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EDITED TRANSCRIPT

LECO.OQ - Lincoln Electric Holdings Inc at CL King & Associates Best Ideas Conference (Virtual)

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OVERVIEW:

Company Summary

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CORPORATE PARTICIPANTS

Gabriel Bruno *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

CONFERENCE CALL PARTICIPANTS

Tom Hayes *CL King - Analyst*

PRESENTATION

Tom Hayes - *CL King - Analyst*

Good morning. This is Tom Hayes, the senior investor analyst for CL King. Welcome to our 22nd Annual CL King Best Ideas Conference. I'm pleased to have the management team of Lincoln Electric with me today, specifically CFO, Gabe Bruno. Again, good morning to all, and thank you for joining us today.

(Conference Instructions) So I've asked Gabe to kind of give us a brief overview of Lincoln Electric to kind of kick things off and then we'll jump into some Q&A. Gabe, thank you very much for being with us today.

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Well, great, Tom. Thanks for having me and all of your interest in Lincoln Electric. So a brief overview. We've been in business for almost 130 years, and we are the global leaders in arc welding. And so we like to emphasize, we're only one of three companies in our industry that have a broad portfolio, complete portfolio of products.

We also emphasize technology, as you can appreciate, and solution. So we've got a broad portfolio of solutions. And one of the things that we differentiate ourselves within the industry is our automation platform. So our automation platform now is about $1 billion run rate and is anchored on the solutions and areas of productivity and quality that our customers have been accustomed to appreciate from how we engage in the markets.

We are broad-based. We've got a very broad level of customer interactions from small, midsized fabricators to large multinational global types of businesses. We serve broad end markets, automotive, to construction to heavy industries, general industries, energy and the like. So we serve a broad base of end markets, as well, we're global. So we're all over in different geographies around the world.

If you consider our strategy, we're emphasizing accelerated growth and that's both organic and inorganic growth. So when you look at the building blocks of our 2025 strategy, it anchors around innovation, technology, accelerated growth through our automation platform as well as acquisitions -- and acquisitions we'd like to emphasize an objective of 300 to 400 basis points of CAGR throughout our business strategy periods.

We also like to emphasize an expansion of our operating margin. So over each cycle over the last 20 years, you will see a 200-basis-point improvement in our operating model. And that can come alongside different work across segments. So we manage our business through three segments: the Americas, International and Harris segments. And then also within the automation portfolio, an emphasis of improving our margins and the business model.

So we're a strong cash-generating business. We like to emphasize 100%-plus cash conversion, very disciplined managing working capital, and also our capital allocation strategy, which yields strong ROIC performance of our business. So just a couple of thoughts there for our business.

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QUESTIONS AND ANSWERS

Tom Hayes - *CL King - Analyst*

That was great. And I think there's a lot in there that we'll kind of build on today. But I think maybe first off, you touched a little bit about your -- you guys have been operating for -- bit of a few years on your current operating strategy of higher standard 2025. Can you maybe just kind of touch on some of those key tenants? I'm sure we'll hear about maybe a new longer-term strategy coming up in the next couple of quarters, but maybe your thoughts on how you're operating against that strategy and some of the goals.

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yeah. So when you think about the objectives that I already emphasized on growth, and our margin profile and cash generation, including working capital type of performance, we'll start with growth. So we're ahead of our progression in our targets. Our objective is to progress into a CAGR of high single-digit, low double-digit type of growth and that includes acquisitions.

During the current year cycle, we've got some pressure on the organic side of our business, but you can see also on the acquisition side, we're ahead of our objective in this year. So growth is very important for us. Again, as I mentioned, leading with technology, if you look into our deck, you'll see the building blocks of that with solutions technology. So we're progressing well on growth.

When you think about the operating margins, we like to emphasize an average operating margin for the period. So for example, up through 2019, we were just shy of 14% on average over the previous five-year period or so. Our current objective is an expansion of 200 basis points on average, which in this period, 2025, would amount to 16%. So that's a 200-basis-point improvement from the last cycle.

And within that, you can see we're performing ahead of that on an annual basis. But because it's an area which takes into account 2020, 2021, et cetera, we're slightly behind coming into 2024, but we're right on top of the objective when you consider the continued performance and profitability in this year and as we continue into the wrap-up 2025 strategy period as well.

Cash generation is also part of the profile. I think I would like to emphasize from a strategic standpoint. You see we're exceeding 100% on cash conversion this year, top quartile type of focus on working capital, top decile performance is the objective at 15% of sales in our working capital to sales type of metric. And you can see the ROIC, we're performing very well.

And also from a capital allocation standpoint, very balanced in looking at how we're driving growth through our investments and then also returning cash to shareholders. So we're progressing right ahead of all of the key objectives and working through the current challenging environment from an organic sales standpoint.

Tom Hayes - *CL King - Analyst*

No, appreciate that color. Maybe kind of touching on automation a little bit because I think you guys go to and kind of built you're offering a little bit different than your competitors. I think you threw out M&A and organically, you've built kind of an internal, I'll call it internally delivered automation solution, which I think probably connects [barely] the customers. Maybe just kind of touch on maybe how you see that as a competitive advantage and how you can continue to build that out.

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yeah. So Tom, that's -- we're really excited about our automation strategy and the portfolio that we've been able to develop over the last 10 years. So the key first element to consider is it anchors on how we are introducing solutions to our customers to address labor needs as well as drive productivity, quality, safety in our customer needs. When you consider what we've done within our automation portfolio, we are serving broad-based industries that can go from small, midsized fabricators now with Cobots for pre-engineered type robotic systems to large-scale lines and capabilities.

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Currently, we're about 55% of our portfolio tied to welding-related capabilities. And then 45%, that's nonwelding that surrounds the automation profile of our needs of customers.

So we've deepened the capabilities of our offering over the years through organic development, but also through acquisitions. And we brought in the footprint on how we serve end markets. So when you think about the industry, the industry was led by the likes of automotive and heavy industry. But we've been focused in driving adoption into automation capabilities far deeper into the markets.

And so prior to our acquisition of a business called Fori a couple of years ago, we had progressed our model to be about a third automotive, a third heavy industry and a third general industries. Before the acquisition, which is a couple of hundred million dollar-type of business in sales, it was almost all automotive. So that also changed the profile a bit, but we're still focused on deepening general industry adoption to the likes of the Cobot introduction in just the last couple of years. So we're now about 45% automotive, 25% general industries, and 30% heavy industry. So we're serving a broad level of end markets.

When we think about how we've grown, you commented on both organic and inorganic type of growth. When we entered the strategy period in 2020, our automation business was a $400 million business. And we had discussed in the markets about our objective to achieve $1 billion of revenues. And so we've achieved that, and that was both through inorganic but plus organic type of growth. And we believe we just have a strong platform to continue to drive accelerated growth, part of our core growth strategy, but also considering the platform within automation as opportunities to also bolt-on businesses into our model.

We believe that the TAM associated with automation is about $35 billion and lots of fragmentation. When we talk about the key competitors within the automation space, we're not talking about the other welding competitors inherently. We're talking about other integrators, particularly in North America, that typically are around that $50 million to $100 million range and just a lot of fragmentation, which becomes ripe for an acquisition bolt-on type of strategy.

And you saw that in this year, we've acquired three businesses. Two businesses are tied to our automation. One continues out building up material handling capabilities. That's the RedViking acquisition that we completed in April. And then we had an acquisition in June Inrotech, which adds on technology, and that was a vision-based technology that we added. So we look at inorganic opportunities to continue to shape our presence, the capabilities, our growth focus over the long term.

Now the last point I'll make on automation is that when you enter into a strategy with a lot of bolt-on types of acquisitions, there's a fragmentation in running the businesses. We've developed what we call a Lincoln business system that pulls together all of our different operations to a single business strategy and model.

And that's what's key to our projects, disciplines around the quoting process, in managing orders, managing change orders, should there be changes in our customer requirements throughout the life cycle of the project, and then continuing to drive and leverage capabilities and also our operating margin. So when you look at our business model from 2020, 2021 to today, we've just about doubled the margin profile from a mid- to high single-digit profile to doubling that. And our objective is to be at the corporate average.

So typically, acquisitions are a little bit of a drag in the overall margin profile being typically in the low double digits, but we expect by the third year to be in line to what our strategic objectives from an operating model standpoint. So it gives you a lot of flavor on kind of how we think of automation.

Tom Hayes - *CL King - Analyst*

No, I appreciate that color because I think it's an important part of what's happening across the environment. So no, that's appreciated. We did get some questions from clients. I just -- maybe kind of trying to work these ones in. How -- I apologize, I didn't go back and read the 2Q transcript, but just how should we think about the price/cost building blocks as we kind of look to the balance of 2024? Should we expect a tailwind from raw materials? Are there any offsets?

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Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yeah. So in terms of price cost, and our overall strategic posture is to be price cost-neutral. And when we think about pricing for this year, while we have updated broader organic assumptions to be down mid- to high single digits, we expect to be positive on price. So generally, throughout the cycle, we hold price.

It's a little bit different when we look at some of the segments. So on the Americas side, you had more movement on the equipment side. When you look at Harris, that's going to move with metals, silver and copper. And we were a little slightly down second quarter for international. But in general, expect to be price positive while overall volumes to be down.

Tom Hayes - *CL King - Analyst*

Okay. And this is kind of a two-part one. Maybe your thoughts on some of the margin building blocks in the Americas for the back half of this year and your thoughts on any implied decremental margins as well and kind of -- I guess it ties to the bigger picture your guys' playbook for these less than robust industrial times.

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yeah. So I've commented on some of the webcast of -- prior webcast. But for the Americas, there's two dynamics that we're working through in the back half of 2024. One is some of the softening demand levels, particularly in short cycle automation. Automation has got -- we just talked about automation, but automation has a larger fixed cost structure.

So typically, with automation, you have higher incrementals and incrementals will be into the low to mid-30s, but also higher decrementals because it's a highly engineering technical capability and a lot of floor space required to be able to serve our customers. So that higher decrementals, you'll see some of that in the second half of this year in the Americas segment. So we have some pressure on our EBIT profile in Americas because of that.

We're also going to have some pressure due to acquisitions. The acquisitions are largely impacting the Americas. They're typically with integration types of costs into the mid- to high single-digit EBIT profile. So expect some of that on the Americas side and the building blocks of the EBIT profile. So we could be in the range of 17%, 18% on the Americas segment EBIT margin for the second half of this year.

Now that said, you mentioned our playbook. We're very disciplined, as you know, in managing through cycles. We have pulled out our playbook and we'll be pretty aggressive in pulling the levers on temporary cost savings. So those are the likes of contractors, supplies, travel, discretionary types of areas of spending, and we'll be pretty aggressive in pulling back the levers to be able to manage and offset some of the margin pressures because of the softening organic sales trends.

And then we also look at accelerating opportunities where we know of and shaping our operating model. We call those permanent or structural changes and -- so we'll have a little bit more pressure as we see the second half progress into the third quarter and then it has the levers. It takes a couple of months to really get the full impact on those temporary cost reduction actions, and then we'll see more of an offset to that into the fourth quarter. But that's how we're operating in this second half.

Tom Hayes - *CL King - Analyst*

Okay. No, I appreciate that. And hopefully, that answered the participant's question. Maybe shifting gears a little bit. I think one area that I think you started talking about a little bit at FABTECH last year was you're moving into the DC charging business. Maybe any updates and thoughts you can give me on that segment?

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Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yes. So we're pretty excited on how our team has progressed with our strategy. And that means that we look at our strategic positioning in three ways. One is operational, and commercial, and products. On the operational side, we had leveraged our internal infrastructure operations to be able to develop a capacity of 500 units a month beginning this January, and we're there. This is a modest investment, which is different than our -- the competitive environment in our industry that's dealing with a lot of pressures in the markets right now. But we're leveraging key capabilities in power electronics and our own facilities and people to be able to achieve that capacity. So we've done that.

On the commercial side, we've brought in some experienced industry leaders on the commercial side, and we're looking at engaging in charge point operators or fleet managers, engineering firms, and developing our relationship with them and what it means to work with Lincoln Electric. So we've done that.

On the product side, we had anchored our development around a 50-kilowatt modular design upwards towards nevi specifications of 150 kilowatts, and we achieved that. So we launched that. This is at the end of the second quarter, beginning of the third, but the market has shifted. There is a hesitation in the market to deepen investment while the evolution of EV and consumer engagement involves.

So we've seen a push to drive to higher charging powers in terms of the fast chargers similar to 300 to 400 type of kilowatts. So our team is working with the building blocks of our modular design to be able to achieve that over the next few quarters. And so we expect there to be a pause in the ability to roll out and progress our product offering into the markets until probably the back half of 2025.

So we're on target with the objectives that we have set for our business. These are modest investments, so we can be patient as we navigate the development of these markets. We -- these are not distractions to our core strategy, but we look at this as low risk, low investment with potential high upside. And so we're pleased to where we are at and now we've got to navigate the development of the industry over the next two quarters.

Tom Hayes - *CL King - Analyst*

Okay. Maybe kind of getting back to the core manufacturing business, I think one of the things I hear frequently from investors is the initiative to kind of reshore manufacturing to the US and it seems to be kind of outside of semi, it seems to be kind of a mixed bag. And maybe just, A, your thoughts on kind of what you're seeing out there, and B, the opportunity going forward?

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Look, near-shoring or on-shoring particularly into the Americas regions is going to be positive for us. whether it's in the US or Mexico or whatever it is. So we look at this as an opportunity in building out the industrial space in North America, which is where, as you know, our largest profit generating and business is at.

So we're excited about that. It's an opportunity. It's hard to quantify like what does that mean in terms of real business activity and growth for us. But we know that the more manufacturing, industrial capabilities that are built out into the North American regions that will have our share of activity that's tied to that. So we think it's an opportunity for us.

Tom Hayes - *CL King - Analyst*

Maybe a topic that's certainly floating out there, maybe not specifically for manufacturing, but I thought I'd bring it up with most of the companies I'm talking about today is AI and how is that maybe impacting your business? Or how are you guys thinking about it maybe both internally and externally?

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Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yeah. So we're still in the development stage when we look at operational or commercial capabilities tied to like degenerative AI. And that's applications, that could be welding knowledge and know-how operational capabilities.

Where we're seeing a lot of progression within our model is on the product side with the additive-based, wire-based process that we have deployed, and we're working through development commercially. This is a machine learning type of software that is an iterative process in taking AI artificial intelligence and refining welding pass and capability in driving a wire-based capability.

And that's progressing. We're excited about where our additive business is developing with some of the key business cases there. But we're still kind of developing the AI positioning from an operating standpoint, see more so on the product side.

Tom Hayes - *CL King - Analyst*

Okay. I think you touched on a little bit, but I just want to make sure we kind of went back to it as far as coming out of 2Q, you had some commentary on the automakers maybe pausing their CapEx as they kind of reevaluate where they want to go between EVs and ICE. Maybe you just kind of refresh us where we were or where you guys are on your thinking on that?

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yeah. So there's been just a lot of movement and thinking through across automotive industry on where investment is progressing, whether or not to stay in the course on some of their EV plans that were contemplated or migrating to either a hybrid or ICE. And so that has caused a slowing in making decisions from a quoting to order process. And so we pointed to that as being an air pocket, if you will, while the industry is kind of repositioning -- do they continue EV or otherwise. So we look at, in general, a typical time frame of six months between quote to order.

And so we're seeing that elongate to another -- to three months or to like nine months. And so what does that mean is that the visibility we have and actually booking orders and then becoming revenue because a lot of our business and the larger projects are percentage completion type of revenue recognition, just haven't seen that come to the past.

And so we pointed that to be a pause. Now the interesting thing is we're agnostic as to whether now there's an EV or ICE or hybrid decision. It's really about the pause in making decisions and an ability to actually book the orders and then begin the revenue recognition type of process.

So we're starting to see some decisions being made. So for example, when you see a cancellation of an EV program, that's not a bad thing for us. That just points to a decision being made and that's good for us. Ultimately, the industry has a couple of key dates in looking at some of the downstream programs. One is in April and one is October. So our team is -- and our industry segment leaders are working with the industry to think to -- what does this mean ultimately between an EV program for 2026, 2027 or is there a shift over to hybrid and ICE.

And so we haven't seen that change much over the last few months, starting to see more decisions being made, but we're looking forward to the fourth quarter is where we believe that we'll see more activity in refining the direction of the industry in pursuing EV, ICE or hybrid investments for the 2026, 2027 time frame. It's about an 18-month lead time to be able to position projects to serve that time frame. So it's pretty important that the industry make those types of decisions to be ready for 2026, 2027 in this fourth quarter or so.

Tom Hayes - *CL King - Analyst*

But I think the key point is that you're, again, agnostic to which direction and you wanted to go -- you just wanted to go somewhere.

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Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

[These fun] decisions to be made, right? And where the investment will go.

Tom Hayes - *CL King - Analyst*

Okay. Maybe just circling back a little bit, you touched on -- maybe I'll shift gears a little bit. One of the things that's been an issue for the industry for a while, and I just wanted to get your take on it and kind of how you're addressing is, is the continued chronic shortage of welders in the space, whether it's -- we touched on obviously bringing automation, but I think there's much more that you are -- and others are doing, whether it's from educational benefits to simplifying some of the equipment. Maybe is there anything else I'm missing or kind of how you guys view the industry progressing?

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Tom, that's a fair observation. So you're right. There are two key drivers in how we address the response to the labor constraints on the welder side. One is automation. So the automation obviously is a solution that ties right into factory productivity, production, quality, safety. We've talked about that.

But the other is, as you mentioned, is education and training. I mean, we are having this conference and I'm sitting in our welding technology and train center, and we have the longest-running well school in the industry, 107 years. So very much anchored on education, training, application development. We'd like to think about the training aspect to education in a few different ways. So one is accelerating our ability to get welders trained and into an effective operational capacity. So the introduction of different tools and techniques and training software enables that. So we've got a Vertex type system that allows for welding training development on a remote type of solution.

Then we also have another product called Voyager that introduces welding to middle schoolers, high schoolers who are contemplating trades and that allows them to kind of get a sense of what welding means. So we've got products that, one, accelerate training, one uses in a fun copoly gamification to introduce welding to high schoolers, middle schoolers in the [store].

And then we also use it to qualify welders. So using the tools to be able to progress someone who's being trained and how well they are learning the skills and processes associated with welding. So very deep in introducing education and schooling capabilities. It's broad-based around the globe. So we've got a lot of trade associations that we work with. And that's a deep part of how we look at our own participation within the industry.

We had talked about for years about our desire to paint the world of red, which means getting into the schools and the trades in showing our products and having them learn welding within our power sources and our consumables. And that provides long-term stickiness and knowing our products and offering and being comfortable in using our capabilities and leveraging what we do in the markets. So very deep in education and also leveraging automation because of the labor constraints.

Tom Hayes - *CL King - Analyst*

Are those labor constraints universally kind of applied globally or there are [part getting markets] where maybe you have a younger workforce that's maybe not as constrained? Just wondering.

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

No, this is a global dynamic. So we look at this from a global perspective, the associations that we're engagement around the globe. It's not just a US dynamic.

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Tom Hayes - *CL King - Analyst*

Okay. Maybe shifting gears a little bit. And I think you mentioned this at a recent event, but you brought in a Chief Procurement Officer and a Chief Transformation Officer. Certainly, you're a company with a long legacy, long history, maybe just kind of -- since you've brought those topics out, maybe just your thoughts on what they can deliver.

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yeah. No, it's -- that's pretty important for us. I didn't mention the 2030 strategy. We haven't rolled that out. But part of that, I mean, you could expect a continuation of driving accelerated growth and a continued focus on shaping our operating model. And as I mentioned, we have been very consistent in expanding our operating margins by -- to 200 basis points for each of the strategy periods.

So when you start thinking about what are some of the next steps, the Chief Procurement Officer transformation are all about how do we leverage capabilities across all of our segments and regions. So looking at material buying practices and how do we leverage our spend on direct materials or indirect materials and sourcing, that's where we think we can find a lot of opportunity to kind of develop our operating model.

So that, plus the transformation officer looking at best practices, how do we look to across our regions and leveraging our capabilities, those were all -- those will be building blocks and how we continue to shape our operating model, again, to continue to expand our operating margins. So those are sensor-led corporate initiatives that we're investing in to be able to drive more improvement in efficiencies across our business. So expect that to continue to shape our model.

Tom Hayes - *CL King - Analyst*

Okay. And will we -- I'm going to see if I can press on this. So will we see the 2030 strategy rolled out 3Q or 4Q?

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

No, we're thinking about end of first quarter, second quarter of next year is probably a time frame because we'll be wrapping up. We'll be deep into 2025. So it kind of was a nice transition.

Tom Hayes - *CL King - Analyst*

Okay, great. We did get another question from the investor base here. Maybe just anything you can provide on general market commentary. You just noted that -- you noted broad-based weakness in August at a prior conference. Are you seeing any difference in that so far?

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

No. I mean, where we are at. I mean, kind of the drivers to our updates in the last couple of weeks for some of the continued softness we've seen in automation. Let me just back up for a moment. So during our second quarter, we had updated the markets to expect an organic trend of mid-single digits down. And if you recall in my comments during our second-quarter earnings, I mentioned that we're tracking on the higher end of the unfavorable range. So that implies 6%.

So we've seen continued pressure, and we commented that August is always difficult to really gauge, but there was enough there that we felt that we should be updating the organic trends to mid- to high single digits. So slight change, but enough to give perspective that it's a more challenging type of environment and that also progressed us to be considering what it means in margins and also our playbook. And so that's really the context, but nothing really add to that commentary.

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Tom Hayes - *CL King - Analyst*

I just looked, there's no further questions, and we've kind of exhausted my list of questions. So unless I missed anything or if you'd like to add anything else, I think we're about done for this morning.

Gabriel Bruno - *Lincoln Electric Holdings Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Okay. No. I'd just like to thank all of you who are on the call of your interest and just continue to look at us as the industry leaders and continuing to shape and drive growth within our business.

Tom Hayes - *CL King - Analyst*

Great, thank you.

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