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LECO - Q1 2016 Lincoln Electric Holdings Inc Earnings Call

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OVERVIEW:

Co. reported 1Q16 sales of $551m, operating income of $75m and diluted EPS of $0.76.

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PRESENTATION

Operator

Greetings and welcome to the Lincoln Electric 2016 first-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, Miss Amanda Butler, Director of Investor Relations. Ma'am, please go ahead.

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

Thank you Michelle. Good morning everyone. Welcome to Lincoln Electric's 2016 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, and our Chief Financial Officer, Vince Petrella. Chris will begin the discussion this morning with an overview of the year and -- excuse me, with the first quarter, and Vince will cover the quarterly numbers in more detail as well as our uses of cash. Following our prepared remarks, we will take your questions.

But 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.

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

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

Thank you Amanda. Good morning everyone.

Moving to Slide 3, we achieved solid margin performance and returns in a challenging quarter with sales declining 16.3% to $551 million in the quarter. The benefits of our cost reduction actions, diligent price management and day-to-day cost control and productivity initiatives delivered steady operating margin performance at 13.7%. A 14.2% decremental margin effectively mitigated the impact of a 14.2% decline in volumes.

EPS was $0.76 in the quarter, reflecting lower volumes and higher interest expense partially offset by the benefit of share purchases.

Returns on invested capital remain strong at 20.4%. Given good cash flow generation and a solid balance sheet profile, we continued to accelerate returns of cash to shareholders through $102 million in share buybacks, and a 10% higher payout rate of our dividend.

Turning to Slide 4, broad end market weaknesses continued to be our greatest challenge. While we believe our diversified end market exposure is an advantage long-term, we are navigating through a challenging portion of the cycle due to the persistent weakness in industrial production, volatility in oil and gas and commodity prices and slowing emerging market economies. Combined with our own challenging year-over-year comparisons due to the relative strength in oil and gas, US exports and strong billings in automation last year, approximately 1/3 of our revenue exposure was flat to growing in the first quarter, whereas over 2/3 of our revenue exposure was contracting, but at a year-over-year rate that appears to have stabilized. This has resulted in year-over-year volume declines across all product areas in our two welding segments.

In Harris Products Group, we achieved 2% volume growth from new commercial programs in the retail channel, largely focused on equipment. End markets showing ongoing strength and resilience were largely consumer oriented, where transportation and automotive achieved mid to upper single digit sales growth across the Americas and international welding segments.

Structural and maintenance and repair were relatively steady in the quarter.

We saw greater compression across our energy end sectors due to market volatility impacting capital investment and challenging year-over-year comparisons. As a result, our global oil and gas direct sales declined over 30% in the quarter and impacted our US exports which declined by over 35% in the quarter. Heavy industrial fabrication also remained challenged due to weakness in mining and agriculture, as well as declines in rolling stock production for railcars.

Moving to Slide 5, while our short-term initiatives are focused on muting the impact of current end market conditions, we continue to remain focused on our customers and executing on our 2020 vision and strategy. We are pleased with the progress we are making across a number of our growth programs in automation, alloys, aluminum, equipment, and education.

As examples, in Europe commercial programs targeting penetration of underdeveloped markets are progressing well. In Germany, organic sales increased over 10% in the quarter and automation sales increased over 50% in Europe with strong order rates expected through the third quarter.

New product rollouts are also gaining traction in the region. Following three new welding machine releases in the fourth quarter, our tig welder sales nearly doubled year-over-year.

Additionally, we launched two new application solution centers in the Asia-Pacific region in the first quarter. These launches are part of a broader global rollout which will allow us to support the Lincoln Electric brand in developing markets and educate new and existing customers of our unique advanced solutions and equipment in automation.

Our M&A pipeline remains active and we will continue to execute our bolt-on acquisition strategies. We continue to work with customers globally to position Lincoln Electric as the partner of choice for strategic and mission-critical welding applications, and we continue to see success penetrating shipbuilding, automation, and energy-related applications with our unique capabilities and technical expertise.

Short-term, we are continuing to maintain the cost reduction actions we outlined in 2015. Given stabilization in the year-over-year rate of sales decline, we are comfortable with the range of actions we have implemented, but will continue to monitor conditions to determine if additional measures are warranted.

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

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

Thank you Chris. Looking at our first-quarter income statement highlights on Slide 6, our consolidated first-quarter sales decreased 16% compared with the prior year. Volumes decreased 14.2% and acquisitions contributed 1.6% to the top line.

Excluding the results of our Venezuelan operation, which are impacted by hyper-inflationary conditions, the Company incurred a modest 1% decline in pricing and a 2.2% unfavorable impact from foreign exchange translation.

Our first-quarter gross profit margin increased 80 basis points to 34.3% compared with 33.5% in the prior-year period from cost reduction actions and lower input costs.

Our SG&A expense improved 12.4% due to foreign currency translation, lower bonus and pension costs, and lower foreign-exchange losses. SG&A as a percentage of sales increased 100 basis points to 20.7%, primarily reflecting the unfavorable impact of lower volumes.

Our operating income declined approximately 17% in the quarter to $75 million, reflecting the impact of lower sales. Operating income margins were resilient at 13.7%, which was 10 basis points lower than the prior year on 14% lower volumes. Our decremental margin was about 14%, reflecting the benefits of our prior cost reduction actions, ongoing cost controls, as well as price cost management.

Our interest expense was $3.8 million in the quarter from interest accrued on higher borrowings. We expect our full-year 2016 interest expense to be approximately $20 million, which includes current and expected future 2016 borrowings as well as anticipated contingent consideration for the year. Contingent consideration is subject to changes due to actual performance compared with the forecasted performance plan.

Our first-quarter effective tax rate was 26.7% due to a higher mix of foreign earnings. For 2016, we expect our effective tax rate to be in the high 20% range, but this expectation is subject to the future mix of earnings and utilization of US tax credits.

First-quarter diluted earnings per share decreased approximately 15% to $0.76 compared with $0.89 in 2015, primarily due to lower volumes. Our share repurchase program did contribute a $0.06 benefit to EPS.

Now moving to our new reportable segments on Slide 7, our Americas Welding segment, which includes our North and South American operations, held EBIT margin steady at 16% despite 19% lower volumes from compressing end markets and challenging year-over-year comparisons from our US exports, oil and gas and automation sales. The margin performance reflects benefits of prior cost reduction actions that leverage our flexible incentive management system, price cost management and ongoing cost controls and productivity initiatives across the business. Excluding (technical difficulty) Venezuelan results, as their pricing actions are driven by a hyperinflationary economy, the Americas segment sales declined 17% because of volume weakness. Pricing, again, excluding Venezuela, was stable with only a 20 basis point decline.

Our domestic organic sales declined approximately 12% in the quarter, reflecting challenged end market conditions, notably, again, in oil and gas, which declined approximately 30% and in US exports which declined over 35% year-over-year. The magnitude of the declines also reflect challenging year-over-year comparisons.

In our International Welding segment, which consists of our European and Asia-Pacific operations, adjusted EBIT margin declined 280 basis points to 4.8% on 7% lower volumes. Volumes compressed from the persistent weakness in the energy and heavy fabrication markets.

Moving to Slide 9, The Harris Products Group's first-quarter EBIT margin was 11.1%, an increase of 60 basis points compared with the prior year. Volumes grew 2% from a double-digit increase in the retail channel, reflecting new commercial programs. Harris equipment growth was favorable to mix and contributed to the solid margin performance. Pricing decreased 3.4% on lower metal costs, primarily silver.

Moving to Slide 10, we generated $24 million in cash flow from operations, which declined on a year-over-year basis due to a challenging comparison, including a $25 million tax refund received last year. Excluding the tax refund, free cash flow generation was comparable in both periods. Our average operating working capital was steady year-over-year at 19%, reflecting seasonality and good management of working capital.

Moving to Slide 11, our capital expenditure spending was light in the quarter at $9 million due to the timing of planned projects. We continue to estimate full-year capital spending to be in the range of $65 million to $75 million.

During the first quarter, we paid a cash dividend to shareholders of $23 million, reflecting a 10% higher dividend payout rate. We also spent $102 million repurchasing 1.9 million shares for treasury. We continue to target $400 million of share buybacks in 2016.

Now, before I pass the call over for questions, I would like to reiterate that the business has continued to navigate through our current macroeconomic conditions extremely well. Our aggressive internal cost reduction actions combined with productivity initiatives and favorable price cost conditions has helped to mitigate near-term challenges. Our commercial teams continue to focus on serving our customers and investing in innovative solutions for long-term growth. We remain (technical difficulty) through 2016 as we anticipate the narrowing of price cost benefits ahead of the anniversarying of our initial cost reduction actions. We will continue to monitor conditions and will respond appropriately to end market demand.

Now I'd like to turn the call over for questions. Michelle?

QUESTIONS AND ANSWERS

Operator

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

Matt McConnell - *RBC Capital Markets - Analyst*

Thank you. Good morning. I wonder if we could talk about the Americas margin a bit. Even with the $9 million of restructuring savings, it was quite strong, and I know you probably saw a mix headwind with oil and gas and export pressures. So, are there any other -- what else might be contributing to that? Do you still have price cost benefits, or what might be driving that relatively good performance there?

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

At the top of the list are raw input cost declines, so those had a significant impact on the quarter on a year-over-year basis, so I put that at the top of the list. We've also continued to drive productivity improvements through the business, and also we've been aided by a year-over-year improvement in pension cost reductions. That's running at about a $2.5 million quarterly pace. So all of those factors together led to a good performance in our Americas segment.

Matt McConnell - *RBC Capital Markets - Analyst*

Okay. And then on the raw material benefit that you've been seeing, steel has gone higher year-to-date. We do you have to take LIFO charges at any point over the coming quarters, or what is your expectation for the raw materials price cost situation over the coming quarters?

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

That's a good question. At this point in time, we did see a continuing easing of raw material costs in the first quarter, but that trend is abating and was relatively slight in terms of a longer-term trend.

Our expectations right now are that we are not booking any LIFO credits or charges at the present time, waiting to see what transpires, at least as the first half finishes out and we move into the second half of the year. So again, we did not book any LIFO credits or charges in the first quarter of 2016.

Matt McConnell - *RBC Capital Markets - Analyst*

Okay, great. Thank you very much.

Operator

Mig Dobre, Baird.

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

Good morning everybody. I guess, sticking with the Americas for me, I understand that we have some tough comps in the first quarter which to some extent maybe distorts things a bit. But if we're thinking about volumes sequentially, can you give us a sense for how volumes have progressed versus the fourth quarter? And what's sort of the normal seasonality here from the fourth to the first quarter in terms of volume?

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

Mig, normally, we would see a little bit of a decline, or almost a similar type of Q1, Q4 type of transition. This past year, we are down in overall sales about 3% from the fourth quarter to the first quarter. In the prior year, moving from the fourth quarter of 2014 to the first quarter of 2015, we are actually down about 4% in overall sales. So that's a little slight better performance on a sequential basis between 2014 to 2015 and 2015 to 2016.

Moving out of the first quarter to the second quarter, we would normally see a little bit of an improvement. Our second quarter tends to be, from a seasonality perspective, our best quarter of the year. And that's sort of the sequential nature of fourth to first and first to second.

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

Got it. That's really helpful. Thank you. And is there any way you can comment in terms of how you saw demand progress through the quarter? When we are listening to the distributors, for instance, they certainly have seen a little bit unusual movement from, say, January all the way through March. I don't know if there's anything that you can add to that, any perspective that is.

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

I wouldn't say that we saw any unique attributes within the quarter relative to demand. It's also very difficult to talk about that to the various segments.

The only comment I would make about demand in general around the world is that we did see, in our international segment, some improvement in our European business as we were moving through the quarter. But outside of that particular attribute, I wouldn't really point towards anything being material from a trending perspective for the business.

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

I see. Nothing standing out in North America, though?

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

Nothing standing out for us in North America, certainly a little bit of movement within the various segments, but nothing that I would identify as being material enough to point out.

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

Thank you.

Operator

Joe O'Dea, Vertical Research.

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

Good morning. First (technical difficulty) with the planned buybacks and some of the cash considerations over the course of the year, and you commented on interest expense. But could you just talk a little bit about financing plans for the buybacks and maybe when we should anticipate from a timing perspective seeing some activity there?

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

Yes. So, we now have about $220 million of cash on the balance sheet. Substantially all of that cash is overseas. There's really very little left in the US to deploy. So, we will be borrowing, taking down our line of credit for the second quarter, and then we will be looking at placing some additional long-term debt on the balance sheet sometime in the third quarter of this year.

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

Okay, thank you. And then you talked about not really seeing any shift I guess in trends through the course of the quarter, but when you think about some of the sharp movement we've seen in commodities, and particularly in oil, has that changed the tone of conversations with customers at all when you think about having seen the balance we've had off the bottom in oil, whether or not that triggers some improvement in demand, when you would expect to see that to start to flow through? Just kind of a general backdrop given these sharp swings.

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

I would say that certainly the rise in a host of the commodity prices, and maybe the outlook that there potentially is some stability at higher prices, creates an environment of more favorable conversations. I think the challenge is that, quite frankly, we just need to have an elongated perspective of those markets before we will see to have those types of activities maybe change the buying behavior.

So, is there a little bit more of a positive discussion around it because of some of the changes we've seen in those underlying commodity prices and how it impacts some of those markets? Yes. I just wouldn't say that we've seen that for a long enough period of time that it's necessarily impacting behavior within those segments at this point. And we are certainly optimistic that, if we can continue to see some of those favorable attributes of those commodity pricings, that we will see some of that activity migrate into those segments as we move through the rest of 2016.

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

Great. Thanks very much.

Operator

Schon Williams, BB&T Capital Markets.

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

Good morning. If we could maybe come back to the price cost dynamic, pricing did decelerate Q1 versus Q4 if you exclude Venezuela. I'm just wondering. When -- given some of the raw material moves we've seen, when -- I don't know, when would you go back out to the market, whether it's Americas or international? When could you potentially go back out to the market and start actually getting that pricing component positive again?

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

We've been managing this process through the cycle very closely. Obviously, we are concerned about the risks associated with inflationary input costs as we are moving further into 2016. We'll have to make relative management decisions around that in various markets around the world.

I'm not sure that I am comfortable in identifying an inflection point, but certainly I think the confidence I have is that we've managed ourselves well through the cycle and shown historically an ability to continue to manage that piece as we drive solutions into the marketplace. And we certainly see some of those challenges ahead of us if we see inflationary input costs moving into 2016.

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

All right. And then maybe if we could talk just about the cost reduction actions, those would start to anniversary in Q3. I'm just wondering, though, what makes you feel comfortable, Chris, that you can go ahead and start to lift some of those? Is it just stopping kind of the accelerating declines? Is that enough to make you want to basically to pull back there, or are you actually looking for I guess positive volume growth going forward in order to start to lift some of those reductions?

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

It's probably someplace in the middle. Certainly, we talked about the rate of decline decelerating. We love to see stability in those markets, especially in our Americas segment. But we've been actively working on various plans relative to what happens if these markets were to shift more negatively, and if necessary then we would have to enact further actions within the business to mitigate that impact. But as we said, in the fourth quarter and in the first quarter, we thought we had taken actions to be able to allow us to migrate through this portion of the cycle. I actually think that the business has performed as we had expected it to.

I know that we had a host of questions around whether we were too pessimistic about the market and our perspectives of the market over the last four or five months, but I believe the market and our business has actually performed as we expected and actually performed very well from a margin profile. So we will evaluate the next 60 to 90 days to see if we continue to see some of that deceleration and evaluate whether we need to make any further actions with the business as we are managing it through 2016.

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

All right. Thanks guys. I'll get back in the queue.

Operator

Eli Lustgarten, Longbow Securities.

Eli Lustgarten - *Longbow Research - Analyst*

Thank you. Good morning everyone. Can we talk a little bit, as some of your end markets, particularly the Americas, as you look out, we cited I guess positive gains in transportation and construction. Construction I understand will get seasonally better in the second quarter, but there seems to be similar spending there is probably a little disappointing. Car sales have peaked. There's been put some postponement of projects. Are we hearing anything from the major markets that have going been growing of a stretch out of deferrals and you probably might see more in the second half of the year than the first half of the year. Particularly automotive is the one we are hearing a lot of stories about.

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

We've also heard some of the rhetoric or the context around the automotive space. Certainly, there are some risk associated with that relative to the consumer, especially here in the US market, but we certainly didn't see that in our performance in Q1.

So, I know the recent economic data that I saw the consumer actually holding up relatively well, and certainly automotive is at a very high unit volume production schedule. So, we are also watching it but, quite frankly, not seeing that currently in our discussions or our activities with large OEMs.

I would also say that potentially our visibility to that may not be as aligned as other market participants. We have a host of new products that we've been driving especially into the automotive space relative to new solutions to support them in aluminum, as well as thin-gauge galvanized products, so it could be that those technologies are providing us that overall lift versus where their build rates might be within the automotive space particularly.

Eli Lustgarten - *Longbow Research - Analyst*

And a follow-up question, you had especially impressive detrimental margin in the first quarter, and somebody has got to ask -- your ability to sustain that or what kind of variability should we expect if we go forward for the rest of the year?

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

Look, I appreciate the comment. I thought our performance on the margin line was exceptional in the quarter and I think our leadership team and broad management team across the world was actively working to mitigate the challenges that we have in the business today.

But I would share with you we still believe strongly that the decremental margins for this business are between 25% and the high 20%s or 30%. And although we performed at an exceptional level in Q1, I don't think our perspective on our ability to achieve through the cycle decremental margins has changed from our prior comments on the subject.

Eli Lustgarten - *Longbow Research - Analyst*

So you expect the rest of the year to possibly trend towards more normal as opposed to the outstanding results of the first quarter? Is that a fair way of looking at it?

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

That would be a fair way of looking at it.

Eli Lustgarten - *Longbow Research - Analyst*

Thank you very much.

Operator

Robert Wertheimer, Barclays.

Robert Wertheimer - *Barclays Capital - Analyst*

Good morning. So, steel has been obviously volatile, in the US particularly. Can you maybe mark to market the basket of steel that you do? And is cost, price cost, already flipping to a headwind based on where the various grades are going? Or -- I mean your comments have been a little more moderate than that with a little more pressure coming up, but not dramatic, but obviously hotrolled at least is up sharply. So I'm thinking about the basket of stuff that you use. Has it already flip-flopped to a headwind or not?

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

The bulk of what we buy is what would be referred to as long steel, so rod and -- we buy significant amounts of that form of steel. We have not seen to date significant increases in the cost of that steel, but we are aware of the broader steel markets and those movements. So that leads us to be a little bit more cautious about the trending in steel costs as the year unfolds. But I would say we have not been impacted, at least so far in 2016, by the kinds of increases that you might see in the broader rolled market. But we are growing more cautious over the trends for the rest of 2016.

Robert Wertheimer - *Barclays Capital - Analyst*

Perfect, thank you. And if you don't mind, are able to give any commentary on where you are on flexible labor cost and how far down you can flex if relatively steep volume declines continue?

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

As many of you are aware, especially in our large equipment and consumables manufacturing facilities in the Americas here in Cleveland, Ohio, we have a very flexible workforce model. We've been addressing that model throughout this cycle. And as we moved into 2016, we had brought that employment base much higher back up to the number of hours that we would be expecting. Let's just say that our average hours for employees were back up to 38 to 40 hours on a basis -- on a work week basis. So we've done that through obviously attrition, the VSEP program that we announced that we ran earlier in the year in 2015. So we've now brought that workforce back up to certainly a higher component of hours a week.

And if, unfortunately, we were to see declines, material declines, in the business, then we could use that flexible work system that we have here to adjust to those lower demands.

Robert Wertheimer - *Barclays Capital - Analyst*

Very helpful. Thank you.

Operator

Walter Liptak, Seaport Global.

Walter Liptak - *Seaport Global Securities - Analyst*

Thanks. Good morning everyone. I wanted to ask about, on the last page of your press release, you've got the pricing number. You've got $80.3 million in price in the Americas segment. I think you already went into some of this, but I wonder if you could just talk about the parts within that pricing. How much is hyper-inflation related? How much is normal price increases? How much is -- I don't know if there's lower rods that impact that number, but what's in that $80 million?

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

$81 million of the number is related to Venezuela. So, the mechanics of translating year-over-year our Venezuelan business, due to the significant devaluation that we initiated at the end of the third quarter last year, creates distortions in both price and foreign exchange. And so if you look to the right of that price column, you see a very large number in the Americas for foreign exchange, and the bulk of that number is Venezuela as well. And that's why we have disclosed a line below the table which is consolidated excluding Venezuela. And if you look at the next table below that that shows the percentages, you'll see that the consolidated excluding Venezuela pricing impact is 1% unfavorable. And then, in the Americas region, it's basis points; it's about 20 BPS. So our pricing, ex-Venezuela, only down ever so slightly in the Americas, which is a very good result in the environment that we are operating in currently.

Walter Liptak - *Seaport Global Securities - Analyst*

Okay, fair enough. And then on the pension, I wanted to ask about the $2.5 million in the quarter. I think you said that's going to carry through in the second quarter at that same rate and throughout 2016. Is that right?

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

Yes, that's a combination of our defined-benefit pension plan reductions in costs as well as our 401(k) match that was suspended last year. So it's the combination of both of those. Part of that $2.5 million will come back to expense because it's viewed as temporary when we restore the 401(k) match.

Walter Liptak - *Seaport Global Securities - Analyst*

Okay, got it. Thank you.

Operator

Stanley Elliott, Stifel.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Good morning guys and congratulations. Help me. From a timing perspective, when does the export business and oil and gas comparisons start to become a little more favorable on a year-over-year basis? My recollection was Q1 was very, very strong for you all and then the rest of the year was kind of more in line with what the typical industry was seeing.

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

It's awfully difficult for us to pinpoint that point. Certainly, I'm expecting to see more favorability in those comparisons as we are moving throughout 2016 in Q2 and Q3. But we certainly have seen where our export business has been closely tied to some of the challenges we've seen globally in the oil and gas segments. But again, I guess we would begin to hope to see some more favorable correlations to that as we are moving through the rest of 2016, hopefully Q2, Q3.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Could you remind us kind of when the rail markets started really to soften for you all as part of that context of the portfolio?

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

I would say that we were cautious about the rail markets as we were exiting Q4 and started to see more material some of that softness now that we are in the first quarter of 2016.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Great. Thank you.

Operator

Liam Burke, Wunderlich.

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

Good morning Chris. Good morning Vince. Chris, you mentioned new product introductions, especially in the automotive space. Have you maintained the R&D budget with all of the related expense cuts in the business?

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

I'll tell you, we have been very committed to the R&D budget. In fact, in 2015, our R&D expense from a ratio basis was actually ahead of the prior year. So, we continue to be focused on driving solutions, and the investment in R&D and the continued investment in evaluating whether we can bring in new solutions and technologies through our M&A strategy continues to be a priority. So we are not mitigating those expenses as we try to drive our 2020 strategy.

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

And then, on the automation, you had tough comps from a year ago. As we look through the balance of the year, has the automation business changed or do you still have the same positive view of the outlook for the business?

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

I absolutely have the same positive outlook for the business. At its current state, there's no question that, at about $350 million, it's a little choppier than I would like just because of the size of the business within the broad portfolio. But we are still expecting and strategically believe that the automation business is growing at a rate of at least two times the broad welding market on a global basis. We see it is continuing to bring us closer to our customers as it relates to providing welding solutions. I just came back from the welding show in Japan last week in Osaka in talking to customers there and talk to customers about automation and our solutions, and continue to believe it's a strong differentiator for Lincoln. I like our first mover advantage as it relates to providing those solutions in the automation space. So, very committed to that strategy, and excited about what we've built at this point of our 2020 strategy.

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

Great. Thanks Chris.

Operator

Joe Mondillo, Sidoti and Company.

Joe Mondillo - *Sidoti & Company - Analyst*

Good morning guys. Just wondering if you could talk about the competitive landscape. Any changing of share over the last couple of quarters and do you anticipate any consolidation just given the stress on the market overall?

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

We like to think the stress on the market would create more consolidation in the space, but we are not really seeing a lot of that activity. Some of that could come from the structural dynamics in the different regions. There's not a lot of opportunity for consolidation in the Americas market. When you think about North America and Latin America, could be some opportunities for consolidation in the international space. Certainly, we would want to participate as a consolidator if possible, but not seeing a lot of that activity at this point in the cycle.

We've been very committed that we don't talk about share relative to changes within quarters or periods for the business. We think share shifts have to be accomplished over a much longer window of time to really be able to say that there has been a market share dynamic within the business. That being said, I'm not necessarily seeing anything in the markets which lead me to believe that there's any large share shift within the broad welding space.

My only probably comment would be is I do believe that the larger players in the space are probably performing better than the smaller players in the space by region. This dynamic generally provides some opportunities for those firms to be able to maintain their positioning within the markets. But no broad share, no broad share perspectives at this point.

Joe Mondillo - *Sidoti & Company - Analyst*

So in terms of your acquisition strategy, you guys have been, over the last several years, been much more sort of strategic, focusing on automation, smaller type acquisitions. Does that strategy shift at all towards consolidation, wherever it may be? You said international. Is that more of a possibility going forward?

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

I think probably the important point would be we've been executing on an acquisition strategy, and certainly that strategy has focused around building out an automation business. But it hasn't been accomplished by not being willing to consider or entertain broader acquisitions if they were available. So we've been executing on acquisitions around automation, and then the other acquisitions we've been accomplishing have tended to be smaller bolt-on technologies. But during this window, it's not as if we've not been interested in a broader transaction if it were available. So I really don't think that our perspective or strategy has shifted any over the last several years relative to acquisitions.

Joe Mondillo - *Sidoti & Company - Analyst*

Okay, great. And then I don't know if I missed it, but what do you anticipate for CapEx this year?

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

We are sticking by our $65 million to $75 million range. I said in prepared remarks that we were light in the first quarter at $9 million, but we have a couple of big projects that are unfolding in 2016 and 2017 that I think will likely bump that number up as we move through the year. So right now, $65 million to $75 million.

Joe Mondillo - *Sidoti & Company - Analyst*

Okay, great. Thanks for taking my questions.

Operator

Justin Bergner, Gabelli and Company.

Justin Bergner - *Gabelli & Co. - Analyst*

Good morning Chris. Good morning Vince. It looks like a good quarter even considering some of the price cost benefits that helped out the first quarter. I guess maybe if you could expand a bit more on the retail initiatives that are helping the performance in the Harris Products Group, that would be helpful.

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

Chris here. Thank you for your comments. I would tell you I think it more than looks like a good quarter. I'm very happy with the performance of the business, considering the volume challenges we had in Q1.

In our Harris business, we have a very strong position in the retail channels here in the domestic market. We have been working with those channel partners to provide heightened improvement in the sets, providing some new sets for certain customers in that space. We've also identified some new product introductions on our equipment side that we've been driving into that particular channel. And we've seen the benefits of that continue to accrete. We were strong with retail in 2015 and we continued that as we migrated into 2016. And it's primarily been just from that new products and enhancement of those sets for the retail space.

Justin Bergner - *Gabelli & Co. - Analyst*

Great. Was there anything about sort of selling into retail that would make the first-quarter volume stand out, or should we expect the benefit to persist throughout the rest of 2016 on a year-on-year basis?

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

Well, look, we have expected our Harris business in the aggregate to continue to make improvements, and we've had a very nice improvement in that business over the last several quarters.

Certainly, when you are providing new sets, there might be a little bit of an inventory draw initially to be able to provide that inventory to the various stores. So, it might not accrete at the same rate, but we certainly like our positioning in that space and expect continued improvement in our retail channel throughout 2016 although it might not be at the level that it was in Q1.

Justin Bergner - *Gabelli & Co. - Analyst*

Great, thank you. I do have one question on price cost. If I look at the decrementals in Europe and try and see out through the FX effect and the gain on sale from first quarter of 2015, it looks like you were running about a 25% decremental in Europe. Is that at the right ballpark? And so are the decremental in Europe sort of already at that decremental rate that you expect the Americas to gravitate to as we continue throughout 2016?

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

That is a good range for our International Welding group, about 25%. That includes Europe, which is the bulk of that segment currently. And then as far as the Americas are concerned, I think decrementals are maybe a tad bit better than that. I'd give it a range of 20% to 25%.

Justin Bergner - *Gabelli & Co. - Analyst*

Great. I mean is it the FIFO versus LIFO inventory accounting that has caused the decrementals in Europe to sort of be more reflective in the first quarter of what you expect for the year as a whole whereas LIFO has sort of delayed that in the Americas, or is it some other driver?

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

No, I don't think it has to do with inventory accounting whether on LIFO or FIFO in those respective regions. The businesses are distinctly different in terms of their structure, how they are managed. We have a great deal more flexibility in our biggest operating unit in the Americas being the US business that we've highlighted heretofore in our conversations surrounding the incentive management system. We also have a much higher incentive pay component in our compensation structures in the Americas, and that gives us a little bit greater cushioning on the down side that improves our decrementals over how we can perform in other parts of our business outside of the US.

Justin Bergner - *Gabelli & Co. - Analyst*

Okay. Thank you for taking my questions today. Good luck for the rest of the year.

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

You're welcome. Thank you.

Operator

Steve Barger, KeyBanc Capital Markets.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Good morning guys. We know the automotive sector has embraced automated solutions a lot more than other industries. Are you making progress selling into other industrial sectors, or could you talk about how that is progressing?

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

Yes, Steve, you are accurate that, when we look at the various industrial segments that we participate in, that automotive has a higher concentration of automation than the other segments. I would also tell you, though, when we look at our automation business, our concentration of automotive automation is less than the average. So we are already beginning to diversify from that. And we've got a multitude of solutions and acquisitions that we have been making to continue to diversify that. An example would be the Wolf Robotics business that we acquired in 2015. That business was really concentrated in the heavy industry space. It was not automotive-centric. It's got heavy industry. It's got some aerospace that's active within that business. So we not only are penetrating but we also use it strategically as we are evaluating options for us from an acquisition perspective as we continue to build out the automation business on a global basis.

Steve Barger - *KeyBanc Capital Markets - Analyst*

And when you look across the industrial sectors, is it really heavy machining and that sort of thing where you see the most opportunity, or what sectors do you think are really ripe for adoption of automation?

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

I'll tell you, Steve, we can actually build a case around nearly all of our segments to be looking at levels of automation. So whether it's automation that we might have in a structural steel facility for our Python solutions or whether it's automation from orbital welding with our new product technologies that we have for that space, we believe that it's easy for us to identify a level of automation. We certainly see automotive as the most material. We see, quite frankly, heavy industry as having applications, but we believe that, quite frankly, a multitude of our segments will have opportunities for us to provide automated solutions and continue to evaluate all of them to be able to provide an offering into the space.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Got it. And Chris, in the release, you talked about good execution in your commercial initiatives helping to mitigate volume declines. Is that all in the automation side or are there some new product wins from the traditional welding equipment, or anything notable there?

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

No, it's not just automation, quite frankly. We are exiting 2015 with a very high vitality index, especially the vitality index for our equipment offering. So we are driving a multitude of those solutions in the marketplace. In fact, we had a couple of releases where the demand has been greater than we expected, and have a little bit longer leadtimes on some of those fill rates than what I'd like to see within the business right now. We've got a new offering that we launched in 2015 for equipment specialized in aluminum that I'm very excited about. So we've got a multitude of new products beyond automation that we are moving to the marketplace, and need to continue to drive those (technical difficulty) throughout the year.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Thanks for that. And then just one more for Vince. Even with the revenue declined year-over-year, free cash flow was about equivalent with the prior year ex the tax refund. Just as you look over the next few quarters, do you expect free cash flow generation will stay on track to meet or exceed 2015?

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

Well, I think that's going to be difficult in this environment with the kind of volume declines that we've experienced early in the year in the first quarter. It is fair to say that the volume declines will be somewhat mitigated by the freeing up of working capital as the business contracts. It's also fair to say that, in the second half of the year, that those declines will moderate. At this point in time, I wouldn't be predicting an equivalent cash flow from ops for the full year as compared to 2015. I think it will be somewhat less than that.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Got it. I do have one more. Maybe I missed this, but when you are looking at the 2Q revenue walk versus the prior year, I know it's your strongest seasonally, but do you expect that revenue will be down single-digit or double-digit versus the prior year?

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

Steve, I don't have any expectations on that right now that I could delineate to you. I think the best we can say at this point is that the rate of decline has decelerated. We've seen some stabilization in the business. We did have difficult first-quarter comps. But early in the second quarter, we are seeing a similar type of order pattern on a year-over-year basis that we saw in the first quarter of 2016.

Steve Barger - *KeyBanc Capital Markets - Analyst*

The same kind of trending volumes.

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

Right, in terms of year-over-year declines.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Got it.

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

It's also early. We're only -- we are not even three weeks in, but we see some continuing softening on a year-over-year basis.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Understood. Thanks.

Operator

Paul Dircks, William Blair.

Paul Dircks - *William Blair & Company - Analyst*

So, briefly on oil and gas, I just wanted to drill down on this. Obviously, you had mentioned that the business was down about 30% year-over-year in the first quarter. Maybe you could delineate for us how your businesses are trending. Is midstream still relatively outperforming your upstream and downstream businesses and have you seen any sorts of inflections or changes in those individual oil and gas markets through the quarter?

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

They are all down fairly significantly on a year-over-year basis. If there's one of those segments that's performing just modestly better, it would be downstream in the quarter. It is one quarter. It's not something that we could draw conclusions from, but certainly, not unexpectedly, the upstream business is down the most on a year-over-year basis.

Paul Dircks - *William Blair & Company - Analyst*

Thanks, that's helpful. Also, I guess, Chris, you had touched upon this a little bit earlier in the call. As far as your R&D investments and looking beyond automation, are there certain other markets, whether it's continue advancing into aluminum or other specialty materials or other areas where Lincoln could consider even ramping its R&D investment in 2016 to kind of get out ahead of the next growth that you see in your markets?

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

I'm not sure that I can point towards an area that we need to be ramping. We certainly already have several strategic focal points within the strategy where we are investing in at a higher rate looking at technologies that might be next gen technologies in our consumables, our equipment line. We continue to invest heavily in automation and education strategies. And as I mentioned earlier in the call, we just launched a new specialty solutions equipment portfolio for the aluminum space. So I think we are making those investments. I'm not thinking that we have an area like that that we have identified that we are not investing in, and quite frankly I think we probably already have enhanced R&D schedules to try to provide investment behind what we believe will be some of those future opportunities.

Paul Dircks - *William Blair & Company - Analyst*

Got it. And then finally for me, a little bit of housekeeping question. Vince, on tax for the year, the tax rate outlook is certainly lower than what you guys had conveyed previously. Were there certain or are there certain credits you're anticipating or that you received in the first quarter to change your full-year outlook by such a large degree from the low 30s% down here into the 20s%?

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

We did have, in the first quarter, a little bit higher discrete items then what we would have expected. Those discreet items will obviously not repeat themselves. We are not, at this point, expecting the same kind of discrete items as we roll through the rest of the year. So we are expecting a higher tax rate as we look at our effective tax rate for the full year.

Paul Dircks - *William Blair & Company - Analyst*

Great. That's all for me. Thank you.

Operator

Schon Williams, BB&T Capital Markets.

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

Thanks for the follow-up. I wonder if you could just comment. What was the actual growth rate for automation in the quarter? Last quarter, you talked about some deceleration in growth. I'm just interested in where we wound up in the quarter. And then also Rimrock contributed a little bit less than what I was expecting. Is that just normal seasonality, or any reason that business would be kind of running below the $40 million run rate that you talked about during the -- initially when you bought it?

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

So, Rimrock is an automation business that's a long-term contractor. You're going to see a lumpiness in a quarter-to-quarter view of that. So I wouldn't say, at this point, we see any distinctive trends there that would explain the first-quarter acquisition revenue stream.

As far as the overall automation business, it was actually -- that particular product line was down in the quarter on a year-over-year basis, and so it did not contribute to increasing volumes and sales in the first quarter of 2016.

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

Is there anything specific you would attribute that down volume to? Is it just kind of the CapEx nature of automation, or is there a specific end market that may be driving that, those year-over-year declines? Anything you could highlight there?

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

I would emphasize again that we saw a very strong first quarter of 2015, so our comps were challenging. And I would emphasize that one quarter we are not seeing any particular trends that are disconcerting or would lead us to believe that there's an inflection negatively in any meaningful way.

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

All right. That's helpful. And then I just noticed, in the presentation, last quarter you talked about kind of general fab and shipbuilding being kind of flat to modest growth in 2015. You've now moved it to declining on a year-over-year basis. I'm just wondering what might be driving that. Are you actually seeing some slowing there? I know shipbuilding, it sounded like you're actually making some -- maybe some market share gains on some new product introductions or some new applications. But I'm just wondering. I don't know. Is there anything that's actually slowing there versus where we were in 2015?

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

Yes, that's a good question, I've got to tell you. We talked about it internally. We don't see anything materially that's happening. So when we did look the data on a year-over-year basis, it could just be the choppiness within orders within that segment. But we are not seeing it. We are not seeing any material change in the way we're approaching the segment or the space. Certainly, it's one quarter. We'll have to see how those two particular end markets trend out here over the next quarter or two.

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

Thanks guys. Appreciate it.

Operator

Thank you. This concludes our Q&A session. And I would like to turn the call back to Mr. Vince Petrella for closing remarks.

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

Thank you Michelle. I'd like to thank everyone for joining us today on the call and for your continued interest in Lincoln Electric. We look forward to discussing the progression of our strategic programs and our 2020 strategy and vision at upcoming investor conferences and on our next earnings call in July. Again, thank you very much.

Operator

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