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Q4 2018 Lincoln Electric Holdings Inc Earnings Call

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## CORPORATE PARTICIPANTS

**Amanda H. Butler** *Lincoln Electric Holdings, Inc. - VP of IR & Communications*  
**Christopher L. Mapes** *Lincoln Electric Holdings, Inc. - Chairman, President & CEO*  
**Vincent K. Petrella** *Lincoln Electric Holdings, Inc. - Executive VP, CFO & Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Brendan Matthew Shea** *RBC Capital Markets, LLC, Research Division - Senior Associate*  
**Christopher M. Dankert** *Longbow Research LLC - Research Analyst*  
**Jason Andrew Rodgers** *Great Lakes Review - VP*  
**Joseph O'Dea** *Vertical Research Partners, LLC - Principal*  
**Mircea Dobre** *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*  
**Nathan Hardie Jones** *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*  
**Robert Stephen Barger** *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*  
**Saree Emily Boroditsky** *Jefferies LLC, Research Division - Equity Analyst*

## PRESENTATION

### Operator

Greetings, and welcome to the Lincoln Electric 2018 Fourth Quarter and Full Year 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. Thank you. You may begin.

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

Thank you, Lauren, and good morning, everyone. Welcome to Lincoln Electric's 2018 Fourth Quarter Conference Call. We released our financial results earlier today, and you can find our release as an attachment to this call's slide presentation as well as on the Lincoln Electric website at [lincolnelectric.com](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 our Chief Financial Officer, Vince Petrella. Chris will begin the discussion with an overview of full year results, and Vince will cover the quarter performance in more detail. Following our prepared remarks, we're happy to take your questions.

But before we start the 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 as well as 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.

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

Thank you, Amanda. Good morning, everyone. I'm pleased to report that we achieved solid performance in 2018. We leveraged our leading product portfolio, our differentiated automation offering and our global team of industry application experts to capitalize on greater industrial demand.

Combined with strong operational execution, we advanced our 2020 Vision and Strategy financially and environmentally for our goals and, in many cases, exceeded our 2020 targets. We did this while successfully navigating inflationary pressures and dynamic trade and tariff uncertainties to deliver value for all of our stakeholders.

Looking at 2018 full year results on Slide 3. Sales increased 15.4% to a record \$3 billion. We achieved 6.7% organic sales growth and



9.1% growth from a combination of the Air Liquide Welding acquisition in the first half of the year and 3 new acquisitions we closed in the fourth quarter. These 3 businesses are expected to contribute \$85 million to \$90 million of revenue in 2019.

We focused on originating our portfolio mix, productivity and mitigating inflation to drive margin growth. We generated 5.6% of price to offset broad inflationary pressures and recover U.S. tariffs through surcharges. These efforts resulted in a 14.7% increase in adjusted operating income to \$405 million, and we're able to maintain one full year adjusted operating income margin relatively steady at 13.4% versus the prior year.

Reported diluted earnings per share was \$4.37. Excluding special items, adjusted EPS increased 27% to a record \$4.82. We generated solid cash flow from operations with full year operating cash flows largely consistent with prior year amounts. We returned \$304 million to our shareholders through \$202 million of share repurchases and over \$100 million in dividend payments. Our board recently approved a 21% increase in our dividend payout rate for 2019. ROIC performance improved 450 basis points to 20.7%, maintaining our top-tier performance.

Moving to Slide 4 and end of year trends. As expected, organic sales growth rate started to decelerate in the fourth quarter due to challenging prior year comparisons as well as softening U.S. export demand. By geography, North America fourth quarter organic sales increased at a high single-digit percent rate, while regions outside North America experienced a high single-digit percent decline in organic sales. The decline was primarily driven by a low double-digit percent organic sales decline in Europe due to integration activities underway to shake that business for long-term competitive success and a slower overall economic environment.

Globally, automotive, heavy industries, construction/infrastructure and energy grew in the fourth quarter with general fabrication flat versus the prior year due to lower volumes from our integration activities in International Welding. By product area, consumable organic sales in the fourth quarter increased at a mid-single digit percent rate, while equipment organic sales, including automation, declined at a low to mid-single digit percent rate versus the prior year. This decline reflected lower volumes in our International Welding segment and a mid-single digit percent decline in automation solutions on a soft automotive capital investment cycle and a very challenging prior year comparison.

As we move into 2019, our January sales performance reflects an uptick in demand after a soft December. January organic sales increased at a low single-digit percent rate versus the prior year led by mid-single digit percent organic sales growth in both Americas Welding and The Harris Products Group. We expect an average low to mid-single digit percent organic sales growth rate in 2019. The slightly slower rate incorporates challenging year-over-year comparisons, an assumed late 2019 normalization of automotive capital spending and ongoing volume compression in International Welding through mid 2019 when we began to anniversary our more significant integration activities.

We expect to generate growth in that segment in the second half of the year. We also expect our price in Americas Welding to start to narrow in the first half of 2019 and are likely to report flat to negative price in the second half of the year. Tariff recovery is reported as price, and as we receive U.S. tariff exemptions, our price will be impacted. Our goal is to protect margin performance through price management and drive margin enhancement through mix and operational improvements as we move through 2019.

Before I pass the call to Vince, I'd like to thank the organization for their successful execution of our strategic initiatives. We accomplished a lot in 2018. We have great momentum in our education offering with the successful launch of our next-generation welding education solutions in new schools around the world. The launch of our new Welding Technology & Training Center and the expansion of 2 new weld tech centers in Dubai and Shanghai, which are critical in helping us showcase and customize our solutions for global and regional customers.

We're also preparing for the 2019 launch of our new additive services business, which will position Lincoln Electric as a manufacturer of large scale 3D-printed metal spare parts, prototypes and tooling for industrial customers. I'm very excited about this new opportunity for Lincoln Electric. While there is a lot of work ahead, this is an exciting time for Lincoln Electric. Our inventive product portfolio, industry-leading team, strong market presence and strong balance sheet positions us well to invest in growth, drive operational excellence and higher returns in 2019.

And now, I will pass the call to Vince.

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

Thank you, Chris. Looking at our fourth quarter income statement highlights on Slide 5, our consolidated fourth quarter sales declined 40 basis points to \$743.8 million. 5.9% higher price and a 40 basis point benefit from fourth quarter acquisitions were offset by 4.3% lower volumes and a 2.3% unfavorable impact from foreign exchange translation.

Our fourth quarter gross profit increased 5% to \$250.3 million. Gross profit margin increased 180 basis points to 33.7% from improved mix, operational initiatives and price/cost management, which remained favorable to margin by 30 basis points in the fourth quarter. We incurred a \$1.3 million LIFO charge in the Americas Welding segment due to raw material inflation and the estimated impact of U.S. trade tariffs.

Our SG&A expense, excluding special items, increased \$3.8 million to \$153.6 million as favorable foreign exchange was primarily offset by higher compensation costs and professional fees. As a percentage of sales, SG&A, excluding special items, increased 70 basis points to 20.7%. We do expect our 2019 SG&A spending level to remain at these higher run rates, as we continue to invest in growth initiatives such as our additive services business.

Reported operating income increased 24.4% to \$94.9 million or 12.8% of sales as the prior year included a \$14.4 million special item charges, primarily related to the ALW acquisition. Excluding special item charges, operating income margin increased 90 basis points to 13% of sales. Margin improvement reflected favorable mix, pricing management and operational initiatives.

Our fourth quarter effective tax rate was 8.1% due to the favorable adjustments related to the U.S. tax act and discrete items. This compares with a prior year tax rate of 67.2%, which included a \$28.6 million charge from the U.S. tax act. Excluding special items, our fourth quarter 2018 tax rate was 14.7% due to favorable adjustments to refined accruals related to the U.S. tax act as well as discrete tax items. This compares to a prior year tax rate of 25.8%.

In 2019, our full year average effective tax rate is expected to be in the mid-20% range, subject to the future mix of earnings and the timing and extent of discrete tax items. Fourth quarter diluted earnings per share increased 275% to \$1.35 compared with \$0.36 in the prior year. The prior year was impacted by special items associated with the ALW acquisition and the U.S. tax act charge previously mentioned. On an adjusted basis, diluted earnings per share increased approximately 28% to \$1.29, primarily from price/cost management, favorable mix, operational initiatives and the lower effective tax rate.

Now moving to geographical segments on Slide 6. Americas Welding segment's fourth quarter adjusted EBIT rose to 15.2% or \$85.9 million. The adjusted EBIT margin increased 90 basis points to 17.7% on price/cost management and favorable mix. The Americas Welding segment achieved solid 8.2% organic growth in the quarter against a very challenging prior year organic rate of 13%.

Early quarter demand was strong across most end markets with December decelerating. Direct OEM sales into automotive, heavy industries, energy and construction/infrastructure all increased at a double-digit pace. General fabrication increased at a high single-digit percent rate.

Fourth quarter organic sales in consumables increased mid-teens percent and equipment held relatively steady with prior year performance, as automation slowed on weaker automotive sector demand and a challenging prior year automation comparison. The 8.3% higher price in the segment reflects the benefits of prior pricing actions and surcharges applied to recover U.S. tariffs.

Americas Welding sales benefited 70 basis points from acquisitions, reflecting one month of sales from the 2 automation acquisitions we announced in the quarter. We expect these acquisitions to add approximately \$60 million to \$65 million in Americas Welding revenue in 2019.

Moving to Slide 7. The International Welding segment adjusted EBIT increased 2.5% to \$12.3 million. The adjusted EBIT margin

improved 90 basis points to 5.5%. Price/cost management, improved mix and benefits from integration activities helped to mitigate the impact of lower volumes in Europe.

European volume declines are associated with actions we're taking in the region to improve long-term performance as well as regional weakness in the automotive, oil and gas and general industrial sectors. We continue to expect similar levels of organic sales performance through the first half of 2019, as we implement our integration plan and experience a softer international economic environment.

Moving to The Harris Products Group. Fourth quarter EBIT margin declined 90 basis points to 12% due to a challenging price/cost environment. Volumes increased 4.6% on strong OEM and retail channel sales despite a challenging prior year volume growth rate of 6.9%. We acquired Worthington Industries' soldering business on December 31. And on February 1, we completed the acquisition of select brazing assets from Worthington. These transactions broadened Harris' consumable portfolio and will add approximately \$25 million of sales to The Harris segment in 2019.

Moving to Slide 9. Fourth quarter cash flows from operations increased 11% to \$99 million with a 92% conversion of free cash flow. On a full year basis, we generated \$329 million of cash flows from operations, which was fairly consistent with the prior year. Average operating working capital was 16.5% of net sales at year end, reflecting consistent working capital management performance.

Moving to Slide 10. In the fourth quarter, we continued to invest for growth with \$108 million in acquisitions, reflecting the 2 automation assets and the soldering business from Worthington Industries. We also repurchased \$80 million in shares. On a full year basis, we increased our use of capital significantly from the prior year with \$202 million in share repurchases, approximately \$102 million in dividend payments, another \$102 million for acquisitions and \$71 million in capital expenditures. While investing for growth, we have maintained a solid balance sheet with an investment grade profile and continue to deliver exceptional ROIC at 20.7%.

Looking ahead to 2019. We expect to continue balanced use of capital, prioritizing growth investments and acquisitions and returning cash to shareholders through our dividend program and share repurchases. We will pursue buybacks opportunistically based on expected cash generation, uses of cash and share price performance through 2019. Finally, we estimate full year capital spending to be in the range of \$70 million to \$80 million.

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

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## QUESTIONS AND ANSWERS

### Operator

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

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

First question on the Americas adjusted EBIT margin in the quarter. I think most of the commentary about some tailwinds related to price/cost and mix. I think if you go back to fourth quarter of '17, there was some higher-than-normal incentive comp. And if we were to adjust for that, year-over-year margins look more flattish. And so, I wanted to understand some of the other puts and takes maybe in the most recent quarter. Anything that you saw as some margin headwinds there.

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

Well, I think, we've covered the price/cost dynamics in the business, Joe. We've done a good job in driving pricing into the market and stemming the headwinds of the inflationary environment. We did have a little bit of a compression in our price/cost achievement in the quarter compared to our run rates with our biggest business unit in the Americas having some slower production volumes and some higher conversion cost that nicked our margin performance a little bit. But I would tell you from an incremental margin perspective, a 28% incremental out of the Americas in the fourth quarter of 2018, we view as a good result.

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

And related to that. As you think about 2019 at the segment level, how should we think about incremental margins there and any impact that we should anticipate from the recent deals?

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

Right. As far as the recent deals are concerned, I don't think they'll have a significant impact on our incrementals in the Americas or The Harris Products Group in 2019. From an incremental perspective on growth, we would anticipate a similar guidance of 20% to 25% on a consolidated basis for our group of companies.

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

Okay. And then you talked a little bit about back half of the year flat to maybe down price on some factors as some offsets to tariffs. Could you talk about where you are on the cost side of things in terms of steel costs today relative to where they were a year ago, where they were when they peaked during 2018? Just to try to get a little bit of perspective on the cost dynamic and things that might be improving for you as you go through 2019?

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

Right. So we see pricing in the fourth quarter of roughly 6% continuing at a similar rate in the first quarter. As tariffs in the U.S. peel back to some extent, we would expect that, that pricing environment would be reduced by a couple, 200, 300 basis points. And I would tell you that from a cost perspective, we did have more LIFO charges and inflationary impact to our raw material input cost in the fourth quarter of 2018. So we think the big driver towards price/cost management and where our steel cost will be will surround the timing and extent of tariff reductions in the U.S. Outside of that, we're anticipating globally a more modest -- moderate raw material input environment during the course of 2019.

**Operator**

Our next question comes from Saree Boroditsky with Jefferies.

**Saree Emily Boroditsky Jefferies LLC, Research Division - Equity Analyst**

I was wondering if you could update us on how you're thinking about capital allocation this year, given the recent debt filing and particularly as it relates to buybacks, as it looks like you continued on a strong pace in the quarter?

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

Yes. So we -- in my prepared comments, I highlighted the conditions that we look at to determine how much we might devote to share buyback. And we felt that it was a opportunistic time in the second half of 2018 to step up our share buyback activity. I would tell you though, Saree, that the extent of buybacks in 2019 will be somewhat dependent upon those same factors, including what we see from an opportunity set in the M&A and acquisition side of business. But I would say that based on our strong cash flows in 2019 and the expectation for another good, strong year of cash flows in 2019, we will continue to purchase at elevated levels from what we have defined as our maintenance mode prior to 2018.

**Saree Emily Boroditsky Jefferies LLC, Research Division - Equity Analyst**

Great. Thanks. And then just a modeling question. Was there anything in particular that drove corporate expense to be a little higher in the quarter? And do you expect it to stay at this level going into 2019?

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

Yes. So there's some higher spending that I also addressed in prepared comments around SG&A. So we are building some capabilities around new product development and growth initiatives. And I would expect that, that growth will continue in the first half of the year and then moderate in the second half of 2019. But do I do expect an elevated level of both corporate and SG&A spending in '19.

**Operator**

Our next question comes from Mig Dobre with Baird.



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

Just starting with a quick housekeeping question. Can you comment at all on shipping days in the fourth quarter? And as we're looking at '19, based on the calendar, where are you seeing maybe some year-over-year shipping day discrepancies?

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

Yes. So we did have an extra day in the fourth quarter of billing days. And I don't have in front of me, Mig, the billing days in 2019, but I can certainly get back to you on that.

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

Okay, I appreciate that. Then I want to go back to Joe's question on incentive comp. Vince, can you give us a sense for the full year 2018 how incentive comp has tracked versus '17? I presume it was up. And then, I'm also sort of wondering how this incentive comp has accrued, because I'm presuming that the pace of accrual has been different than it's been in 2017.

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

It was a -- if you focus on the fourth quarter, we did take a greater provision as a percentage of EBIT this year than in the prior year. So if you look at what our incentive compensation accruals were in the fourth quarter, they were at a higher rate compared to 2017.

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

Right. I mean you were up year-over-year, but I'm wondering if incentive comp was a moderating headwind on a year-over-year basis. Meaning you had more that you accrued earlier in '18 than later in '18 on a year-over-year basis. That was the nature of my question.

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

No, I don't think so. But clearly, I would emphasize on the fourth quarter, we did have a bigger drag on incentive compensation accruals than the prior year.

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

Understood. And then I have one more question on -- I'm looking to understand Chris's comments on January and the way you're starting the year. As I heard, this was -- his comments were organic growth rather than price versus volume. Please correct me if I'm wrong. I mean, you gave us a sense for how you're expecting pricing early in 2019. I'm looking to make sure that we have our volume assumptions properly tagged as well.

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

Yes, Mig. Look, as we were -- we saw some shallowness as we were exiting Q4. And as we've looked at the first few weeks of 2019, we've had a nice step back up from that trend data that we saw in December and have seen a nice recovery on the organic growth side, as I stated in the remarks.

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

Organic growth, not volume, Chris, though?

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

Yes. Organic growth.

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

Correct, yes, organics, yes.

**Operator**

Our next question comes from Seth Weber with RBC Capital Markets.

**Brendan Matthew Shea** *RBC Capital Markets, LLC, Research Division - Senior Associate*

This is Brendan on for Seth. If I could just kind of keep going on this international volume. You noted that Europe was a bit weaker. You also have the integration portion that should anniversary after the first half. I guess, what are you seeing, specifically, in the weaker European market? And what do you think you need to see there in order to see a turnaround?

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

Look, as we've been sharing with the execution, the integration of the Air Liquide Welding business that we brought into the portfolio, we knew that there would be challenges associated with us addressing that particular restructuring. As we stated, we believe strongly that we'll begin to turn that in the back half of 2019 and begin to have that into a structure where we begin -- we can grow from that. We certainly have had product areas that we have been able to grow from that portfolio, but we've not been able to see that as we've been doing the broader restructuring. I will tell you that I'm optimistic, continue to see the improvements that we're looking for in that business. We decided that we wanted to integrate it at a more aggressive pace. As I look at the first few weeks of 2019, which I do caution that it's only the first few weeks, but, certainly, we're seeing some improvements relative to the rate of that revenue impact in our European business, but feel confident that we're making the right decisions associated with the long-term value that we saw within that business and still confident that our teams are going to execute on that, and we'll be able to begin to see improvements in the back half of '19. Now as you've seen in the marketplace, there has been some broad data that would share or would show that, quite frankly, the European market might be slowing slightly. We've seen the consumer and Producer Price Indexes coming out of Germany and France that are more challenged. So we believe that there is a little more of a headwind associated with accomplishing that in the European market today, but, certainly, feel confident that we're still going to be able to move that towards a growth platform within the back half of 2019.

**Brendan Matthew Shea** *RBC Capital Markets, LLC, Research Division - Senior Associate*

Okay. And then one more, if I may. Any additional color you can give us on what you're seeing specifically in your energy end markets?

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

Well, energy was actually a bright spot in January. Oil and gas was strong.

**Operator**

Our next question comes from Nathan Jones with Stifel.

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

I'd like to start with some questions around these growth investments. I think what you said, there are capabilities around product development and some other growth investments. Can you maybe talk -- I mean, I guess, first about what the level of those investments are? And how they phase through the year? And then a little longer term maybe you can talk about what it is you're looking to develop in terms of these investments? I know you mentioned something about additive. I think, previously, we talked about that being a pretty small opportunity. Maybe any color you can give us on what you're doing there.

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

Well, look, I really think about the growth investments we've been making in the portfolio here really within 2 distinct groups. So I would tell you as we were executing on our 2020 Vision and Strategy, we had identified within the broad global welding and cutting space 4 or 5 vertical markets within that areas like fume and others where we didn't think we were participating at the level that we should be participating. And we developed SBUs and developed some structures and engineering capabilities within 4, 5 of those vertical areas to try to grow at an accelerated pace to the marketplace and gain part of the profit pools and opportunities that we thought were available within the core welding space. The second piece that you mentioned is the movement that we are making into the additive space. And additive is a natural progression for Lincoln Electric, especially additive as it relates to the development and manufacture of larger parts. Competencies required for that are really centered around metallurgy, robotics, software engineering, all things that Lincoln Electric -- that we believe we have expertise and competencies in today. We have built an organization. We have a facility. We're bringing in equipment, and we expect to be starting to greenfield productive assets from that in the back half of the year. I would tell you that as I think about all of those initiatives within the business, I think, that those initiatives are probably creating a drag somewhere between \$6 million to \$8 million a year from a cost basis. We'll start to see growth from some of those core initiatives more quickly, the additive



initiative. Although we'll start doing some productive assets, I certainly don't expect it to be providing us much benefit in 2019. But I do believe as you see us start to roll out our longer-term strategy for Lincoln Electric, our new 2025 strategy that we'll be bringing towards the market towards the middle of the year, you'll see that, that additive services business can be a more material part of our global portfolio through the duration of the strategy.

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

Okay. I look forward to hearing more about that later in the year then. I am going to ask one on Harris. I know that's a more challenging business to get price, given the channel structure that you've got there. Do you guys anticipate being able to push more price through in that business to recover your increased cost in 2019? How far are you behind on price/cost in Harris at the moment?

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

So, look, I believe, there is an opportunity for us to move some price within the marketplace at Harris as we move through 2019. Vince and I actually just completed a global review with that leadership team. We also continue to want to try to drive improved margin enhancement within the broad portfolio. So it's not just price. It's also trying to accelerate some productivity activities and other actions that we have within the business. So I do believe we're slightly behind on price. With the nature of that product category and the multitude of channels, it's hard to see exactly what that specific number might be. We're slightly behind. We'll be instituting some actions as we move into 2019 and, again, trying to really focus also on driving some broad productivity initiatives to try to enhance the broader margin portfolio.

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

Do you think just on straight price/cost you can get to neutral in '19 or price/cost and productivity you could get to neutral in '19?

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

I certainly think with price/cost and productivity, we can certainly achieve that result.

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**Operator**

Our next question comes from Chris Dankert with Longbow Research.

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

I guess, looking at the Americas, you highlighted auto, energy, infrastructure, a lot of things growing very nicely in the quarter. I guess, could you just kind of call out where were some of the more friction points in some of the markets that were holding you back a little bit in 4Q?

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

As far as the Americas are concerned, maybe the softest area was one quarter was power generation was a negative for us. It was probably the greatest end market segment that was down on a year-over-year basis.

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

Got it. That was the biggest kind of offset that get you back towards the -- that flattish volume number?

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

Right.

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

Okay. Okay. And then thinking about international as we move into '19 here, I think, from the pruning actions you guys have done have been quite successful, particularly on showing through on the margin. I guess, how much more pruning do we have to be go? Like kind of if you could break out what the fixed bucket is versus kind of the optimized bucket at this point?

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

I think we've done a good portion of what we're going to need to do at this point in time, and we're now in a phase of stabilizing the business after a multitude of facility consolidations and organizational movements and product line adjustments and implementations



of software system. So I think we're in a mode of stabilization and then growth in the second half of the year. I would say that there's likely to be 1 or 2 or a handful of other actions that will be necessary over the next couple of years, but the most significant wave is behind us now. And we will be fine tuning the integrated assets as the 2019 and 2020 unfolds.

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**Operator**

(Operator Instructions) Our next question is a follow-up from Mig Dobre with Baird.

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

Just looking at kind of clarify a couple of things on pricing. At this point, are you contemplating additional pricing action for 2019? Or is the color that you provided in terms of how pricing is progressing simply a factor of price increases that you've already sort of put through in '18 carrying over into '19?

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

Right. Mig, good question. Right now, the guidance that I've provided in terms of pricing as it unfolds during the course of the year assumes that we do not put additional price increases into the market. At this point in time, I would tell you that there will probably be very specific narrow geographic and product line actions that are taken in our book of business that will not result in a material change at this point to the outline that I provided earlier in the call. But again, just to emphasize, we're looking at an environment of a flat pricing from an action perspective with some exceptions and anticipating these declines on a year-over-year basis caused by rolling back of some portion of the tariffs that have been put on our business from a steel and aluminum perspective in 2018.

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

Okay. And then on this very last point. When you're saying rolling back, I mean, you're not essentially assuming that the tariffs go away. You're just reflecting a lower input cost for yourself, right?

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

No, no. We're assuming that some of the tariffs will be rolled back.

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

Yes. Mig, if you think about the way at Lincoln Electric, we executed on that strategy as we were forced to impose the tariffs because of the increase in the raw material cost that we have, we applied surcharges to those activities. If we were to receive an exemption from that tariff or the tariffs were rolled back, then we'll be rolling back those tariff costs as it relates to the way we're providing those products to our customers.

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

Okay. Okay. And then in International -- I mean, this is a question that I often get, the discrepancy in pricing International versus the Americas. If we're kind of isolating the effect of tariffs in the Americas, is it fair to say that the pricing is relatively consistent International versus Americas? Or is there a delta there that we should know about?

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

From a product -- from a market-facing product pricing question, you're asking or from raw inputs?

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

I can answer it.

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

However, you want to tackle it really.

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

Both -- there are differences in pricing globally market-by-market, region-by-region. And there are as well differences in raw input costs on a market-by-market basis as well. So each were organized in a way that the business unit leaders can manage these costs and manage their pricing environment based on the local conditions that they might be faced with, and there are differences in pricing and costs from a global perspective.

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

Okay. Then last question in terms of the 30 basis points of price/cost benefit in the fourth quarter, is there a way to maybe quantify this for the Americas region specifically?

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

Well, I think, the Americas region led the way in terms of price/cost achievement.

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

So better than that? Better than the 30?

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

Yes. If you look at The Harris and you look at International, yes, the Americas did better than that.

**Operator**

Our next question comes from Steve Barger with KeyBanc Capital Markets.

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

Just a follow-up question on price. The last 2 quarters, Americas price has run well ahead of volume, especially this quarter. Any thought that you've run ahead of competitors that's maybe resulted in some customer pushback or share shifts? And would you even be able to tell that in within a quarter or 2?

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

I think it is a fairly narrow period of time to look at one quarter, but we don't think there has been a meaningful share shift in the last 2, 3, 4 quarters as we see it. And we also believe that our key competitors in major markets are moving price up in similar ways that we are.

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

Okay. And then on free cash flow, you said you expect good free cash flow in 2019. From 2014 to 2017, conversion from net income was 100% or better, step down to 82% in 2018. You've talked about some growth initiatives that you'll spend on in 2019. Can we get back on track to conversion more towards 100% given your revenue outlook? And how you see spending for the year?

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

Yes. I think so. One of the drivers behind the extraordinary long run of more than 100% cash conversion was the steep improvements in working capital management, Steve, that we've achieved. Now that's flattened out and actually working capital bumped up on a year-over-year basis in 2018, but we expect to have a renewed focus on and improvement in working capital management as we move forward. There is still more to be done there, and we're confident that our cash conversion will migrate back up towards the historical achievement that we've had over that period of time.

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

Historical achievement meaning 2014 to 2017 was extraordinary, and that's a real stretch goal or you think you can hit...

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

I think we're going to do better than what we did in 2018. I think that was a bit of a down year although still a good year from a cash flow perspective. I think we're going to migrate back up somewhere in between what we did this year and what we were able to achieve in those 3 or 4 years that you cited.

**Operator**

The next question comes from Nathan Jones with Stifel.

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

Just to follow up on the tariff stuff there, and I apologize if I missed you discussing this before. But it didn't sound like you think the tariffs are going to get rolled back, but you think you're going to be able to get an exemption from the tariffs?

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

So look, the way we've approached it is that, look, we're not trying to forecast whether the tariffs will or won't be formally rolled back. That's outside the control of Lincoln Electric, and we're trying to educate our customers on the impacts that we have and the challenges in the marketplace. But as those tariffs have come on, especially here in the U.S. market, there is a process where you can seek out an exemption relative to those tariffs. We have been active in trying to accomplish that. And if we can accomplish that, then we can work with our customers and talk about that mitigation. But we're not forecasting any formal overall rollback of the tariffs, but we are working through the exemption process to see if we can mitigate the impact on Lincoln Electric and our customers.

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

Got it. Thanks for the clarification there. And then if we take out the tariffs and the surcharges that you've used to offset tariffs. We have seen still retrench here. You guys have a good record of being able to hold on to price in deflationary environment. So if we take the tariff and surcharges out of the equation, can you maybe talk a little bit about how you think -- how well you think you could hold on to pricing in a deflationary environment, deflationary steel environment that we've seen over the last couple of quarters?

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

Nathan, so that's dependent upon a number of variables, as you know. But aside from trying to predict those variables at this point in time, I would tell you that I would rely on Lincoln's history of managing through both deflationary and inflationary raw material environments. So again, the extent of our ability to maintain margin and perhaps expand margin is largely dependent upon what the volume line might do as well as what the pricing changes might do in terms of their magnitude and timing. But we're confident that we'll manage the way we always have in these types of environments and protect and maintain margins.

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

Okay. And then just on the acquisitions that you made in the fourth quarter there. You gave us plenty of color around what the revenue additions in 2019 are going to be. Can you maybe talk a little bit more strategically about those? And how they advance -- the strategic goals rather than just the financial impacts?

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

Yes. That's a great question. Actually, that's the rational basis behind all of it. So we had the opportunity to pick up an additional robotic plasma cutting technology with the Canadian acquisition that we're very excited about, fits in with the portfolio of products there that we already produce for the global marketplace. We'll be able to take that product and provide it to our trained salespeople on a global basis and assist that firm in taking that technology from really a regional play to a global play. The other acquisition that we made is the acquisition in our automation space, Coldwater engineering. They actually have 2 locations. Very excited about that acquisition. I was actually at that facility and met with all those employees last week. They're very, very excited about their ability to assist us in having even further penetration into the appliance marketplace. So we have some appliance automation competencies across our portfolio. They have some in-depth capabilities there that are very interesting. They also bring us some competencies and capabilities that we think will assist us on the additive side of the build out of that portion of our portfolio. And they have a secondary location that's in the Midwest that actually has done more focused automation competencies centered around plastics and plastic composites. And we don't do a lot of automation in that space today, but we're interested in that area and excited to have those 2 pieces and those 2 teams into our portfolio. And then the final acquisition, the product enhancement for The Harris business. We've been actively engaged in looking at expanding the product competencies for our Harris business. Bringing in these really what we believe to be a best-in-class brand from Worthington as it relates to soldering competencies that will move through the wholesale and the retail marketplace is a great addition for our Harris business as well as, as Vince mentioned, in picking up some additional manufacturing assets as we expand our brazing alloys business here in the Americas. So I love the strategy competencies of those businesses. And as I mentioned earlier, as material as

those are, our investment in our new additive services business is going to be exciting for Lincoln Electric. And again, we'll be more forward as we move into 2019 and present our longer-term strategy and providing you with some details on those investments and the strategies behind those investments.

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

So it sounds like these are more revenue synergy plays than cost synergy plays?

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

These are absolutely revenue synergy plays. We're -- they are bringing us competencies and capabilities that we can enhance or bring to Lincoln Electric. And I see these as growth investments. And the additive play as 100% growth investment for us. So I would agree strongly, these are growth investments.

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**Operator**

Our next question comes from Jason Rodgers with Great Lakes Review.

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**Jason Andrew Rodgers *Great Lakes Review - VP***

Did want to ask about the organic forecast for 2019. I think you said low to mid-single digits. Could you break that out by segment?

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

Well, I would tell you that the Americas will probably be at the high end of that, and we'll still see the compression going on in the International segment. So I think we'll see a similar type of distribution in that group-wide roll up as we saw finishing 2018. So a better result in Harris and Americas from an organic perspective and a slower or a greater compression relative to the group number in International.

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**Jason Andrew Rodgers *Great Lakes Review - VP***

And looking at the automation business, do you expect that to -- allow me just ask -- how do you expect that to perform for the year? And are you seeing any change in the competitive dynamics in that market?

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

No real change in the competitive dynamic. So we've got very solid backlog as we move into the year. As you would expect, the automotive capital spending cycle has been a little softer in 2018. We expect that to probably continue for the first couple of quarters. Although that's one of the reasons why, as I mentioned earlier on the call, I like the acquisition that we just made at Coldwater engineering, which broadens the industry segment base that we have within that portfolio, which minimizes some of the cyclicality around any one particular segment. So we're still very excited about investments in our automation strategy and believe that it can continue to be a growing piece of our broad global portfolio.

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**Operator**

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

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

Thank you, Lauren. And I do have one cleanup question that came in on the shipping days, billing days in 2019. So we anticipate the first quarter to be the same. We anticipate second quarter we'll lose a day. Third quarter will be the same year-over-year between '19 and '18. And then, finally, the fourth quarter, we should pick up a day, which will make our total billing shipping days in '19 equivalent to 2018.

And with that, I'd like to thank, everyone, for joining us on the call today and for your continued interest in Lincoln Electric. We very much look forward to discussing our progression and execution of our strategic programs during the course of the first quarter. And thank you very much again, and have a good day.

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**Operator**

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

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