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LECO - Q4 2016 Lincoln Electric Holdings Inc Earnings Call

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

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

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

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## PRESENTATION

**Operator**

Greetings and welcome to the Lincoln Electric 2016 fourth-quarter and full-year financial results conference call. At this time, all participants are in a listen-only mode, and this conference call is being recorded. It is now my pleasure to introduce your host, Amanda Butler, Director of Investor Relations. Thank you. You may begin.

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

Thank you, Candace, and good morning everyone. Welcome to Lincoln Electric's 2016 fourth-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, Chief Executive Officer, as well as our Chief Financial Officer, Vince Petrella. Chris will begin the discussion with an overview of full-year results, and Vince will cover the quarter performance in more detail. Following our prepared remarks, we are happy to take your questions.

Before we start our discussion, please note that certain statements made during this call may be forward-looking and actual results may differ materially from our expectations due to a number of risk factors. A discussion of some of the risks and uncertainties that may affect our results are provided in our press release and in our SEC filings on Forms 10-K and 10-Q.

In addition, we discuss financial measures that do not conform to US GAAP. A reconciliation of non-GAAP measures to the most comparable GAAP 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. Chris?

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

Thank you Amanda. Good morning everyone.

We completed 2016 with solid results and are well positioned to capitalize on opportunities in the year ahead. In 2016, our flexible incentive management system and 2020 strategy initiatives mitigated the impact of another downcycle year in industrials. While sales, excluding Venezuela, declined 7.6% to $2.3 billion, our initiatives to reduce costs, improve mix, and drive innovation did an excellent job of sustaining margin performance.

We generated a 150 basis point increase in our gross profit margin in the year, and held our adjusted operating profit margin reasonably steady at 14.2% with only a 50 basis point decline versus the prior year. This yielded a decremental operating margin of 19% on approximately 22%, excluding Venezuela.

Reported diluted earnings per share was $2.91, primarily impacted by lower volumes and the non-cash loss from the deconsolidation of our Venezuelan subsidiary. Excluding special item charges, adjusted EPS for 2016 was $3.29, a 5% decline versus the prior year.

We generated $303 million in operating cash flows aided by a record 15.6% average operating working capital ratio. This yielded a 113% free cash flow conversion of adjusted net income.

In 2016, we returned $429 million of cash to shareholders from the 10% increase in our dividend rate and $342 million spent on share repurchases, which reduced our average share count by approximately 9%.

Our results continued to demonstrate the benefits of the structural changes we've made to the business as part of our 2020 strategy, and we are on the right track to achieve best-in-class performance. I am confident that we are better positioned today than in the past to benefit from stabilizing end market trends and a future recovery in 2017.

Moving to Slide 4, given improved fourth-quarter volume trends, markets appear to have broadly stabilized and we are also benefiting from easier year-over-year comparisons. While volumes have remained compressed in our Americas Welding segment, rates narrowed in the fourth quarter and our International segment achieved volume growth in both Europe and Asia-Pacific. Additionally, Harris Products Group's volumes continued to increase due to the ongoing strength of their US retail program and from a series of successful new product launches. Our Automation solution sales also grew in the quarter on strong demand for automotive, structural steel, and pipe mill applications.

Investments in R&D have been critical to mitigating volume declines and continuing to position Lincoln as the leader in our industry. In 2016, we continued to maintain a high 34% vitality index of new products, which is one of the key differentiators of why customers choose Lincoln. Early 2017 sales trending suggests ongoing stabilization in our end markets, and we continue to expect low single-digit sales growth in 2017 with modest margin and earnings growth.

Before I pass the call to Vince to cover fourth-quarter numbers in detail, I'd like to thank our global Lincoln Electric team who successfully delivered on our initiatives, collaborated to successfully impact results and who always prioritized our customers first.

In addition to a solid financial performance, I am pleased to report that our team continued to advance our environmental, health and safety performance towards our 2020 EH&S goals. In 2016, we have achieved a 65% improvement in our safety performance as compared with our 2011 baseline year. This keeps us on pace to achieve our 75% safety improvement target by 2020.

We also reduced our carbon footprint and energy intensity in 2016, and increased our recycling and reuse rates to 93% of eligible materials. Great work. So, as markets improve, I am confident that the Lincoln Electric team is ready to capitalize on growth opportunities, drive continuous improvement, and continue to work towards our 2020 strategic goals.

And now I will pass the call to Vince.

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

Thank you Chris. We finished a challenging year with stabilizing end markets and solid results that demonstrate the structural improvements achieved with our 2020 strategy.

Looking at our fourth-quarter income statement highlights on Slide 5, our consolidated fourth-quarter sales have held relatively flat compared with the prior year as the benefit of acquisitions and steady pricing offset a modest 1.3% decline in volumes. Excluding Venezuela from the prior-year period, volumes declined 60 basis points.

Our fourth-quarter gross profit margin rose 50 basis points on favorable mix and lower costs. Our SG&A expense as a percentage of sales increased to 20.3% because of higher incentive compensation and added acquisition Company expenses. These expenses were largely offset by ongoing cost management across the business.

Our operating income was $83 million, or 14.7% of sales. Margin performance was reasonably steady with a 40 basis point decline against a challenging year-over-year comparison of 15.1%.

Our interest expense was $7.3 million, reflecting higher borrowings. Compared with the prior year, interest expense declined $2.5 million as the prior year included a $6.4 million adjustment and the consideration expected to be paid to acquire an additional ownership interest in a majority-owned subsidiary.

Now, looking ahead to 2017, we expect our full-year interest expense to be approximately $25 million, reflecting the cost of current borrowings.

Our fourth-quarter effective tax rate was 31.7% compared with 31.6% in the prior-year period. In 2017, our effective tax rate is expected to be in the low 30% range subject to the geographical mix of earnings and the utilization of US tax credits.

Fourth-quarter diluted earnings per share increased 19% to $0.81 compared with $0.68 in 2015. On an adjusted basis, diluted earnings per share increased 8%, reflecting solid operational performance and a $0.07 EPS benefit from share repurchases.

Now moving to the geographical segments on Slide 6, Americas Welding segment's fourth-quarter adjusted EBIT margin was 18.2%, a 120 basis point decline versus the prior year. The decline was due to lower volumes and challenging year-over-year comparisons. The rate of sales declines narrowed to 3.5%, excluding Venezuela in the prior year. Revenue from acquisitions and flat pricing were offset by 4.8% lower volumes. In the quarter, automation sales rose modestly and US export sales held steady with the prior year at $37 million.

Moving to Slide 7, the International Welding segment adjusted EBITDA margin improved 280 basis points to 5.5% on higher volumes, flat pricing, improved mix and favorable year-over-year comparisons. Volumes improved 10% in the quarter from growth in both the European and Asia-Pacific regions, notably from expanding our presence in targeted customer accounts and from double-digit percentage growth in the automotive, pipe mill, and heavy fabrication sectors.

Moving to the Harris Products Group, fourth-quarter EBITDA margins improved 100 basis points to 10.2% on 4% higher volumes and 1.5% price improvement. Volume growth reflected the continued strength of our commercial programs in the US retail channel and pricing benefit from higher input cost trends.

Moving to Slide 9, we generated strong cash flows in the fourth quarter of $67 million with a 105% cash conversion of net income. On a full-year basis, we achieved $303 million of cash flow from operations and a solid 113% cash conversion ratio, as well as record working capital efficiency. At year-end, we achieved a 15.6% average operating working capital ratio, which positions us closer to our 2020 goal of 15%.

Moving to Slide 10, we invested $72 million towards acquisitions in the year and capital expenditure spending held steady over the prior year at $50 million. Looking ahead to 2017, we estimate full-year capital spending to be in the range of $65 million to $75 million, including the completion of our new welding technology center here in Cleveland, Ohio.

During the fourth quarter, we continued to return cash to shareholders. We paid cash dividends of $21 million, reflecting an increase of 10% in the dividend payout rate. The board also approved an additional 9.4% dividend rate increase for 2017. We spent $53 million on repurchasing approximately 834,000 shares at an average price of $64.06 in the fourth quarter. Our full-year 2016 repurchases were $342 million at an average price of $58.34 per share. Share buyback activity finished the year below our $400 million share buyback target, because share valuation models exceeded our buyback pricing thresholds in the fourth quarter.

Our net debt position at December 31 was $326 million, reflecting the new $350 million of senior notes secured in October of last year. With these new notes, we have approximately $705 million in total debt at an average weighted interest rate of 3.3%, achieving our targeted gross debt to EBITDA leverage ratio of 1.75 times. These actions optimize our capital structure and provide ample flexibility to pursue growth initiatives through the cycle, manage our dividend improvement strategies, and execute our share repurchase program as conditions allow.

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

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**Operator**

(Operator Instructions). Mig Dobre, Baird.

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

Good morning, everyone, and hats off to you guys on delivering a really good 2016, given all you had to deal with.

Maybe my first question is trying to get a little more clarity as to the puts and takes for 2017. You talk about low single-digit growth. Can you maybe give us a flavor here as to how you see the year playing out? At what point do you expect volumes to inflect positively in North America? And how do you think about the sustainability of international volumes at this point?

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

Thanks for your comments. So, look, I don't think our perspective on 2017 has changed materially over the last several months. We had conversations about our business in the third quarter. We said we expected those rates to continue to decline in the fourth quarter. They did. A couple of areas actually accelerated maybe a little bit more than what we had expected, which is a positive. And we had always thought, as we moved in towards 2017 with the stabilizing markets, that we would expect to trend towards an overall growth profile in the business sometime in the first half. Difficult to tell whether that will be the first or the second quarter, but still believe that we will be turning towards growth as we move into 2017.

The Americas business and the North American business has continued to make improvements. We've got some great new products, some initiatives, that's in that business I'm very excited about. Expect it to continue to narrow and turn favorably as we're moving into 2017. And our expectations for the international business is for us to be able to continue this trend. It was coming off a comparison in 2015 that was certainly not very robust, but we just completed reviews over there. We think we've seen some stabilization in those markets. We also have new product initiatives that we are driving in those regions also, and would expect to continue to see improvement in our international business as we move through 2017.

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

And maybe to kind of focus in on international here, you had call it $12.5 million worth of volume growth in the quarter. Any way you can parse this out in terms of what is Asia or maybe China specifically versus what is Europe and your automation initiatives?

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

I'll provide you this background -- is that certainly our China business was improved on a year-over-year basis and our European basis was improved on a year-over-year basis. We really don't break those data points out. But we've seen some stabilization, especially in Europe, across a host of those markets and some of that driven from I think improvements in the core markets, some of that driven from some of the initiatives that we are driving. We had a very favorable quarter in the fourth quarter with our equipment offering across some of those regions, and certainly that came through. We'd expect that to continue as we move into 2017.

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

And I would add that both of those regions improved on a year-over-year basis, but Asia-Pacific was the preponderance of the improvement. Europe was up, but Asia-Pacific had a very strong quarter. And as Chris noted, I would emphasize on the equipment side of the business is a good order flow and new product introductions aided the region.

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

That's great. Thanks for the color. If you may take one more, maybe a little bit of detail on incentive compensation and bonus accruals, where you came out in 2016 versus the prior year and how we should be thinking about any potential headwind here into 2017.

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

So, we had a difficult comparison to the prior year's fourth quarter as we had a lighter fourth-quarter provision in 2015 and a heavier provision in 2016, so those comparisons, particularly in the Americas, had a detrimental effect on SG&A and margins in the quarter.

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

But Vince, to clarify, I think, as of Q3, you were benefiting from something like an $18 million tailwind through the first three quarters on bonus accruals. As I understand it, some of that got reversed in the fourth quarter. Can you give me a sense as to what it was for the full year in terms of incentive comp?

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

I'll have to come back to that, and I'll look at the full-year impact on incentive compensation. I'll respond to that later in the call.

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

Thanks for taking my questions.

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**Operator**

Eli Lustgarten, Longbow Securities.

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

Good morning. Nice execution. Can we talk a little bit about, following the last question, fourth-quarter costs, I know you had a tough LIFO comparison supposedly versus last year. Was there some LIFO in the quarter, foreign currency, and these cost issues? And more importantly, as we look into 2017, can you give us some quantification of what these employee costs are coming back this year and what's going on with material costs and whether -- you had LIFO in 2016 and what do we see in 2017 from a material standpoint?

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

So, I would say that our puts and takes on our cost profile in 2017 will be a stable environment outside of raw materials. We've said as we entered the fourth quarter and moving into 2017 that our cost savings initiatives would be tempered as we move into 2017 as we restore some of what we refer to as temporary cost savings initiatives, the suspension of the 401(k) matching, some freezing of wages and salary pay cuts. Those are now restored but we believe that, overall, our cost profile will be stable in 2017 moving out of the fourth quarter of 2016.

As far as raw material costs are concerned, we are starting to see an inflationary impact, particularly in commodities, primarily steel, so our expectations are that we will have increases in inputs, material input costs like steel, during the course of 2017.

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

I guess I'm trying to -- were LIFO gains or LIFO earnings in the fourth quarter this year and for the year 2016, and what would that swing look like between 2016 and 2017 is what I'm trying to say.

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

There was a small credit in the fourth quarter of just under $1 million, but, at this point, it would be difficult to try to estimate what 2017 will bring. But I think you could use that as an initial sort of foundational baseline that we are going to have LIFO charges in 2017. We are exiting 2016 with right around $1 million, but I think it's too early to try to comment on what those charges might be. But I think it will be an inflationary environment supported by what we are seeing in the steel markets, as well as volume starting to firm up.

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

I guess LIFO credit in 2016 for the whole year, any magnitude?

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

No, it was actually a charge.

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

Okay, thank you. And when we talk a little bit about the demand getting better, can you give us some things -- pipelines have been improved, at least supposedly, and I think you cited some pipelines here. Are you seeing any change in either attitude or orders or something from some of the initiatives that are either have -- supposedly forthcoming or promise to be forthcoming, or is it just still you saw a little bit of a Trump bump and everybody's waiting for actual activity?

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

As we talked about, the fourth quarter and end market trends, we cited the strength that we had seen in automotive and transportation and MNR in the pipe mill segment. But I can assure you that activity was from the products and technologies that we were driving towards those markets, not because of there necessarily being any structural change in the broad demand profiles yet in those markets, certainly not here in the US market relative to some of the infrastructure another opportunities that are being discussed for this market. We certainly are excited about those if they materialize, but it's just too early to actually see those actually start to move through our business. I do think (multiple speakers)

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

(multiple speakers) is there any foreign currency expectations for 2017 versus 2016?

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

We wouldn't have a view on that at this point in time. We would expect there to be a relatively modest impact based on where we finish the year and what you see in the fourth quarter.

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

Thank you very much.

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

Then in terms of the LIFO, let me just respond to a couple of questions here. On LIFO, the total LIFO charge in 2016 was about $1.5 million. In 2015, as a reminder, were $11.5 million of credits. So the fourth quarter of 2015 had over $4 million of credits.

And then in terms of Mig's question on incentive compensation, the full year had a $15 million decline in incentive compensation, and the fourth quarter had about a $4 million increase, again, because of challenging comparisons on a year-over-year basis, so an increase in the fourth quarter and a decrease for the full year of $15 million.

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**Operator**

Saree Boroditsky, Deutsche Bank.

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

Thank you. Good morning. I appreciate the earlier color that you gave on international, but it appears that you had much stronger results than some of your peers. So, I was wondering if you could provide some more color on just the competitive environment there and if you're seeing any growth in your market position.

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

Look, I would tell you that we were very pleased with some of the progress we made in those markets, as we stated, core Europe as well as Asia-Pacific, both Southeast Asia and in China, strength in India for us. So, we had a multitude of places where we started to see some acceleration in our business. Very difficult for us to apply that within one quarter towards any particular share or shift within the competitive dynamics in those various regions, and each one of those regions have different competitive dynamics. So certainly solid performance, excited about the work our teams are doing in those areas, expect it to continue into 2017, but probably not willing to comment on that being necessarily any broad market dynamic.

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

Okay, that's fair. And then as a follow-up, since we are fairly deep into the first quarter at this point, I was wondering if you could give us an update on how demand has trended so far as you started the year. And I believe you normally have slight decline into 1Q, so anything that you would see that would impact normal seasonality as -- would be helpful.

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

So, what we've seen with January in the book and order trends into February is a low single-digit improvement on a year-over-year basis. So, the year has started well. It's tracking in line with what our expectations were exiting the fourth quarter as the year-over-year comparisons continue to narrow. And the first quarter's view is, right now where we stand, a low single-digit year-over-year improvement.

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

Okay, that was helpful. I'll get back into queue.

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**Operator**

Liam Burke, Wunderlich.

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

Good morning Chris. Good morning Vince. Chris, could you talk a bit about the automation space, how the competitive environment is shaping up and how you are looking at the -- I know you've got opportunity in the growth side, but any particular market or vertical that's attractive vis-a-vis competition?

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

I'm not sure if I would say for the competition, but I would share with you that we continue to love -- to enjoy the balance (technical difficulty) replacing that business. The acquisition that we were able to complete in 2016 with Vizient Technologies provided us further expansion into the heavy industry space for the Automation portfolio. We continue to drive different technologies into that space. So I think it's not only as we've talked about our automation strategy over the last three to four years, it's not only been the growth opportunity that we wanted to see and we've been capitalizing on that, but it's also been our ability to take welding technologies and employ that into the various automation solutions that we are driving to these various segments to really provide us with a value proposition which we still strongly believe is an excellent way for us to provide these solutions into our customers. So, the automation business goes into a multitude of various segments. There are various competitors in those segments. We are very focused on welding, very focused on the technology around welding and how we can bring those automated solutions into the marketplace efficiently, and continue to expect to execute on our 2020 strategy for our automation business as we continue to try to expand that and drive that to a $600 million or $700 million business for us at the end of this strategy term.

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

Just as a follow-up to that, so you talk about adjacent applications over and above the welding applications that you focus the automation on. Does that move the needle?

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

I'm not sure if it moves the needle today, but it certainly could move the needle for us over the tenure of our continued advancement into automation. And I think that's relative to the way we think about our 122-year-old company here at Lincoln Electric. I'm not certain that the work we are doing in additive manufacturing today is going to move the needle in 2017 or 2018, but it certainly could be some technology that can be material for us over the longer term.

You may be aware that, through the utilization of flexible automation, we've been able to show that we can do additive manufacturing processes. We've provided that out at a multitude of tradeshows. We are working with some OEMs on that technology. Probably not a near-term needle mover, but certainly it does two things for us. It gives us confidence in our ability to be a technology leader in the space of automation, and certainly might provide us the foundation for other growth opportunities for the business moving forward.

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

Great. Thanks Chris.

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**Operator**

Stanley Elliott, Stifel.

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

Hey guys. Good morning and congratulations on a nice year. A quick question on the outlook for the raw materials. With the increase that you mentioned in the steel prices, some of the other commodities, what our expectations for pricing in this year? And is it going to be more challenging to get it? Historically, you guys have done a nice job, but given where volumes are -- and I guess the other parts of that is kind of where does that lead from an incremental margin perspective heading into 2017?

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

Thank you Stanley. Good morning. My expectations are that we will have pricing increases this year in the low to mid single digits based on the trends that we are seeing. As you might recollect, we haven't had price increases last year in 2016 in order to recoup the expected raw material cost acceleration that we are seeing in 2017.

From an incremental margin perspective, as we manage through a more inflationary environment, my expectations are that our incrementals will be somewhere around 20-ish% in this modest low single digit type of topline improvement environment. If we get a little bit better performance in the top line, I think we could migrate up from there, but what we see in the first quarter now, based on the cost profile, the pricing environment that we have to manage, and the top line growth, I'm looking at roughly a 20% type of incremental.

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

Perfect. Then just to clarify, you guys had the heavy fab pieces in the compressing but narrowing section. I also thought I heard you say that Asia-Pacific, the heavy fab piece was positive. What are the expectations here for the other parts of the heavy fab market, be it construction or mining, or ag, however you guys want to break it up, if you do it all, just from an outlook perspective heading into this coming year?

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

Yes, we did see some improvement in that particular region. I would share with you that certainly the longer-term outlook for ag and for mining is more favorable. If we just look at those particular segments, they've both been in a challenging cycle for those industries for a period of time. Mining has been in a longer run cycle than we've seen for ag. We've seen some initial data for ag with some of the data we see that looks like it's trending slightly more favorably. We certainly like the fact that some of the commodity costs associated with mining, both coal, iron ore and copper, have been escalating commodity prices in the marketplace, which bodes favorable for the dynamics for those industries to turn. So we're certainly more optimistic about ag and mining moving forward than we were in 2015 and 2016. Just difficult for us to understand when we'll see the tipping point in that particular segment will turn to broad growth.

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

Perfect. One last one if I could. I'm looking at these Q4 market trends, I know there's been a lot of moving parts with some of the cyclical markets being up and down, but it looks to me like that -- would it be fair to say that, say, 70%, maybe even a little bit higher than that, of the overall portfolio would fall into that increasing/steady category?

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

I would say probably less than that. I would -- yes.

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

Great. Thanks guys.

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**Operator**

Steve Barger, KeyBanc Capital Markets.

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

Good morning. Just following up on the incremental answer, you said if performance is a little bit better, you can migrate up from that 20% level. What does that mean or what would you guess that means if things do line up and you get more like high single-digit growth?

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

If we had high single-digit growth we would be bumping up against 25%, 30% incrementals.

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

Got it. Thank you. When you're looking at taking pricing actions like you just mentioned, do you typically need to see a return to positive volume before you can drive price increases, or will you take action to reflect that inflationary pressure regardless of what the volume is doing?

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

If our raw inputs are increasing, we will need to and we will increase pricing. So, it certainly is, in normal markets, it's certainly helpful to have volume improvements. We are starting to see modest year-over-year improvements, which are helpful, but, at the end of the day, if our costs are going up from our raw material vendors, we need to pass that on.

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

Got it. And can you talk about demand trends in consumables versus equipment in the quarter? What are you seeing on each, any areas of specific strength or weakness?

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

Actually, in the quarter, if we're talking about the fourth quarter, the fourth quarter had a strong equipment showing, as we talked about, in some of our international regions and in our Harris Products Group business in particular. So, in the fourth quarter and moving into the first quarter, equipment has accelerated more than consumables to a point where equipment was actually up in the fourth quarter and consumables were down in the aggregate across the global portfolio in the fourth quarter.

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

Got it. And I'll just ask one more if I can. Your CapEx guidance, can you break out growth versus maintenance and where does the growth GAAP CapEx go towards this year?

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

Well, a bigger part of the CapEx over the $50 million that we spent for last year will go towards what I would refer to as growth. As we finish off our welding tech center in Cleveland and make investments internationally, I would say that the mix is, in 2017, going to be more slanted towards growth. My view of our maintenance CapEx in the environment that we are in is roughly $30 million or so would be a maintenance -- good maintenance CapEx number for Lincoln Electric globally.

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

Outside of the technology center, what are some of the growth areas that you are targeting? And what can you expect to drive in 2017?

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

We've got a couple of key items that I would talk to. We are doing some new products in our Harris business. We are making a large investment down there in some aluminum applications that they are driving into the broad HVAC market globally. We've got two or three new equipment technology advancements that we are investing in that we expect will be moving towards the market in 2018 and early 2019. So, most of those investments, from a capital perspective, have to do with advancing technologies around new products. And that's just two examples that I would guide you towards. But we have a multitude of those across the portfolio around the world all centered around continuing to advancing growth in our business, in our portfolio. It's one of the ways that we maintain and continue to stay focused on our vitality index.

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

Very good. Thanks gentlemen.

**Operator**

Matthew Trusz, Gabelli.

**Matthew Trusz** - *Gabelli & Co. - Analyst*

Good morning. Thank you for taking my question. I was hoping if you could comment a bit on what you're seeing in your M&A pipeline in terms of size and actionability, how valuations are looking in the space, and whether you're looking more at automation hard-facing assets right now.

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

We are always active in looking at properties that extend our strategies. Certainly, automation has been a focus of ours over the past several years. We continue to look at those opportunities that improve both our solutions opportunities as well as our geographical presence. At this time, certainly there are active discussions going on amongst Lincoln and various target parties. I would say pricing is stable, but certainly evaluations have improved in the last three months or so. So, we have a track record of being able to bring into the fold at least one or two meaningful acquisitions that hit our strategic marks every year, and I expect 2017 to be no exception to that historical track record.

**Matthew Trusz** - *Gabelli & Co. - Analyst*

Thanks. Just to follow-up on that, if we think about the huge amounts of cash flow you expect to generate this year in a higher share price environment where you said you are less excited about doing repurchases, what would you do with all the cash if M&A doesn't materialize in large quantity? Would you just don't cash on the balance sheet and wait for better opportunities?

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

I don't think I said I was less excited. But I would tell you, Matthew, that we will reset 2017 and we will buy back shares during the course of the year. We finished 2016 recognizing that we had achieved our targeted gross debt to EBITDA after a five-year multiyear plan to adjust our capital structure for the sake of greater optimization. But we will have to evaluate that when the time comes as the year unfolds. But I can assure you that we will continue to buy shares in 2017 and maintain an appropriate capital structure weighing the most advantageous use of the Company's balance sheet and its cash flows as the opportunities arise in 2017 and beyond.

**Matthew Trusz** - *Gabelli & Co. - Analyst*

Excellent. Thank you Vince.

**Operator**

Jim Giannakouros, Oppenheimer.

**Jim Giannakouros** - *Oppenheimer & Co. - Analyst*

Good morning Chris, Vince, Amanda. Thanks for letting me sneak in here. Just one quick one on the automation side just to better understand your strategy versus aggregators out there that aren't tied to any one OE for any part of the system, etc. How should we be thinking about your value proposition there versus competitive strategy? And are you seeing greater traction from what you can see, just given your relationships and your ability to leverage your installed base of equipment? Thanks.

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

That's a great question and it's one that, when we talk about our automation business here at Lincoln, our value proposition is all centered around the welding and the cutting that, at the end of the day, you have a multitude of other participants in the market you might be able to provide some competencies relative to doing automated-like systems, whether those are material handling systems or welding systems or other systems. But at the end of the day, the OEM that has fabrication as a key competency is looking towards Lincoln Electric to drive that solution. And that value proposition for us is just that. We believe we bring a level of competency and expertise on welding and cutting that cannot be matched by the other competitors in the marketplace. And that's really a driver for us as we continue to grow this business in the broad global markets.

**Jim Giannakouros** - *Oppenheimer & Co. - Analyst*

Thank you.

**Operator**

David Stratton, Great Lakes Review.

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

Good morning. Thanks for taking the questions. When you talk about the welding tech center, will that represent any noticeable increase in expenses going forward once that's completed?

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

No. We already have an existing welding tech center and school in Cleveland. This is a replacement and an expansion to improve our capabilities and our opportunities to demonstrate the solutions that we can drive into the market as well as a greater capacity to demonstrate those welding capabilities. The increased expense will be relatively modest.

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

Okay. And then you mentioned earlier Automation is targeted at around $600 million, $700 million. What is the current run rate? Where are you? I think last time we heard, it was around $450 million.

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

Right. I would put it less than that, actually. It's under $400 million.

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

Okay. And then you also touched on additive manufacturing. Is that a noticeable part of sales yet, or how does that compare? Do you have a sales number you could give us?

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

No, it's not a noticeable piece of our sales. That question was related to whether some of these new technologies in some of these closely adjacent markets are yet material for the business. And we have some very unique technology there that we are working with a multitude of companies with, but it's not material to our business, nor do I expect it to be a material portion of our business near term, although I do believe our ability to show the competency and the technology and to advance it could create opportunities for us as we move forward.

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

All right. Thanks for the questions.

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**Operator**

Mig Dobre, Baird.

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

Yes, thank you for taking my follow-up. I just want to go back to mix here. Very strong equipment, consumables still declining. To me, that looks to be a little bit unusual. I'm wondering. Did you get a sense that there was some kind of a CapEx flush that would've driven this in the fourth quarter, or are there some other elements here that we need to be aware of?

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

No, I don't think that, looking at the performance in the fourth quarter, that we would be able to cite that kind of phenomenon. We did have some very nice wins in the regions that we talked about. We've been talking about an improvement in our commercial channel in retail in North America that has been very successful. Because it was some larger orders and was fairly broadly achieved, I wouldn't cite any particular, if you will, flushing phenomenon at the end of the year.

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

Okay. And just so that we make sure we have our expectations set properly, when you are thinking about mix and the way that would flow into 2017 based on this low single-digit topline growth outlook that you've provided, how should we think about that? Would the mix be sustainable here? Are you thinking that consumables can play a bigger part of the growth in 2017 versus equipment? And how does that flow to the incremental margin assumption that we have to make?

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

My view at this point is that I'm not sure that equipment will sustain these kind of double-digit improvements. My view, at this point in time, albeit early in the year, is they will probably migrate a little more towards each other, that consumables will likely improve a bit and equipment should back off a bit, because we did have a very, very strong fourth quarter on the equipment side. And I think it's a little too early to argue that that's a sustainable trend.

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

Thank you Vince.

**Operator**

This concludes our question-and-answer session. I'd like to turn the conference back over to Vince Petrella for closing remarks.

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

Thank you, Candace, and thanks, everyone, for joining us on the call today, and your continued interest in Lincoln Electric. We very much look forward to discussing the outcome of our first quarter and the progression of our strategic programs in the future. Again, thank you very much and good day.

**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Have a great day everyone.