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## LECO.OQ - Q4 2021 Lincoln Electric Holdings Inc Earnings Call

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**OVERVIEW:**

LECO reported 2021 sales of $3.2b and adjusted diluted EPS (excluding special items) of $6.22. 4Q21 diluted EPS was $1.25 and adjusted diluted EPS (excluding special items) was $1.61. Also, anticipates high single-digit to low double-digit percent organic sales growth in 2022.

## CORPORATE PARTICIPANTS

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

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

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

## CONFERENCE CALL PARTICIPANTS

**Bryan Francis Blair** *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

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

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## PRESENTATION

**Operator**

Greetings, and welcome to the Lincoln Electric Fourth Quarter and Full Year 2021 Financial Results Conference Call.

(Operator Instructions)

This call is being recorded. It is my pleasure to introduce your host, Amanda Butler, Vice President of Investor Relations and Communications. Thank you. You may begin.

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

Thank you, Kevin, and good morning, everyone. Welcome to Lincoln Electric's Fourth Quarter and Full Year 2021 Conference Call. We released our financial results earlier today, and you can find our release as an attachment to this call's slide presentation as well as on the Lincoln Electric website at lincolnelectric.com in the Investor Relations section.

Joining me on the call today is Chris Mapes, Lincoln's Chairman, President and Chief Executive Officer; and Gabe Bruno, our Chief Financial Officer. Chris will begin the discussion with an overview of our full year results and business trends, and Gabe will cover our fourth quarter financial performance in more detail. And finally, we will conclude with comments on our outlook and updates to our 2025 Higher Standard Strategy. And following our prepared remarks, we're happy to take your questions.

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

In addition, we discuss financial measures that do not conform to U.S. GAAP, and a reconciliation of non-GAAP measures to the most comparable GAAP measure is found in the financial tables in our earnings release, which again is available in the Investor Relations section of our website at lincolnelectric.com.

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

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

Thank you, Amanda. Good morning, everyone. Turning to Slide 3. We finished the year with a solid fourth quarter and achieved record sales, operating income, earnings and returns for full year 2021. Our results demonstrate the strength of our business and our team's perseverance and commitment to put our customers first, while still advancing our strategic initiatives, even under these unprecedented conditions. So I would like to thank our team as well as our suppliers and partners who tirelessly worked with us to help us serve our customers and generate record results.

Our 2021 sales increased 22% to a record $3.2 billion or 19% organic growth, led by higher volumes and 2% from acquisitions, reflecting a strong recovery in the early stages of an industrial expansion. We achieved a 240 basis point increase in our adjusted operating income margin to 14.8% with a 26% incremental margin reflecting solid commercial and operational execution across our business.

We achieved neutral price cost due to diligent price management, which offset unprecedented inflation and approximately $39 million in LIFO charges. We also benefited from structural cost savings and our Higher Standard Strategy operational initiatives. Our adjusted earnings per share increased 50% to a record $6.22, and we achieved record returns of 23.9%. Cash generation grew to $365 million and represented approximately 81% cash conversion, which is lower than our standard 100%-plus performance. This reflects our early decision in this pandemic to use our balance sheet to strategically elevate inventory levels to service customers' needs.

I am proud that we increased our dividend nearly 10% this year, making our 26th consecutive increase, which again reinforces our confidence in the business and cash flow generation through a cycle. Combined with $165 million in share repurchases, we returned approximately $286 million to shareholders this year. We also maintained a solid balance sheet profile, have approximately $729 million in liquidity and have no near-term debt maturities.

We enter 2022 with over 80 new product families, a higher vitality index of new products, a strong pipeline of additional product launches, new acquisitions to scale up, and are seeing strong quoting activity and record backlogs for both our equipment systems and our automation solutions. I believe Lincoln Electric is better positioned today than ever before to capture growth and accelerate our performance in this industrial cycle.

Looking at end market trending in the fourth quarter on Slide 4. We achieved organic sales growth across all of our end markets despite challenging operating conditions for our customers. Our end sector organic sales growth was led by a strong mid-30% increase in construction infrastructure, which reflects the strength of nonresidential pre-engineered building projects and our competitive advantage in that market with our unique solutions. Where we see the most opportunity for resurgence is in the automotive sector and in general industries, which faced the tightest supply and labor challenges as well as in energy, which is still in the early stages of recovery.

We achieved solid organic sales growth across all product areas, led by broad end sector demand for our equipment and automation solutions. While consumable volumes grew in the quarter, we anticipate performance will increase as customers' operating conditions improve and we navigate past challenging first quarter comparisons, which represented strong consumable demand last year prior to weakening supply chain conditions.

Geographically, North America and European organic growth outpaced Asia Pacific due to slow industrial output in China. Despite this pocket of weakness, the underlying fundamentals of our end markets are strong with customers expressing needs for added capacity to address high demand for their products, record backlogs and low inventory levels. Paired with long-term demand drivers, including skilled labor shortages, reshoring, EV investments, aging fleets, infrastructure, maintenance and repair and renewable energy, Lincoln is well positioned to serve customers' needs.

And now I'll pass the call to Gabe to cover fourth quarter financials in more detail.

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

Thank you, Chris. Moving to Slide 5. Our consolidated fourth quarter sales increased approximately 22% driven by 13% higher prices, a 6% increase in volumes, a 5% contribution from acquisitions, which was partially offset by a 2% unfavorable impact from foreign exchange. Our gross profit margin decreased 70 basis points to 32.3% as additional pricing actions and the benefit of volumes and cost reduction actions did not fully mitigate a $14 million LIFO charge. For the full year, we achieved neutral price cost as diligent price management offset broad inflation and approximately $39 million in LIFO charges.

Our SG&A expense increased approximately 11% or $14 million to $151 million in the quarter, primarily due to higher wages and incentive compensation as well as acquisitions. SG&A as a percent of sales decreased 180 basis points to 17.9% due to higher sales. Reported operating income increased approximately 44% to $120 million or 14.3% of sales. Operating income included approximately $2 million of special items. Excluding special items, adjusted operating income increased 32% to $122 million or 14.5% of sales with an approximate 20% incremental margin, reflecting a challenging prior year comparison. We incurred a $43 million expense in other income substantially related to a $46 million noncash settlement charge associated with the termination of a frozen U.S. defined benefit pension plan. This plan is fully terminated, and excess funds will be allocated towards another employee retirement plan over the next several years.

Our fourth quarter adjusted effective tax rate was 19.7% due to our mix of earnings and discrete items. Fourth quarter diluted earnings per share increased 16% to $1.25. Excluding special items, adjusted diluted earnings per share increased approximately 30% to a record $1.61 in the quarter. Foreign exchange had an unfavorable $0.04 impact to EPS.

Now moving to our reportable segments on Slide 6. Americas Welding segment's fourth quarter adjusted EBIT increased 21% to approximately $84 million. The adjusted EBIT margin compressed 30 basis points to 16.4% as the benefits of higher volumes and price, did not fully offset a $14 million LIFO charge. Americas Welding organic sales increased approximately 24%, led by 9% higher volumes and a 15% benefit from pricing actions. Organic sales increased across all product areas and end markets in the quarter, led by an acceleration in infrastructure construction and mid-teens percent growth in heavy industry and energy.

Moving to Slide 7. The International Welding segment's adjusted EBIT nearly doubled to $28 million. The adjusted EBIT margin increased 430 basis points to 11.2% on the benefits of structural cost saving initiatives and price cost management. Organic sales increased approximately 13%, reflecting continued price management to mitigate inflation. Volume performance reflected lower industrial production in China. Across the International Welding segment, equipment volumes improved at a double-digit percent rate. The segment also benefited approximately 8% from the Zeman acquisition. The segment incurred a negative 7% impact from unfavorable foreign exchange, predominantly as a result of the devaluation of the Turkish lira.

Moving to the Harris Products Group on Slide 8. Fourth quarter adjusted EBIT increased approximately 16% to $16 million. Adjusted EBIT margin decreased 130 basis points to 12.9% on acquisition integration costs and less favorable mix. We expect margin performance to improve through 2022. Organic sales increased approximately 12%, led by pricing actions to mitigate raw material costs. Volumes increased 5% on strength in the HVAC and industrial end markets, which offset lower retail sales due to challenging prior year comparisons in that channel.

Moving to Slide 9. We generated $110 million in cash flows from operations and achieved 98% cash conversion. At year-end, average operating working capital was 16.3% of sales, and remains intentionally elevated to support product availability and mitigate supply chain issues. We expect to maintain this posture through the first half of 2022.

Moving to Slide 10. As Chris mentioned, we finished the year having strengthened our balance sheet and liquidity position. In the quarter, we invested approximately $16 million in capital expenditures and returned approximately $91 million to shareholders through a combination of our dividend program and $61 million in share repurchases. On a full year basis, we invested $219 million towards growth and returned $286 million to shareholders, including $165 million in share repurchases. We maintained ample liquidity at year-end with $729 million. With no near-term debt maturities and strong cash flows, we will continue to prioritize growth investments and return cash to shareholders.

Looking ahead to 2022. We anticipate navigating through another dynamic operating environment with continued strong demand momentum, which we have seen quarter-to-date. Given what we see today, we anticipate a high single-digit to low double-digit percent organic growth rate in 2022. Our organic growth assumption does not include incremental pricing actions, and we expect a price tailwind in 2022, which will be higher in the first half as prior pricing actions anniversary. We will continue to target a neutral price cost position for full year 2022.

Our revenue assumptions are centered on organic sales as we expect the approximate $50 million of incremental sales from acquisitions to be offset by unfavorable foreign exchange at current rates. In this environment, we are expecting a low to mid-20% incremental operating income margin for the full year as organic sales growth, lower LIFO charges and incremental structural cost savings will offset inflation and higher employee costs.

The full year 2022 effective tax rate is expected to be in the low 20% range. We anticipate continued strong cash flow generation from sales and from improved working capital in the second half of the year. We are planning to invest $70 million to $80 million in capital expenditures in 2022 on growth and efficiency-oriented projects, which suggests an approximate 90% cash conversion rate for the full year. So while operating conditions are not ideal, we will continue to effectively navigate and manage the business through this part of the cycle and focus on serving our customers, operating safely and investing in our long-term strategic initiatives while driving improved sales, profitability and earnings throughout the year.

And now, I'd like to turn the call back over to Chris to discuss our 2025 Higher Standard Strategy.

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

Thanks, Gabe. Yes, 2021 was really just an exceptional year for the company. I'm really proud of all of our employees. And given our team's execution of our strategic initiatives and the solid demand momentum we see across our end markets, we've revisited our 2025 Higher Standard Strategy financial targets and have adjusted them up to reflect the superior value we believe we can generate through 2025.

As you can see on Slide 12, on the left side, our key focus areas have not changed. We are pivoting to higher levels of growth. Our strong product development pipeline, industry-leading position in automation, bold investments in new technologies like additive and a solid balance sheet to fund our active M&A program position us well for higher performance.

We now expect our top line reported sales growth rate from 2020 to 2025 to be in the high single-digit to low double-digit percentage range. We remain focused on richening the mix of our business, advancing operational excellence through continuous improvement projects, including initiatives that progress our safety and environmental 2025 goals and leveraging our Lincoln business system, which aligns the organization and generates greater efficiencies through standardized best practice tools and processes. We expect these initiatives, combined with volume growth, will increase our average operating income margin by over 200 basis points versus the last cycle, which was in the mid-13% range.

We are now targeting to achieve an average 16% operating income margin between 2020 and 2025. We've also provided adjusted EBIT margin ranges for our reportable segments, including a new target range for our International Welding segment of 12% to 14%, depending on where we are in the cycle. This improved performance is expected to yield a high teens to low 20% EPS growth rate from 2020 to 2025.

We will continue to maintain our top quartile ROIC and top decile working capital performance with the ROIC range positioned to accommodate additional M&A. We expect strong cash flow generation and remain committed to our balance sheet capital allocation strategy by pursuing growth investments, while returning cash to shareholders through our dividend program and opportunistically repurchasing shares above our maintenance buyback level.

I am confident that our team will successfully execute our Higher Standard 2025 strategic (sic) [Higher Standard 2025 Strategy] plan. The investments we've made in the business and the strength of our balance sheet position us well to deliver on our higher sales, profitability and earnings goals, generating superior value for all of our stakeholders.

And now I'd like to turn the call over for questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Our first question comes from Bryan Blair with Oppenheimer.

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**Bryan Francis Blair** - *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

So frame Lincoln's positioning and demand momentum entering 2022 a bit more. How much higher are backlog levels relative to 2018, '19 timeframe? And how are orders trending to start the year?

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

So Bryan, just to give you a sense, as you saw, we've got strong momentum as we ended the fourth quarter that continues into this first part of the year. Backlogs are very strong, primarily in the equipment and automation side of our business. So we're pretty confident in the demand profile within our business.

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**Bryan Francis Blair** - *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

Okay. Understood. To level set on the 2022 sales guide, what are you contemplating for volume versus price contribution to the high single to low double-digit organic growth?

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

When we participate in 2021, we ended up at about half volume and half price as it relates to the performance of the company. And I certainly think that as we're moving into '22 we'll probably have more price in the first half of the year than the back half of the year, really driven by two reasons, Bryan. The first is, obviously, some of that price is going to continue to anniversary as you're working through the year. But the second comment I would make is look at the accelerating costs that we covered in the fourth quarter, and you see a portion of that in that LIFO charge. So obviously, the actions that we had to take to cover those increased costs, you're going to see a larger portion of that in the first half of the year than the back half of the year. But we're confident in our thought process on the organics and the way we're thinking about 2022.

And probably, while I've still got you on the call that because the -- I think that earlier question you asked about the confidence and the demand profile is just critical. When you take where we're at from a backlog perspective and where we're seeing our industry segments and the favorable trending with energy turning in the back half of '21 and the fact that we continued to target closer towards our 2019 volume levels, which we're still under at Lincoln Electric, I think it sets us up very well for very strong volumes as we're moving through the year.

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**Bryan Francis Blair** - *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

That's very helpful color. And thinking a little more medium term, it would be great to hear any updated perspectives on infrastructure spending and related catalysts over the coming years? We know direct exposure nets to 15-plus percent of your sales. I'm actually more curious about indirect catalysts and in with the simple logic that plan spending is pretty steel-intensive. So perhaps there will be broader tailwinds across Americas Welding and in parts of HPG?

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

Yes. Look, it's very logical that we would see that move through the subsegments and certainly a lot of the general industries type businesses that we participate with. I mean, it's not hard to draw that analogy. If we're seeing more infrastructure and a portion of that infrastructure is going into the commercial side of the business, you've seen Lincoln Electric strength in that segment that's driven from our solutions as well as that demand. But that trickles through those industries. That leads to the plumbing applications that require utilization of the Harris solutions and Harris products that goes into the general fabrication markets.

So I agree with you. I think that seeing demand in those segments is a broader positive momentum for many of the customers and areas that Lincoln Electric serves today. I would also tell you that we continue to see just an enormous amount of activity in our automation businesses, which gives me confidence that you're seeing manufacturers in the U.S. market continue to want to dedicate capital to improving performance and profitability within their businesses. So our automation business improved in '21 over '20. I'm expecting very solid improvement in that business in '22. And again, I think it's a catalyst to the broader continuing positive industrial cycle we see here in North America.

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**Operator**

Our next question comes from Chris Dankert with Loop Capital.

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**Christopher M. Dankert** - *Loop Capital Markets LLC, Research Division - SVP*

Sorry, I had a bit of a connection issue. I guess, to kind of follow-up on that last comment you made about kind of the expectation for solid automation improvement. I guess, any further color on kind of what that contribution could be in '22 to growth? When do we get back to 2018 levels or is that a little bit too optimistic at this point in the cycle?

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

Yes. Look, I think that might be a little optimistic. And then the other challenge that I have in commenting on that Chris is that, as you've seen us continue to expand the solution offering that we have in our automation business and acquire companies into that portfolio like we did last year with the Austrian acquisition of Zeman. That portfolio is continuing to shape and grow. So I would tell you that when I think about that business, that business is still a business that we should be growing much faster than our core. We talk about it being 2x our core, I want to see that business get into solid double-digit margins for us in 2022 to get closer to where we're trying to drive that target. But we're well positioned in that space, and we had very strong momentum exiting '21 moving into '22.

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**Christopher M. Dankert** - *Loop Capital Markets LLC, Research Division - SVP*

Got it. That's very helpful. And then I guess on the updated kind of international margin target. Obviously, a very impressive level, not that we've seen even in the past decade. I guess, is getting to that new target in international, mostly about volume and kind of leveraging SG&A here or kind of what really helps you hit those new profitability goals in International specifically?

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

Well, look, our team has just done an amazing job in international to get to this first step. And we've always talked about it being a first step to get to double-digit margins. But there's no question when I think about that business, us continuing to drive our solutions into that region and further penetrating those segments that we have relationships within other areas of the world, which is volume driven is going to be a catalyst for us to reach those margin targets.

I'll also tell you the team there is still working on process performance opportunities that we have in the business where we think we can build an even better business just from a process perspective. Catalysts of those two, the volume, continued process improvements, we've got great confidence we'll make this next step-change in the business from an operating performance perspective.

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**Christopher M. Dankert** - *Loop Capital Markets LLC, Research Division - SVP*

Understood. And really, again, congrats to the whole team on a really strong '21.

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

Thank you.

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

Thanks, Chris.

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**Operator**

Our next question comes from Mig Dobre with Baird.

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

This question for Gabe. I heard that apparently there were $39 million worth the LIFO charges in '21. And I'm kind of curious, Gabe, as you're compensating '22 here in the operating plan. What sort of headwind from LIFO is baked into your assumptions? And if we continue to see lower steel prices, which we're body starting to see that, I'm curious as to what happens in the back half of the year, right? Does this sort of refer to the -- to where you're actually going to start seeing some LIFO benefit? Do you kind of become price cost positive? How do you think about that?

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

Yes. So not to give a lesson in LIFO, but just remember that LIFO is always anchored on the end of the year inventory position. And so we did see an acceleration in the fourth quarter on material costs. And with that price actions, and that's what -- that's how we ended with the price cost neutral. At the beginning of the year, we're projecting out based on what the current cost that we see within our business. So that's why I wanted to anchor our conversations around incremental margins. a lot of inflationary pressures.

We're anchored on a very disciplined price/cost neutral. We'll have some inflationary pressures on wages and other costs and we've got actions that are offsetting that. So I want to move our conversation towards more of a traditional view of incremental margins in the low to mid-20s because I think that's important. And that's on top of the step change that we made on the international side and the margin profile of our business. So we'll monitor, as you know, LIFO progressed throughout the year, but that's all baked into that incremental margin expectation.

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

Well, right. And I appreciate what you're saying here. But obviously, you have to make some assumptions right now vis-a-vis your input cost, right? And I'm sort of curious as to sort of how you're going about that. Are you using current sort of spot prices or are you having some sort of a forward outlook here baked into this guidance as well? Sorry to press you on this. I'm just trying to understand.

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

No, that's okay. That's a fair question. It's all based on what we currently see. Our assumptions for organic growth for the year. It's all based on pricing actions taken to date and it's all the profile of what we see in our business now. I don't project that where material costs will be at the end of the year or whatever pricing actions we'll take into play to respond to that. But it is all based on a full view of what we see today in our business.

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

Mig, this is Chris. It's interesting when we were discussing the performance of the company at the end of the Q3 results, we were talking about what our expectations were for LIFO and input costs. And quite frankly, our input costs continued to accelerate through the fourth quarter, and that's why you see that LIFO charge that was much greater than what we had expected in the fourth quarter.

So I think part of that discussion and the dynamic that Lincoln is managing. And I would say that I believe strongly, Lincoln's managed very well certainly in 2021 and confidence that we'll continue to be able to imagine in '22 is the dynamics around those material costs because I'm like you read that there's potentially some discussions around some steel products that might be beginning to mitigate from a cost perspective. We're just not seeing that in our business.

The products that we're buying as it shows from the LIFO charges that we had to take in the fourth quarter, we're still accelerating. So it is dynamic quite frankly, it could move materially throughout the year, but we just don't have the visibility to be able to provide you much more guidance on that at this point in 2022.

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

Totally fair, and I understand if you'll humor me for one more. Curious as to how you think about the international business here in terms of volume growth potential for '22? You talked about Asia being a little bit softer. How do you think that kind of plays out? And should we kind of think about this segment maybe having negative volume for the full year if China weakness continues?

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

Yes. Well, I'll tell you, Mig, our volume ex-China in the International business was actually very solid in the fourth quarter. So it had volume growth associated with it. I expect that business is going to continue to show very solid volume growth. So at this point in time, the real question as it relates to the entire segment is how quickly will we see things maybe improve in China.

China had a host of variables that were impacting it, everything from some supply chain challenges as well as supply chain challenges for customers, some COVID lockdowns prior to the Olympics as well as the operation of the Olympics within China. So we're certainly not thinking those will permeate through the year. That will really be the variable, but I will tell you, I fully expect there to be volume growth inside our European portions of the international business in 2022.

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**Operator**

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

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

I'm just going to follow-up on that last call and maybe -- or the question in a slightly different way. Just relative to that outlook for high single to low double-digit organic growth, can you talk about those assumptions, to include automation, maybe just rank the -- how you see growth across the portfolio?

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

Yes. So Steve, I would -- you mentioned automation. I would expect our -- considering our backlog and demand patterns that automation would be strong. we talked about double-digit type growth volumes for automation. So we continue to expect strength there. the equipment part of our business also to remain robust. And then as the factories of manufacturing generally accelerate, we should see similar consumable demand accelerates. But I would put it in that order, automation, equipment, consumables.

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

Yes. And Steve, you know our business well. I mean, think about it. Most of our backlog is quite frankly, in automation and in our equipment solutions, we have a mid- to high 90s percent on-time delivery ratio that we're achieving in our consumable products. We may not like the input costs that we're having to move to the marketplace. But we're serving those customers very, very well. So we've got that backlog there. Again, most of that backlog sitting in automation and equipment solutions, and I completely agree with Gabe. I believe that automation should be a real growth catalyst and our fastest grower as it relates to the portfolio in '22.

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

Right. And all of that comes out of North America, right?

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

A good bit of that portion. Yes, a good bit of that. But we track our backlogs on a global basis.

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

Okay. And Chris, you said pricing is probably stronger in the first half, which makes sense given the comps. Do you think you can see double-digit growth each quarter as the year progresses, or does that moderate into the back half just given those strong pricing comps and the strong activity in the back half of '21?

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

Yes, that's a really good question, Steve. I still would expect that we should. But at the end of the day, I think that we know that pricing is going to be stronger in the first half. And look, the achievement of that is critically important, which we've, I think, shown a great ability to manage that through the cycle. But I also want to continue to see that underlying volume growth inside the business. We've got a large demand for our solutions, and I want to make sure we're continuing to see volume growth inside the portfolio. But I'm confident in the business. I'm confident in our positioning. And quite frankly, I think we should see a very strong volume year for Lincoln Electric.

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

And Steve, maybe just to add, just keep in mind that in our assumptions, we did not incorporate any additional pricing actions, right?

**Operator**

Our next question comes from Nathan Jones with Stifel.

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

I wanted to ask a question on the electronics side. I know you guys make a layer on board, let your own -- and put together a lot of your electronics component. Do you think that's giving you an advantage at this point, or is the bottleneck there of supply of those components to construct those boards still completely impacting you?

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

Yes. Nathan, look, it's a great question. I would tell you, it's provided Lincoln Electric with a competitive advantage for quite some time. And the reason it provides us a competitive advantage is that by us being able to have controls of those processes, which we made that investment here in Cleveland. I know since I've been here with the company probably now maybe 8, 9 years ago, we made those investments so that we could control the product development and the innovation associated with power electronics and the utilization of the boards. It gives us better visibility into the supply chain side of those components.

So today, if you were someone who was in our industry and you were just buying boards from a third party, you probably don't have visibility back into that component supply. We have that visibility. So that visibility provided us the opportunity to see where some of those weaknesses were. And then we've talked often about in the cycle using our balance sheet to protect our business and serve customers. place customers first.

So we've gone out very early and made sure that we've got an allocation and purchase the components that we know we need for our business. So that vertical integration in that area has served us well and has been another catalyst in assisting us in mitigating some of the impacts we would have otherwise had in supply in our equipment portfolio.

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

And I wanted to ask a follow-up on the automation margins. I think you said looking to get those into double digits this year. I think the automation business is very high value add. Can you talk about the reasons that business is below corporate average? Is that just because there's a large amount of pass-through costs in the robot where you think those margins can get to over the long term?

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

Yes. Our expectation is that we'll get those margins to our corporate average. So we had some challenges within that business a couple of years ago. We made some changes. We put in some process improvements, and we've been driving volume and making improvements in that portion of the portfolio. I will tell you that depending on the tail of the automation project, there's times when you may have input costs that are rising during that window that are difficult for you to be able to recapture. But that's all a point in time type of a challenge that our teams are managing through.

We will -- we have been saying that those were migrating towards high single-digit. We expect those to be at or above double-digit operating margins, and we think about the company in '22. And our expectation will be to continue to make those improvements so that it is at our corporate average over the longer term.

**Operator**

(Operator Instructions)

Our next question comes from Dillon Cumming with Morgan Stanley.

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

Just to go back to your prepared remarks real quick. You guys called out reshoring, which is something we've been talking about I think qualitatively really since the start of COVID. But have those conversations really started to kind of crystallize for you here over the past few months and you're kind of expecting some actual tangible product activity over the next year? And I guess, kind of look related to that, is the greatest opportunity from reshoring for you guys still on the automation side or would you expect actually a broader uplift across your broader business?

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

Yes, that's a great question, Dillon. It's sometimes difficult for us to give you a data point associated with that, but I can share with you the context that we're having with our teams. And our automation teams are telling us that they're having a lot of conversations and some quoting activity with large firms that are talking about investing in automation to protect their supply chains, investing in automation to be able to enhance their ability to serve their demand needs or maybe they're seeing demand in the marketplace and they didn't have the capacities available. So they're expanding those capacities and are choosing to expand those capacities closer to the local demand markets. We're certainly seeing that in our Automation business.

And then the second piece does come down to reshoring but really gets lost inside of productivity. And what I mean by that is many of our customers are working with Lincoln Electric to drive higher productivity inside their manufacturing facilities to increase capacities to minimize some of the capacity requirements they might have in other areas of the world. And we're seeing a lot of that activity with our equipment solutions or our equipment and consumable solutions that we'd be providing into specific segments.

So it does trickle into many areas of our business. but I'm confident that we've had more reshoring discussions with our customers over the last 6, 12 months than we had prior.

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

Okay. Great. That's helpful color, Chris. And then maybe not significant in the quarter too much, just given that margins were down year-over-year in the Americas. I mean, you guys obviously have the LIFO charge in there, but to what extent was that also kind of a reflection of things like absenteeism premium freight and maybe some general manufacturing efficiencies. I would just be curious how much of those factors impacted the quarter? And if you guys can comment on January, even if it was kind of like on a (inaudible) something to what extent that is kind of spilling over into the first quarter as well?

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

Yes. First of all, I'll tell you, January has had a solid start -- saw a solid start to the business. Even though in certain markets, obviously, you still have a host of the issues that were a headwind for us in Q4. I mean challenges associated with Asia PAC and certainly here in the U.S. market, I think that there was some softness that was early in January when people were dealing, our customers were dealing with some of the Omicron challenges.

But I will tell you, Lincoln Electric's had a solid start. As it relates to the operating margins in the Americas business, I got to tell you, being able to manage through the challenges of Q4 and the additional input costs that we had to cover through the LIFO charges when you do your quick math and look at mitigating those LIFO charges and see what the margins were in that portfolio, you'll be very impressed.

So I'm very happy with the performance of our Americas business, and that business is still not at 2019 volume levels. And as I expect, we continue to make improvements in that business and see the volume come through the portfolio, we'll continue to get the leverage off of that and expand that margin profile.

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**Operator**

Our next question comes from Walter Liptak with Seaport Research.

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**Walter Scott Liptak** - *Seaport Research Partners - MD & Senior Industrials Analyst*

I wanted to do a follow-on on the automation and just a question about how big is automation in revenue now.

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

Yes. Well, our automation businesses in the aggregate are at a run rate of around $500 million globally.

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**Walter Scott Liptak** - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. Great. And the order activity backlog sounds like they're picking up. But I wonder which sectors are you seeing that in or is it across the board? Any color there?

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

We're seeing it across the board in a host of areas, and I've got very good visibility to that. We've got some internal tools where we can actually see on a daily and weekly basis where our quoting activities are coming in by segment and actually where we're seeing those quotes actually turn into orders for Lincoln Electric. We've seen some really nice order patterns in the electric vehicle marketplace and some individuals that are investing or retrofitting for that particular area. Real strength in the appliance marketplace with some of the solutions that we've been providing, some of our standard solutions have continued to gain traction.

So I would also tell you that the general industries marketplace continues to show good strength. And there's capital investment in Automotive outside of EV. So one of our goals has always been to make sure that we're penetrating these solutions across the industry segments that we participate in. we continue to show some really impressive wins in a multitude of those segments.

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**Walter Scott Liptak** - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. All right. And then part of that is auto and within welding, I think there's auto. I wonder if you could comment -- I know it's just happening, but like the trucker thing in Canada, if you think that's going to have a negative impact on some demand levels in the first quarter?

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

Yes. While we could talk about the trucker issue in Canada, we could talk about the Olympics, we could talk about whether there'd be another Omicron spike. I mean, look, those challenges are real and they exist. But at the end of the day, we've had a really solid start to January. I've got a lot of confidence in the business, and we're expecting to execute on our plans. So it's there. Could it raise to a level where it causes some concerns? Possibly, but we don't see those things raising to that level today, and we're going to manage and lead right through those challenges.

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**Walter Scott Liptak** - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. Great. And then maybe just a last one. Congratulations on the higher standard strategy and some of the goals out there. I wanted to understand a little bit more about the International margins that you're looking for. And I think you went into this a little bit, but I just missed it. But what do you have to do to get to the 12% to 14%? Is there more structuring or is it block and tackling at this point to get to 12 to 14?

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

Yes, there's really two points to that. And Walt really, the first piece is we do need to have volume in the business. We've made a lot of improvements in our asset base there and investments in our processes, both with capital investments and people investments in systems, and we moved the volume through there, we're going to see that operating leverage. So clearly, I'm thinking about volume being the first. But I'll also tell you that the team there continues to work on a host of Lincoln Business Systems improvements in the business that will generate positive tailwinds for us in the business. So we're not through positioning that business for where we want it to be longer term. But I think it's really those two components but we need to see some of that volume, we'll get the operating leverage off that business.

And I'm -- I love what that team has been able to accomplish. And I would hope that the accomplishments that we've made historically with the Harris business, now with the International business, the improvements we're making in automation should give our stakeholders confidence in our ability to execute on our long-term higher standard strategy targets that we put out because that's the type of work and execution that we need to be able to do that. I certainly have great confidence in our ability to execute on that as we're moving forward.

**Walter Scott Liptak** - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. As I look at the 12% to 14% number, I mean, it's a good number, but I wonder why you guys went with 12% to 14% and not with something higher (inaudible).

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

Yes. Well, I'll tell you -- no look, that's a very fair question. And -- but I would tell you that our methodology is that we need to make sure we're working with our teams around the world and that we can set targets that are achievable for them within a window where we can drive those programs. We can drive those initiatives. I mean I could have just as easily put on the slide for you today that we want to get them to the target over time because we do want to get them to the target over time. But we need to be able to provide our employees with a path to be able to achieve those targets, and that's why we set them up in phases. And that has worked very well for Lincoln Electric as we've made improvements to this portfolio over the last several years.

**Operator**

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

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

Gabe, when you think about MerPay, normal inflation and whatever other cost inputs you have to SG&A, how much leverage do you expect to run on, say, 10% sales growth in 2022?

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

I'd go back to those incremental margin assumptions there, Steve. So still within that low to mid-20s type view. We are going to see a little bit more higher inflation on the wage side. We expect that as you're tracking across the industrial base. But that's all baked into our assumptions.

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

Yes. I guess I was trying to get a sense for how you saw gross margin versus SG&A margin evolving through the year.

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

Yes. I mean, I'll give you one split on that is that we are very measured in introducing or restoring some level of discretionary spending, and we'll be very disciplined with that in alignment with real volumes. So we're very much on top of how we look at the mix of our cost drivers within our business.

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

Got you. And Chris, relative to the suite of the 70 or so many new products you introduced in '21, can you talk about growth rates for that cohort relative to legacy products or how that's played out in the past?

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

Yes. Look, we would tell you that it depends a little bit on the solution and the segment that we're targeting. As you would expect, Steve, that some of the solutions might be going into a segment that has a longer time frame for us to be able to get that into the industry, get it into the large players in the industry and then start to see that growth.

And then quite frankly, some of our products in the commercial space, we may see an increase from a run rate perspective instantaneously because they get that on the shelves, it's going through the channel, it's there very quickly, and we see that step up very fast. So I always think about our business in that way and think that you know what, when we're driving those new products in the aggregate, we ought to be 100 to 150 basis points above where we're trending normally, but it is different depending upon the solution and the segment that we're moving it into.

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

Understood. And last one, what's the typical time from drawing board to production? And I'm really trying to get a sense for how you see new product launches in 2022, how your visibility is there?

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

Yes. So look, our visibility is good, and it's good in that we've got a detailed process inside the business where we're looking at all of those, but I can tell you that some of those, which where we might be doing software enhancements to provide much more functionality in some of our businesses, might be something we could get more quickly. And some of them are very innovative that quite frankly, we expect them to take 12 months to 36 months to actually be able to execute on that particular strategy. So it does go back to -- it does go back to being very dependent on the individual solution.

I will share with you, Steve, that I had an operating review yesterday with our additive business, and we haven't talked much about our additive business. It's still very much incubating. It's very, very small piece inside the company. But in our additive business, we had an opportunity to work with a customer and that particular customer, we took a CAD file and developed a new product for them that they needed for their operations apart, and it was done in days.

And look, that's the type of innovation that I think long term can be a catalyst for the company, but it goes back to your point on how quick can innovation move inside the company and what's that rate of innovation. And look, I think that, that 100 to 150 basis points above our core is probably a good number.

**Operator**

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

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

Thank you, Kevin. I would like to thank everyone for joining us on the call today and for your continued interest in Lincoln Electric. We look forward to discussing the progression of our higher standard 2025 strategic initiatives in the future. Thank you very much.

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**Operator**

Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.

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