

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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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)**

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

*(In thousands, except per share data)*

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
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)*

	<b>September 30, 2007 (UNAUDITED)</b>	<b>December 31, 2006 (NOTE A)</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
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
<b>TOTAL CURRENT ASSETS</b>	<b>997,867</b>	<b>829,410</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
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
<b>OTHER ASSETS</b>		
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
<b>TOTAL ASSETS</b>	<b>\$ 1,626,432</b>	<b>\$ 1,394,579</b>

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)*

	<b>September 30, 2007 (UNAUDITED)</b>	<b>December 31, 2006 (NOTE A)</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
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
<b>TOTAL CURRENT LIABILITIES</b>	<b>356,610</b>	<b>338,288</b>
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
<b>SHAREHOLDERS EQUITY</b>		
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)
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>1,033,519</b>	<b>852,976</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 1,626,432</b>	<b>\$ 1,394,579</b>

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)

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2007</b>	<b>2006</b>
<b>OPERATING ACTIVITIES</b>		
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)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>204,107</b>	<b>105,091</b>
<b>INVESTING ACTIVITIES</b>		
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
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	<b>(51,272)</b>	<b>(52,961)</b>
<b>FINANCING ACTIVITIES</b>		
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)
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>(53,120)</b>	<b>(15,258)</b>



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):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
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:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
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:

	<b>North America</b>	<b>Europe</b>	<b>Other Countries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<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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	<b>North America</b>	<b>Europe</b>	<b>Other Countries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<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)	
<b>Total</b>	<b>\$ 1,130,033</b>	<b>\$ 392,621</b>	<b>\$ 278,654</b>	<b>\$ (100,803)</b>	<b>\$ 1,700,505</b>
Income before interest and income taxes	\$ 156,283	\$ 49,001	\$ 17,120	\$ (1,871)	\$ 220,533
Interest income					5,439
Interest expense					(8,379)
Income before income taxes					\$ 217,593
<b>Total assets</b>	<b>\$ 987,754</b>	<b>\$ 478,052</b>	<b>\$ 337,675</b>	<b>\$ (177,049)</b>	<b>\$ 1,626,432</b>
<i>Nine months ended September 30, 2006:</i>					
Net sales to unaffiliated customers	\$ 986,299	\$ 264,150	\$ 215,592	\$	\$ 1,466,041
Inter-segment sales	68,590	18,485	11,473	(98,548)	
<b>Total</b>	<b>\$ 1,054,889</b>	<b>\$ 282,635</b>	<b>\$ 227,065</b>	<b>\$ (98,548)</b>	<b>\$ 1,466,041</b>
Income before interest and income taxes	\$ 132,985	\$ 28,531	\$ 20,172	\$ (1,991)	\$ 179,697
Interest income					4,201
Interest expense					(7,343)
Income before income taxes					\$ 176,555
<b>Total assets</b>	<b>\$ 912,679</b>	<b>\$ 312,578</b>	<b>\$ 262,360</b>	<b>\$ (131,999)</b>	<b>\$ 1,355,618</b>

The Europe segment includes rationalization charges of \$665 for the three months ended September 30, 2006 and \$396 and \$3,006 for the nine months ended September 30, 2007 and 2006, respectively.

**NOTE I RATIONALIZATION CHARGES**

In 2005, the Company committed to a plan to rationalize manufacturing operations (the Ireland Rationalization) at Harris Calorific Limited (Harris Ireland). In connection with the Ireland Rationalization, the Company transferred all manufacturing taking place at Harris Ireland to a lower cost facility in Eastern Europe and sold the facility in Ireland for \$10,352 in the fourth quarter of 2006. A total of 66 employees were impacted by the Ireland Rationalization.

The Company expects to incur charges of approximately \$3,500 (pre-tax) associated with employee severance costs, equipment relocation, employee retention and professional services. In addition, the Company recorded a gain of \$9,006 (pre-tax) on the sale of the facility in Ireland during the fourth quarter of 2006 which was reflected in Selling, general and administrative expenses. Cash expenditures are expected to be paid through 2007.

**NOTE J ACQUISITIONS**



On July 20, 2007, the Company acquired Nanjing Kuang Tai Welding Company, Ltd. ( Nanjing ), a manufacturer of stick electrode products based in Nanjing, China, for approximately \$4,245 in cash and assumed debt. The Company began consolidating the results of Nanjing in the Company s consolidated financial statements in July 2007. The Company previously owned 35% of Nanjing indirectly through its investment in Kuang Tai Metal Industrial Company, Ltd. Nanjing s annual sales are approximately \$10,000. The Company does not expect the transaction to have a material impact on its financial statements in 2007.

On March 30, 2007, the Company acquired all of the outstanding stock of Spawmet Sp. z.o.o. ( Spawmet ), a privately held manufacturer of welding consumables headquartered near Katowice, Poland, for approximately \$5,000 in cash. The Company began consolidating the results of Spawmet in the Company s consolidated financial statements in April 2007. This acquisition provides the Company with a portfolio of stick electrode products and the Company expects this acquisition to enhance its market position by broadening its distributor network in Poland and Eastern Europe. Annual sales are

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approximately \$5,000. The Company does not expect the transaction to have a material impact on its financial statements in 2007.

On October 31, 2006, the Company acquired all of the outstanding stock of Metrode Products Limited ( Metrode ), a privately held manufacturer of specialty welding consumables headquartered near London, England, for approximately \$25,000 in cash. The Company began consolidating the results of Metrode in the Company's consolidated financial statements in November 2006. The purchase price allocation for this investment resulted in goodwill of approximately \$4,000. The Company expects this acquisition to provide high quality, innovative solutions for many high-end specialty applications, including the rapidly growing power generation and petrochemical industries. Annual sales are approximately \$25,000.

**NOTE K CONTINGENCIES AND GUARANTEE**

The Company, like other manufacturers, is subject from time to time to a variety of civil and administrative proceedings arising in the ordinary course of business. Such claims and litigation include, without limitation, product liability claims and health, safety and environmental claims, some of which relate to cases alleging asbestos and manganese induced illnesses. The claimants in the asbestos and manganese cases seek compensatory and punitive damages, in most cases for unspecified amounts. The Company believes it has meritorious defenses to these claims and intends to contest such suits vigorously. Although defense costs remain significant, all other costs associated with these claims, including indemnity charges and settlements, have been immaterial to the Company's consolidated financial statements. Based on the Company's historical experience in litigating these claims, including a significant number of dismissals, summary judgments and defense verdicts in many cases and immaterial settlement amounts, as well as the Company's current assessment of the underlying merits of the claims and applicable insurance, the Company believes resolution of these claims and proceedings, individually or in the aggregate (exclusive of defense costs), will not have a material adverse impact upon the Company's consolidated financial statements.

The Company has provided a guarantee on loans for an unconsolidated joint venture of approximately \$8,100 at September 30, 2007. The guarantee is provided on four separate loan agreements. Two loans are for \$2,000 each, one which matures in June 2008 and the other maturing in May 2009. The other two loans mature in July 2010, one for \$2,700 and the other for \$1,400. The loans were undertaken to fund the joint venture's working capital and capital improvement needs. The Company would become liable for any unpaid principal and accrued interest if the joint venture were to default on payment at the respective maturity dates. The Company believes the likelihood is remote that material payment will be required under these arrangements because of the current financial condition of the joint venture.

**NOTE L PRODUCT WARRANTY COSTS**

The Company accrues for product warranty claims based on historical experience and the expected material and labor costs to provide warranty service. Warranty services are provided for periods up to three years from the date of sale. The accrual for product warranty claims is included in Accrued expenses. Warranty accruals have increased as a result of the effect of higher sales levels. The changes in the carrying amount of product warranty accruals for the three and nine months ended September 30, 2007 and 2006 are as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Balance at beginning of period	\$ 10,417	\$ 8,627	\$ 9,373	\$ 7,728
Charged to costs and expenses	3,657	2,106	8,557	7,097
Deductions	(2,764)	(1,889)	(6,620)	(5,981)
Balance at end of period	\$ 11,310	\$ 8,844	\$ 11,310	\$ 8,844

Warranty expense was 0.7% and 0.4% of sales for the three months ended September 30, 2007 and 2006, respectively. Warranty expense was 0.5% of sales for the nine months ended September 30, 2007 and 2006.



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During March 2002, the Company issued Senior Unsecured Notes (the Notes) totaling \$150,000 through a private placement. The Notes have original maturities ranging from five to ten years with a weighted average interest rate of 6.1% and an average tenure of eight years. Interest is payable semi-annually in March and September. The proceeds are being used for general corporate purposes, including acquisitions. The proceeds are generally invested in short-term, highly liquid investments. The Notes contain certain affirmative and negative covenants, including restrictions on asset dispositions and financial covenants (interest coverage and funded debt-to-EBITDA, as defined in the Notes Agreement, ratios). As of September 30, 2007, the Company was in compliance with all of its debt covenants. During March 2007, the Company repaid the \$40,000 Series A Notes which had matured, reducing the total balance outstanding of the Notes to \$110,000.

The maturity and interest rates of the Notes outstanding at September 30, 2007 are as follows (in thousands):

	<b>Amount Due</b>	<b>Matures March</b>	<b>Interest Rate</b>
Series B	\$ 30,000	2009	5.89%
Series C	\$ 80,000	2012	6.36%

During March 2002, the Company entered into floating rate interest rate swap agreements totaling \$80,000, to convert a portion of the outstanding Notes from fixed to floating rates. These swaps were designated as fair value hedges, and as such, the gain or loss on the derivative instrument, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk were recognized in earnings. Net payments or receipts under these agreements were recognized as adjustments to interest expense. In May 2003, these swap agreements were terminated. The gain on the termination of these swaps was \$10,613, and has been deferred and is being amortized as an offset to interest expense over the remaining life of the Notes. The amortization of this gain reduced interest expense by \$880 and \$1,584 in the first nine months of 2007 and 2006, respectively, and is expected to reduce annual interest expense by \$1,121 in 2007. At September 30, 2007, \$1,954 remains to be amortized which is recorded in Long-term debt, less current portion. During July 2003 and April 2004, the Company entered into various floating rate interest rate swap agreements totaling \$110,000, to convert a portion of the Notes outstanding from fixed to floating rates based on the London Inter-Bank Offered Rate (LIBOR), plus a spread of between 179.75 and 226.50 basis points. The variable rates are reset every six months, at which time payment or receipt of interest will be settled. These swaps are designated as fair value hedges, and as such, the gain or loss on the derivative instrument, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings. Net payments or receipts under these agreements are recognized as adjustments to interest expense.

The fair value of these swaps is recorded in Other long-term liabilities with a corresponding decrease in Long-term debt. The fair value of these swaps at September 30, 2007 and December 31, 2006 was \$1,936 and \$3,428, respectively.

Active and terminated swaps have increased the value of the Series B Notes from \$30,000 to \$30,554 and decreased the value of the Series C Notes from \$80,000 to \$79,464 as of September 30, 2007. The weighted average effective interest rate on the Notes, net of the impact of active and terminated swaps, was 6.26% for the first nine months of 2007.

**Revolving Credit Agreement**

The Company has a \$175,000, five-year revolving Credit Agreement. The Credit Agreement may be used for general corporate purposes and may be increased, subject to certain conditions, by an additional amount up to \$75,000. The interest rate on borrowings under the Credit Agreement is based on either LIBOR plus a spread based on the Company's leverage ratio or the prime rate, at the Company's election. A quarterly facility fee is payable based upon the daily aggregate amount of commitments and the Company's leverage ratio. The Credit Agreement contains customary affirmative and negative covenants for credit facilities of this type, including limitations on the Company with respect to indebtedness, liens, investments, distributions, mergers and acquisitions, dispositions of assets,

subordinated debt and transactions with affiliates. As of September 30, 2007, there are no borrowings under the Credit Agreement.

*Short-term Borrowings*

Amounts reported as Amounts due banks represent the short-term borrowings of the Company's foreign subsidiaries.

**Table of Contents****NOTE N NEW ACCOUNTING PRONOUNCEMENTS**

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115*, which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses arising subsequent to adoption are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 159 on its financial statements. In September 2006, the FASB issued SFAS 157 *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, rather it applies under existing accounting pronouncements that require or permit fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS 157 as required. The Company is currently evaluating the impact of SFAS 157 on its financial statements.

**NOTE O RETIREMENT AND POSTRETIREMENT BENEFIT PLANS**

A summary of the components of net periodic benefit costs is as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Service cost – benefits earned during the period	\$ 4,283	\$ 4,267	\$ 13,341	\$ 13,947
Interest cost on projected benefit obligation	10,041	9,474	30,252	28,471
Expected return on plan assets	(14,201)	(12,586)	(41,911)	(37,737)
Amortization of prior service cost	22	2	54	565
Amortization of net loss	1,086	2,819	3,735	8,079
Net pension cost of defined benefit plans	\$ 1,231	\$ 3,976	\$ 5,471	\$ 13,325

The Company has voluntarily contributed \$10,000 to its U.S. plans in the first nine months of 2007. Based on current pension funding rules, the Company did not anticipate that contributions to the plans would be required in 2007.

In the first quarter of 2006, the Company modified its retirement benefit programs whereby employees of its largest U.S. company hired on or after January 1, 2006 will be covered under a newly enhanced 401(k) defined contribution plan. In the second quarter of 2006, current employees of this U.S. company made an election to either remain in the existing retirement programs or switch to new programs offering enhanced defined contribution benefits, improved vacation and a reduced defined benefit.

In September 2006, the FASB issued SFAS 158 *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS 158 requires companies to recognize the funded status of a benefit plan as the difference between plan assets at fair value and the projected benefit obligation. Unrecognized gains or losses and prior service costs, as well as the transition asset or obligation remaining from the initial application of Statements 87 and 106 will be recognized in the balance sheet, net of tax, as a component of Accumulated other comprehensive loss and will subsequently be recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of those Statements. In addition, SFAS 158 requires additional disclosures about the future effects on net periodic benefit cost that arise from the delayed recognition of gains or losses, prior service costs or credits, and transition asset or obligation. SFAS 158 also requires that defined benefit plan assets and obligations be measured as of the date of the employer's fiscal year-end balance sheet. The recognition and disclosure provisions of SFAS 158 were effective for fiscal years ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end balance sheet is effective for fiscal years ending after December 15, 2008. The Company adopted SFAS 158 as of December 31, 2006. The adoption of SFAS 158 had no impact on the measurement date as the Company has historically measured the plan assets and benefit obligations of its pension and other postretirement plans as of December 31.

As of December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158. As a result of adopting SFAS 158, the Company recorded liabilities equal to the underfunded status of defined benefit plans, and assets equal

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to the overfunded status of certain defined benefit plans measured as the difference between the fair value of plan assets and the projected benefit obligation. As of December 31, 2006, the Company recognized liabilities of \$34,900 and prepaids of \$16,773 for its defined benefit pension plans and also recognized Accumulated other comprehensive loss of \$69,978 (after-tax).

**NOTE P INCOME TAXES**

The effective income tax rates of 29.6% and 30.2% for the nine months ended September 30, 2007 and 2006, respectively, are lower than the Company's statutory rate primarily because of the utilization of foreign tax credits, lower taxes on non-U.S. earnings and the utilization of foreign tax loss carryforwards, for which valuation allowances have been previously provided. The anticipated effective rate for 2007 depends on the amount of earnings in various tax jurisdictions and the level of related tax deductions achieved during the year.

**Adoption of FIN 48**

In July 2006, the FASB issued FIN 48 which clarifies the recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 requires the cumulative effect of adoption to be recorded as an adjustment to the opening balance of retained earnings. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted this interpretation as of January 1, 2007.

The cumulative effects of applying this interpretation have been recorded as a decrease of \$1,591 to retained earnings. The Company's unrecognized tax benefits upon adoption were \$28,997, of which \$21,602 would affect the effective tax rate, if recognized.

In conjunction with the adoption of FIN 48, uncertain tax positions have been classified as Accrued taxes, non-current unless expected to be paid in one year. The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense, consistent with the accounting method used prior to adopting FIN 48. At January 1, 2007 the Company's accrual for interest and penalties totaled \$4,781.

For the three and nine month periods ending September 30, 2007, the gross increase in unrecognized tax benefits affecting the income statement are \$2,838 and \$3,427, respectively, due to various international and U.S. tax audit matters. For the three and nine month periods ending September 30, 2007, a tax benefit of \$4,269 was recorded from the resolution of prior years' tax liabilities.

As of September 30, 2007, the Company had \$29,458 of unrecognized tax benefits. If recognized, approximately \$21,364 would be recorded as a component of income tax expense.

The Company files income tax returns in the U.S. and various state, local and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for years before 2004. The Company anticipates no significant changes to its total unrecognized tax benefits through the end of the third quarter of 2008. The Company is currently subject to an Internal Revenue Service ( IRS ) audit for the 2005-2006 tax years.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (in thousands, except share and per share data)**

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 following discussion and analysis of the Company's results of operations and financial position should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 and the unaudited consolidated financial statements and related notes included in this Quarterly Report on Form 10-Q. This report contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those indicated in the forward-looking statements. See Risk Factors in Part II, Item 1A of this report for more information regarding forward-looking statements.



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**GENERAL**

The Company is the world's largest designer and manufacturer of arc welding and cutting products, manufacturing a full line of arc welding equipment, consumable welding products and other welding and cutting products.

The Company is one of only a few worldwide broad line manufacturers of both arc welding equipment and consumable products. Welding products include arc welding power sources, wire feeding systems, robotic welding packages, fume extraction equipment, consumable electrodes and fluxes. The Company's welding product offering also includes regulators and torches used in oxy-fuel welding and cutting. In addition, the Company has a leading global position in the brazing and soldering alloys market.

The Company invests in the research and development of arc welding equipment and consumable products in order to continue its market leading product offering. The Company continues to invest in technologies that improve the quality and productivity of welding products. In addition, the Company continues to actively increase its patent application process in order to secure its technology advantage in the United States and other major international jurisdictions. The Company believes its significant investment in research and development and its highly trained technical sales force provide a competitive advantage in the marketplace.

The Company's products are sold in both domestic and international markets. In North America, products are sold principally through industrial distributors, retailers and also directly to users of welding products. Outside of North America, the Company has an international sales organization comprised of Company employees and agents who sell products from the Company's various manufacturing sites to distributors and product users.

The Company's major end user markets include:

- general metal fabrication,
- infrastructure including oil and gas pipelines and platforms, buildings, bridges and power generation,
- transportation and defense industries (automotive, trucks, rail, ships and aerospace),
- equipment manufacturers in construction, farming and mining,
- retail resellers, and
- rental market.

The Company has, through wholly-owned subsidiaries or joint ventures, manufacturing facilities located in the United States, Australia, Brazil, Canada, Colombia, France, Germany, Indonesia, Italy, Mexico, the Netherlands, People's Republic of China, Poland, Spain, Taiwan, Turkey, United Kingdom and Venezuela.

The Company's sales and distribution network, coupled with its manufacturing facilities are reported as two separate reportable segments, North America and Europe, with all other operating segments combined and reported as Other Countries.

The principal raw materials essential to the Company's business are various chemicals, electronics, steel, engines, brass, copper and aluminum alloys, all of which are normally available for purchase in the open market.

The Company's facilities are subject to environmental regulations. To date, compliance with these environmental regulations has not had a material effect on the Company's earnings. The Company is ISO 9001 certified at nearly all facilities worldwide. In addition, the Company is ISO 14001 certified at most significant manufacturing facilities in the United States and is working to gain certification at its remaining United States facilities, as well as the remainder of its facilities worldwide.

**Key Indicators**

Key economic measures relevant to the Company include industrial production trends, steel consumption, purchasing manager indices, capacity utilization within durable goods manufacturers, and consumer confidence indicators. Key industries which provide a relative indication of demand drivers to the Company include farm machinery and equipment, construction and transportation, fabricated metals, electrical equipment, ship and boat building, defense, truck manufacturing and railroad

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equipment. Although these measures provide key information on trends relevant to the Company, the Company does not have available a more direct correlation of leading indicators which can provide a forward-looking view of demand levels in the markets which ultimately use the Company's welding products.

Key operating measures utilized by the operating units to manage the Company include orders, sales, inventory and fill-rates, all of which provide key indicators of business trends. These measures are reported on various cycles including daily, weekly and monthly depending on the needs established by operating management.

Key financial measures utilized by the Company's executive management and operating units in order to evaluate the results of its business and in understanding key variables impacting the current and future results of the Company include: sales; gross profit; selling, general and administrative expenses; earnings before interest and taxes; earnings before interest, taxes and bonus; operating cash flows; and capital expenditures, including applicable ratios such as return on investment and average operating working capital to sales. These measures are reviewed at monthly, quarterly and annual intervals and compared with historical periods, as well as objectives established by the Board of Directors of the Company.

**RESULTS OF OPERATIONS**

The following tables present the Company's results of operations:

(In thousands)	Three Months Ended September 30,					
	2007		2006		Change	
	Amount	% of Sales	Amount	% of Sales	Amount	%
Net sales	\$ 564,824	100.0%	\$ 495,137	100.0%	\$ 69,687	14.1%
Cost of goods sold	405,083	71.7%	353,800	71.5%	51,283	14.5%
Gross profit	159,741	28.3%	141,337	28.5%	18,404	13.0%
Selling, general and administrative expenses	92,140	16.3%	81,019	16.4%	11,121	13.7%
Rationalization charges		0.0%	665	0.1%	(665)	NA
Operating income	67,601	12.0%	59,653	12.0%	7,948	13.3%
Interest income	2,290	0.4%	1,607	0.3%	683	42.5%
Equity earnings in affiliates	2,263	0.4%	2,450	0.5%	(187)	(7.6%)
Other income	819	0.1%	436	0.1%	383	87.8%
Interest expense	(2,866)	(0.5%)	(2,504)	(0.5%)	(362)	14.5%
Income before income taxes	70,107	12.4%	61,642	12.4%	8,465	13.7%
Income taxes	20,129	3.6%	17,787	3.5%	2,342	13.2%
Net income	\$ 49,978	8.8%	\$ 43,855	8.9%	\$ 6,123	14.0%

(In thousands)	Nine Months Ended September 30,					
	2007		2006		Change	
	Amount	% of Sales	Amount	% of Sales	Amount	%
Net sales	\$ 1,700,505	100.0%	\$ 1,466,041	100.0%	\$ 234,464	16.0%
Cost of goods sold	1,213,880	71.4%	1,048,171	71.5%	165,709	15.8%

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Gross profit	486,625	28.6%	417,870	28.5%	68,755	16.5%
Selling, general and administrative expenses	274,977	16.2%	241,126	16.4%	33,851	14.0%
Rationalization charges	396	0.0%	3,006	0.2%	(2,610)	(86.8%)
Operating income	211,252	12.4%	173,738	11.9%	37,514	21.6%
Interest income	5,439	0.3%	4,201	0.3%	1,238	29.5%
Equity earnings in affiliates	7,418	0.4%	4,974	0.3%	2,444	49.1%
Other income	1,863	0.1%	985	0.0%	878	89.1%
Interest expense	(8,379)	(0.4%)	(7,343)	(0.5%)	(1,036)	14.1%
Income before income taxes	217,593	12.8%	176,555	12.0%	41,038	23.2%
Income taxes	64,366	3.8%	53,332	3.6%	11,034	20.7%
Net income	\$ 153,227	9.0%	\$ 123,223	8.4%	\$ 30,004	24.3%

**Table of Contents****Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006**

*Net Sales.* Net sales for the third quarter of 2007 increased 14.1% to \$564,824 from \$495,137 in the prior year quarter. The increase in Net sales reflects a 3.8% or \$19,038 increase due to volume, an increase of 4.6% or \$22,810 in price increases, a 2.6% or \$12,259 increase from acquisitions and a 3.1% or \$15,580 favorable impact as a result of changes in foreign currency exchange rates. Net sales for the North American operations increased 4.9% to \$346,723 for the third quarter 2007 compared to \$330,387 in the prior year quarter. This increase reflects a decrease of 0.3% or \$1,035 due to volume and an increase of \$15,421 or 4.7% in price increases. European sales have increased 36.3% to \$121,935 in the third quarter of 2007 from \$89,482 in the prior year quarter. This increase is a result of a 10.9% or \$9,794 increase in volume, an increase of 3.9% or \$3,485 in price increases, an increase of 10.9% or \$9,714 relating to acquisitions and a 10.6% or \$9,460 favorable impact as a result of changes in foreign currency exchange rates. Other Countries sales increased 27.8% to \$96,166 in the third quarter of 2007 from \$75,268 in the prior year quarter. This increase reflects an increase of \$10,279 or 13.7% due to volume, an increase of \$4,170 or 5.5% as a result of changes in foreign currency exchange rates, an increase of \$3,904 or 5.2% in price increases and an increase of \$2,545 or 3.4% relating to acquisitions.

*Gross Profit.* Gross profit increased 13.0% to \$159,741 during the third quarter 2007 compared to \$141,337 in the prior year quarter. As a percentage of net sales, Gross profit was 28.3% during the third quarter 2007 compared with 28.5% in the prior year quarter. This decrease, as a percentage of sales, was a result of an increased portion of sales and mix from lower margin geographies and businesses, and a deterioration in margin leverage as a result of the weakening U.S. dollar partially offset by favorable product mix in North America as well as volume leverage within European businesses. Lower margin geographies were impacted by pricing pressures associated with market share growth, cost increases and start-up costs associated with continued capacity expansion. In addition, foreign currency exchange rates had a \$3,482 favorable translation impact in the third quarter 2007.

*Selling, General & Administrative (SG&A) Expenses.* SG&A expenses increased \$11,121, or 13.7%, in the third quarter 2007, compared with the prior year quarter. The increase was primarily due to higher bonus expense of \$2,542, higher selling expenses of \$2,496 resulting from increased sales activity, incremental Selling, general and administrative expenses from acquisitions totaling \$1,947 and a higher level of foreign exchange transaction losses of \$1,465. The year over year change in foreign currency exchange rates increased SG&A expenses by \$2,084.

*Rationalization Charges.* In the third quarter of 2006, the Company recorded Rationalization charges of \$665 (\$665 after-tax) primarily related to severance costs covering 66 employees at the Company's facility in Ireland. See Note I to the Consolidated Financial Statements for further discussion.

*Interest Income.* In the third quarter of 2007, Interest income increased to \$2,290 from \$1,607 in the prior year quarter. The increase was a result of increases in interest rates and cash balances in 2007 when compared to 2006.

*Equity Earnings in Affiliates.* Equity earnings in affiliates decreased to \$2,263 in the third quarter of 2007 from \$2,450 in the prior year quarter as a result of decreased earnings at the Company's joint venture investments in Turkey and Taiwan.

*Interest Expense.* Interest expense increased to \$2,866 in the third quarter of 2007 from \$2,504 in the prior year quarter. The increase is a result of higher interest rates and a lower level of amortization of the gain associated with previously terminated interest rate swap agreements offset by lower debt levels in 2007. See Note M to the Consolidated Financial Statements for further discussion.

*Income Taxes.* Income taxes for the third quarter of 2007 were \$20,129 on Income before income taxes of \$70,107, an effective rate of 28.7%, compared with income taxes of \$17,787 on Income before income taxes of \$61,642, or an effective rate of 28.9% in the prior year quarter. The effective rate for the third quarter of 2007 was lower than the Company's statutory rate primarily because of the utilization of foreign tax credits, lower taxes on non-U.S. earnings and the utilization of foreign tax loss carryforwards, for which valuation allowances had been previously provided.

*Net Income.* Net income for the third quarter 2007 was \$49,978 compared to \$43,855 in the prior year quarter. Diluted earnings per share for the third quarter of 2007 were \$1.15 compared to \$1.02 per share in 2006. Foreign currency exchange rate movements had a \$1,064 favorable translation impact on Net income for the third quarter of 2007. Foreign currency exchange rate movements did not have a material impact on Net income for the third quarter of 2006.



**Table of Contents****Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006**

*Net Sales.* Net sales for the first nine months of 2007 increased 16.0% to \$1,700,505 from \$1,466,041 in the prior year period. The increase in Net sales reflects a 7.0% or \$101,967 increase due to volume, an increase of 4.2% or \$61,838 in price increases, a 2.1%, or \$30,488 increase from acquisitions and a 2.7% or \$40,171 favorable translation impact as a result of changes in foreign currency exchange rates. Net sales for the North American operations increased 7.1% to \$1,056,289 for the first nine months of 2007 compared to \$986,299 in the prior year period. This increase reflects an increase of 2.3% or \$23,120 due to volume and an increase of \$44,061 or 4.5% in price increases. European sales have increased 42.3% to \$375,935 in the first nine months of 2007 from \$264,150 in the prior year period. This increase is a result of an 18.3% or \$48,404 increase in volume, an increase of 3.1% or \$8,151 in price increases, an increase of 10.6% or \$27,943 relating to acquisitions and a 10.3% or \$27,287 favorable translation impact as a result of changes in foreign currency exchange rates. Other Countries sales increased 24.4% to \$268,281 in the first nine months of 2007 from \$215,592 in the prior year period. This increase reflects an increase of \$30,443 or 14.1% due to volume, an increase of 4.5% or \$9,626 in price, an increase of \$10,075 or 4.7% as a result of changes in foreign currency exchange rates and an increase of \$2,545 or 1.1% relating to acquisitions.

*Gross Profit.* Gross profit increased 16.5% to \$486,625 during the first nine months of 2007 compared to \$417,870 in the prior year period. As a percentage of net sales, Gross profit was 28.6% during the first nine months of 2007 compared with 28.5% in the prior year period. This increase was primarily a result of favorable leverage on increased volumes offset by a shift in sales mix to lower margin geographies and businesses. In addition, foreign currency exchange rates had a favorable impact of \$9,194 and \$1,711 in the first nine months of 2007 and 2006, respectively.

*Selling, General & Administrative Expenses.* SG&A expenses increased \$33,851, or 14%, in the first nine months of 2007, compared with the prior year period. The increase was primarily due to higher bonus expense of \$9,014, higher selling expenses of \$6,597 resulting from increased sales activity, incremental Selling, general and administrative expenses from acquisitions totaling \$5,079, higher administrative expense of \$3,787 and higher foreign exchange transaction losses of \$2,962. The year over year change in foreign currency exchange rates increased SG&A expenses by \$5,213.

*Rationalization Charges.* In the first nine months of 2007 and 2006, the Company recorded Rationalization charges of \$396 (\$396 after-tax) and \$3,006 (\$3,006 after-tax), respectively, related to severance costs covering 66 employees at the Company's facility in Ireland. See Note I to the Consolidated Financial Statements for further discussion.

*Interest Income.* In the first nine months of 2007, Interest income increased to \$5,439 from \$4,201 in the prior year period. The increase was a result of increases in interest rates and cash balances in 2007 when compared to 2006.

*Equity Earnings in Affiliates.* Equity earnings in affiliates increased to \$7,418 in the first nine months of 2007 from \$4,974 in the prior year period as a result of increased earnings at the Company's joint venture investments in Turkey and Taiwan.

*Interest Expense.* Interest expense increased to \$8,379 in the first nine months of 2007 from \$7,343 in the prior year period as a result of higher interest rates and a lower level of amortization of the gain associated with previously terminated interest rate swap agreements offset by lower debt levels in 2007. See Note M to the Consolidated Financial Statements for further discussion.

*Income Taxes.* Income taxes for the first nine months of 2007 were \$64,366 on Income before income taxes of \$217,593, an effective rate of 29.6%, compared with income taxes of \$53,332 on Income before income taxes of \$176,555, or an effective rate of 30.2% in the prior year period. The effective rate for the first nine months of 2007 was lower than the Company's statutory rate primarily because of the utilization of foreign tax credits, lower taxes on non-U.S. earnings and the utilization of foreign tax loss carryforwards, for which valuation allowances have been previously provided.

*Net Income.* Net income for the first nine months of 2007 was \$153,227 compared to \$123,223 in the prior year period. Diluted earnings per share for the first nine months of 2007 were \$3.53 compared to \$2.87 per share in 2006. Foreign currency exchange rate movements had a favorable translation impact of \$2,979 and \$689 on Net income for the first nine months of 2007 and 2006, respectively.

**LIQUIDITY AND CAPITAL RESOURCES**

The Company's cash flow from operations, while cyclical, has been reliable and consistent. The Company has relatively unrestricted access to capital markets. Operational cash flow is a key driver of liquidity, providing cash and access to capital markets. In assessing liquidity, the Company reviews working capital measurements to define areas of improvement. Management anticipates the Company will be able to satisfy cash requirements for its ongoing businesses for the foreseeable

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future primarily with cash generated by operations, existing cash balances and, if necessary, borrowings under its existing credit facilities.

The following table reflects changes in key cash flow measures:

<b>(In thousands)</b>	<b>Nine Months Ended September 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>Change</b>
Cash provided by operating activities:	\$204,107	\$105,091	\$ 99,016
Cash used by investing activities:	(51,272)	(52,961)	1,689
Capital expenditures	(45,777)	(53,318)	7,541
Acquisitions of businesses, net of cash acquired	(6,102)	(502)	(5,600)
Cash used by financing activities:	(53,120)	(15,258)	(37,862)
Amounts due banks, net	(505)	(4,499)	3,994
Payments on long-term borrowings	(40,459)	(1,561)	(38,898)
Proceeds from exercise of stock options	7,589	10,282	(2,693)
Tax benefit from exercise of stock options	5,001	3,847	1,154
Purchase of treasury shares		(126)	126
Cash dividends paid to shareholders	(28,271)	(24,178)	(4,093)
Increase in Cash and cash equivalents	103,008	37,904	65,104

Cash and cash equivalents increased 85.7% or \$103,008 during the first nine months of 2007, to \$223,220 as of September 30, 2007. This compares to an increase of 35.1% or \$37,904 to \$145,911 during the first nine months of 2006.

Cash provided by operating activities increased by \$99,016 for the first nine months of 2007 compared to 2006. The increase was primarily related to an increase in net income and a lower increase in working capital levels when compared to 2006. Average working capital to sales was 25.8% at September 30, 2007 and December 31, 2006 versus 26.6% at September 30, 2006. Days sales in inventory decreased to 108.8 days at September 30, 2007 from 117.3 days at December 31, 2006 and 119.4 days at September 30, 2006. Accounts receivable days increased to 59.9 at September 30, 2007 from 57.7 days at December 31, 2006 and 58.2 days at September 30, 2006. Average days in accounts payable decreased to 34.5 days at September 30, 2007 from 38.9 days at December 31, 2006 and 37.8 days at September 30, 2006.

Cash used by investing activities for the first nine months of 2007 compared to 2006 reflects an increase in cash used in the acquisition of Spawmet Sp. z.o.o. ( Spawmet ) and Nanjing Kuang Tai Welding Company, Ltd. ( Nanjing ). In addition, capital expenditures during the first nine months of 2007 were \$45,777, a \$7,541 decrease from 2006. The Company anticipates capital expenditures in 2007 of approximately \$60,000 to \$65,000. Anticipated capital expenditures reflect plans to expand the Company's manufacturing capacity due to an increase in customer demand and the Company's continuing international expansion. Management critically evaluates all proposed capital expenditures and requires each project to increase efficiency, reduce costs, promote business growth, or to improve the overall safety and environmental conditions of the Company's facilities. Management does not currently anticipate any unusual future cash outlays relating to capital expenditures.

Cash used by financing activities increased \$37,862 to \$53,120 in the first nine months of 2007 compared to the first nine months of 2006. The increase was primarily due to an increase in the reduction of debt resulting from the \$40,000 repayment of the Company's Series A Senior Unsecured Notes and a decrease in proceeds and tax benefits associated with stock option exercises of \$1,539.

The Company's debt levels decreased from \$161,099 at December 31, 2006, to \$126,639 at September 30, 2007. Debt to total capitalization decreased to 10.9% at September 30, 2007 from 15.9% at December 31, 2006.

The Company's Board of Directors authorized share repurchase programs for up to 15 million shares of the Company's common stock. Total shares purchased through the share repurchase programs were 10,243,988 shares at a cost of \$216,392 through September 30, 2007.

In July 2007, the Company paid a quarterly cash dividend of \$0.22 per share, or \$9,446 to shareholders of record on June 29, 2007.





**Table of Contents****Rationalization**

In 2005, the Company committed to a plan to rationalize manufacturing operations (the Ireland Rationalization) at Harris Calorific Limited (Harris Ireland). In connection with the Ireland Rationalization, the Company transferred all manufacturing taking place at Harris Ireland to a lower cost facility in Eastern Europe and sold the facility in Ireland for \$10,352 in the fourth quarter of 2006. A total of 66 employees were impacted by the Ireland Rationalization. The Company expects to incur charges of approximately \$3,500 (pre-tax) associated with employee severance costs, equipment relocation, employee retention and professional services. In addition, the Company recorded a gain of \$9,006 (pre-tax) on the sale of the facility in Ireland during the fourth quarter of 2006 which was reflected in Selling, general and administrative expenses. Cash expenditures are expected to be paid through 2007.

**Acquisitions**

On July 20, 2007, the Company acquired Nanjing, a manufacturer of stick electrode products based in Nanjing, China, for approximately \$4,245 in cash and assumed debt. The Company began consolidating the results of Nanjing in the Company's consolidated financial statements in July 2007. The Company previously owned 35% of Nanjing indirectly through its investment in Kuang Tai Metal Industrial Company, Ltd. Nanjing's annual sales are approximately \$10,000. The Company does not expect the transaction to have a material impact on its financial statements in 2007.

On March 30, 2007, the Company acquired all of the outstanding stock of Spawmet, a privately held manufacturer of welding consumables headquartered near Katowice, Poland, for approximately \$5,000 in cash. The Company began consolidating the results of Spawmet in the Company's consolidated financial statements in April 2007. This acquisition provides the Company with a portfolio of stick electrode products and the Company expects this acquisition to enhance its market position by broadening its distributor network in Poland and Eastern Europe. Annual sales are approximately \$5,000. The Company does not expect the transaction to have a material impact on its financial statements in 2007.

On October 31, 2006, the Company acquired all of the outstanding stock of Metrode Products Limited (Metrode), a privately held manufacturer of specialty welding consumables headquartered near London, England, for approximately \$25,000 in cash. The Company began consolidating the results of Metrode in the Company's consolidated financial statements in November 2006. The purchase price allocation for this investment resulted in goodwill of approximately \$4,000. The Company expects this acquisition to provide high quality, innovative solutions for many high-end specialty applications, including the rapidly growing power generation and petrochemical industries. Annual sales are approximately \$25,000.

The Company continues to expand globally and periodically looks at transactions that would involve significant investments. The Company can fund its global expansion plans with operational cash flow, but a significant acquisition may require access to capital markets, in particular, the public and/or private bond market, as well as the syndicated bank loan market. The Company's financing strategy is to fund itself at the lowest after-tax cost of funding. Where possible, the Company utilizes operational cash flows and raises capital in the most efficient market, usually the U.S., and then lends funds to the specific subsidiary that requires funding. If additional acquisitions providing appropriate financial benefits become available, additional expenditures may be made.

**Debt**

During March 2002, the Company issued Senior Unsecured Notes (the Notes) totaling \$150,000 through a private placement. The Notes have original maturities ranging from five to ten years with a weighted average interest rate of 6.1% and an average tenure of eight years. Interest is payable semi-annually in March and September. The proceeds are being used for general corporate purposes, including acquisitions. The proceeds are generally invested in short-term, highly liquid investments. The Notes contain certain affirmative and negative covenants, including restrictions on asset dispositions and financial covenants (interest coverage and funded debt-to-EBITDA, as defined in the Notes Agreement, ratios). As of September 30, 2007, the Company was in compliance with all of its debt covenants. During March 2007, the Company repaid the \$40,000 Series A Notes which had matured reducing the total balance outstanding of the Notes to \$110,000.

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The maturity and interest rates of the Notes outstanding at September 30, 2007 are as follows (in thousands):

	<b>Amount Due</b>	<b>Matures</b>	<b>Interest Rate</b>
Series B	\$ 30,000	March 2009	5.89%
Series C	\$ 80,000	March 2012	6.36%

During March 2002, the Company entered into floating rate interest rate swap agreements totaling \$80,000, to convert a portion of the Notes outstanding from fixed to floating rates. These swaps were designated as fair value hedges, and as such, the gain or loss on the derivative instrument, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk were recognized in earnings. Net payments or receipts under these agreements were recognized as adjustments to interest expense. In May 2003, these swap agreements were terminated. The gain on the termination of these swaps was \$10,613, and has been deferred and is being amortized as an offset to interest expense over the remaining life of the Notes. The amortization of this gain reduced interest expense by \$880 and \$1,584 in the first nine months of 2007 and 2006, respectively, and is expected to reduce annual interest expense by \$1,121 in 2007. At September 30, 2007, \$1,954 remains to be amortized which is recorded in Long-term debt, less current portion.

During July 2003 and April 2004, the Company entered into various floating rate interest rate swap agreements totaling \$110,000, to convert a portion of the Notes outstanding from fixed to floating rates based on the London Inter-Bank Offered Rate ( LIBOR ), plus a spread of between 179.75 and 226.50 basis points. The variable rates are reset every six months, at which time payment or receipt of interest will be settled. These swaps are designated as fair value hedges, and as such, the gain or loss on the derivative instrument, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in earnings. Net payments or receipts under these agreements are recognized as adjustments to interest expense.

The fair value of these swaps is recorded in Other long-term liabilities with a corresponding decrease in Long-term debt. The fair value of these swaps at September 30, 2007 and December 31, 2006 was \$1,936 and \$3,428, respectively.

Active and terminated swaps have increased the value of the Series B Notes from \$30,000 to \$30,554 and decreased the value of the Series C Notes from \$80,000 to \$79,464 as of September 30, 2007. The weighted average effective interest rate on the Notes, net of the impact of active and terminated swaps, was 6.26% for the first nine months of 2007.

*Revolving Credit Agreement*

The Company has a \$175,000, five-year revolving Credit Agreement. The Credit Agreement may be used for general corporate purposes and may be increased, subject to certain conditions, by an additional amount up to \$75,000. The interest rate on borrowings under the Credit Agreement is based on either LIBOR plus a spread based on the Company's leverage ratio or the prime rate, at the Company's election. A quarterly facility fee is payable based upon the daily aggregate amount of commitments and the Company's leverage ratio. The Credit Agreement contains customary affirmative and negative covenants for credit facilities of this type, including limitations on the Company with respect to indebtedness, liens, investments, distributions, mergers and acquisitions, dispositions of assets, subordinated debt and transactions with affiliates. As of September 30, 2007, there are no borrowings under the Credit Agreement.

*Short-term Borrowings*

Amounts reported as Amounts due banks represent the short-term borrowings of the Company's foreign subsidiaries.

**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.

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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.

**Product liability expense**

Product liability expenses remain significant, particularly with respect to welding fume claims. The costs associated with these claims are predominantly defense costs, which are recognized in the periods incurred. The long-term impact of the welding fume loss contingency, in the aggregate, on operating cash flows and capital markets access is difficult to assess, particularly since claims are in many different stages of development and the Company benefits significantly from cost sharing with co-defendants and insurance carriers. Moreover, the Company has been largely successful to date in its defense of these claims, indemnity payments have been immaterial and new filings have not been significant. If cost sharing dissipates for some currently unforeseen reason, however, or the Company's trial experience changes overall, it is possible on a longer term basis that the cost of resolving this loss contingency could materially reduce the Company's operating results and cash flow and restrict capital market access. See Note K to the Consolidated Financial Statements for further discussion.

**OFF-BALANCE SHEET FINANCIAL INSTRUMENTS**

The Company utilizes letters of credit to back certain payment and performance obligations. Letters of credit are subject to limits based on amounts outstanding under the Company's Credit Agreement. The Company has also provided a guarantee on loans for an unconsolidated joint venture of approximately \$8,100 at September 30, 2007. The Company believes the likelihood is remote that material payment will be required under this arrangement because of the current financial condition of the joint venture.

**NEW ACCOUNTING PRONOUNCEMENTS**

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115*, which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses, arising subsequent to adoption, are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 159 on its financial statements.

In September 2006, the FASB issued SFAS 157 *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, rather it applies under existing accounting pronouncements that require or permit fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS 157 as required. The Company is currently evaluating the impact of SFAS 157 on its financial statements.



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In July 2006, the FASB issued Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. FIN 48 clarifies the recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 requires the cumulative effect of adoption to be recorded as an adjustment to the opening balance of retained earnings. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted this Interpretation as of January 1, 2007. See Note P to the Consolidated Financial Statements for further discussion.

**CRITICAL ACCOUNTING POLICIES**

The Company's consolidated financial statements are based on the selection and application of significant accounting policies, which require management to make estimates and assumptions. These estimates and assumptions are reviewed periodically by management and compared to historical trends to determine the accuracy of estimates and assumptions used. If warranted, these estimates and assumptions may be changed as current trends are assessed and updated. Historically, the Company's estimates have been determined to be reasonable. No material changes to the Company's accounting policies were made from the prior period. The Company believes the following are some of the more critical judgment areas in the application of its accounting policies that affect its financial condition and results of operations.

**Legal and Tax Contingencies**

The Company, like other manufacturers, is subject from time to time to a variety of civil and administrative proceedings arising in the ordinary course of business. Such claims and litigation include, without limitation, product liability claims and health, safety and environmental claims, some of which relate to cases alleging asbestos and manganese-induced illnesses. The costs associated with these claims are predominantly defense costs, which are recognized in the periods incurred. Insurance reimbursements mitigate these costs and, where reimbursements are probable, they are recognized in the applicable period. With respect to costs other than defense costs (i.e., for liability and/or settlement or other resolution), reserves are recorded when it is probable that the contingencies will have an unfavorable outcome. The Company accrues its best estimate of the probable costs, after a review of the facts with management and counsel and taking into account past experience. If an unfavorable outcome is determined to be reasonably possible but not probable, or if the amount of loss cannot be reasonably estimated, disclosure is provided for material claims or litigation. Many of the current cases are in differing procedural stages and information on the circumstances of each claimant, which forms the basis for judgments as to the validity or ultimate disposition of such actions, will vary greatly. Therefore, in many situations a range of possible losses cannot be made. Reserves are adjusted as facts and circumstances change and related management assessments of the underlying merits and the likelihood of outcomes change. Moreover, reserves only cover identified and/or asserted claims. Future claims could, therefore, give rise to increases to such reserves. See Note K to the Consolidated Financial Statements and the Legal Proceedings section of this Quarterly Report on Form 10-Q for further discussion of legal contingencies.

The Company is subject to taxation from U.S. federal, state, municipal and international jurisdictions. The calculation of current income tax expense is based on the best information available and involves significant management judgment. The actual income tax liability for each jurisdiction in any year can in some instances be ultimately determined several years after the financial statements are published.

The Company maintains reserves for estimated income tax exposures for many jurisdictions. Exposures are settled primarily through the settlement of audits within each individual tax jurisdiction or the closing of a statute of limitation. Exposures can also be affected by changes in applicable tax law or other factors, which may cause management to believe a revision of past estimates is appropriate. Management believes that an appropriate liability has been established for income tax exposures; however, actual results may materially differ from these estimates. See Note P to the Consolidated Financial Statements for further discussion.

**Deferred Income Taxes**

Deferred income taxes are recognized at currently enacted tax rates for temporary differences between the financial reporting and income tax bases of assets and liabilities and operating loss and tax credit carryforwards. The Company does not provide deferred income taxes on unremitted earnings of certain non-U.S. subsidiaries which are deemed

permanently reinvested. It is not practicable to calculate the deferred taxes associated with the remittance of these earnings. Deferred income taxes of \$215



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have been provided on earnings of \$1,588 million that are not expected to be permanently reinvested. At September 30, 2007, the Company had approximately \$79,778 of gross deferred tax assets related to deductible temporary differences and tax loss and credit carryforwards which may reduce taxable income in future years. In assessing the realizability of deferred tax assets, the Company assesses whether it is more likely than not that a portion or all of the deferred tax assets will not be realized. The Company considers the scheduled reversal of deferred tax liabilities, tax planning strategies, and projected future taxable income in making this assessment. At September 30, 2007, a valuation allowance of \$29,019 was recorded against these deferred tax assets based on this assessment. The Company believes it is more likely than not that the tax benefit of the remaining net deferred tax assets will be realized. The amount of net deferred tax assets considered realizable could be increased or reduced in the future if the Company's assessment of future taxable income or tax planning strategies changes.

**Pensions**

The Company maintains a number of defined benefit and defined contribution plans to provide retirement benefits for employees in the U.S., as well as employees outside the U.S. These plans are maintained and contributions are made in accordance with the Employee Retirement Income Security Act of 1974 ( ERISA ), local statutory law or as determined by the Board of Directors. The plans generally provide benefits based upon years of service and compensation. Pension plans are funded except for a domestic non-qualified pension plan for certain key employees and certain foreign plans.

In September 2006, the FASB issued SFAS 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS 158 requires companies to recognize the funded status of a benefit plan as the difference between plan assets at fair value and the projected benefit obligation. Unrecognized gains or losses and prior service costs, as well as the transition asset or obligation remaining from the initial application of Statements 87 and 106 will be recognized in the balance sheet, net of tax, as a component of Accumulated other comprehensive loss and will subsequently be recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of those Statements. In addition, SFAS 158 requires additional disclosures about the future effects on net periodic benefit cost that arise from the delayed recognition of gains or losses, prior service costs or credits, and transition asset or obligation. SFAS 158 also requires that defined benefit plan assets and obligations be measured as of the date of the employer's fiscal year-end balance sheet. The recognition and disclosure provisions of SFAS 158 are effective for fiscal years ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end balance sheet is effective for fiscal years ending after December 15, 2008. The Company adopted SFAS 158 as of December 31, 2006. The adoption of SFAS 158 had no impact on the measurement date as the Company has historically measured the plan assets and benefit obligations of its pension and other postretirement plans as of December 31. See Note O to the Consolidated Financial Statements for further discussion.

As of December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158. As a result of adopting SFAS 158, the Company recorded liabilities equal to the underfunded status of defined benefit plans, and assets equal to the overfunded status of certain defined benefit plans measured as the difference between the fair value of plan assets and the projected benefit obligation. As of December 31, 2006, the Company recognized liabilities of \$34,900 and prepaids of \$16,773 for its defined benefit pension plans and also recognized Accumulated other comprehensive loss of \$69,978 (after-tax).

A substantial portion of the Company's pension amounts relate to its defined benefit plan in the United States. The market-related value of plan assets is determined by fair values at December 31.

A significant element in determining the Company's pension expense is the expected return on plan assets. At the end of each year, the expected return on plan assets is determined based on the weighted average expected return of the various asset classes in the plan's portfolio and the targeted allocation of plan assets. The asset class return is developed using historical asset return performance, as well as current market conditions such as inflation, interest rates and equity market performance. The Company determined this rate to be 8.5% for its U.S. plans at December 31, 2006. The assumed long-term rate of return on assets is applied to the market value of plan assets. This produces the expected return on plan assets included in pension expense. The difference between this expected return and the actual return on plan assets is deferred and amortized over the average remaining service period of active employees

expected to receive benefits under the plan. The amortization of the net deferral of past losses will increase future pension expense. During 2006, investment returns in the Company's U.S. pension plans were approximately 13.7%. A 25 basis point change in the expected return on plan assets would increase or decrease pension expense by approximately \$1,400.

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Another significant element in determining the Company's pension expense is the discount rate for plan liabilities. At the end of each year, the Company determines the discount rate to be used for plan liabilities by referring to investment yields available on long-term bonds rated Aa- or better. The Company also considers the yield derived from matching projected pension payments with maturities of a portfolio of available non-callable bonds rated Aa- or better. The Company determined this rate to be 6.0% for its U.S. plans at December 31, 2006. A 25 basis point change in the discount rate would increase or decrease pension expense by approximately \$2,000.

The Company made voluntary contributions to its U.S. defined benefit plans of \$17,500 in 2006. Based on current pension funding rules, the Company did not anticipate that contributions to the plans would be required in 2007. The Company has voluntarily contributed \$10,000 in the first nine months of 2007.

Pension expense relating to the Company's defined benefit plans was \$17,926 in 2006. The Company expects 2007 pension expense to decline by approximately \$10,000.

In the first quarter 2006, the Company modified its retirement benefit programs whereby employees of its largest U.S. company hired on or after January 1, 2006 will be covered under a newly enhanced 401(k) defined contribution plan. In the second quarter of 2006, current employees of this U.S. company made an election to either remain in the existing retirement programs or switch to new programs offering enhanced defined contribution benefits, improved vacation and a reduced defined benefit.

**Inventories and Reserves**

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 valuation of LIFO inventories is made at the end of each year based on inventory levels and costs at that time. The excess of current cost over LIFO cost amounted to \$74,830 at September 30, 2007. The Company reviews the net realizable value of inventory in detail on an on-going basis, with consideration given to deterioration, obsolescence and other factors. If actual market conditions differ from those projected by management, and the Company's estimates prove to be inaccurate, write-downs of inventory values and adjustments to cost of sales may be required. Historically, the Company's reserves have approximated actual experience.

**Accounts Receivable and Allowances**

The Company maintains an allowance for doubtful accounts for estimated losses from the failure of its customers to make required payments for products delivered. The Company estimates this allowance based on the age of the related receivable, knowledge of the financial condition of customers, review of historical receivables and reserve trends and other pertinent information. If the financial condition of customers deteriorates or an unfavorable trend in receivable collections is experienced in the future, additional allowances may be required. Historically, the Company's reserves have approximated actual experience.

**Impairment of Long-Lived Assets**

In accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company periodically evaluates whether current facts or circumstances indicate that the carrying value of its depreciable long-lived assets to be held and used may not be recoverable. If such circumstances are determined to exist, an estimate of undiscounted future cash flows produced by the long-lived asset, or the appropriate grouping of assets, is compared to the carrying value to determine whether impairment exists. If an asset is determined to be impaired, the loss is measured based on quoted market prices in active markets, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including the discounted value of estimated future cash flows and established business valuation multiples.

The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management's judgment. Any changes in key assumptions about the Company's businesses and their prospects, or changes in market conditions, could result in an impairment charge.

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**Impairment of Goodwill and Intangibles**

The Company performs an annual impairment test of goodwill in the fourth quarter of each year. In addition, goodwill is tested as necessary if changes in circumstances or the occurrence of events indicate potential impairment. The Company evaluates the recoverability of goodwill and intangible assets not subject to amortization as required under SFAS 142 *Goodwill and Other Intangible Assets* by comparing the fair value of each reporting unit with its carrying value. The fair values of reporting units is determined 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.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes in the Company's exposure to market risk since December 31, 2006. See Item 7A in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

**Item 4. Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this Form 10-Q. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures are operating effectively as designed. There have been no changes in the Company's internal controls or in other factors that occurred during the period covered by this Form 10-Q that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company is subject, from time to time, to a variety of civil and administrative proceedings arising out of its normal operations, including, without limitation, product liability claims and health, safety and environmental claims. Among such proceedings are the cases described below.

At September 30, 2007, the Company was a co-defendant in cases alleging asbestos induced illness involving claims by approximately 31,059 plaintiffs, which is a net decrease of 361 claims from those previously reported. In each instance, the Company is one of a large number of defendants. The asbestos claimants seek compensatory and punitive damages, in most cases for unspecified sums. Since January 1, 1995, the Company has been a co-defendant in other similar cases that have been resolved as follows: 24,122 of those claims were dismissed, 10 were tried to defense verdicts, 4 were tried to plaintiff verdicts (3 of which were satisfied and 1 of which is subject to appeal), 1 was resolved by agreement for an immaterial amount and 502 were decided in favor of the Company following summary judgment motions.

At September 30, 2007, the Company was a co-defendant in cases alleging manganese induced illness involving claims by approximately 3,762 plaintiffs, which is a net decrease of 791 claims from those previously reported. In each instance, the Company is one of a large number of defendants. The claimants in cases alleging manganese induced illness seek compensatory and punitive damages, in most cases for unspecified sums. The claimants allege that exposure to manganese contained in welding consumables caused the plaintiffs to develop adverse neurological conditions, including a condition known as manganism. At September 30, 2007, cases involving 1,641 claimants were filed in or transferred to federal court where the Judicial Panel on MultiDistrict Litigation has consolidated these cases for pretrial proceedings in the Northern District of Ohio (the MDL Court). Plaintiffs have also filed eight class actions seeking medical monitoring in state courts, six of which have been removed and transferred to the MDL Court. In addition, plaintiffs filed a class action complaint seeking medical monitoring on behalf of current and former welders in eight states, including three states covered by the single-state class actions, in the United States District Court for the Northern District of California. This case was also transferred to the MDL Court. A motion to certify a medical monitoring class related to this case was denied on September 14, 2007. Since January 1, 1995, the Company has been a co-defendant in similar cases that have been resolved as follows: 11,342 of those claims were dismissed, 14 were tried to defense verdicts in favor of the Company, 2 were tried to hung juries,



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1 of which resulted in a plaintiff's verdict upon retrial and 1 of which resulted in a defense verdict upon retrial (subsequently, however, a motion for a new trial has been granted), and 12 were resolved by agreement for immaterial amounts.

On December 13, 2006, the Company filed a complaint in U.S. District Court (Northern District of Ohio) against Illinois Tool Works, Inc. seeking a declaratory judgment that 8 patents owned by the defendant relating to certain inverter power sources have not and are not being infringed and that the subject patents are invalid. Illinois Tool Works filed a motion to dismiss this action, which the Court denied on June 21, 2007. On September 7, 2007, the Court stayed the litigation, referencing pending reexaminations before the U.S. Patent and Trademark Office.

**Item 1A. Risk Factors**

From time to time, information we provide, statements by our employees or information included in our filings with the SEC may contain forward-looking statements that are not historical facts. Those statements are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements, and our future performance, operating results, financial position and liquidity, are subject to a variety of factors that could materially affect results, including those described below. Any forward-looking statements made in this report or otherwise speak only as of the date of the statement, and, except as required by law, we undertake no obligation to update those statements. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless expressed as such, and should only be viewed as historical data.

The risks and uncertainties described below and all of the other information in this report should be carefully considered. These risks and uncertainties are not the only ones we face. Additional risks and uncertainties of which we are currently unaware or that we currently believe to be immaterial may also adversely affect our business.

**If energy costs or the prices of our raw materials increase, our operating expenses could increase significantly.**

In the normal course of business, we are exposed to market risk and price fluctuations related to the purchase of energy and commodities used in the manufacture of our products (primarily steel, brass, copper and aluminum alloys). The availability and prices for raw materials are subject to volatility and are influenced by worldwide economic conditions, speculative action, world supply and demand balances, inventory levels, availability of substitute materials, currency exchange rates, our competitors' production costs, anticipated or perceived shortages and other factors. Since 2003, the price of the type of steel used to manufacture our products has increased significantly and has been subject to periodic shortages due to global economic factors, including increased demand for construction materials in developing nations such as China and India. Since 2003, we have also experienced substantial inflation in prices for other raw materials, including metals, chemicals and energy costs. Energy costs could continue to rise, which would result in higher transportation, freight and other operating costs. Our future operating expenses and margins will be dependent on our ability to manage the impact of cost increases. Our results of operations may be harmed by shortages of supply and by increases in prices to the extent those increases can not be passed on to customers.

**We are a co-defendant in litigation alleging manganese induced illness and litigation alleging asbestos induced illness. Liabilities relating to such litigation could reduce our profitability and impair our financial condition.**

At September 30, 2007, we were a co-defendant in cases alleging manganese induced illness involving claims by approximately 3,762 plaintiffs and a co-defendant in cases alleging asbestos induced illness involving claims by approximately 31,059 plaintiffs. In each instance, we are one of a large number of defendants. In the manganese cases, the claimants allege that exposure to manganese contained in welding consumables caused the plaintiffs to develop adverse neurological conditions, including a condition known as manganism. In the asbestos cases, the claimants allege that exposure to asbestos contained in welding consumables caused the plaintiffs to develop adverse pulmonary diseases, including mesothelioma and other lung cancers.

Since January 1, 1995, we have been a co-defendant in manganese cases that have been resolved as follows: 11,342 of those claims were dismissed, 14 were tried to defense verdicts in favor of us, 2 were tried to hung juries, 1 of which resulted in a plaintiff's verdict upon retrial and 1 of which resulted in a defense verdict upon retrial, and 12 were resolved by agreement for immaterial amounts. Since January 1, 1995, we have been a co-defendant in asbestos cases that have been resolved as follows: 24,122 of those claims were dismissed, 10 were tried to defense verdicts, 4 were

tried to plaintiff verdicts, 1 was resolved by agreement for an immaterial amount and 502 were decided in favor of us following summary judgment motions.

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Defense costs remain significant. The long-term impact of the manganese and asbestos loss contingencies, in each case in the aggregate, on operating cash flows and capital markets is difficult to assess, particularly since claims are in many different stages of development and we benefit significantly from cost-sharing with co-defendants and insurance carriers. While we intend to contest these lawsuits vigorously, and have applicable insurance relating to these claims, there are several risks and uncertainties that may affect our liability for personal claims relating to exposure to manganese and asbestos, including the future impact of changing cost sharing arrangements or a change in our overall trial experience.

Manganese is an essential element of steel and cannot be eliminated from welding consumables. Asbestos use in welding consumables in the U.S. ceased in 1981.

### **We may incur material losses and costs as a result of product liability claims that may be brought against us.**

Our products are used in a variety of applications, including infrastructure projects such as oil and gas pipelines and platforms, buildings, bridges and power generation facilities, the manufacture of transportation and heavy equipment or machinery, and various other construction projects. We face risk of exposure to product liability claims in the event that accidents or failures on these projects result, or are alleged to result, in bodily injury or property damage. Further, our welding products are designed for use in specific applications, and if a product is used inappropriately, personal injury or property damage may result. For example, in the period between 1994 and 2000, we were a defendant or co-defendant in 21 lawsuits filed by building owners or insurers in Los Angeles County, California. The plaintiffs in those cases alleged that certain buildings affected by the 1994 Northridge earthquake sustained property damage in part because a particular electrode used in the construction of those buildings was unsuitable for that use. In the Northridge cases, one case was tried to a defense verdict in favor of us, 12 were voluntarily dismissed, 7 were settled and we received summary judgment in our favor in another.

The occurrence of defects in or failures of our products, or the misuse of our products in specific applications, could cause termination of customer contracts, increased costs and losses to us, our customers and other end users. We cannot be assured that we will not experience any material product liability losses in the future or that we will not incur significant costs to defend those claims. Further, we cannot be assured that our product liability insurance coverage will be adequate for any liabilities that we may ultimately incur or that it will continue to be available on terms acceptable to us.

### **The cyclicity and maturity of the United States arc welding and cutting industry may adversely affect our performance.**

The United States arc welding and cutting industry is a mature industry that is cyclical in nature. The growth of the domestic arc welding and cutting industry has been and continues to be constrained by factors such as the increased cost of steel and increased offshore production of fabricated steel structures. Overall demand for arc welding and cutting products is largely determined by the level of capital spending in manufacturing and other industrial sectors, and the welding industry has historically experienced contraction during periods of slowing industrial activity. If economic, business and industry conditions deteriorate, capital spending in those sectors may be substantially decreased, which could reduce demand for our products, our revenues and our results of operations.

### **We may not be able to complete our acquisition strategy or successfully integrate acquired businesses.**

Part of our business strategy is to pursue targeted business acquisition opportunities, including foreign investment opportunities. We cannot be certain that we will be successful in pursuing potential acquisition candidates or that the consequences of any acquisition would be beneficial to us. Future acquisitions may involve the expenditure of significant funds and management time. Depending on the nature, size and timing of future acquisitions, we may be required to raise additional financing, which may not be available to us on acceptable terms. Our current operational cash flow is sufficient to fund our current acquisition plans, but a significant acquisition would require access to the capital markets. Further, we may not be able to successfully integrate any acquired business with our existing businesses or recognize expected benefits from any completed acquisition.

### **If we cannot continue to develop, manufacture and market products that meet customer demands, our revenues and gross margins may suffer.**

Our continued success depends, in part, on our ability to continue to meet our customers' needs for welding products through the introduction of innovative new products and the enhancement of existing product design and performance



characteristics. We must remain committed to product research and development and customer service in order to remain competitive. Accordingly, we may spend a proportionately greater amount on research and development than some of our competitors. We cannot be assured that new products or product improvements, once developed, will meet with customer acceptance and

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contribute positively to our operating results, or that we will be able to continue our product development efforts at a pace to sustain future growth. Further, we may lose customers to our competitors if they demonstrate product design, development or manufacturing capabilities superior to ours.

**The competitive pressures we face could harm our revenue, gross margins and prospects.**

We operate in a highly competitive global environment and compete in each of our businesses with other broad line manufacturers and numerous smaller competitors specializing in particular products. We compete primarily on the basis of brand, product quality, price, performance, warranty, delivery, service and technical support. If our products, services, support and cost structure do not enable us to compete successfully based on any of those criteria, our operations, results and prospects could suffer.

Further, in the past decade, the United States arc welding industry has been subject to increased levels of foreign competition as low cost imports have become more readily available. Our competitive position could also be harmed if new or emerging competitors become more active in the arc welding business. For example, while steel manufacturers traditionally have not been significant competitors in the domestic arc welding industry, some foreign integrated steel producers manufacture selected consumable arc welding products. Our sales and results of operations, as well as our plans to expand in some foreign countries, could be harmed by this practice as well.

**We conduct our sales and distribution operations on a worldwide basis and are subject to the risks associated with doing business outside the United States.**

Our long-term strategy is to continue to increase our share in growing international markets, particularly Asia (with emphasis in China and India), Latin America, Eastern Europe and other developing markets. There are a number of risks in doing business abroad, which may impede our ability to achieve our strategic objectives relating to our foreign operations. Many developing countries, like Venezuela, have a significant degree of political and economic uncertainty that may impede our ability to implement and achieve our foreign growth objectives. In addition, compliance with multiple and potentially conflicting foreign laws and regulations, import and export limitations and exchange controls is burdensome and expensive.

Moreover, social unrest, the absence of trained labor pools and the uncertainties associated with entering into joint ventures or similar arrangements in foreign countries have slowed our business expansion into some developing economies. Our presence in China has been facilitated largely through joint venture agreements with local organizations. While this strategy has allowed us to gain a footprint in China while leveraging the experience of local organizations, it also presents corporate governance and management challenges.

Our foreign operations also subject us to the risks of international terrorism and hostilities and to foreign currency risks, including exchange rate fluctuations and limits on the repatriation of funds.

**Our operations depend on maintaining a skilled workforce, and any interruption in our workforce could negatively impact our results of operations and financial condition.**

We are dependent on our highly trained technical sales force and the support of our welding research and development staff. Any interruption of our workforce, including interruptions due to unionization efforts, changes in labor relations or shortages of appropriately skilled individuals for our research, production and sales forces could impact our results of operations and financial condition.

**Our revenues and results of operations may suffer if we cannot continue to enforce the intellectual property rights on which our business depends or if third parties assert that we violate their intellectual property rights.**

We rely upon patent, trademark, copyright and trade secret laws in the United States and similar laws in foreign countries, as well as agreements with our employees, customers, suppliers and other third parties, to establish and maintain our intellectual property rights. However, any of our intellectual property rights could be challenged, invalidated or circumvented, or our intellectual property rights may not be sufficient to provide a competitive advantage. Further, the laws and their application in certain foreign countries do not protect our proprietary rights to the same extent as U.S. laws. Accordingly, in certain countries, we may be unable to protect our proprietary rights against unauthorized third-party copying or use, which could impact our competitive position.

Further, third parties may claim that we or our customers are infringing upon their intellectual property rights. Even if we believe that those claims are without merit, defending those claims and contesting the validity of patents can be



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time-consuming and costly. Claims of intellectual property infringement also might require us to redesign affected products, enter into costly settlement or license agreements or pay costly damage awards, or face a temporary or permanent injunction prohibiting us from manufacturing, marketing or selling certain of our products.

**Our global operations are subject to increasingly complex environmental regulatory requirements.**

We are subject to increasingly complex environmental regulations affecting international manufacturers, including those related to air and water emissions and waste management. Further, it is our policy to apply strict standards for environmental protection to sites inside and outside the United States, even when we are not subject to local government regulations. We may incur substantial costs, including cleanup costs, fines and civil or criminal sanctions, liabilities resulting from third-party property damage or personal injury claims, or our products could be enjoined from entering certain jurisdictions, if we were to violate or become liable under environmental laws or if our products become non-compliant with environmental laws.

We also face increasing complexity in our products design and procurement operations as we adjust to new and future requirements relating to the design, production and labeling of our electrical equipment products that are sold in the European Union. The ultimate costs under environmental laws and the timing of these costs are difficult to predict, and liability under some environmental laws relating to contaminated sites can be imposed retroactively and on a joint and several basis.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds** None.

**Item 3. Defaults Upon Senior Securities** None.

**Item 4. Submission of Matters to a Vote of Security Holders** None.

**Item 5. Other Information** None.

**Item 6. Exhibits**

(a) Exhibits

10.1 Amendment No. 2 to the 2006 Stock Plan for Non-Employee Directors dated July 26, 2007 (filed herewith).

31.1 Certification by the Chairman, President and Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

31.2 Certification by the Senior Vice President, Chief Financial Officer and Treasurer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LINCOLN ELECTRIC HOLDINGS, INC.

/s/ Vincent K. Petrella  
Vincent K. Petrella, Senior Vice President,  
Chief Financial Officer and Treasurer  
(principal financial and accounting officer)  
October 29, 2007

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