about something in the low-single digits from a top line improvement. And certainly, the mix has helped us in terms of the higher margin profitability that came through the quarter. So all those factors resulted in a very attractive incremental margin performance for the global business.

James Giannakouros - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Okay. And -- that's helpful. And just a follow up on -- I think, Mig framed that -- just to talk about mix, I think it's typically just viewed as equipment versus consumables. But you do have some potential mix benefits in selling other specialty alloys within consumables or certain end markets are typically higher-margin, like oil and gas. How much outside of equipment versus consumables kind of drove that mix comment or benefits the margin in the quarter?

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

That's largely the driver. There are subcategories where there could be categories within equipment where we had lower volume performance, that had lower margins, that aided us as well. So I would say, globally that is the right way of looking on our business. But there are also a number of subcategories, as you pointed out, in energy-related markets that help us and other parts of the equipment or consumables business that may have lower or higher margins, so that we could be benefiting, and in some cases from lower equipment sales as well as higher consumable sales. So mix has a number of moving pieces, but certainly, in the aggregate, we had a mix benefit in the first quarter.

Operator

Our next question will come from line of Robert Wertheimer with Barclays.

Robert Cameron Wertheimer - *Barclays PLC, Research Division - Director and Senior Industrials Analyst*

Question is on Automotive. I mean, just for the conformation on SAAR and then maybe, consumer impact and in general, consumer health. Could you just talk about what's driving strength in auto, and how you feel about that market looking through the rest of the year and thereafter?

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

Well, auto continues to be a very strong segment for us. It was one of our strongest segments at Lincoln Electric in the quarter. And automotive has been a more robust segment over the last several quarters. I would really point towards a couple of items first. Lincoln Electric's been driving some unique applications and solutions into that marketplace. Expanding those applications. So I believe we are certainly finding more opportunities for us to drive some solutions into the automotive space. And especially, when we're talking about applications around thin gauge, galvanized. And our aluminum welding business has also been doing well and a portion of that is going towards the automotive space.

We believe automotive can stay very healthy. Although, certainly, there are some dynamics that we're watching very closely. We know that -- from the consumer side, that I believe consumer sales of light-duty vehicles, at least in Q1, trail prior year. So that's not a positive trend line. We'll watch that very closely. Certainly, our work with our customers in this space believe that automotive still has some very opportunistic elements associated with that segment as we're looking throughout 2017, but it has been trending at a very high level over the last couple of years. I'll also point out that a portion of our automation business is aligned with automotive. That side of our business has seen a lot of activity as well as a lot of coding activity. So we continue to see investments in the automotive space. So very strong segment. A segment that we are expecting to stay firm, that we're watching very closely some of those consumer demand issues, which might mitigate this segment as we move through the rest of '17.

Robert Cameron Wertheimer - *Barclays PLC, Research Division - Director and Senior Industrials Analyst*

That is very helpful. Can I -- if I can ask a follow up on the automation side. I mean, do you foresee enough value add, and what you're doing with that to continue to have companies invest, even if (inaudible) slows down, CapEx slows down? I mean is that somewhere where you really see strides being made? Or is it just more, it moves along with CapEx generally?

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

No. I absolutely see people willing to invest at different points in the cycle, because at the end of the day, our value proposition around our automation business is, it's all around the welding and cutting solution that we're driving, and usually that is driving a level of productivity for the OEM. And these large OEMs, even when they are in more challenging environments, are willing to make investments, especially in this low cost of capital environment, to drive productivity. So we believe that, certainly, it has an element that's related to global CapEx. But that element is not linear, and we see many of these large OEMs talking to us and willing to invest to drive productivity, quality improvements, other analytics that they're looking for in their welding processes, even when their broader markets may be challenged.

Operator

Our next question will come from the line of Sarre Boroditsky with Deutsche Bank.

Saree Emily Boroditsky - *Deutsche Bank AG, Research Division - Research Analyst*

I was hoping we could start with exports, since this is a first quarter in a while we've seen growth there. Could you just talk about what's driving the improvement? And any thoughts about how that will trend going forward?

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

All I would say, the improvement is fairly broad based. Certainly, we've seen improvements in the Asia Pacific region in oil and gas markets. We are at a low point, historic -- our export business. So a 10%, 12% improvement year-over-year is a relatively modest improvement in aggregate dollars to the global company. But it is notable that we're starting to see a firming up and an improvement in overseas markets. But I would attribute it mostly to the Asia Pacific region and energy-related categories.

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

Yes, and I would add to that. That, look, I think, that it's too early for us to be able to acknowledge that we know this is driving some of this improvement in the export sales. But certainly, in the Asia Pacific region, over the last 24 to 36 months, we've been investing in technical centers. We launched a new technical center in Sydney, Australia. We launched a new technical center in Singapore, where we can bring our customers into that location, share with them the new advancements and technology that we believe we can bring to their manufacturing floors. And we're seeing that activity continue to grow. And I'm hopeful that, that is part of a catalyst for the increase in those particular markets, and that would give us more confidence in being able to continue to grow those sales in those regions as we move forward.

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

And then, I would also add that, we've seen strength from a category -- product category perspective, in our automations businesses. So there's been a growing export performance for out of the Americas region and into world markets, targeting automation end market customers.

Saree Emily Boroditsky - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. That was helpful. And then, I guess, maybe could we just talk more about your broader strategy in China? And how you're thinking about automation, the equivalent demand there over the longer-term? And potentially, your market share with domestic versus international firms?

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

Well, I'm not sure we're comfortable talking about any market share positions in China, relative to automation or equipment. But as we stated, our strategy in that marketplace is continue to drive more higher end solutions into the marketplace. Certainly, that involves us continuing to advance our equipment solutions and automation solutions in the market. We've invested in more technologies, both including people and capital, to be able to drive those solutions. We saw improvements in Q1 and would expect to continue to see those improvements. It's a very important marketplace for us, not only because of the size of the market, but also because of the various industry segments that participate in that markets and the global customers that are engaged in those segments. And Lincoln Electric intends to continue to invest and advance our strategies and build that business.

Operator

Our next question will come from David Stratton with Great Lakes Review.

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

Could you give us a little detail on the shipbuilding end market and what you're seeing there? And what stage of the cycle that is looking to be in?

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

Well, that's one of our end markets, David, that's actually down year-over-year. And so we would view that as an opportunity going forward to show some improvement as those markets continue to bottom and stabilize into the future. But that's one of just a handful of markets that still continues to be compressing on a year-over-year basis.

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

Okay. And then, you've mentioned new products pretty consistently throughout. Is there anything that is really showing a lot of promise? Or anything that you guys are pretty excited about, that might be helping some of that equipment sales?

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

Look, I think that in -- Lincoln Electric, instead of thinking about any 1 item that's driving that, it's our consistent and deliberate investment in new technology. So we look at our vitality index. It's part of the way we think about the way we're driving the business, the products and the utilization of those products in the marketplace. So we have a host of new technologies in equipment side and the consumable side that we've brought into the market in the last several months. And I don't think it's any 1 item. It's probably our continued investment in driving those new products and technologies that gives us great confidence in our ability to continue to make those improvements and continue to bring solutions to the market that our global customers will want to bring into their manufacturing floors.

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

And what is your current vitality index?

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

It's in the high 30s.

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

Yes, it's about 34% or 35%, is our current vitality index.

Operator

Our next question will come from the line of Walter Liptak with Seaport Global.

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

Wanted to ask about -- your commentary on the trends through April sound pretty positive. I wonder if I can try one. During the quarter, did you see -- I guess, how would you characterize the distribution channel and demand from those partners and kind of visibility from larger projects? Is there anything that you can discern from your revenue? You know revenue came in or volumes came in a little bit better-than-expected as you talked about?

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

You know, I can't identify any large projects or any uniqueness relative to any particular channel, which was unique or divergent from the way we think about the business. So I wouldn't say that, as we looked at Q1, that OEM or distribution on a global basis had any material impact as far as the way we compare and contrast the business. And certainly, no large projects that I can identify that impacted Q1.

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

Okay. So how would you characterize the -- you got -- your volume stream was a little bit better than in the first quarter than you were originally thinking. Where would you attribute that to?

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

Well, look, I think when we talked about the business over the last several quarters, we said that we would begin cross over sometime in early 2017. And we thought that the business would begin to grow in the low-single digits, and we're not far from that expectation. So certainly, the inflation that came into the marketplace could be creating a little bit of that activity. And then, as we stated, and as Vince provided in his remarks, we're just seeing some improvements across the broad category of the segments. And we're hoping that, that is a continuing trend for the business.

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

Okay. Sounds great. I hope so it will. If I can ask one about the (inaudible) volume business. Have you provided any metrics about the profitability in that business or what multiple you're paying forwards?

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

No, you know. We'd not at this point. So I'll share with those of you on the call our process. So we've announced that we have a memorandum of understanding to work with Air Liquide to get to a share purchase agreement for the Air Liquide Welding business. We are still in those negotiations, and once we have completed them, which we're expecting that we can get to a share purchase agreement, then we'll be providing a broad update to the investor community on the transaction.

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

Okay. Okay, good luck with it.

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

Yes, and again, I would remind everyone that when we provide that update, we will still have anti-trust approval and some other regulatory approval that will be required before we'd be able to get to a closing, which we stated we would expect to be able to accomplish in the back half of 2017, if we're successful in negotiating the share purchase agreement.

Operator

Our next question will come from the line of Tom Hayes with Northcoast Research.

Thomas Lloyd Hayes - *Northcoast Research Partners, LLC - MD and Senior Research Analyst*

Just some quick follow up questions, Vince. Regarding cash flow, you indicated lower pension contributions this year. Just wondering how much lower on a year-over-year basis, and your thoughts for funding this year?

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

It was $20 million lower on a year-over-year basis. So we put a little over $20 million in last year, and really very little in 2017. From a go-forward basis, we are fully funded on our defined benefit pension plan. So to the extent that our returns meet plan and the interest and discount rates don't move, we do not anticipate in the near or foreseeable future funding that define benefit plan in any substantial way. But that again, Tom, that's dependent upon what the markets might do and what interest rates might do, but right now, we're pretty well funded.

Thomas Lloyd Hayes - *Northcoast Research Partners, LLC - MD and Senior Research Analyst*

Okay. Should we expect a similar amounts of acquisition-related cost in the next couple of quarters, just from a forecasting point of view?

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

We don't -- are unable at this point to provide an estimate on what we think those costs will be. But I can tell you that they will continue throughout the year. And we will certainly have integration related costs if we're able to reach a stock purchase agreement and acquire the business sometime this year. So I would expect us to continue to have those one-off costs as we move through the acquisition process and integrate the 2 businesses together.

Thomas Lloyd Hayes - *Northcoast Research Partners, LLC - MD and Senior Research Analyst*

Okay. If I could sneak one more in real quick on pricing. It sounds like you're expecting pricing still to increase throughout the year. Just your thoughts on being able to stay ahead of that and capture that pricing in the marketplace?

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

Well, we have announced price increases, Tom, for over the second quarter. That will go into effect in varying degrees across our world. So I -- pretty confident that we'd see a higher pricing element to that sales line in the second and third quarter of 2017. And our confidence is predicated on the history of the company dealing with these types of markets. And certainly, the markets are firming up a bit from a volume perspective, but we'll just have to wait and see what our suppliers do with us and react to those actions in an appropriate manner.

Operator

Our next question is going to come from the line of Matthew Trusz with Gabelli & Company.

Matthew A. Trusz - *G. Research, LLC - Research Analyst*

To follow-up on the Asia-Pac discussion, can you elaborate a little bit more on the underlying market demand trends there and performance in China maybe versus your other key markets, and whether they feel sustainable going forward?

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

Well, I'll start by saying that we had strong performance across many of the subregions or categories in Asia Pacific. China was up. India, Southeast Asia, Japan, we had a good result across most of our geographies there. As a matter of fact, on a constant dollar basis, we had a double-digit improvement in our top line in Asia Pacific. And it was fairly broadly based, so -- I also mentioned a little bit earlier in my comments that we saw it in commodity and energy and oil and gas market. So we've seen a pretty broad improvement in the Asia Pacific end markets.

Matthew A. Trusz - *G. Research, LLC - Research Analyst*

And then, just noticeable, that Harris, the retail channel, did have the volume decreases. What's your point of view on demand trends there? And was there a function in the quarter of selling versus sell-through in prior periods that customers are now working down their inventory?

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

Actually, when you think about the Harris business, the Harris business had a very good quarter. The challenge associated with the retail business in the quarter was related to an activity we had with a couple of the large retailers in Q1 of 2016 were we were renovating some of the sets in the stores and created some demand in Q1 that we talked about in 2016 for the business. So the comparison was very challenged. I was actually very happy with the performance of the business increasing the margins for the business by 80 bps, really on -- and improvements in the sales side, even with the challenges associated with retail. So a very good performance in the business, but we realized we had a challenging Q1 comparison for the retail space for the Harris business.

Operator

Our next question will come from the line of Steve Barger with KeyBanc Capital Markets.

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

Going back to the comment on the April continuing to trend favorably. Are you running at a higher rate than the 1Q growth rate in April so far? Or maybe more broadly, would you expect 2Q come in better than the 5.5% in 1Q?

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

Yes, I would. And ordinarily, our seasonality, Steve, as you know, picks up a little bit in the second quarter. We can expect something like 3% to 5% improvement in a normal type of a cycle. So my expectation sitting here today, knowing that we did have some improvement in our order book and sales during the course of the first quarter and from what we see so far in April. Still it's early in the quarter, but my expectations are that we ought to see a bump in the top line between the first and the second quarter.

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

Would you think that's like 3% to 5% volume, with a couple of points of price on top of that kind of thing?

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

I wouldn't put the couple of points on top of that. I'd -- the best I can give you today is somewhere around maybe 3% to 5% better than the first quarter.

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

Understood. And just thinking about those price increases. Is the sales force saying, the market's absorbing that pretty well, or did you try for more and you ended up giving some back? And how is the competitive response been from other manufacturers in terms of what they're doing?

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

Well, it's difficult to talk about pricing environment when we think about it from a global perspective. So you have different dynamics in various areas around the world. We see raw material input costs increasing. And our objective is to identify those costs and recover those costs in the marketplace. So we're continuing to work with our teams around the world to accomplish that. We're certainly not thinking about striving for more and then resending back that. That's not the way we think about the market. Our goal in the marketplace is to see those raw material input costs globally, and try to go to the marketplace and recover those costs with our markets. So very challenging, especially, in an environment where we're already seeing multiple cost increases in certain markets, but we're going to continue to work that diligently and continue to try to drive what's necessary for us to be able to achieve our expectations for the business.

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

Understood. I'm going to sneak in 1 more. Just following up on the auto. Can you tell us what the growth rate of traditional machines and consumables into auto was versus automation? I'm just trying to get a sense of how much of your growth there is the function of customer CapEx versus actual production rates.

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

No. I really don't have that data and really don't think about it that way. Other than I can tell you, I'm not aware of any large projects associated with our automotive customer base that would have impacted that materially. So I don't think that -- I don't think CapEx versus demand is what's driving it. And I wouldn't expect necessarily that I would see that within a quarter, as it relates to a segment.

Operator

Our next question will come from the line of Mircea Dobre with Robert W. Baird.

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

I want to go back to the Air Liquide, the potential acquisition here. And when we try to look through Air Liquide's disclosures, I mean, what we found was, what looked to us to be a business that certainly had quite a few challenges over the last few years in terms of both growth as well as margin. So I guess, I'm wondering the strategic rationale from your point of view. Why does it make sense to have this business as part of Lincoln? And if this is indeed a bit of a turnaround story, do you sort of feel as if you have the necessary internal expertise, manpower and so on and so forth to deploy, to actually get this business to run to Lincoln's standards?

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

That's a great question. I can share with you that over the last 60 to 90 days, as we've even had more exposure to the individuals and the details of the business, I'm even more excited about the opportunity it can create for Lincoln Electric and our ability to execute on our longer-term strategies for the business. We found individuals, who quite frankly, are very passionate about what they do. We found some technologies that we think will be interesting for us to bring into our portfolio, that we can bring to our customers and markets around the world. And we've seen a host of areas where we think we can provide some of those necessary improvements that they're looking for, for their business. So -- and as I stated, once we've completed the memorandum of understanding and been able to move towards the stock purchase agreement, we'll be providing a full update to the investor community on the strategic rationale, and what we believe this business can bring to Lincoln Electric. But I think you're going to see that we're very excited about this opportunity, and there are multitude of areas that we believe we can make this business better and that this business can assist us in driving our long-term strategy for the company.

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

All right. And my last question, just a clarification here. You talked about rising material costs and the impact that's got on the business. But I'm trying to clarify as to whether or not you're talking about is that having an impact on volume down the line, or you're talking about the way that plays into margins?

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

Well, really we're focused on highlighting the risks that we have surrounding margin management. And so we don't believe that input cost increases that affect the whole of the industry will have a significant dampening or any volume impact from a longer-term perspective. We're really focused on the short and intermediate term management of our pricing and cost management strategies.

Operator

Last question comes from Seth Weber with RBC Capital Markets.

Seth Weber - *RBC Capital Markets, LLC, Research Division - Analyst*

Vince, just following up on Mig's last question. I just wanted to make sure I'm understanding the incremental margin commentary. I mean, you did 30% in the first quarter. Pricing seems to be getting better. You're kind of saying input cost may or may not be an issue. I mean, are you suggesting that incrementals are going to go back? You've talked previously about kind of a low 20% range, is that how we should be thinking about it or is this 30% kind of a number that you did in the first quarter a good way to think about the rest of the year? I'm just trying to understand -- I make sure I understand what you're messaging.

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

Well, that question is certainly dependent upon what our volumes do. But if you see a similar year-over-year improvement, and for example, the second quarter mid single -- mid- to high single-digit improvement in the top line, we can expect a 30% plus incremental in my view. So obviously, if volumes are a low single-digit improvement year-over-year, we'll see less. If we see more, a better performance than what we saw in the first quarter, we can expect to see a better result on incrementals. The other variables, obviously, are -- I'll say it again, are price cost management. I think the performance that we saw in the first quarter is reflective of our management or the issues in the first quarter of the year as well as stating the mix improvement that we've seen. So bottom line to your question is, we ought to see this type of incremental or better, provided we have the kind of volume improvements that we've been talking about today in the second quarter.

Seth Weber - *RBC Capital Markets, LLC, Research Division - Analyst*

That's very helpful. And maybe just 1 quick follow-up on the share buyback. Should we just assume that that's on hold until the -- until you get better clarity on the acquisition? Or it was just kind of -- just for the first quarter?

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

Look, Seth, that's a good assumption. We'll be on the sidelines until we work through the process of signing our SPA and, hopefully, completing the transaction with Air Liquide.

Operator

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

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

Thank you. And thank you, everyone, for joining us today on our first quarter call and your continued interest in Lincoln Electric. We very much look forward to discussing our second quarter results with you in July and covering the progression that we will accomplish during the course of 2017. Thank you very much.

Operator

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