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LECO - Q2 2018 Lincoln Electric Holdings Inc Earnings Call

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OVERVIEW:

Co. reported 2Q18 sales of $790m, reported operating income of $94.6m and diluted EPS of $1.04.

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PRESENTATION

Operator

Greetings, and welcome to the Lincoln Electric 2018 Second Quarter Financial Results Conference Call. (Operator Instructions) And this call is being recorded.

It is now my pleasure to introduce your host, Amanda Butler, Vice President of Investor Relations and Communications. Ma'am, you may begin.

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

Thank you, Crystal, good morning, everyone. Welcome to Lincoln Electric's 2018 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 on the Lincoln Electric website at lincolnelectric.com in the Investor Relations section.

Joining me on the call today is Chris Mapes, Lincoln's Chairman, President and Chief Executive Officer; as well as our Chief Financial Officer, Vince Petrella. Chris will begin the discussion with an overview of second quarter 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 Form 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 measures is found in the financial tables in our earnings release, which is available, again, in the Investor Relations section of our website at lincolnelectric.com.

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

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

Thank you, Amanda. Good morning, everyone. Our second quarter results demonstrate our team's focus on capitalizing on organic growth, richening our portfolio mix, rapidly integrating our European business and mitigating inflation during this portion of the cycle. The organization's strong execution generated sequential and year-over-year improvement across our key metrics and advanced our 2020 Strategy.

We achieved good sales momentum in the second quarter as industrial production trends and our order rates remained strong. Our sales increased 26% to $790 million, led by 9.3% organic growth and a 16% benefit from our Air Liquide Welding acquisition. Diligent price management, improved mix and supply chain and operational productivity initiatives offset inflation on a dollar basis in the quarter.

Adjusted operating income increased 18.8% to $107 million or 13.5% of sales. In our legacy business, our adjusted operating margin improved 30 basis points year-over-year to 14.7% on volumes and favorable mix.

The team is successfully managing inflationary headwinds, which have been compounded by trade tariffs. As a result, we've expanded our latest pricing actions with surcharges on impacted products. Despite a lag in recognizing the full benefit of all of our actions, we're confident that we have the right strategy to offset inflationary pressures, and we will continue to successfully navigate the business through this portion of the cycle.

Moving to earnings. Adjusted earnings per share increased 25.8% to $1.22. The ALW acquisition contributed $0.05 of adjusted EPS in the quarter. The team did an excellent job improving working capital efficiency in the quarter with sequential and year-over-year improvement in cash flows and working capital performance. ROIC improved 200 basis points to 18%.

Moving to Slide 4. We continued to capitalize on growing industrial markets. All of our reportable segments achieved organic growth. Areas of notable strength that generated low- to mid-teens percent growth were in North America, U.S. exports and in Asia Pacific.

Additionally, our Harris Products Group generated mid-single-digit organic growth against a challenging prior year compassion. Europe continued to compress due to integration activities and choppy end-market performance in the region. We achieved high single-digit percent organic sales growth across consumables and equipment systems.

Automation solutions remained strong, and order trends continued to exceed prior year levels for the second half of the year. Our R&D and commercial teams have continued to launch several new solutions into the market, including the new POWER MIG 260 for light industrial applications that features a larger, more intuitive display system and performance features for enhanced ease-of-use.

We also launched our new Red Max stainless steel alloys, incorporating a proprietary surface treatment that delivers improved weldability in semiautomatic applications. These are examples of new solutions along with our strong core portfolio and extensive automation capabilities, which have allowed us to capitalize on the broadly improving demand trends across most end markets.

Organic sales in our 3 largest end markets -- automotive, heavy industries and general fabrication -- increased at a double-digit percent pace in the quarter, and we expect ongoing strength in these areas.

Moving to Slide 5. We're approaching the anniversary of the Air Liquide Welding acquisition, and I'm extremely pleased by the accomplishment and the pacing our teams have achieved to shape the business into a more efficient and successful enterprise in the region. While always a challenging decision given the impact to employees, we continued to consolidate our manufacturing facilities and several distribution centers in

Europe. These efforts align our platform with demand trends and improve efficiencies for better positioning in the region. I am very confident in our ability to achieve our strategy.

We've also made strong progress streamlining commercial and back-office functions and are benefiting from procurement synergies. A standardized ERP system is being deployed across Europe to ensure one instance of SAP, and we're working towards standardizing tools and processes to reduce complexity and drive commercial and operational excellence.

We've also started to introduce the Oerlikon brand of consumables into the North American market. This presents a long-term incremental growth opportunity, especially in attractive downstream energy applications. While there is more work ahead of us, these initial efforts have improved Air Liquide Welding's operating income margin profile by several hundred basis points. We expect synergy contributions to improve over time as program benefits fully mature.

I am very pleased by the organization's positioning in this part of the cycle. We're actively addressing near-term inflationary challenges while staying focused on executing initiatives and investments to drive superior long-term value for all of our stakeholders.

And now, I will pass the call to Vince.

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Thank you, Chris. Moving to Slide 6. Our consolidated second quarter sales increased 26% on 4.9% higher price, 4.4% volume growth, a 16% benefit from the Air Liquide Welding acquisition and 70 basis points from favorable foreign exchange.

Our second quarter gross profit margin declined modestly by 30 basis points to 34.2% due to the addition of Air Liquide Welding. The price cost impact on gross margin narrowed to 40 basis points compared to 50 basis points in the first quarter of 2018. Excluding the acquisition and special items, gross profit margin was 35%, a 50 basis point increase versus the prior year on volumes and favorable mix. Margin performance was unfavorably impacted by a $5.3 million LIFO charge in our Americas Welding segment. The higher LIFO charge reflects higher raw material inflation in the quarter and the estimated impact of U.S. trade tariffs.

Our SG&A expense increased 25% to $163.9 million or 20.8% of sales due to the addition of Air Liquide Welding and acquisition-related expenses. Excluding the acquisition and special items, SG&A expense increased 11% to $140.2 million. The increase was primarily due to higher incentive compensation, professional service fees, and salary and wage costs.

Reported operating income increased 10.6% to $94.6 million or 12% of sales. Operating income results included approximately $12.3 million in special item charges related to the rationalization and asset impairments from our European integration activities and acquisition transaction and integration costs.

Excluding these special items, adjusted operating income increased 18.8% to $107 million or 13.5% of sales. Excluding the acquisition and special items, adjusted operating income would have been 14.7% of sales. Volume leverage, mix, pricing management and operational initiatives helped improve margin performance.

Our second quarter effective tax rate held steady year-over-year at 27%. Excluding special items, our second quarter tax rate was 24.6%. We expect our 2018 effective tax rate to be in the mid-20% range, subject to the future mix of earnings and the timing and extent of discrete tax items, including stock option exercises.

Second quarter diluted earnings per share increased 13% to $1.04 compared with $0.92 from the prior year. On an adjusted basis, diluted earnings per share increased 25.8% to $1.22 on higher organic sales and the lower effective tax rate.

Now moving to the geographical segments on Slide 7. Americas Welding segment second quarter adjusted EBIT dollars rose 18.3% to $88.2 million. The adjusted EBIT margin increased 70 basis points to 17.9% on 13.1% higher organic sales. Demand remained strong in the quarter across most end markets with the segment's top 3 end markets up at a double-digit pace. Consumables, equipment systems and automation solutions all performed well in the quarter.

Moving to Slide 8. The International Welding segment adjusted EBIT increased 71.4% to $16.3 million due to the addition of Air Liquide Welding, pricing management and growth in Asia Pacific. Adjusted EBIT margin performed steady with the prior year at 6.5%, reflecting solid execution of our integration activities.

Excluding the acquisition, adjusted EBIT margin was 8.4%, a 190 basis point increase versus the prior year. This improvement reflects the benefits of our commercial initiatives. Organic sales increased 1% with 5.5% higher price and a 4.5% decline in volumes. As expected, volumes were impacted by acquisition integration activities and lower European sales.

Now moving to the Harris Products Group. Second quarter EBIT margin held steady at 11.8% as volumes increased 3.5% from solid demand across all sales channels and against challenging prior year comparisons. Volume leverage continued to be offset by unfavorable price cost and mix.

Moving to Slide 10. Cash flows from operations increased 6% in the second quarter to $80 million on improved working capital efficiency. Average operating working capital was 16.5%, a 20 basis point improvement compared to the prior year period. Excluding Air Liquide Welding, the average operating working capital ratio improved approximately 150 basis points to 15.2%.

Moving to Slide 11. We returned $61 million to shareholders in the quarter with an 11% higher dividend payout rate and $35.5 million in share repurchases. In the first half of 2018, we repurchased approximately $50 million of shares. This pacing exceeds our annual share repurchase maintenance buyback rate of approximately $40 million to $50 million. We will continue to pursue buybacks opportunistically based on expected cash generation, uses of cash and share price performance through 2018.

We also invested in the business with $16.7 million in capital expenditures. We continue to estimate full year capital spending to be in the range of $60 million to $70 million. We expect to maintain a balanced capital allocation strategy in 2018, prioritizing growth investments and returning cash to shareholders through our dividend program and share repurchases.

With that, I would like to turn the call over for questions. Crystal, please open up the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Jason Rodgers from Great Lakes Review.

Jason Andrew Rodgers - *Great Lakes Review - VP*

Just wondering how far along you are in pruning the lower-margin sales internationally and when we might expect volumes to turn positive in that segment?

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

Well, as we think about that process, when we moved forward and had the opportunity to bring the Air Liquide Welding business into Lincoln Electric, we said the integration process would be a multiyear event for us. I'm very happy, as I stated in my comments, with the pacing of the process that we would expect to continue to see some of that activity at least through the rest of '18 and potentially into the early portions of 2019. Really, the reason behind that is because it's not just as easy as going in and pruning out the particular products. We need to evaluate whether those products can be made in a more cost-effective manner. We need to determine whether we can provide more value for those customers or those segments to potentially enhance that margin profile. So we're going through a detailed exhaustive process as you would expect. And again, I would expect us to see that continue through the latter part of '18 and potentially into the first half of '19.

Jason Andrew Rodgers - *Great Lakes Review - VP*

And just looking at the automation area. What was the growth year-over-year in the quarter? And maybe you can make a comment on the bidding activity you're seeing out there.

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes, Jason. We grew year-over-year at a high single-digit pace. Our mix improved in automation. We saw nice improvement in the operating profit margin contribution. We continue to see strong order levels and backlogs in automation in the second quarter of this year.

Operator

Our next question comes from Joe O'Dea from Vertical Research Partners.

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

First just a couple, I guess, questions related to the surcharges you mentioned. Could you talk about the sort of portion of sales where the surcharges are applied? What kind of price increases we're looking at there and if you're seeing competitors follow suit in some of the surcharge actions?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. So Joe, these surcharges are primarily related to the U.S. business where the tariffs are having the greatest impact. Those surcharges are also exclusively related to the consumable side of the business where the greatest impact from steel and aluminum tariffs are prevalent. So it's -- the U.S. business is roughly 50% of our total book of business, and then consumables would be a little bit less than 60% of that. So it's effecting about 25%, 30% of our total business when we think about the tariff surcharges.

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

And is that in terms of the actual price increases that would be implemented on the consumables related to surcharges? Just kind of rough order of magnitude in terms of what's falling through in terms of price increases?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

It's in the high single digits in the consumable portfolio, would be tariff surcharge. Some a little higher than that. Some a little lower. But I'd say it averages high single digits.

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

And in terms of just understanding this mechanism of pricing actions versus what you've done previously, my understanding of it is previous price actions have been implemented and realization there is good. With respect to the surcharges, is this flow-through the market in a way such that as these raw commodity prices change, the flow-through to the customer will also change?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Well, the thought behind surcharges were that they were directly associated with the tariffs that are coming into the market. There is still a fair amount of uncertainty regarding the length of duration, extent of the surcharge of the tariffs. So it's our thought that treating the tariffs as a surcharge was a more appropriate pricing mechanism than traditional inflationary cost increases in the marketplace.

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

Got it. And then just to pivot bigger picture on the demand front, and I guess, in particular, what you're seeing in the U.S., but what we see on the organic side of things. Another very strong quarter of growth. It sounds like from the tone that we haven't seen any slowdown there, but I think just with a lot of sensitivity to what we could be seeing on the demand front, what you saw in June, what you're seeing in July in terms of customers potentially, maybe, just staying on the sidelines a little bit and waiting for a little bit better certainty moving forward.

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

No we -- July is not completed yet, but we see on a daily order and sales basis in our largest Americas segment a continual strong performance. So we haven't seen that back off at this point in time. And we see more positive than we do see negative as far as the demand trends in the U.S. North American marketplace.

Operator

And our next question comes from Saree Boroditsky from Deutsche Bank.

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

Just want to follow up on the pricing and surcharge commentary. Could you -- maybe what you're seeing from customers as far as buying patterns and if these anticipated price increases are causing any customers to buy ahead?

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

Yes. As Vince mentioned, we've moved forward to offset the cost associated with the tariff impact or raw material impact by placing surcharges out in the marketplace. I'm not going to mitigate that these are very difficult conversations with our customer base, but there are real input costs to Lincoln Electric, and we're very confident that we'll be able to manage through and recover those costs just as we have other inflationary pressures that have hit the business over the last 6 to 12 months, and quite frankly, as we've been able to do with our business here historically. So we've not seen any changes in order patterns. I've not seen any change relative to customers on the sidelines trying to determine whether this is a shorter or longer-term impact and will this continue to manage it over the next several months as we just need to manage through this portion of the cycle and the impacts of inflation and economic tariffs.

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

Great. That's helpful. And then in the slide deck, I know you highlighted lower demand in Portions of Energy but a competitor this morning talked about strong demand in North America oil and gas market. Could you provide any additional color on what you're seeing across energy markets and maybe how you're thinking about the growth in the remainder of the year and into 2019?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. So overall, our energy business was flattish on a year-over-year basis. The softness was really in upstream offshore, primarily in international. So we still have a relatively important segment of our overall energy business associated with offshore that continues to be soft and compressing. But there are other bright spots within midstream and, to a lesser extent, downstream. But overall, as far as our book of business is concerned, we've seen a stabilization and are hopeful that second half of the year we might start to see some growth.

Operator

And our next question comes from Mig Dobre from Baird.

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

Just to clarify on a previous question here. Are you essentially saying that you have not seen any of your customers anticipate cost increases and thus buy ahead of that; that that's just not something that you've seen yet?

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

Well, Mig, I made the comment. Look we -- traditionally, when we have provided price increases out in the marketplace, there's always some of your channel partners or individuals that might be pulling some of that forward. As it relates to the tariffs and the recent inflation that we've seen, it's not been a material impact to the business. So I don't want to imply that there's not some that occurs. But when I think about materiality within the broad portfolio, I would not say that I believe it's been material.

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

And just from a macro perspective, Mig, our consumable and equipment sales increased by similar amounts in the second quarter of the year.

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

Okay, okay. That makes sense. Then I remember last year you talked about having one less shipping day. I wonder how this quarter played out, if there was any impact from that. Yes, if you can comment on that.

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

We did have 1 more shipping day this year compared to the prior year.

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

Do you expect something similar in the third quarter as well, year-over-year, having an extra shipping day?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

I don't have the third quarter in front of me, but it all tends to balance out for the full year. We could potentially have 1 more or 1 less depending upon how the weeks lay out, but I don't have a view of that right now.

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

All right. And one other small one, just back on this pricing and surcharges. I don't remember if you clarified as to what the timing of the surcharges was. Depending on that, should we expect an acceleration in pricing growth -- reported pricing growth in Americas Welding in third quarter or fourth quarter?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. We put that surcharge in the middle of July, Mig. So we should see an increase in Americas' pricing in the third and fourth quarters of the year as compared to where we finish the second quarter.

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

Excellent. And lastly, on Harris, I know that the margin comps are getting a bit tougher as we look at the back half on a year-over-year basis. How do you think about all the moving pieces here? Should we expect margins to expand on a year-over-year basis any beyond incremental?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

I think we're going to see the same kind of environment in the third quarter and perhaps even the fourth quarter at Harris as they attempt to improve their price cost performance. The welding -- Americas Welding business certainly led the way with the improvement in covering costs, and we lagged behind in Harris in the third -- in the second quarter, and it's likely that will take us the second half of the year to equalize our cost and inflationary increases against the pricing management that needs to occur in that segment. So I expect more of the same in the second half of the year.

Operator

And our next question comes from Matthew Trusz from Gabelli & Company.

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

Can you provide what core Europe growth would have been if you X out the integration activities? And then relatedly, if you could just elaborate on the soft European demand environment you called out, like what the reasons are and what your outlook is looking forward.

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

Yes. When we started down the integration process, we signaled that we were not going to be a very good proxy for the European markets for a period of time. There's just so much activity around the integration. It's very, very difficult, and I would be uncomfortable trying to guide or provide a projection as to what the growth would have been without the activities that we're going through. I think we're confident in saying that we recognize that European business is growing at a lesser pace than many of the other markets that we see around the world. We certainly see that there are some markets there that we're participating in that were not generating some of the growth that we've seen in other areas of the world that as Vince mentioned some of the energy components that we participate with there in Europe. But because of the amount of activity around the integration, just uncomfortable trying to determine what the growth would have been but for that other than confident that Europe is certainly growing at a slower pace -- a much slower pace than many of the other markets we're participating in globally.

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

Okay. Understood. On a global basis, how would you compare your current level of overall business confidence in the macro outlook when compared to how you felt, say, last quarter? Are there any specific geographies or markets that you're focused on for the back half?

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

No, I wouldn't say that there is. I would say that, look, we've continued to see very positive trends. Our industry segment outlook continues to look very favorable with growth across segments. We've seen just a very nice continued progression of the demand model globally. One of the things that I was very happy with within the broad portfolio in the second quarter was the number of our entities around the world which showed a positive progression. So I don't think I'd get into any one area around the world that we're targeting. We've seen very solid, strong, broad geographic improvements and are expecting that to continue as we move in through the rest of '18.

Operator

And our next question comes from Nathan Jones from Stifel.

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

Vince, I think you gave me enough numbers here that if I could x out the acquisition and x out all of the price increases here, the underlying incrementals for the business look to have been high 20s, maybe 30% for the quarter. I think that shows -- and that's higher than the 20% to 25% you guys have been talking about targeting. Is that the way the business is fundamentally performing if we get rid of all of the noise out of here? Is that the kind of level that you think x all of this noise, the business can continue to function at with their mix impacts that their kind of reaching to in the quarter, or any color you can give there?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Right. So the way that I would -- I have calculated our incrementals in the core business x the acquisition, I come up with something in the high-teens, say 18%, 18.5%. So that's the consistent way that Lincoln has chosen to calculate the incrementals and not to sort of take out the price cost impact that is prevalent in many periods of our historical financial performance. Having said that, that 18% I think is a good number compared to where we were sequentially in the last quarter. I think we were maybe 11%. The quarter before that, I think we were in the high single digits. So we're generally pleased with the progression of the business and our price cost management, the drive to improve productivity and improve our operational performance and excellence through our business in this type of volume environment while still integrating and restructuring our combined European businesses. So we like the progression. We appreciate that the 18% is continuing to show an improvement from the previous 2 quarters. And I still believe on the methodology that we look at incrementals, that a 20% to 25% incremental margin performance is in line with what your expectations of Lincoln Electric should be moving forward.

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

Yes. I think with the steel price included, I get the same kind of thing there. You guys did put through more price increases surcharges in the second quarter. So assuming steel price behaves itself, which we know it won't, you would then expect to see further progression that is higher incrementals in the third quarter and fourth quarter as we get into this. So is it reasonable to say that your expectation would be that you're in that 20% to 25% range in the second half of the year beginning in the third quarter?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Well, we certainly are having the right trends and progressions, so my expectations are that we will tick over that 20% here in the second half of the year, and we'll need to continue to manage aggressively our price cost. And our expectations are that, second half of the year, we should see something north of 20%.

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

Okay. I just got one more on the international business. You guys have been pretty clear about the portfolio pruning leading to the lower volume levels. Those volume comps have been decelerating. Is that more a reflection of you increasing the amount of product rationalization you're doing or weaker underlying market fundamentals?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Certainly, the level and pace and intensity of our integration activities have hit a peak in the second quarter of this year. The number of manufacturing rationalizations has escalated from the first and the second quarter. And there's no doubt that the integration activities are hitting there what I would refer to as maximum pacing as heretofore seen during the course of the last half of last year and the first quarter of this year. So I think it's pretty clear that, that activity is intensified. And certainly, as Chris mentioned, it's challenging to try to tease that out from the underlying demand trends in Europe. But what we do know is that our activity is at a very high level currently.

Operator

And our next question comes from Walter Liptak from Seaport Global.

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

A follow-on to the last one and thinking about ALW. Obviously, we're still in the early innings of getting these $30 million of operational synergies. How much would you say that we've gotten so far in year one? And what are those related to? And then what kind of -- what do you think the cadence will be get to that $30 million as we look into, say, next year?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. Well, I think we're about 1/4 of the way there when I think about the $30 million of synergies. Most of that has come through procurement savings and a little bit through the manufacturing rationalizations. But I think we're roughly about a quarter of the way there, and my expectations, again, I'll reiterate what Chris laid out is that, we'll hit that mark by the fourth year, and we're confident, based on some of the activities that we've delivered to-date, that it's well within our expectations to hit the $30 million.

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

Okay, great. Are there any big projects, and I'm thinking of employment costs or consolidations that are coming up that we should be aware of? Or are some of those things behind us?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Well, we took our biggest rationalization charge now to-date in the second quarter of 2018. It was roughly $12.5 million. Those charges will then be followed by the benefits that will be attributable to the combination of the manufacturing facilities. So my expectations are that the dust will begin to settle in the third and fourth quarter of this year, and you'll see the benefits accrue to taking those $12.5 million of charges in the second quarter of the year.

Operator

And our next question comes from Liam Burke from B. Riley FBR.

Liam Dalton Burke - *B. Riley FBR, Inc., Research Division - Analyst*

Chris, you seem to have a strong innovative or new-product pipeline, both on a traditional and on the automation side. What have you seen in terms of competitive response in the market to your new-product introductions?

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

Well, it's not surprising that, especially on the equipment side of portfolio, I think, we've launched some very innovative products over the last few years. And you do see competitors then starting to look at trying to determine if they can develop similar types of capabilities. And I don't think that's surprising nor is it unique to our business. So I think what's critical for us as we drive our strategy is that we want to be viewed as and recognized as the company that's driving innovation within the space. And we're going to continue to invest behind that strategy. And that's why I'm very excited about the new equipment product that we've launched during the last month here in the U.S. market and its sister product that we've launched in Europe. Probably, the other element that's been very exciting for us and it's probably been a slightly larger catalyst than I had estimated when we had moved forward with the acquisition, but we have found some technologies and innovation within the Air Liquide Welding portfolio that we believe we can commercialize and take to the broader Lincoln Electric supply and customer base globally. So we'll also be working to drive away to execute on that innovation and bring it to the marketplace. We just had our board meeting last week and had our European team in, and certainly sharing with our board some of that innovation was very exciting for our executive team.

Liam Dalton Burke - *B. Riley FBR, Inc., Research Division - Analyst*

Great. And in terms of automation, just staying there, you're pretty much happy with the growth rates across the board globally. I know you mentioned that North America was up double digits, but in terms of growth rates in all your markets, you're pleased with progress?

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

Yes. I think that our global automation business, high single-digit growth in the quarter, I'm very confident that we'll continue to invest behind that long-term strategy for automation. It continues to progress. We're at a very good portion of the cycle, and I believe automation is going to stay strong for us, certainly through the rest of '18 and moving into '19. We have a lot of activity around that particular product portfolio right now. And again, as it relates to our longer-term 2020 Strategy, we're very confident in automation's positioning within Lincoln Electric's strategic profile.

Operator

And our next question comes from Tom Hayes from Northcoast Research.

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

Most of my questions have been answered. But I guess, 2 quick ones. One, Chris, maybe you could provide some commentary on what you're seeing in the China market and then maybe some color on what you guys are seeing in the M&A pipeline.

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

Sure. So looking at Asia Pac and in China, we saw very favorable trends in Q2. Our China business, specifically performed well. We have been repositioning that business over the last several quarters trying to drive a more innovative solutions-based program, the team there working very hard on it. I came through that region in the first quarter. Looking forward to going back there to see their progress. But I would say positive in China, positive in Asia Pac. The M&A pipeline continues to stay robust. Lots of opportunities for us to review and evaluate strategies or businesses that we think could be accretive to our strategy here. But as you would expect, we're going to continue on our perspective, which is to be mindful of how it impacts our strategy and be disciplined in our approach to the way we allocate capital. If we can find the opportunities that are strategic for the business at the right valuation, then we'll continue to deploy capital towards acquisition. I'd like nothing more than that. But we will continue our disciplined approach, but there are lots and lots of opportunities for us to evaluate in the M&A pipeline.

Operator

And our next question comes from Seth Weber from RBC.

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

Wanted to go back to the automation discussion for a second. Can you -- the double-digit growth -- or sorry, the high single-digit margin percent growth there. Can you just talk about your success with diversifying away from the automotive end market -- the auto end market? And maybe just give us some color on where you think end market mix could be over the next -- where it is today versus where you think it could go over the next kind of couple years?

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

Well, there's no question that our acquisition strategy over the last few years and bringing in a couple of the acquisitions that were more centric in heavy industry than in general industry than they were in automotive, has improved our mix. And then, we've seen those industries continue to expand over the last 3, 4, 5 quarters. And as those industries have expanded, we've seen more capital come back in for automation into their manufacturing facilities. So we had a favorable trend in the mix, certainly, driven from the improvements in those underlying industries and the acquisitions that we brought into the portfolio over the last few years. As it relates to the long-term mix that we would have within automation, we don't have any set parameters around that. We recognize that we don't want to have too much concentration in any one of those particular segments, so we'll continue to study that and evaluate that, but we've had a favorable trend within that mix and would like to continue to be able to find opportunities for us to expand upon the global automation portfolio.

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

Okay. That's very helpful. And then just a clarification. I guess, the Air Liquide business added $0.05 this quarter. It was $0.06 last quarter. Is that just a seasonality issue with Europe kind of been relatively slower in the summer? Or just is there something going on there?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

No, Seth. I view it as a relatively stable performance between the 2 quarters. You could round the $0.05 up to $0.06 and the $0.06 down to $0.05. So from a dollar earnings perspective, they're relatively consistent.

Operator

And our next question comes from Steve Barger from KeyBanc Capital Markets.

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

Vince, you said price cost narrowed to 40 basis points in the quarter. Can you tell us how that was relative to your plan? And do you get to 0 or positive exiting the year?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

I think it's going to be very difficult to get to 0 or positive during the course of the year simply because of the math behind another substantial increase in pricing associated with the tariffs. So I -- look, we're pleased with our performance in this regard. We've largely passed through, on a dollar basis, the inflationary increases across our manufacturing businesses. I would tell you that reaching a positive number is not within the realm of expectations just based on the inflation we're seeing at the top line.

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

But it -- back to your previous response to somebody else, even with that, you would expect that you'll exit the year at that 20% to 25% range?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Right. So I think our volume expectations, the continued narrowing of that 40 basis points would, I think, tip us over into the 20-plus-percent type of incremental range. There's a lot of other activity and initiatives driven by the company to improve our productivity, and we're expecting some mix improvements. And then finally, I think we'll see some better results as we exit the year from a couple of the other segments outside of the Americas from a price cost and integration perspective.

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

Can you tell us what that price cost spread was for the Americas, specifically in the quarter, if you have that?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

No, I don't actually have it for the Americas broken out separately.

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

Okay. Going back to international, and I'm sorry if I missed this, but given market conditions in Europe and the continuing pruning exercises, would you expect to have revenue growth to show growth over the first half? Or should we be thinking that this $245 million quarterly run rate is the more likely outcome?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Could you rephrase the question?

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

Do you think, just on a dollar basis, you put up $490 million in the international segment in the first half, does second half grow over that?

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

Steve, this is Chris. It would be -- we've got so many moving parts. We've got 1 month of Air Liquide Welding in Q3 as we anniversary. So we'll have the July, and then we'll be back to being a full year basis. But then we were certainly pruning that initial business as we were starting the integration process. So a lot of moving parts. I wouldn't tell you that I've necessarily thought of it in that manner and probably can't comment for you on the call.

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

Yes. I would go so far as to say that if you just look at the international volume x acquisition year-over-year, I'm expecting at least, in the third quarter, another negative number.

Operator

And our last question in queue comes from Mig Dobre from Baird.

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

Can you maybe give us a little bit of color on freight. How much is that when we're thinking about your expense structure as a whole? What sort of drags are you experiencing from that part of the business?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

We estimate that our total distribution cost increase was about a 40 basis point headwind in the quarter so accelerating from the first quarter of the year into the second quarter.

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

And Vince, your exposure, is it mostly through trucking or rails or -- I presume trucking?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Well -- but we use all forms of transportation. Trucking is probably the greater proportion of our freight costs.

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

Are you seeing any sort of challenges in terms of actual availability of freight? Or is this for you primarily a cost issue?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Yes. I think it's primarily a cost issue. You hear the anecdotal story. But I wouldn't say from an enterprise-wide perspective that our customers are not getting their products on time because of freight availability issues.

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

Got you. And then lastly, this other income line, we've seen this number be a little bit higher than what we expected over the past couple of quarters. How are you thinking about this going forward?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Don't think about it a whole lot because it can have some variability and volatility in it. It's not a -- other income can vary from period-to-period in an unpredictable way.

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

Okay. So we should be thinking 0 or something like that going forward in a model?

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Well, I would take the last couple of years and just look at an average and use that as an assumption. I don't know about 0. We always have something in that line item.

Operator

And I am showing no further questions from our phone lines. I would now like to turn the conference back over Vincent Petrella for any closing remarks.

Vincent K. Petrella - *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

Thanks, Crystal. I did have a follow-up answer to the question that came earlier about our number of billing or shipping days. We will pick up 1 day in the second half of the year, but that day is in the fourth quarter and not the third quarter. Our third quarter billing days will be equal in 2018 as they were in 2017.

And with that, I'd like to wrap the call up by thanking everyone for joining us today and for your continued interest in Lincoln Electric. We very much look forward to discussing the progression of our strategic programs and our operational execution in the future. Thank you very much.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This will conclude the program. You may all disconnect. Everyone, have a wonderful day.
