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LECO.OQ - Q4 2020 Lincoln Electric Holdings Inc Earnings Call

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## OVERVIEW:

Co. reported 2020 adjusted EPS of \$4.15. 4Q20 reported operating income, including \$9.5m of rationalization charges, of \$83.4m and diluted EPS of \$1.08.

## CORPORATE PARTICIPANTS

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

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

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

## CONFERENCE CALL PARTICIPANTS

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

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

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

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

**Robert Cameron Wertheimer** *Melius Research LLC - Founding Partner, Director of Research & Research Analyst*

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

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

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

## PRESENTATION

### Operator

Greetings, and welcome to Lincoln Electric 2020 Fourth Quarter Financial Results Conference Call.

(Operator Instructions)

And 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, Michelle, and good morning, everyone. Welcome to Lincoln Electric's 2020 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; and Gabe Bruno, our Chief Financial Officer. Chris will begin the discussion with an overview of our annual sales results and business trends, and Gabe will cover our fourth quarter financial performance in more detail. Following our prepared remarks, we're happy to take your questions.

Before we start a discussion, though, please note that certain statements made during this call may be forward-looking, and actual results may differ materially from our expectation due to a number of risk factors. A discussion of some of the risks and uncertainties that may affect our results are provided in our press release and in our SEC filings on forms 10-K and 10-Q. In addition, we discuss financial measures that do not conform to U.S. GAAP. A reconciliation of non-GAAP measures to the most comparable GAAP measure is found in the financial tables in our earnings release, which again is available in the Investor Relations section of our website at [lincolnelectric.com](http://lincolnelectric.com).

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

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

Thank you, Amanda. Good morning, everyone. I'm pleased to report that we ended a challenging year with good recovery momentum and solid positioning for growth in 2021. At Lincoln Electric, we're guided by the golden rule, treating others as you would like to be treated. The challenges of 2020 exemplified how we live our values and lead our company. We remain committed to delivering for our customers as an essential business. We focused on supporting ONE another internally and executing on our higher standard 2025 strategy to drive long-term value for all of our stakeholders.

In 2020, I'm proud to report, we achieved record safety and environmental performance. We safeguarded wages, benefits and bonus programs to minimize the impact of COVID-19 on our employees. We amplified our community engagement and outreach. We were recognized for our initiatives and our culture, being named as a top global employer in 2020 and we're again named as one of the world's most ethical organizations by *ethisphere*.

Turning to Slide 4. Solid recovery momentum of an April trough resulted in a 12% decline in 2020 organic sales. By aggressively deploying our Lincoln cost savings playbook early in the year and executing on planned permanent cost reduction initiatives, we achieved \$88 million of cost saving benefits. These actions, combined with lower incentive compensation, largely offset the impact of lower sales. Our adjusted operating income margin compressed 50 basis points to 12.4% in 2020. Adjusted earnings per share declined approximately 12% to \$4.15, but represented our third highest earnings performance in our history. We achieved return on invested capital at 17.7% and strong cash flows from operations, free cash flow and 117% cash conversion. We also continued to return cash to shareholders in 2020 to \$113 million in share repurchases and the 25th consecutive increase in our dividend program.

Looking at demand trends in the fourth quarter on Slide 5. We achieved good sequential demand improvement in our 2 welding segments as end markets continue to recover in the fourth quarter. We saw ongoing recovery in all geographic regions and across most end sectors.

Geographically, Asia Pacific improved to a low single-digit percent decline; Europe improved to a low to mid single-digit percent decline; and North America declined narrowed to a high single-digit percent rate in the fourth quarter. Globally, Consumable and Equipment organic sales improved with Consumable demand exceeding Equipment for the first time in 2020. As expected, automation weakened to a mid-teens percent decline and was at or near trough levels as an acceleration in fourth quarter automation orders will translate to growth for that portfolio by mid-2021. We are encouraged by these trends and the opportunity to benefit from the resumption of capital spending.

Looking at end markets, approximately 50% of our fourth quarter sales were from growing end sectors, up from 45% in the third quarter. General industries and transportation automotive grew in the fourth quarter, and heavy industry sales declines narrowed as demand started to improve in that market. We would expect oil and gas, which is approximately 15% of sales to remain challenged through 2021.

Moving to Slide 6. Looking at January, I'm pleased to report that order rates have continued to improve across all segments, and we expect first quarter organic sales to be flat to modestly higher compared with prior year levels. While we remain cautious on conditions given customer supply chain risks and general COVID-19 uncertainties, current demand trends suggest high single-digit organic sales growth for 2021.

Our cost savings actions yielded \$28 million of benefits in the fourth quarter, and we exited the year with a \$12 million per quarter run rate in permanent cost savings. As conditions improve in 2021, we would expect temporary cost savings to ease as we service growth. We continue to expect incremental cost savings for full year 2021 of \$25 million to \$30 million, primarily from permanent cost actions, and these benefits will substantially occur in the first half of the year. We are seeing in 2021 from rising labor and raw material costs. We expect higher labor costs to be offset by the incremental cost savings. Pricing actions will mitigate raw material and freight inflation, and we anticipate achieving neutral to positive price costs for the full year.

We have already issued price increases globally and are preparing further pricing actions to address these inflationary pressures across our markets. Given our assumption for high single-digit percent organic growth, we expect our incremental margin will average in the mid- to high 20% range for full year 2021. While we expect to continue to operate the business through an uncertain COVID environment through much of 2021, we are encouraged by our growth prospects as markets rebound. We're confident in our strategy, the strength of our balance sheet and our team's ability to deliver sales, profit and earnings growth this year.

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 7. Our consolidated fourth quarter sales declined 5.8%, as a 2% benefit from price was offset by 7.6% lower volumes and 20 points of an unfavorable impact from foreign exchange. Our gross profit margin increased 30 basis points to 33% as benefits from cost reduction actions and price management offset lower volumes. Price/cost was positive in the quarter.

Our SG&A expense declined 8.7% or \$13 million, reflecting savings from cost reduction actions, which was partially offset by approximately \$3 million in higher incentive compensation. SG&A as a percent of sales decreased 60 basis points to 19.7%. We expect 2021 SG&A expense to increase due to higher wage and incentive compensation. Reported operating income increased 90 basis points to \$83.4 million or 12% of sales.

Operating income results included \$9.5 million of rationalization charges. Excluding special items, adjusted operating income (technical difficulty) increased 1.5%, a 100 basis point increase versus the prior year. Adjusted operating income benefited from \$28 million in cost savings. Our fourth quarter effective tax rate was 19.8% due to our mix of earnings and discrete items. This compares with 20.6% in the prior year period. We expect our full year 2021 effective tax rate to be in the low to mid-20% range, subject to the mix of earnings and anticipated extent of discrete tax items.

Fourth quarter diluted earnings per share increased 4.9% to \$1.08 compared with \$1.03 in the prior year. Excluding special items, adjusted diluted earnings per share increased 7.8% to \$1.24.

Now moving to our reportable segments on Slide 8. The Americas Welding segment's fourth quarter adjusted EBIT declined 7.7% to \$69.2 million. The adjusted EBIT margin increased 60 basis points to 16.7% from benefits of cost reduction actions and lower discretionary spending. Americas Welding organic sales declines narrowed to 11.2%, reflecting growth in general industries, relatively steady year-over-year demand in the transportation automotive industry and improving trends in heavy industries. Energy end markets remain challenged.

Moving to Slide 9. The International Welding segment's adjusted EBIT increased 31.7% to \$15.3 million. The adjusted EBIT margin increased 170 basis points to 6.9% on the benefits of cost reduction activities and lower discretionary spending. Organic sales decreased 2.9%, reflecting ongoing recovery in key European end sectors and modest growth in Asia Pacific, which was led by strong growth in China where we have a larger concentration in automotive and in heavy industry.

Moving to the Harris Product Group on Slide 10. Fourth quarter adjusted EBIT increased 25.4% to \$13.4 million. Adjusted EBIT margin increased 110 basis points to 14.2% due to strong growth in the retail channel, price management and cost reduction actions. Organic sales increased 18%, primarily from the continued strength in the North American retail channel and price increases due to rising commodity costs, and in particular, silver and copper.

Moving to Slide 11. We generated \$136 million in cash flows from operations, a fourth quarter record and a 152% cash conversion ratio from strong free cash flow. Working capital improved sequentially and remained intentionally elevated to support the recovery. We expect our working capital ratio to improve through 2021. We strengthened our liquidity position to \$737 million in the fourth quarter and maintained a strong investment-grade profile balance sheet with no near-term debt maturities.

Looking ahead to 2021, we expect strong cash flow generation and cash conversion in excess of 90%.

Moving to Slide 13. We pursued our disciplined capital allocation strategy. We invested \$22 million in capital spending and returned \$29 million to shareholders through our dividend program during the quarter. Looking ahead to 2021, given the strength of cash flows, we expect to prioritize our uses of cash on growth. Our capital spending is expected to be in the range of \$65 million to \$75 million, and we are maintaining an active M&A program that supports our higher standard 2025 strategy.

We also remain committed to returning cash to shareholders through our dividend program with a 4.1% higher payout rate and through share repurchases on an opportunistic basis.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Our first question comes from the line of Saree Boroditsky with Jefferies.

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

So you gave guidance of high single-digit growth in 2021. We appreciate that. But could you just help us understand how much of this is price versus volume? And is this guidance pretty similar across the segments? Or is there anywhere where you see higher or lower growth?

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

Yes. Saree, nice to speak to you today. Inherently, we are -- as Chris mentioned, we did announce some price increases. But at this point, we expect most of that high single-digit growth to come from volume increases. And as we progress through the year, as you know, we dropped in the second quarter. So we'll see more accelerated growth here during that time frame where we're anniversarying the impact of the pandemic. But that's the profile of where we see growth for this year.

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

So as you put in price -- additional price increases, will that be upside to your current guidance?

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

Yes. It would be.

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

Perfect. And then just one last thing on cash, you put out guidance for over 90% cash flow conversion in 2021. I know you're coming off a strong cash generation year, but you typically average closer to 100%. So is there any reason that you would expect to be less than that in 2021?

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

Yes, Saree, this is Chris. And look, I think the real challenge that we see with it is really twofold. First is it's not uncommon when we're migrating into this point in the cycle where we see this type of growth, that we're actually utilizing more cash to be able to support that growth within the business. And then the second element, which is really driving maybe a slightly more conservative model on cash as we look at 2021 is that these supply chain challenges that are out there in the marketplace. And we believe that those are going to exist for a considerable period of time. And because of that, we sent directions out to our operating units around the world to ensure that they're doing what they can to make sure our supply chain is resilient and that we have the parts and components and products that we need to drive our solutions to the marketplace, which probably will also increase some of our inventory levels throughout various times through the year.

And at this point in time, we just don't have great visibility. So as we've thought about our cash utilization for the year, really those are the 2 drivers, not uncommon for us to be slightly under the target at this point in the cycle and servicing growth. And then the challenges with the supply chain have made us even a little bit more conservative.

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

I just add on, Saree -- Saree, I was just going to add. We ended the year at 5 days, about 5 days more in inventory, and that's intentional. And as Chris mentioned, there's just so much uncertainty in dealing with the pandemic and also supply chain risk that we feel it's just wise to continue to maintain a higher level of inventories.

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**Operator**

And our next question comes from the line of Rob Wertheimer with Malius Research.

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**Robert Cameron Wertheimer** - *Melius Research LLC - Founding Partner, Director of Research & Research Analyst*

I know this is a tumultuous year, and you all managed through it very well. I wonder if you can speak to the underlying progress in International/Europe on whether you think you're gaining traction there on maybe market share dynamics or otherwise? Just how do you think that's come along and looks for the next couple of years? And maybe just to even broaden it out a bit, how much of the operating system that makes you guys so special is ported over to Europe and can be? And I'll stop there.

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

Yes. Look, thanks for the question, Rob. I would say I'm just enormously proud of the progress that our teams have made in the international business and especially in the European business over the last 12 to 24 months. I think that because of the deliberate approach that we've taken there, we had already started to work on a host of structural cost improvements in that market and that was pre-pandemic. And then certainly, those cost improvements assisted us as we were moving throughout 2020 with the performance of the business. Now that team is still very focused on driving double-digit operating profit levels of performance, and we've said for a while that, that was our target. And then once we set that target, we'd be talking to our shareholders about our next step as it relates to the higher standard 2025 strategy for that business. We've made good progress.

And as I think I've said on the call over the last few quarters, that progress has been made in many areas in the business. The most important focus for us has been in the customer service metric. And what are we doing to ensure that we have the solutions in the right place for our customers across that broad portfolio, across those markets. Even during the challenges of the supply chain with the pandemic, our customer service metrics in both our consumables and equipment portfolio stayed very resilient. And we want to make sure that, that market knows that we're there for them as their supplier of choice.

To your question is, are we starting to regain share in the market? I believe for a long time that share doesn't shift quickly. It's something that you need to go capture and then you need to be able to hold on to, and that will show up over a longer set of quarters as it relates to our international business. But I'm confident that they're performing well and that we're on the right path with improvements in international.

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**Operator**

And our next question comes from the line of Nathan Jones with Stifel.

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

Just wanted to follow-up on the price cost equation here. Speaking back to 2018. And if I recall correctly, there was a lag between pricing getting through and costs going up and some short-term margin pressure there. Is that something that you maybe expect to see over the next quarter or 2? Or have there been more proactive price increases taken this time than they were last time? And if there's anything that's changing your pricing model that allows you to gain that pricing more quickly now than you did a few years ago?

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

Well, Nathan, we've been very good historically at managing price cost. But I agree with your assessment that, quite frankly, many times, there has been a lag by a quarter or 2 in that recovery. And I would share with you that I believe that the risks associated with that are pretty significant as we think about the business moving into 2021. And it's not so much about the cycle that we saw in 2018, but I'll take you a little further back to maybe the cycle that many of us managed through in the early 2000s and 2004, where we see rapid escalation in raw material costs, freight costs, packaging costs, and it's really coming in from a host of areas within the business. And it's really probably going to be one of those cyclical environments that might require multiple activities from a commercial perspective to address that, which also then creates more challenges associated with lag.

But look, I've got great confidence in our team and our ability to understand those issues and the ability for us to ensure we get recovery and that we perform in that cost price analysis. But I do think as it relates to the lag, there will be some challenges that we'll be working through throughout the year.

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

Fair enough. And then my follow-up question on the automation business. You guys have been pretty clear that the second half of 2020 was going to be challenged just based on order patterns earlier in the year, talking about increased orders now to drive growth beginning in the middle of 2021. Can you talk a little bit more about the velocity of things moving through the automation pipeline? And any impact that you would expect that to have that -- that lower automation revenue had on margins in the fourth quarter, please?

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

Well, it certainly was a drag on our margins in the fourth quarter in our Americas business. But I would tell you that as I think about the order improvements we saw in the fourth quarter, it was a solid quarter for our automation business in orders. I'd like to see us begin to continue to replicate that as we're migrating into early 2021. I do think that the further removed we are from the economic disruption of Q2 with the pandemic, where many people saw a significant drop in their business results and probably many people made decisions around conserving capital, that the further we are removed from that. And as we begin to see what, I believe, Lincoln Electric will see with the organic growth driving back into the industrial markets. And that automation business for Lincoln Electric is very central to the North American market that we'll begin to see more capital spend and really believe that, that business has troughed out in the back half of the year and in Q4 and like the order results that we had in Q4.

So I think positive signs as we had expected with the business. And now we just need to see some continuance of that activity and that order activity as we're migrating into the early parts of 2021. But a lot of positive signals.

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

Could you share the order growth in automation in fourth quarter?

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

I'll just comment, Nathan. So it was a step change to the positive. Choppy, though, you still have activity that's choppy, but I would just expect that we'll see contributions to revenues by mid part of 2021. We have a lag in our automation business of between 3 to 6 months, but we're pretty optimistic on what we see.

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**Operator**

And our next question comes from the line of Chris Dankert with Longbow Research.

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

Kind of sticking on automation. Curious, is there any -- when you look at the order book and kind of what's percolating now, are there any opportunities or orders outside of automotive? I mean, have we seen heavy industry come back to the table? Are there other opportunities to kind of chase down? Or is it really still very automotive-centric here?

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

Chris, I think that's really going to be one of the interesting dynamics associated that comes out of the pandemic. I really think the pandemic is going to challenge many industries, maybe beyond the concentration that we've traditionally seen in automotive to really start to expand into the automation field because the challenges associated with keeping employees safe, the challenges associated with supply chains, which have been just exacerbated with the pandemic impact all industries.

And I will tell you that our order book improvement in Q4 was not automotive-centric relative to increases that we had. A matter of fact, a couple of the very large projects that we have were non-automotive. So we are seeing that divergence from just seeing more of that activity around automotive. Automotive is still strong for us. I don't want to imply that there's not automotive in the book, there is. But quite frankly, we're continuing to see that. And I believe as we see improvements in the heavy industry market that, that general industry's piece will continue to climb as we move through 2021 and 2022 also. Those particular industries have always been prevalent in automation, and I think that they'll start to recover as they make improvements in their CapEx spending moving in the early part of the cycle.

But again, I think the pandemic and the disruption of the pandemic is only going to amplify the utilization of automation across the broad industrial segment space and probably over the longer term, minimize the concentration that businesses see today around automotive and automation.

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

Got it. And thanks so much for the -- go ahead.

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

I was just going to say, Chris, maybe just to add to what Chris just said. If you remember that heavy industry cycle kind of peaked out in the early part of 2019. And we kind of went through the cycle throughout the year and then the pandemic hit, so that pullback on capital investment. But as you monitoring the markets, there's just more favorable expectations to progress in the heavy industries throughout 2021. When you look at ag, mining, construction. And so we're optimistic in the back half of the year more so on where heavy industries could turn. But still, we'll be comparing to kind of the low part of the cycle when you go back to 2019.



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

Got it. Got it. Thanks for the color. I mean it just sounds like that's a very interesting opportunity out there besides auto, so glad to hear you're on the same page. And I guess heading into the first quarter here, a lot of moving parts. Obviously, we've got the \$5 million, \$6 million from temporary costs rolling off from what you guys did in 2020, kind of offset by the permanent savings you've been executing on all throughout the year, I guess. Can you kind of level set us on what you were looking for in terms of SG&A cost into the first quarter? Do we kind of come back into that low mid-40 -- \$140 million range at this point?

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

Well, just, Chris, I think about it more broadly than that. When you look at our trends and the impact of structural changes, I mean, we're at that \$12 million run rate. And last year's first quarter, we didn't have any permanent cost savings in the first quarter. And then on the temporary side, we had disclosed 6. So we'll have last temporary savings in the first quarter, but and I'm really going to start migrating our conversations into incrementals. And so we should stay. We're still operating in the pandemic environment. So we'll continue to maintain a level of cost savings into the first quarter. But really, as we're looking to the full year, look at the incrementals as we've highlighted, that mid- to high 20s with some noise throughout the quarters with all the comparables being choppy compared to 2020's quarters.

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

Chris, just as a follow-up to that first question on automation. I mean, one of the advantages that Lincoln Electric has with our balance sheet profile is look that automation business, not only am I happy to start to see that we believe we're migrating towards growth, but it's an area that we still want to invest in. And when we look at our higher standard 2025 strategy, that's a business that we want to continue to identify acquisitions, identify other growth markets for us to be able to continue to build out that business. So I think it can be a catalyst for us as we're moving through '21 and '22.

**Operator**

And our next question comes from the line of Mig Dobre with Baird.

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

I want to go back to your comments on pricing and the fact that the guidance doesn't seem to embed a whole lot of pricing upside. And frankly, I guess, I'm wondering why that is at this point, right? I mean it's pretty clear that raw materials are going up. Chris, you talked about the 2000 -- I mean, the 2000, you guys had fantastic pricing is high single-digit pricing. So I guess I'm wondering, is it simply a factor of conservatism and the way you're structuring the guidance? Or is there more uncertainty than normal in the way you're kind of thinking about your ability to push price?

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

Well, Mig, first, thanks for the question. Look, I can assure you, it's not any lack of confidence in our ability to drive recovery of cost pressures within our business. I think we've got a historical ability to show that our model is very effective at that recovery. Again, at times, there are some lags associated with it, but we're effective in being able to manage it.

As it relates probably more directly to your question, I would tell you that we're early in that cycle. As I mentioned in my comments, I'm beginning to feel like this is like those early 2000s, and we may see multiple challenges associated with commodity and other structural cost increases that have to be addressed in the business. And we're certainly at the early portion of that. We have had some of those cost increases hit us. We've started to address those in our markets globally. And as I said, having discussions about further activities. So confident that -- and confident that we believe

we'll be able to recover those costs over the duration of 2021. But certainly not at a level to provide any guidance or discussion around the effectivity of that other than the confidence that we believe we'll be able to cover that cost increase as we're managing the business in 2021.

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

Chris, but to clarify here maybe a bit. Is the competitive environment seems any different as far as you can assess it? Do you think your competitors are going to take a similar approach to you?

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

Look, I really have no idea. I have no concerns over our ability to execute on our strategy. From all of the information that I review out in the markets, everything from the steel market and public steel pricing and what we're seeing on ocean freight and air freight and the wage improvements, there will not be industrial companies that will be able to hide from the fact that there are inflationary pressures. So I'm not aware of there being any structural or dynamic changes in our markets from other times when we've had to address these issues.

And again, most importantly, great confidence in the Lincoln team and the Lincoln process and going out and being able to work with our customers and recover those costs in the business.

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

Understood. And then my follow-up maybe for you, Gabe. So out of the \$88 million of cost savings in 2020, you outlined here that about \$54 million were temporary. As we're looking at this slide though, you're only kind of calling out \$25 million of -- or rather \$27 million of labor cost headwinds. How should we think about the rest of those temporary cost savings reverting? Is that baked into the guidance somehow? Or is that something that happens down the line in further years?

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

Yes, Mig. So that's really -- we will be responsive to how we see markets rebound, right? So that's why we anchored an incremental conversation aligned with group growth. Temporary savings as we go into second, third quarters and the anniversary, and we'll see the dynamic of how we restore that, which will be dependent on our activity in the markets. So that's why we come back to an incremental conversation with the volatility quarter-by-quarter that we saw in 2020.

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

Okay. So on that, you have more control in terms of how those costs come back into the business and they're more volume-driven?

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

Yes, definitely.

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**Operator**

And our next question comes from the line of Dillon Cumming with Morgan Stanley.

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

I just wanted to start at a high level. Chris, you kind of alluded to the fact that you've seen several of these industrial cycles at this point. And I guess I just wanted to ask now that we're returning to an environment of year-over-year growth next year. How would you describe the breadth of kind of the recovery across your end market mix in this cycle versus other ones? And I guess I'm just looking at some of your comments in terms of energy being a bit weaker, construction that kind of saw a bit of a tone shift quarter-over-quarter. So I was wondering if you can talk about kind of how broad-based the recovery is that you're expecting in 2021?

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

Well, I think it's going to be broad. I mean, I think we're seeing -- I think when you hear from Lincoln Electric that we were talking about growth sequentially across all geographic regions and seeing a continued improvement across our segment base, that's a very positive statement. And as much as oil and gas -- we talk about oil and gas. Let's remember that oil and gas, as much as it's certainly not in a growing element of the business. We've seen stability in much of the marketplace. We've seen now oil stabilized out in the higher \$50 range per barrel. We've seen stability. There are some discussions around whether there'll be an increase in demand there as we start to see broader growth across the markets. So I wouldn't want to imply that, that market is compressing. It's just probably not migrating in the way that we would like to see it from a growth perspective.

I think you're going to see a real push in heavy industries. I think that we're at a point in the cycle for reinvestment in mining, in ag, in construction. We are not talking about in today about whether there will be an infrastructure package in the U.S., which would be yet another catalyst associated with potential growth.

But when I look at the business, I see geographic growth. I see multiple segments that are moving positively. I've seen 2 or 3 quarters of sequential improvement. Those are the dynamics that when I see those things lead me to confidently talk about the fact that it's a pretty broad base of growth verticals that should support our perspective on organic growth for 2021.

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

Okay. Great. That's helpful, Chris. and then maybe switching over to the balance sheet real quick. 2020, I think, represented the first year in a while since next several years that you hadn't kind of completed any M&A, which is certainly understandable. But I guess, in the context of some of the 2021 capital allocation priorities you laid out, it didn't look like M&A was kind of one of the top 3 priorities that you mentioned. So I guess and thinking about next year. Can you just talk a little bit about your willingness to maybe revisit M&A? Is that still going to be part of the strategy? And are you kind of seeing attractive opportunities out in the marketplace today?

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

Yes, Dillon, I would share with you that M&A is always at the top of our capital allocation strategy. So we obviously want to have the capital to invest within our business. We're very committed to our dividend for our shareholders. But before we get into capital allocation vehicles like share repurchases or other items, let me assure you, we are always looking for acquisitions. And our higher standard 2025 strategy specifically discusses our ability to execute on quality acquisitions that bring more solutions to our marketplace. And we're actively looking. We haven't slowed down any of that process even during the pandemic. But as you can imagine, that level of disruption has some individuals who might have thought that they were wanting to migrate forward and change their business by selling their business might have paused. But we're actively engaged with all of our businesses within Lincoln Electric and looking for those solutions and would love to execute on some acquisitions in 2021.

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**Operator**

And our next question comes from the line of Walter Liptak with Seaport Global.

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

I wanted to ask about just some of the recent trends in automation, as we turn the calendar, some capital budgets could be picking up. And I wonder what the orders for automation look like early in the year?

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

Yes. Well, we agree with you that what I read out there on the capital spending side, I believe we are going to see some improvements in capital spending in 2021. Again, the order trends were very favorable as they migrated into Q4, we've talked about that. We've seen broad consistent improvement across our demand portfolio as we're entering into 2021. We've not broken out any particular region or business as we're talking about that, just that we've continue to see improvements in those demand trends. But I believe all the catalysts for there continue to be investments in automation are there. Our business is well positioned and believe that we are starting to see and should start to see really a structural improvement in growth in that area of our business as we're moving into 2021.

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

Okay. All right. And kind of in a similar thought on the channel inventory. I wonder if we're starting to see the distributors build back some inventory? It sounds like you're building some safety stock in working capital. I wonder if you're starting to see that in the channel yet?

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

Yes, I can't necessarily point, Walt, that we're seeing it yet. I think there's still a lot of disruption in the supply chain. There could be pockets of it, but I can't say broadly that necessarily that has started to occur. But we made a strategic decision back in March of 2020 as we were starting to get more visibility into the challenges of COVID-19 and the pandemic. And globally, back in March, we told our teams to ensure that they made product if we had individuals and the components there to be able to make our products and increase our inventory levels. And I continue to support that strategy. I think that helped us minimize issues for our customers.

As Gabe said, yes, we're entering 2021 with a higher inventory per day level than what we have historically. But I think that's a good utilization of our balance sheet in the market right now. And as this demand moves back into the marketplace, and if there are challenges with the supply chains, Lincoln Electric will be in a better position to be able to execute on our strategy and service our customers.

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

Okay. Yes, it makes sense. I wanted to ask too about the share repurchase. And I may have missed this, but can you review with us the size of the authorization that you have for share repurchase?

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

We have total about 11.5 million of shares authorized. And we'll be in the market as we had sort of not suspended in terms of share repurchases, our maintenance level of spend is somewhere around \$50 million. And so that's part of our capital allocation strategy, and we'll remain disciplined with that.

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

Okay. Does that mean you'll be opportunistic? Or do you think you'll be in the market that this year will be a bigger year for buybacks?

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

Yes. Well, we're really not targeting a particular amount. And part of it has to go with an earlier question. I really want to make sure that we're looking at allocating our capital towards acquisitions. And as we are doing that, and hopefully, we're executing that in 2021, we can apply more of that capital towards that. We certainly will be back in the marketplace from a share repurchase perspective. I certainly would expect us to be at a minimum out there, making sure that we don't have dilution relative to the incentive compensation, utilization of shares. But we're not targeting a particular amount as it relates to our 2021 budget. Again, expecting and wanting to execute on more acquisitions and investments in the business as we're moving through the year.

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**Operator**

And our last question comes from the line of Steve Barger with KeyBanc Capital Markets.

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

Chris, appreciate the comments on general growth and specific international improvements. Just looking at margin there, it's been around 6% for quite a few years. So is the walk to double digit, a steady progression from here of, say, 100 basis points per year or more of a step function as volume picks up, to the point where you could get there in 2022, maybe?

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

Look, I think that -- I would say 2 things, Steve. One is I would point you back towards our Harris business. So when we were in front of our investors several years ago, we said we were going to make steady, consistent, structural improvements to that business to improve that margin profile. And that was more of a year-over-year improvement in the business, and we executed on that. And I think that business is a high-performing operation for us now in the Lincoln Electric portfolio.

As I think about our international business, I would tell you, in the short term, over the next 24 to 36 months, I'm actually looking for a little bit more of a step change because of some of the aggressive structural actions that we've taken in that business. But then I think what you'll see from us is then very quickly getting into a consistent -- I think about it as kind of an operational flywheel approach where, quite frankly, we're just making that business a little bit better every year. So it's almost a little bit of a hybrid approach. I do think we have a little step opportunity in the business over the next 24 to 36 months. But then I think you'll see us generating consistent improvement in that portfolio longer-term when we get it to our longer-term targets for the international business.

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

Got it. And part of the higher standard 2025 strategy is to expand differentiated solutions. When you think about that organically, is that primarily driving efficiency or output quality into existing products? Or does the R&D group have anything that's truly new or something that can get you into a new category?

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

I would tell you both, Steve. I think that there's an opportunity for you to enhance the solutions that are currently there as our customers continue to identify other ways that they're looking to make improvements in their fabrication technologies. But if you also just look very quickly even at the last year or 2 at Lincoln Electric, look, we brought some new solutions to the marketplace, whether that's our HyperFill product, which is new twin wire technology that really no one else in the world is operating or new pipe fab product that we brought to the marketplace. I could go down a list of new solutions that are there. And let's not forget, and it's in the very, very early innings.

But we're investing in that additive space for something that I believe can be important to the business, whether that's 2, 3 or 5 years out. So we've got an R&D strategy to not only enhance current technologies but identify new solutions as well as potential longer-term breakthrough solutions that might allow us to continue to migrate into other markets.

Look, as a very small side comment, one of the exciting things about our additive business, which is still very, very small inside of Lincoln Electric, very de minimis from a revenue basis. But quite frankly, recently, we've had some very interesting products and solutions that we've been delivering into the space market. A market that, quite frankly, we had very little visibility to over the last few years. Again, that's a really small piece of the business. But as it relates to your question, where we're trying to develop solutions and processes to enter into other spaces or other areas of markets.

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

That's really great detail. And then, well, I guess, as you transition back to growth in '21, are there any other takeaways you have from the automation and how that performed in the downturn anything you can do to mitigate cyclicalities there?

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

So I think there are some things Mike Whitehead, who runs that business for us is doing a really nice job of trying to leverage across that portfolio. So one of the things that we've seen is that, quite frankly, when we have large projects, how can we ensure that we have the processes and tools in place for our controls engineers to be able to work on multiple projects across multiple businesses at any point in time. How can we ensure that as we're servicing our customers, we're also leveraging the various groups within Lincoln Electric. I was at an automation site just in the last 6 months, and we had 4 or 5 of our automation businesses that had resources at that site, working with that customer on the solution. That wouldn't have been that way a few years ago. So some of those things are certainly emerging.

I know Mike and his team have some other ideas to continue to make improvements in the automation business to minimize the impacts that we can have in the cycle. But I'll also share, Steve, that when I think of that automation business, because of the criticality of some of the human capital requirements unique to automation that when I think about the business, it's always going to be the 1 that probably performs a little bit more challenged than a down economic cycle versus consumable versus equipment. But we have made improvements and think we can make some more improvements as we're moving that business forward.

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

Understood. And since I'm last on the call, I'll just squeeze one more in. Gabe, going back to the organic framework above high single digits, much easier comp in the Americas. And obviously, some of the positives from automation that we've talked about. Should we expect that translates into double-digit growth in the Americas versus a single-digit for international? Or just how should we frame up growth in the 2 segments?

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

Steve, I'd like to just stick to the consolidated view on our organic increases. And yes, you're right that the automation improvements that we kind of see in mid-2021 will provide us some upside within the Americas segment, but we want to stick to that overall framework.

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**Operator**

This does conclude the question-and-answer session. And 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, Michelle. I'd like to thank everyone for joining us on the call today and for your continued interest in Lincoln Electric. We look forward to discussing the progression of our strategic initiatives in the future. Thank you very much.

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**Operator**

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

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