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LECO.OQ - Q2 2020 Lincoln Electric Holdings Inc Earnings Call

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## OVERVIEW:

Co. reported 2Q20 reported operating income of \$39.8m, diluted EPS of \$0.45 and YoverY consolidated sales decline of 24%.



## CORPORATE PARTICIPANTS

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

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

**Gabriel Bruno** *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Christopher M. Dankert** *Longbow Research LLC - Research Analyst*

**Dillon Gerard Cumming** *Morgan Stanley, Research Division - Research Associate*

**Joseph John O'Dea** *Vertical Research Partners, LLC - Partner*

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

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

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

## PRESENTATION

### Operator

Greetings, and welcome to the Lincoln Electric 2020 Second Quarter Financial Results Conference Call. (Operator Instructions) This call is being recorded. It is my pleasure to introduce your host, Amanda Butler, Vice President of Investor Relations and Communications. Thank you. You may begin.

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

Thank you, Catherine, and good morning, everyone. Welcome to Lincoln Electric's 2020 Second Quarter Conference Call. We released our financial results earlier today, and you can find our release as an attachment to this call's slide presentation as well as on the Lincoln Electric website at [lincolnelectric.com](http://lincolnelectric.com) in the Investor Relations section.

Joining me on the call today is Chris Mapes, Lincoln's Chairman, President and Chief Executive Officer; as well as Gabe Bruno, our Chief Financial Officer. Chris will begin the discussion with an overview of our second quarter results and our cost reduction initiatives, and Gabe will cover our second quarter financial performance in more detail. Following our prepared remarks, we're happy to take your questions.

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

In addition, we discuss financial measures that do not conform to U.S. 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](http://lincolnelectric.com). And with that, I'll turn the call over to Chris Mapes.



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

Thank you, Amanda. Good morning, everyone. As you saw in our earnings release issued earlier today, we continued to successfully operate as an essential infrastructure sector business due to the dedication of all of our global employees. So first and foremost, thank you for your perseverance and commitment to operating safely.

Our regional teams are now highly adept at operating productively with heightened safety protocols, and our customers are engaged with us on product webinars, are experiencing high service levels and are seeing continued innovation with the launch of 6 new products in the quarter. We're also focused on long-term initiatives that advance our 2025 higher standard strategy goals.

Our higher inventory build and new product investments will allow us to capitalize on the next growth cycle. Our work on enterprise initiatives that leverage shared services and further standardized processes and systems will also generate long-term value and differentiation in our business.

Moving to Slide 4, and an overview of our second quarter financial results. We successfully navigated what we believe was the economic trough of COVID-19. Despite second quarter organic sales declines of 24.8%, we achieved solid profitability, strong returns and cash generation. Our focused execution of cost reduction initiatives generated \$27 million in savings, which exceeded our plan and contributed to an adjusted operating profit margin of 10.7% and a 23% decremental margin.

Adjusted earnings per share decreased 37.5% to \$0.80, and returns on invested capital remained solid at 18.6%. Cash flow generation improved sequentially to \$104 million in the second quarter with 189% free cash flow conversion.

We returned approximately \$29 million to shareholders through our 4% higher dividend payout rate and continued to invest in internal capital programs focused on growth and operational efficiency. We continue to maintain a strong balance sheet and increased available liquidity by reducing short-term debt. Our capital allocation strategy positions us well to successfully navigate the conditions ahead and generate value for all of our stakeholders.

Moving to Slide 5. We experienced broad regional end market decline as industrial activity slowed due to customer shutdowns and project deferrals. Demand troughed in April and improved sequentially in May and June across all segments as activity resumed.

In Asia-Pacific and in our Harris Products Group segment, June organic sales were positive. By end sector, automotive and heavy industries remain the most challenged, while general fabrication and energy compressed at low-teens percent, and infrastructure construction was relatively steady versus prior year.

Looking at product demand trends, our consumables and standard equipment systems compressed at a comparable rate to our consolidated organic sales results. Given commercial success of new solutions, our equipment sales have been more resilient than in prior downturns. Our automation solutions remain challenged at a mid-teens rate.

July month-to-date orders have continued to improve at a slower rate and are trending down high-teens to low 20%. The Harris segment's July order rates have remained relatively steady with the prior year. While early in the quarter, we remained cautious due to differing regional recovery rates and risks of secondary shutdowns.

Turning to Slide 6. Our team did an outstanding job curtailing costs in the second quarter. We achieved \$27 million in savings, which substantially exceeded our plan and was largely driven by an outperformance of temporary cost savings such as lower discretionary spending and reduced work hours. Given ongoing macro uncertainties and limited visibility due to COVID-19, we are maintaining diligent cost control measures.

We have increased our 2020 cost savings targets due to the accelerated pace of temporary cost savings year-to-date and an increase in permanent cost savings in Americas welding. We now expect to recognize \$55 million to \$65 million of savings in 2020. This range compares with our first quarter estimate of \$40 million to \$45 million. Approximately 35% of the consolidated benefits will be permanent. We expect to exit 2020 at \$8 million to \$9 million in permanent cost savings in the fourth quarter. We anticipate temporary cost savings to moderate in the third quarter as markets slowly recover and our organization resumes some spending to support growth.

Looking ahead, I'm confident that our organization will continue to operate safely, prioritize our customers' needs and maximize cost savings to align the business to demand. Our disciplined execution of our higher standard 2025 strategy and prudent uses of cash will deliver superior results for our stakeholders long term.

And now I'll turn the call over to Gabe to review second quarter financials in more detail.

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Thank you, Chris. Moving to Slide 7. Our consolidated second quarter sales declined 24% as a 2% benefit from acquisitions was offset by 24.5% lower volumes, 30 basis points of lower price and a 1.1% unfavorable impact from foreign exchange.

Our gross profit margin decreased 260 basis points to 32.1% as benefits from cost reduction actions and price management were offset by the unfavorable impact of lower volumes. Our SG&A expense declined 22.7% or \$37 million, reflecting savings from our cost reduction actions and \$13 million in lower incentive compensation. SG&A as a percent of sales increased 40 basis points to 21.4%. We expect a decline in year-over-year incentive compensation will narrow in the second half of 2020. Reported operating income decreased 62.2% to \$39.8 million or 6.7% of sales. Operating income results included \$23.2 million of rationalization and asset impairment charges.

Substantially, all of these charges were noncash charges in Americas Welding and include a \$3.3 million pension settlement charge also in the Americas segment. Excluding special items, adjusted operating income declined 40.5% to \$63 million or 10.7% of sales, a 290 basis point decline versus the prior year.

Adjusted operating income benefited from \$27 million in cost savings, lower wage and incentive compensation expenses. Our decremental adjusted operating income margin was 23% in the quarter.

Our second quarter effective tax rate was 19.8% compared with 17.4% in the prior year period. Excluding special item charges, our second quarter tax rate was 20.3% due to the mix of earnings and discrete items. This compares with 22% in the prior year period. We expect our full year 2020 effective tax rate to be in the low to mid-20% range, subject to the mix of earnings and anticipated extent of discrete tax items. Second quarter diluted earnings per share decreased 66.9% to \$0.45 compared with \$1.36 in the prior year. Excluding \$0.35 of EPS from special items, adjusted diluted earnings per share decreased 37.5% to \$0.80.

Now moving to the geographical segments on Slide 8. Americas Welding segment second quarter adjusted EBIT dollars declined 45% to \$46.7 million. The adjusted EBIT margin declined 370 basis points to 12.9% as benefits from cost reduction activities, lower discretionary spending and lower incentive compensation expense were offset by the impact of lower volumes.

Looking at the top line, Americas Welding reported a 29.5% decline in organic sales, primarily from comparable declines in consumables and in our standard equipment offering. Automation remained challenged from lower capital spending in automotive and heavy industries. The segment's 30 basis point decline in price primarily reflects the impact of the removal of U.S. tariff surcharges, which anniversaried in late Q2.

Moving to Slide 9. The International Welding segment's adjusted EBIT decreased 36.2% to \$9.7 million, and the adjusted EBIT margin declined 170 basis points to 5.3%. Benefits from cost reduction activities, lower discretionary spending and a net \$2.5 million benefit from public paid leave programs helped mitigate the impact of lower volumes organic sales decreased 21.5%, primarily from lower volumes in Europe and to a lesser extent in Asia-Pacific. We achieved an increase in organic sales in China following a strong second quarter rebound.

Moving to the Harris Products Group on Slide 10. Second quarter adjusted EBIT decreased 13.2% to \$11.7 million. Adjusted EBIT margin decreased 70 basis points to 14.3% versus a record 15% in the prior year period. Cost reduction actions and operational efficiencies drove solid margin performance. Harris reported a 7.8% decline in volumes as growth in the retail channel was offset by industrial sector weakness.

Moving to Slide 11. We generated \$104 million in cash flows from operations in a 189% cash conversion ratio from higher free cash flow versus the prior year. Working capital increased on higher inventory levels as we have strategically been building inventory to support the recovery. We expect

our working capital ratio to improve sequentially in the second half of the year. We strengthened our liquidity position and maintained a strong balance sheet profile in the second quarter.

As highlighted on Slide 12, we have an investment-grade profile balance sheet with no near-term debt maturities. We reduced our short-term debt by \$83 million in the quarter, increasing liquidity to \$545 million. Our strong cash flow generation and lower use of working capital in the second half of the year will deliver continued strong cash conversion performance.

Moving to Slide 13. We are prudently maintaining our capital allocation strategy. We deployed \$45 million in the quarter across internal investments and the return of cash to shareholders through our dividend program. We repurchased 3.2 million of shares at an average share price of \$70.25. We continue to estimate full year capital spending to be in the range of \$55 million to \$65 million as we prioritize growth and cost efficiency projects at this point of the cycle.

We're continuing to evaluate M&A opportunities and expect to resume share buyback activity once business conditions have further improved.

As we look ahead to the third quarter, while the shape of the recovery remains uncertain, we are confident in our commercial and operational initiatives and the strength of our business model. Continued strong cash flow generation, increased liquidity and conservative, disciplined management of the balance sheet enable us to continue to navigate this challenging environment, while delivering solid returns to our shareholders.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And our first question comes from Joe O'Dea with Vertical Research.

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**Joseph John O'Dea** - Vertical Research Partners, LLC - Partner

First, just a quick one on cadence. You previously talked about April that was down in the low 40s, May in the low 30s. Just what did June come in at?

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**Gabriel Bruno** - Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer

Our volumes were down for the quarter at 24.5% for the quarter.

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**Joseph John O'Dea** - Vertical Research Partners, LLC - Partner

Okay. But June would have been down, I don't know, 10 or 15.

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**Gabriel Bruno** - Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer

It would track at lower 20s.

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

Yes, Joe, we've seen a nice progression down from that trough in April that we believe is the trough of what we'll see from the pandemic and the recession that looks like it's coming from the pandemic. Obviously that rate has slowed as we're exiting June and moving into July, but we're still seeing improvements in that. And as we stated, some positive areas around the world, positive with the Harris business almost at prior year as well as China performing well.

And I would say our U.S. businesses, our Americas businesses are slightly behind that pacing that we're seeing in our International businesses, but we really look at that and view that as just the migration of the impact of COVID across that business. And again, it's also seeing a rate of improvement. I just think that we're going to continue to be challenged by seeing a gradual improvement as we're moving through the rest of this year and into 2021.

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**Joseph John O'Dea** - *Vertical Research Partners, LLC - Partner*

Got it. And then can you expand on the cost savings a little bit? I think back towards the end of April, you were talking about second quarter cost savings that would approximate the \$7 million that you did in the first quarter and then instead, it comes in at \$27 million. So can you bridge that at all? And can you talk about how those savings evolved over the course of the quarter in terms of what you were able to identify actions you were able to take?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes, Joe. So if you think about in our communications back in April, you're right, we were at that range of \$40 million to \$45 million in total savings. And 45% of that was permanent, and that's what we were tracking. We're still in that same range. We talked about permanent savings at 35%, but it's in that \$20 million to \$22 million range. The key difference there, though, is a bit of shifting between what we expected on the international side with a little bit more of the delay and just working through the dynamics in our international regions versus the Americas, and you saw some of the actions we've taken in the second quarter on the Americas side. But the big change is really a temporary dynamic, and we did see progressively the impact of all the discretionary spending coming more quickly as we progressed the quarter. And so that's where we ended about \$27 million in total, of which \$22 million of that would be temporary.

Now going forward, we do expect temporary savings to decline. And I would expect temporary savings to decline in half, let's say, in Q3 and then half again in Q4. So that progression that we saw is going to be tempered as we progress throughout the year and our business reengages. I do see the permanent side to begin to increase in the third quarter and then as we exit the fourth quarter to have permanent structural savings in that \$8 million to \$9 million range per quarter as we exit the year.

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**Joseph John O'Dea** - *Vertical Research Partners, LLC - Partner*

And last one is just the cost savings trajectory when we think forward. If you're going to kind of be close to \$40 million in temporary cost savings this year? Based on what you know today, how much of that persists into next year?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Well, I mean, our trajectory is that, at least we're hopeful that how the business engaged and how that response to volume level starts to temper as we end the year. And really, our focus, as we exit the year is on the permanent structural changes that we have introduced that will impact the fixed cost structure of our business on a go-forward basis. So we have the temporary savings trajectory coming to almost a breakeven by the end of the year.



**Operator**

Our next question comes from Nathan Jones with Stifel.

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

I'll just follow-up a little bit on that -- the cost savings there. So it sounds like the 3Q cost savings number is going to be a little bit less than the \$27 million that you saw in 2Q. That will then, I assume, translate into your decrementsals at the segment level were really, really good this quarter at about 23%. We should assume that those are going to come in at a higher decremental in the third quarter as the temporary costs fall off and the permanent costs to ramp up?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

So Nathan, I would just assume that our decrementsals follow the range of what we saw in Q2. And think about the projection or the trajectory of savings, dropping into that \$10 million to \$15 million range per quarter, of which the mix begins to evolve to more of a permanent structure as I've outlined. The other thing to think about, Nathan, is we've disclosed the incentive comp reduction in Q2 being \$13 million year-over-year. And if you recall, last year's third quarter and fourth quarter, we had significant adjustments in incentive comp. And so I would expect in the third quarter, based on what we're seeing now, that, that change progressively is less than half of what we saw in the second quarter and about even in the fourth quarter. So we'll have a dynamic of our incentive compensation plays out into our decrementsals as well. But I think using a range of decrementsals that's similar to what we saw in the second quarter is fair.

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

Okay. So kind of low 20s decrementsals to your expectation. And then I would like to just discuss a little bit the inventory level. You talked about wanting to carry some more inventory to take advantage of growth opportunities as we come out of the recession here. You also talked about your working capital level in the second half coming down a bit. Maybe you could just talk about what kinds of opportunities you see out there? If you're prepared and ready with inventory, where you can take some market share there? And how that plays off with the comment that you expect working capital to come down in the second half?

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

Yes, Nathan, when we were entering the pandemic back in mid-January, early February, we were seeing this start to permeate across our operations around the world. We just sat down as a leadership team and recognized that with our balance sheet strength and our financial profile that we were going to assume that if we had our employees available and we had the raw materials that we were going to make our high-running products and place them into inventory.

The uncertainty associated with whether facilities would be able to operate or the resiliency of the supply chains, were just too opaque at that time, and we felt that was the best decision for our business and our customers longer term. And quite frankly, I'm very glad that we made those decisions.

Now that we sit here today as we're entering into the third quarter, those supply chains have been stressed. As I mentioned in my opening comments, we've got more confidence in our ability to be able to operate our facilities effectively with the appropriate protocols that are required to keep our employees safe. So now we believe we can bring down some of those inventory levels and still, obviously, meet, if not exceed, all of the customer expectations that we have around the world from a demand perspective as some of those start to continue to make improvements in their business.

So we've talked to our operating teams globally about slowly starting to address some of that inventory build that we put in place to ensure that we'd be able to service those customers during this cycle.



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

So it's kind of fair to characterize that as you had some strategic inventory and some safety stock and now you're going to keep the strategic inventory and take out the safety stock?

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

Absolutely. Absolutely. I mean, I think that there's still challenges out there in the marketplace, certainly a lot of uncertainty as we're all moving through the back half of 2020. We are not going to place ourselves in a position that would put our ability to service at a very high level at risk, but there's certainly some safety stock that we put in place that we can minimize at this point.

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**Operator**

Our next question comes from Mig Dobre with Baird.

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

My first question on the Americas segment. Can you give us a little bit of color as to how the export business has progressed through the quarter? What it's looking like in July? And a quick reminder of the size of this business at this point as well? And related to this, as we're watching the dollar weaken pretty quickly here, can you give us a sense as to how you're thinking about competitive dynamics more broadly? And what the impact of a weaker dollar will be to your segment margin?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Well, Mig, I'll start off, just give you a big picture perspective of exports. So we had -- exports had progressed nicely in the first quarter and -- but have come off a bit from first quarter trends. So we're about -- our overall trends, we're about half the decrease that we saw in the overall business and exports represents about a little over 5% of our overall business.

So historically, with a weakening U.S. dollar, we would see some potential leverage opportunity on exports. But it's really difficult to see on a go-forward basis, depending really on the mix of investment in many of the end markets. But we're tracking it. And the overall impact on exchange is not significant. As you saw in the second quarter, it was a bit over 1%. But we are tracking the progression and how exchange rates are impacting our business, and we do expect our exports are well positioned for growth.

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

Yes, Mig, the other thing I would add is that when I think about our export strategy, a lot of that strategy centers around our equipment -- profile and our equipment solutions. So as we are continuing to advance equipment and you see equipment holding up slightly better than it has in previous cycles and now this is really where it's done that for a few quarters, I believe that can be another catalyst for us to at least make improvements in that export performance as we're moving forward.

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

Okay. Maybe switching gears to International. I guess the thing that I'm wondering here given that you're calling out maybe some slightly better trends there than the Americas business. And I don't know, maybe there is a chance that those end -- those geographies recover quicker. How do you think about the long-term margin profile here, Gabe? I mean what sort of revenue or volume do you need in order to get back to that trajectory



of attaining double-digit margin in the segment? Do you think that's still achievable at this point? Is that still a target you guys are operating with internally?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes, definitely. We're still anchored on that double-digit EBIT margin profile. And the actions we're taking and with a little bit of help of growth, we should be in a position to achieve that. So we've been -- we discussed that quite often internally, and we've got lots of actions to continue to develop the fixed cost structure of our business, and so we're pretty confident that we're anchored on that target.

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

And as far as the -- what does a little bit of growth mean? Can you help us there in order to get there?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Firstly, I look at 2019 as kind of a baseline. So a little bit of growth is looking at macros begin to improve. As we know, macros in 2019 particularly in Europe, were soft, they were down. And so we do look to a little bit of stabilization in the macroeconomic environment in Europe, particularly. And with a little bit of growth, I think we'll have a pretty strong platform for achieving a double-digit EBIT margin.

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

Okay. And if I may, one last one? Just about I'm clear in terms of this incentive comp dynamic, a \$13 million benefit in the second quarter, you said you're going to do probably another \$6 million to \$7 million benefit in the third quarter. Was there any benefit in the first? And as we think about 2021, I'm presuming that this number sort of gets reset and all these benefits become an automatic headwind. Am I thinking about it correctly?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. That's a good way to think about it, Mig. So first quarter was essentially flat in terms of year-over-year comparison. So the second quarter reflects the results that we achieved profitability-wise and the impact in Q2. And yes, you're right, as I mentioned, a little bit less than half in Q3 and then flat in Q4. And that's reflective of how 2019 progressed. And as we look to reset our objectives on that for 2021, then that will potentially create a headwind, but that's still to be determined.

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**Operator**

Our next question comes from Walter Liptak with Seaport.

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

I wanted to ask about -- Gabe, I know you went through the decrementals and what was going on international with the profitability, but it looked much better than I was expecting. Can you run through those items that impact profitability international?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. So just give you a couple of drivers there. So we did mention that \$2.5 million impact of the paid lead programs we were able to leverage in Europe that largely expect to go away as we progress into the third quarter. And then we did have some improvement, as I highlighted on volumes



in China. So that was also a favorable progression in how that resulted in our EBIT profile for international. But outside of that, we continue to drive the cost initiatives in the region and look for opportunities to grow. So progressing in the international really is depending on our continued execution and our -- in improving our business model as well as expectations and growth?

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

Yes. Well, I would tell you, I was pleased with our broad operating performance. Yes, we had a couple of elements there that were favorable, but I'm seeing the kinds of actions and improvements in the broader international business and European business that we're looking for. I think Q3 will be a challenging quarter relative to the uncertainty around August in the European markets. Traditionally, a month where we've seen broad vacations and shutdowns from employers. And with the varying market dynamics from Spain to France to Germany and whether they have that same dynamic in 2020 is just very difficult for us to measure at this point. So I do think that August is a little bit of a wildcard as it relates to what kind of activity we'll see in Europe.

But broadly, I believe we're on the right path. And believe that, quite frankly, the business is moving in the right direction. And I think that's why we had started some of those structural cost savings in our international business prior to the pandemic, it's given us an opportunity to get ahead of some of those issues, but certainly believe that it's on the right path. And as Gabe stated earlier that with some growth in that broad region, we're confident that we can get to that 10% operating profit number that we're targeting.

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

Okay. Sounds good. And speaking of wildcards, and there's a lot of macro wildcards out there. I wonder if -- Chris, you wouldn't mind commenting on your thoughts that with these virus cases going up again, do you see any kind of moderation as maybe some of the reopenings slowed? Does that have any impact on how you're thinking about the back half of the year?

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

Yes, Walt, it is very uncertain as to what that shape of that recovery looks like. I'm -- like everyone, I suppose, we've read a host of materials and looked at a lot of data points, and the only thing I can assure you is that we're not managing with an expectation that there's going to be V-like recovery. I personally believe that we're going to be managing through a gradual recovery into 2021. And now fortunately, for us, we've got a very resilient balance sheet. Our teams have shown an ability to do this well. And I do believe we'll continue to see gradual recovery.

But I think that that's our perspective on the business today. And then you have the risks associated with -- if there was a broader secondary challenge out there in the global economic markets because of the pandemic which we couldn't see today. There are a couple of other variables that I view as slightly more positive than when we were together in April that we haven't talked about. I do like the fact that we've at least seen some improvement in the energy markets as it relates to crude, WTI now above \$40 and it's kind of stabilized above \$40, that's better, than where we were in April. And although that's going to be a challenged segment for us, at least they've gotten some stability.

And then we've seen the broad recovery and slow recovery in many of the segments. And I still believe that automotive will continue to make improvements throughout the year, and we'll begin to see some improvements in those heavy industry segments as we migrate through the rest of 2020. So I think we're managing towards and through a very gradual recovery that will take us into 2021.

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**Operator**

Our next question comes from Chris Dankert with Longbow Research.

**Christopher M. Dankert** - Longbow Research LLC - Research Analyst

It's, obviously, been a very tough 12 months in the automation business. And Chris, thanks so much for kind of the end-market breakdown. But I guess, could we -- can you give us any color on automation, specifically July bidding activity, backlog in that business? Just any comments on how you kind of view that in the back half of the year here would be great?

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

Well, one of the challenges with the automation business, as you're well aware, is that the beginning of those conversations towards when we generate an order to actually delivering those solutions to the marketplace is elongated versus the other solutions that we have within the portfolio. So I'm actually expecting in front of us, especially in Q3 and maybe early Q4 that we'll have some other challenges for us relative to that business.

We love the long-term perspective of automation. I still believe that if anyone is going to talk about reshoring that you're not going to be talking about reshoring from a manufacturing perspective without talking about automation. So we like the structural dynamics around it.

We have had some challenges, but I believe our teams have got our arms around that business. And I would tell you that from the data that I've seen within our sales force tool that we utilize to track those automation opportunities and orders across that business, our opportunity set still looks relatively strong. Now the challenge is some of those opportunities get pushed out. But we're still engaged with a lot of large customers relative to those opportunities.

Certainly a portion of the segments that are very strong within our automation business is heavy industry, general industries and automotive and a little slower in that piece of the business at this point.

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**Christopher M. Dankert** - Longbow Research LLC - Research Analyst

Got it. Yes, yes. And then just any comment -- the surcharge roll off, we're through that headache now. Steel prices are starting to rebound a little bit. I think my expectation was pricing in the Americas was pretty flattish in the back half of the year. Is there an opportunity to do some increases so we can get some positive price in the back half or not quite at this point?

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

I don't believe so. We move forward with some equipment pricing that occurred in early April. At this point in time, we don't have any of that planned. I would expect us to be flattish to slightly positive. But I think that we've shown an ability to manage that element of our business very well. And if, obviously, the economics around that were to change materially, then we'd have to go out and address that in our markets around the world.

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**Operator**

And our final question comes from Dillon Cumming with Morgan Stanley.

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**Dillon Gerard Cumming** - Morgan Stanley, Research Division - Research Associate

I wanted to ask about kind of channel inventories more broadly, I guess, as more of the customers have kind of come back online here over the past few months. What are customers telling you in terms of production rates kind of reaching pre-COVID levels? And are you kind of getting the sense that customers have been reducing inventory in the consumables side as part of your production -- at the customer levels and coming back online?

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

Well, one of the favorable elements of the business model, especially on the consumables side, that portion of our business that's going through the OEM channels, is there's not a lot of inventory in that channel between our manufacturing capacities and the consumption of the OEM. So that's a relatively tight supply chain. So Dillon, I usually am not worried about there being a drawdown on that inventory or someone actually bringing that inventory forward by stockpiling some inventory. There probably was a little bit of that in the end of March. Individuals that maybe like us were just worried about what the supply chains would look like and might have brought in a little bit of material, but it was de minimis as it relates to the way I think about our supply chain metrics with our global OEM. So I am not worried that we have a supply glut or there are some sort of inventory there that needs to be worked off at the OEM level.

Now I will tell you that we have to be very cautious because you'll read in the paper that industries or employers are back up and operating, and we're still hearing that some of those facilities may be back up and operating, but prior to the COVID or the pandemic, they were operating at 2 or 3 shifts, and now they're operating at 1 shift. So we are seeing some of those dynamics back and forth. It's difficult for me to give you a characterization across all customers or all segments because, obviously, that's very different depending upon the region as well as the industry segment that we would be working with. But we're very cautious internally when we have those conversations about, okay, what's that OEM doing? How many shifts? What do we really view their consumption level to be at? The positive, Dillon, would be that we are seeing that gradual improvement in the business. Favorable trend throughout the quarter in Q2, leading into Q3 where we believe July, high-teens, low 20s as it relates to that order pattern and expecting to see that gradual improvement as we move through the rest of 2020.

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**Dillon Gerard Cumming** - *Morgan Stanley, Research Division - Research Associate*

Okay. Got it. That's super helpful color. And then maybe just the last one. I appreciate the comment you kind of gave around the shape of the recovery being unknown. And I guess, Chris, you did kind of allude to this earlier, but I guess, to date, have you seen any tangible evidence of that dynamic vis-à-vis factory shutdowns or customer shutdowns? Or would you just still characterize that as more general caution?

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

No, I would probably characterize it as more general caution, especially when I think about our business on a global basis. And then looking at the data; look, the data tells me that, that longer-term gradual recovery is certainly what we've seen to date. Now the caution becomes, what happens if we have a very difficult business economic scenario because of a second wave from the pandemic or something else that were to occur that would create those challenges that we just can't see today.

But we are managing our business for the long play, the long return. We're going to continue to invest in our capital to generate new products and cost reductions. We're going to continue to use our capital allocation strategy if there are opportunities for us in the marketplace to do that. And we're assuming that we have to be managing through this recovery for a few more quarters, and that's what we're driving our teams to do here at Lincoln Electric.

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**Operator**

Pardon me, we have a question from Steve Barger with KeyBanc Capital.

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

Gabe, I just wanted to make sure I understood the comments on June sales. If April was down 40% and presumably May wasn't that much better, it seems like June had to be down low- to mid-double digit to get to the 24%. Is there some dynamic I'm not catching there?



**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes, Steve, I don't know if you recall, but in May, we had talked about our trajectory being in the low 30s. So I think that may be an issue in how you're modeling this quarter's volumes. And again, volumes for the quarter were down 24.5%.

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

Right. All right. Chris, going back to your comments on August being tough to call. I mean I totally get that. But normally, revenue steps down in 3Q for all the reasons we know, but does the big 2Q drop make that look more flat to up this year in 3Q? Or do some of the tougher end markets make that unlikely?

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

No. That's a good observation, Steve. I think that would be accurate.

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

Then you'd be flat or up this year?

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

Yes. Yes, that it would be flat or up because of the other dynamics. Yes, I think that will probably mitigate what normally would be the cyclical trend in the business.

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

Yes. Okay. And then just a quick question on the incentive comp number that you talked about. Does that include profit sharing from the factory floor or is that separate from the broad LECO profit share or incentive comp?

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. That does include the profit share from our U.S. business.

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**Operator**

This concludes our question-and-answer session. I'd like to turn the call back to Gabe Bruno for closing remarks.

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**Gabriel Bruno** - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Thank you. I would like to thank everyone for joining us on the call today and for your continued interest in Lincoln Electric. We look forward to discussing the progression of our strategic initiatives and cost reduction programs in the future. Thank you very much.

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**Operator**

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

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