

LINCOLN ELECTRIC HOLDINGS INC

Form 10-Q

October 29, 2007

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 0-1402

LINCOLN ELECTRIC HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Ohio

34-1860551

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

22801 St. Clair Avenue, Cleveland, Ohio

44117

(Address of principal executive offices)

(Zip Code)

(216) 481-8100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of the registrant's common shares as of September 30, 2007 was 43,119,057.

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LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Net sales	\$ 564,824	\$ 495,137	\$ 1,700,505	\$ 1,466,041
Cost of goods sold	405,083	353,800	1,213,880	1,048,171
Gross profit	159,741	141,337	486,625	417,870
Selling, general & administrative expenses	92,140	81,019	274,977	241,126
Rationalization charges		665	396	3,006
Operating income	67,601	59,653	211,252	173,738
Other income (expense):				
Interest income	2,290	1,607	5,439	4,201
Equity earnings in affiliates	2,263	2,450	7,418	4,974
Other income	819	436	1,863	985
Interest expense	(2,866)	(2,504)	(8,379)	(7,343)
Total other income	2,506	1,989	6,341	2,817
Income before income taxes	70,107	61,642	217,593	176,555
Income taxes	20,129	17,787	64,366	53,332
Net income	\$ 49,978	\$ 43,855	\$ 153,227	\$ 123,223
Per share amounts:				
Basic earnings per share	\$ 1.16	\$ 1.03	\$ 3.57	\$ 2.90
Diluted earnings per share	\$ 1.15	\$ 1.02	\$ 3.53	\$ 2.87
Cash dividends declared per share	\$ 0.22	\$ 0.19	\$ 0.66	\$ 0.57

See notes to these consolidated financial statements.

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LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
(In thousands)

	September 30, 2007 (UNAUDITED)	December 31, 2006 (NOTE A)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 223,220	\$ 120,212
Accounts receivable (less allowance for doubtful accounts of \$7,799 in 2007; \$8,484 in 2006)	353,316	298,993
Inventories		
Raw materials	97,446	106,725
Work-in-process	50,028	50,736
Finished goods	208,503	193,683
	355,977	351,144
Deferred income taxes	14,243	5,534
Other current assets	51,111	53,527
TOTAL CURRENT ASSETS	997,867	829,410
PROPERTY, PLANT AND EQUIPMENT		
Land	40,843	34,811
Buildings	249,731	230,390
Machinery and equipment	613,391	574,133
	903,965	839,334
Less accumulated depreciation and amortization	483,402	449,816
	420,563	389,518
OTHER ASSETS		
Prepaid pension costs	28,823	16,773
Equity investments in affiliates	56,571	48,962
Intangibles, net	44,479	41,504
Goodwill	37,796	35,208
Long-term investments	29,874	28,886
Other	10,459	4,318
	208,002	175,651
TOTAL ASSETS	\$ 1,626,432	\$ 1,394,579

See notes to these consolidated financial statements.

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LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	September 30, 2007 (UNAUDITED)	December 31, 2006 (NOTE A)
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Amounts due banks	\$ 11,272	\$ 6,214
Trade accounts payable	140,203	142,264
Accrued employee compensation and benefits	109,430	45,059
Accrued expenses	24,313	24,652
Accrued taxes, including income taxes	23,416	35,500
Accrued pensions	1,333	1,483
Dividends payable	9,473	9,403
Other current liabilities	36,389	32,793
Current portion of long-term debt	781	40,920
TOTAL CURRENT LIABILITIES	356,610	338,288
Long-term debt, less current portion	114,586	113,965
Accrued pensions	34,179	33,417
Deferred income taxes	22,125	27,061
Accrued taxes, non-current	34,504	
Other long-term liabilities	30,909	28,872
SHAREHOLDERS EQUITY		
Preferred shares, without par value at stated capital amount; authorized 5,000,000 shares; issued and outstanding none		
Common shares, without par value at stated capital amount; authorized 120,000,000 shares; issued 49,290,717 shares in 2007 and in 2006; outstanding 43,119,057 shares in 2007 and 42,806,429 shares in 2006	4,929	4,929
Additional paid-in capital	146,606	137,315
Retained earnings	1,029,331	906,074
Accumulated other comprehensive loss	(12,802)	(54,653)
Treasury shares, at cost - 6,171,660 shares in 2007 and 6,484,288 shares in 2006	(134,545)	(140,689)
TOTAL SHAREHOLDERS EQUITY	1,033,519	852,976
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 1,626,432	\$ 1,394,579

See notes to these consolidated financial statements.

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LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(In thousands)

	Nine Months Ended September	
	30,	
	2007	2006
OPERATING ACTIVITIES		
Net income	\$ 153,227	\$ 123,223
Adjustments to reconcile net income to net cash provided by operating activities:		
Rationalization charges	396	3,006
Depreciation and amortization	39,096	35,817
Equity earnings of affiliates, net	(5,531)	(3,541)
Deferred income taxes	(12,438)	2,462
Stock-based compensation	3,275	3,038
Amortization of terminated interest rate swaps	(880)	(1,584)
Other non-cash items, net	(233)	1,835
Changes in operating assets and liabilities net of effects from acquisitions:		
(Increase) in accounts receivable	(35,185)	(48,422)
Decrease (increase) in inventories	17,841	(54,982)
Decrease (increase) in other current assets	4,570	(6,139)
(Decrease) increase in accounts payable	(13,332)	6,843
Increase in other current liabilities	65,102	54,495
Contributions to pension plans	(12,292)	(19,656)
Increase in accrued pensions	915	12,395
Net change in other long-term assets and liabilities	(424)	(3,699)
NET CASH PROVIDED BY OPERATING ACTIVITIES	204,107	105,091
INVESTING ACTIVITIES		
Capital expenditures	(45,777)	(53,318)
Acquisition of businesses, net of cash acquired	(6,102)	(502)
Proceeds from sale of property, plant and equipment	607	859
NET CASH USED BY INVESTING ACTIVITIES	(51,272)	(52,961)
FINANCING ACTIVITIES		
Proceeds from short-term borrowings	4,529	2,035
Payments on short-term borrowings	(1,004)	(1,058)
Amounts due banks, net	(505)	(4,499)
Payments on long-term borrowings	(40,459)	(1,561)
Proceeds from exercise of stock options	7,589	10,282
Tax benefit from exercise of stock options	5,001	3,847
Purchase of treasury shares		(126)
Cash dividends paid to shareholders	(28,271)	(24,178)
NET CASH USED BY FINANCING ACTIVITIES	(53,120)	(15,258)

Effect of exchange rate changes on cash and cash equivalents	3,293	1,032
INCREASE IN CASH AND CASH EQUIVALENTS	103,008	37,904
Cash and cash equivalents at beginning of period	120,212	108,007
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 223,220	\$ 145,911

See notes to these consolidated financial statements.

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LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(In thousands, except share and per share data)

September 30, 2007

NOTE A BASIS OF PRESENTATION

As used in this report, the term *Company*, except as otherwise indicated by the context, means Lincoln Electric Holdings, Inc., its wholly-owned and majority-owned subsidiaries and all non-majority owned entities for which it has a controlling interest. The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (*GAAP*) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these consolidated financial statements do not include all of the information and notes required by GAAP for complete financial statements. However, in the opinion of management, these consolidated financial statements contain all the adjustments (consisting of normal recurring accruals) considered necessary to present fairly the financial position, results of operations and changes in cash flows for the interim periods. Operating results for the nine months ended September 30, 2007 are not necessarily indicative of the results to be expected for the year ending December 31, 2007. The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date, but does not include all of the information and notes required by GAAP for complete financial statements. For further information, refer to the consolidated financial statements and notes thereto included in the *Company*'s Annual Report on Form 10-K for the year ended December 31, 2006.

Certain reclassifications have been made to the prior year financial statements to conform to current year classifications.

NOTE B STOCK-BASED COMPENSATION

On April 28, 2006, the shareholders of the *Company* approved the 2006 Equity and Performance Incentive Plan, as amended (*EPI Plan*), which replaces the 1998 Stock Plan, as amended and restated in May 2003. The *EPI Plan* provides for the granting of options, appreciation rights, restricted shares, restricted stock units and performance-based awards up to an aggregate of 3,000,000 of the *Company*'s common shares. In addition, on April 28, 2006, the shareholders of the *Company* approved the 2006 Stock Plan for Non-Employee Directors, as amended (*Director Plan*), which replaces the Stock Option Plan for Non-Employee Directors adopted in 2000. The *Director Plan* provides for the granting of options, restricted shares and restricted stock units up to an aggregate of 300,000 of the *Company*'s common shares.

There were 541 restricted shares granted and issued from treasury during the nine months ended September 30, 2007 and 6,230 options granted during the nine months ended September 30, 2006. The *Company* issued 312,087 and 423,439 shares of common stock from treasury upon exercise of employee stock options during the nine months ended September 30, 2007 and 2006, respectively. The *Company* issued 8,411 shares of common stock from authorized but unissued shares upon vesting of deferred shares during the nine months ended September 30, 2006.

In December 2004, the Financial Accounting Standards Board (*FASB*) issued Statement of Financial Accounting Standards No. (SFAS) 123 (Revised 2004), *Share-Based Payment*, which is a revision of SFAS 123, *Accounting for Stock-Based Compensation*. SFAS 123(R) supersedes Accounting Principles Board Opinion No. (APB) 25,

Accounting for Stock Issued to Employees. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. The *Company* adopted SFAS 123(R) on January 1, 2006 using the modified-prospective method. The adoption of the standard did not have a material impact on the *Company*'s financial statements.

Expense is recognized for all awards of stock-based compensation by allocating the aggregate grant date fair value over the vesting period. No expense is recognized for any stock options or restricted stock options or restricted or deferred shares ultimately forfeited because recipients fail to meet vesting requirements. Total stock-based compensation expense recognized in the consolidated statements of income for the three months ended September 30, 2007 and 2006 was \$1,046 and \$1,100, respectively. The related tax benefit for the three months ended September 30, 2007 and 2006 was \$400 and \$420, respectively. Stock-based compensation expense recognized for the nine months ended September 30, 2007 and 2006 was \$3,275 and \$3,038, respectively. The related tax benefit for the nine months

ended September 30, 2007 and 2006 was \$1,252 and \$1,161, respectively.

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The Company performs an annual impairment test of goodwill in the fourth quarter of each year. Goodwill is tested for impairment using models developed by the Company which incorporate estimates of future cash flows, allocations of certain assets and cash flows among reporting units, future growth rates, established business valuation multiples, and management judgments regarding the applicable discount rates to value those estimated cash flows. In addition, goodwill is tested as necessary if changes in circumstances or the occurrence of events indicate potential impairment. There were no impairments of goodwill during the first nine months of 2007 and 2006. Goodwill totaled \$37,796 and \$35,208 at September 30, 2007 and December 31, 2006, respectively. Goodwill by segment at September 30, 2007 was \$13,308 for North America, \$11,899 for Europe and \$12,589 for Other Countries.

Gross intangible assets other than goodwill as of September 30, 2007 and December 31, 2006 were \$63,071 and \$58,346, respectively, and related accumulated amortization was \$18,592 and \$16,842, respectively. Aggregate amortization expense was \$1,573 and \$1,568 for the nine months ended September 30, 2007 and 2006, respectively. Gross intangible assets other than goodwill with indefinite lives totaled \$13,521 at September 30, 2007 and \$12,585 at December 31, 2006.

NOTE D EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Numerator:				
Net income	\$ 49,978	\$ 43,855	\$ 153,227	\$ 123,223
Denominator:				
Basic weighted average shares outstanding	42,969	42,608	42,875	42,468
Effect of dilutive securities — Stock options and awards	498	511	498	492
Diluted weighted average shares outstanding	43,467	43,119	43,373	42,960
Basic earnings per share	\$ 1.16	\$ 1.03	\$ 3.57	\$ 2.90
Diluted earnings per share	\$ 1.15	\$ 1.02	\$ 3.53	\$ 2.87

NOTE E COMPREHENSIVE INCOME

The components of comprehensive income are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	\$ 49,978	\$ 43,855	\$ 153,227	\$ 123,223
Other comprehensive income:				
Unrealized (loss) gain on derivatives designated and qualified as cash flow hedges, net of tax	(592)	177	(3,045)	830
Currency translation adjustment	22,250	1,069	42,640	14,830
Amortization of defined benefit plan prior service costs and actuarial losses, net of tax	601		2,256	
Total comprehensive income	\$ 72,237	\$ 45,101	\$ 195,078	\$ 138,883

NOTE F INVENTORY VALUATION

Inventories are valued at the lower of cost or market. For most domestic inventories, cost is determined principally by the last-in, first-out (LIFO) method, and for non-U.S. inventories, cost is determined by the first-in, first-out (FIFO) method. The

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valuation of LIFO inventories is made at the end of each year based on inventory levels. Accordingly, interim LIFO calculations, by necessity, are based on estimates of expected year-end inventory levels and costs and are subject to final year-end LIFO inventory calculations. The excess of current cost over LIFO cost amounted to \$74,830 at September 30, 2007 and \$68,985 at December 31, 2006.

NOTE G ACCRUED EMPLOYEE COMPENSATION AND BENEFITS

Accrued employee compensation and benefits at September 30, 2007 and 2006 include accruals for year-end bonuses and related payroll taxes of \$77,307 and \$66,956, respectively, related to Lincoln employees worldwide. The payment of bonuses is discretionary and is subject to approval by the Board of Directors. A majority of annual bonuses are paid in December resulting in an increasing bonus accrual during the Company's fiscal year. The increase in the accrual from September 30, 2006 to September 30, 2007 is due to the increase in profitability of the Company.

NOTE H SEGMENT INFORMATION

The Company's primary business is the design, manufacture and sale, in the U.S. and international markets, of arc, cutting and other welding, brazing and soldering products. The Company manages its operations by geographic location and has two reportable segments, North America and Europe, and combines all other operating segments as Other Countries. Other Countries includes results of operations for the Company's businesses in Argentina, Australia, Brazil, Colombia, Indonesia, Mexico, People's Republic of China, Taiwan and Venezuela. Each operating segment is managed separately because each faces a distinct economic environment, a different customer base and a varying level of competition and market conditions. Segment performance and resource allocation is measured based on income before interest and income taxes. Financial information for the reportable segments is as follows:

	North America	Europe	Other Countries	Eliminations	Consolidated
<i>Three months ended September 30, 2007:</i>					
Net sales to unaffiliated customers	\$ 346,723	\$ 121,935	\$ 96,166	\$	\$ 564,824
Inter-segment sales	24,072	5,502	2,077	(31,651)	
Total	\$ 370,795	\$ 127,437	\$ 98,243	\$ (31,651)	\$ 564,824
Income before interest and income taxes	\$ 52,050	\$ 15,812	\$ 3,385	\$ (564)	\$ 70,683
Interest income					2,290
Interest expense					(2,866)
Income before income taxes					\$ 70,107
<i>Three months ended September 30, 2006:</i>					
Net sales to unaffiliated customers	\$ 330,387	\$ 89,482	\$ 75,268	\$	\$ 495,137
Inter-segment sales	22,392	5,501	3,773	(31,666)	
Total	\$ 352,779	\$ 94,983	\$ 79,041	\$ (31,666)	\$ 495,137
Income before interest and income taxes	\$ 46,541	\$ 10,723	\$ 7,516	\$ (2,241)	\$ 62,539
Interest income					1,607
Interest expense					(2,504)

Income before income taxes

\$ 61,642

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	North America	Europe	Other Countries	Eliminations	Consolidated
<i>Nine months ended September 30, 2007:</i>					
Net sales to unaffiliated customers	\$ 1,056,289	\$ 375,935	\$ 268,281	\$	\$ 1,700,505
Inter-segment sales	73,744	16,686	10,373	(100,803)	