

LINCOLN ELECTRIC HOLDINGS INC

Form 10-Q

July 30, 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 June 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 June 30, 2007 was 42,998,180.

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

*(In thousands, except per share data)*

	<b>Three Months Ended June</b>		<b>Six Months Ended June</b>	
	<b>30,</b>		<b>30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net sales	\$ 586,638	\$ 502,510	\$ 1,135,681	\$ 970,904
Cost of goods sold	417,970	356,043	808,797	694,371
Gross profit	168,668	146,467	326,884	276,533
Selling, general & administrative expenses	93,317	83,436	182,837	160,107
Rationalization charges		1,292	396	2,341
Operating income	75,351	61,739	143,651	114,085
Other income (expense):				
Interest income	1,699	1,400	3,149	2,594
Equity earnings in affiliates	3,677	2,160	5,155	2,524
Other income	580	176	1,044	549
Interest expense	(2,786)	(2,438)	(5,513)	(4,839)
Total other income	3,170	1,298	3,835	828
Income before income taxes	78,521	63,037	147,486	114,913
Income taxes	23,272	20,418	44,237	35,545
Net income	\$ 55,249	\$ 42,619	\$ 103,249	\$ 79,368
Per share amounts:				
Basic earnings per share	\$ 1.29	\$ 1.00	\$ 2.41	\$ 1.87
Diluted earnings per share	\$ 1.27	\$ 0.99	\$ 2.38	\$ 1.85
Cash dividends declared per share	\$ 0.22	\$ 0.19	\$ 0.44	\$ 0.38

See notes to these consolidated financial statements.

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

	<b>June 30, 2007 (UNAUDITED)</b>	<b>December 31, 2006 (NOTE A)</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 147,981	\$ 120,212
Accounts receivable (less allowance for doubtful accounts of \$7,503 in 2007; \$8,484 in 2006)	360,945	298,993
Inventories		
Raw materials	108,891	106,725
In-process	52,972	50,736
Finished goods	213,264	193,683
	375,127	351,144
Deferred income taxes	11,733	5,534
Other current assets	49,474	53,527
<b>TOTAL CURRENT ASSETS</b>	<b>945,260</b>	<b>829,410</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Land	37,685	34,811
Buildings	239,357	230,390
Machinery and equipment	600,999	574,133
	878,041	839,334
Less: accumulated depreciation and amortization	473,979	449,816
	404,062	389,518
<b>OTHER ASSETS</b>		
Prepaid pension costs	26,699	16,773
Equity investments in affiliates	53,352	48,962
Intangibles, net	44,269	41,504
Goodwill	37,072	35,208
Long-term investments	29,514	28,886
Other	10,196	4,318
	201,102	175,651
<b>TOTAL ASSETS</b>	<b>\$ 1,550,424</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)

	<b>June 30, 2007 (UNAUDITED)</b>	<b>December 31, 2006 (NOTE A)</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Amounts due banks	\$ 11,617	\$ 6,214
Trade accounts payable	160,722	142,264
Accrued employee compensation and benefits	87,178	45,059
Accrued expenses	23,686	24,652
Accrued taxes, including income taxes	23,184	35,500
Accrued pensions	1,489	1,483
Dividends payable	9,446	9,403
Other current liabilities	34,326	32,793
Current portion of long-term debt	764	40,920
<b>TOTAL CURRENT LIABILITIES</b>	<b>352,412</b>	<b>338,288</b>
Long-term debt, less current portion	112,422	113,965
Accrued pensions	33,835	33,417
Deferred income taxes	19,795	27,061
Accrued taxes, non-current	37,397	
Other long-term liabilities	30,318	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 42,998,180 shares in 2007 and 42,806,429 shares in 2006	4,929	4,929
Additional paid-in capital	142,483	137,315
Retained earnings	988,839	906,074
Accumulated other comprehensive loss	(35,061)	(54,653)
Treasury shares, at cost 6,292,537 shares in 2007 and 6,484,288 shares in 2006	(136,945)	(140,689)
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>964,245</b>	<b>852,976</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 1,550,424</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>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 103,249	\$ 79,368
Adjustments to reconcile net income to net cash provided by operating activities:		
Rationalization charges	396	2,341
Depreciation and amortization	25,833	22,985
Equity earnings of affiliates, net	(3,987)	(1,591)
Deferred income taxes	(11,567)	(34)
Stock-based compensation	2,229	1,938
Amortization of terminated interest rate swaps	(639)	(1,050)
Other non-cash items, net	(713)	1,624
Changes in operating assets and liabilities net of effects from acquisitions:		
Increase in accounts receivable	(53,759)	(55,800)
Increase in inventories	(12,236)	(49,428)
Decrease (increase) in other current assets	5,086	(8,072)
Increase in accounts payable	14,529	27,824
Increase in other current liabilities	47,425	46,812
Contributions to pension plans	(10,395)	(16,397)
Increase in accrued pensions	1,025	8,637
Net change in other long-term assets and liabilities	976	(1,827)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>107,452</b>	<b>57,330</b>
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(29,640)	(32,261)
Acquisition of businesses, net of cash acquired	(4,414)	(95)
Proceeds from sale of property, plant and equipment	201	641
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	<b>(33,853)</b>	<b>(31,715)</b>
<b>FINANCING ACTIVITIES</b>		
Proceeds from short-term borrowings		2,035
Payments on short-term borrowings	(13)	(925)
Amounts due banks, net	4,348	(4,634)
Payments on long-term borrowings	(40,307)	(1,449)
Proceeds from exercise of stock options	5,062	8,952
Tax benefit from the exercise of stock options	2,736	3,051
Cash dividends paid to shareholders	(18,825)	(16,077)
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>(46,999)</b>	<b>(9,047)</b>
Effect of exchange rate changes on cash and cash equivalents	1,169	852

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INCREASE IN CASH AND CASH EQUIVALENTS	27,769	17,420
Cash and cash equivalents at beginning of year	120,212	108,007
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 147,981	\$ 125,427

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)

June 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 six months ended June 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 during the six months ended June 30, 2007. The *Company* issued 191,751 and 365,867 shares of common stock from treasury upon exercise of employee stock options during the six months ended June 30, 2007 and 2006, respectively.

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 six months ended June 30, 2007 and 2006 was \$2,229 and \$1,938, respectively. The related tax benefit for the six months ended June 30, 2007 and 2006 was \$852 and \$741, respectively.

**NOTE C GOODWILL AND INTANGIBLE ASSETS**

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 six months of 2007 and 2006. Goodwill totaled \$37,072 and \$35,208 at June 30, 2007 and

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December 31, 2006, respectively. Goodwill by segment at June 30, 2007 was \$13,316 for North America, \$10,993 for Europe and \$12,763 for Other Countries.

Gross intangible assets other than goodwill as of June 30, 2007 and December 31, 2006 were \$61,791 and \$58,346, respectively, and related accumulated amortization was \$17,522 and \$16,842, respectively. Aggregate amortization expense was \$955 and \$827 for the six months ended June 30, 2007 and 2006, respectively. Gross intangible assets other than goodwill with indefinite lives totaled \$13,136 at June 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 June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Numerator:				
Net income	\$ 55,249	\$ 42,619	\$ 103,249	\$ 79,368
Denominator:				
Denominator for basic earnings per share Weighted average shares outstanding	42,947	42,514	42,895	42,397
Effect of dilutive securities Employee stock options	514	494	512	477
Denominator for diluted earnings per share Adjusted weighted average shares outstanding	43,461	43,008	43,407	42,874
Basic earnings per share	\$ 1.29	\$ 1.00	\$ 2.41	\$ 1.87
Diluted earnings per share	\$ 1.27	\$ 0.99	\$ 2.38	\$ 1.85

**NOTE E COMPREHENSIVE INCOME**

The components of comprehensive income are as follows:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net income	\$ 55,249	\$ 42,619	\$ 103,249	\$ 79,368
Other comprehensive income:				
Unrealized income (loss) on derivatives designated and qualified as cash flow hedges, net of tax	(2,142)	1,519	(2,453)	653
Currency translation adjustment	15,389	10,199	20,390	13,761
Amortization of defined benefit plan prior service costs and actuarial losses, net of tax	829		1,655	
Total comprehensive income	\$ 69,325	\$ 54,337	\$ 122,841	\$ 93,782

**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 valuation of inventory under the LIFO method 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 \$74,925 at June 30, 2007 and \$68,985 at December 31, 2006.

**NOTE G ACCRUED EMPLOYEE COMPENSATION AND BENEFITS**

Accrued employee compensation and benefits at June 30, 2007 and 2006 include accruals for year-end bonuses and related payroll taxes of \$53,994 and \$45,774, 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

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resulting in an increasing bonus accrual during the Company's fiscal year. The increase in the accrual from June 30, 2006 to June 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 June 30, 2007:</i>					
Net sales to unaffiliated customers	\$ 363,846	\$ 132,219	\$ 90,573	\$	\$ 586,638
Inter-segment sales	25,644	4,525	2,853	(33,022)	
<b>Total</b>	<b>\$ 389,490</b>	<b>\$ 136,744</b>	<b>\$ 93,426</b>	<b>\$ (33,022)</b>	<b>\$ 586,638</b>
Income before interest and income taxes	\$ 55,130	\$ 18,507	\$ 7,347	\$ (1,376)	\$ 79,608
Interest income					1,699
Interest expense					(2,786)
Income before income taxes					\$ 78,521
<i>Three months ended June 30, 2006:</i>					
Net sales to unaffiliated customers	\$ 335,717	\$ 92,355	\$ 74,438	\$	\$ 502,510
Inter-segment sales	25,669	6,596	3,815	(36,080)	
<b>Total</b>	<b>\$ 361,386</b>	<b>\$ 98,951</b>	<b>\$ 78,253</b>	<b>\$ (36,080)</b>	<b>\$ 502,510</b>
Income before interest and income taxes	\$ 47,428	\$ 8,735	\$ 7,928	\$ (16)	\$ 64,075
Interest income					1,400
Interest expense					(2,438)
Income before income taxes					\$ 63,037

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	<b>North America</b>	<b>Europe</b>	<b>Other Countries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<i>Six months ended June 30, 2007:</i>					
Net sales to unaffiliated customers	\$ 709,566	\$ 254,000	\$ 172,115	\$	\$ 1,135,681
Inter-segment sales	49,672	11,184	8,296	(69,152)	
Total	\$ 759,238	\$ 265,184	\$ 180,411	\$ (69,152)	\$ 1,135,681
Income before interest and income taxes	\$ 104,233	\$ 33,189	\$ 13,735	\$ (1,307)	\$ 149,850
Interest income					3,149
Interest expense					(5,513)
Income before income taxes					\$ 147,486
Total assets	\$ 942,295	\$ 464,813	\$ 312,167	\$ (168,851)	\$ 1,550,424
<i>Six months ended June 30, 2006:</i>					
Net sales to unaffiliated customers	\$ 655,912	\$ 174,668	\$ 140,324	\$	\$ 970,904
Inter-segment sales	46,198	12,984	7,700	(66,882)	
Total	\$ 702,110	\$ 187,652	\$ 148,024	\$ (66,882)	\$ 970,904
Income before interest and income taxes	\$ 86,445	\$ 17,808	\$ 12,656	\$ 249	\$ 117,158
Interest income					2,594
Interest expense					(4,839)
Income before income taxes					\$ 114,913
Total assets	\$ 899,927	\$ 318,200	\$ 249,643	\$ (143,962)	\$ 1,323,808

The Europe segment includes rationalization charges of \$1,292 for the three months ended June 30, 2006 and \$396 and \$2,341 for the six months ended June 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 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. The Company has not yet completed the evaluation and allocation of the purchase price as the appraisal associated with the valuation of certain tangible and intangible assets is not complete. The Company anticipates the final purchase price allocations for this transaction will be completed by the end of 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.

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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 were 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 \$8,000 at June 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 \$1,300. 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 Other current liabilities. 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 six months ended June 30, 2007 and 2006 are as follows:

	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Balance at beginning of period	\$ 9,373	\$ 7,728
Charged to costs and expenses	4,900	4,991
Deductions	(3,856)	(4,092)
Balance at end of period	\$ 10,417	\$ 8,627

Warranty expense was 0.4% and 0.5% of sales for the six months ended June 30, 2007 and 2006, respectively.

**NOTE M 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 June 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 June 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 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 instrument. The amortization of this gain reduced interest expense by \$639 and \$1,050 in the first six months of 2007 and 2006, respectively, and is expected to reduce annual interest expense by \$1,121 in 2007. At June 30, 2007, \$2,195 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 outstanding Notes 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 June 30, 2007 and December 31, 2006 was \$4,318 and \$3,428, respectively. Active and terminated swaps have increased the value of the Series B Notes from \$30,000 to \$30,405 and decreased the value of the Series C Notes from \$80,000 to \$77,471 as of June 30, 2007. The weighted average effective interest rate on the Notes, net of the impact of active and terminated swaps, was 6.1% for the first six 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 June 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.

**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.

**Table of Contents****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>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Service cost – benefits earned during the period	\$ 4,557	\$ 4,813	\$ 9,058	\$ 9,680
Interest cost on projected benefit obligation	10,142	9,457	20,211	18,997
Expected return on plan assets	(13,900)	(12,545)	(27,710)	(25,151)
Amortization of prior service cost	17	282	32	563
Amortization of net loss	1,331	2,726	2,649	5,260
Net pension cost of defined benefit plans	\$ 2,147	\$ 4,733	\$ 4,240	\$ 9,349

The Company expects to voluntarily contribute \$10,000 to its U.S. plans in 2007. Based on current pension funding rules, the Company does not anticipate that contributions to the plans would be required in 2007. As of June 30, 2007, \$9,000 has been contributed.

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. The Company did not incur a significant change in retirement costs immediately after the change, however, the Company does expect cost savings in future years as a result of reduced benefits to be accrued for employees hired on or after January 1, 2006.

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 No. 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 No. 158. As a result of adopting SFAS No. 158, the Company recorded liabilities equal to the under funded status of defined benefit plans, and assets equal to the over funded 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 30.0% and 30.9% for the six months ended June 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.

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**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.

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 2003. The Company anticipates no significant changes to its total unrecognized tax benefits through the end of the second quarter of 2008. The Company is currently subject to an Internal Revenue Service ( IRS ) audit for the 2005 tax year.

**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.

**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.



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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 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, 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.



**Table of Contents****RESULTS OF OPERATIONS**

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

(In thousands)	Three Months Ended June 30,					
	2007		2006		Change	
	Amount	% of Sales	Amount	% of Sales	Amount	%
Net sales	\$ 586,638	100.0%	\$ 502,510	100.0%	\$ 84,128	16.7%
Costs of goods sold	417,970	71.2%	356,043	70.9%	61,927	17.4%
Gross profit	168,668	28.8%	146,467	29.1%	22,201	15.2%
Selling, general and administrative expenses	93,317	16.0%	83,436	16.6%	9,881	11.8%
Rationalization charges		0.0%	1,292	0.2%	(1,292)	N/A
Operating income	75,351	12.8%	61,739	12.3%	13,612	22.0%
Interest income	1,699	0.3%	1,400	0.3%	299	21.4%
Equity earnings in affiliates	3,677	0.6%	2,160	0.4%	1,517	70.2%
Other income	580	0.1%	176	0.0%	404	229.5%
Interest expense	(2,786)	(0.4%)	(2,438)	(0.5%)	(348)	14.3%
Income before income taxes	78,521	13.4%	63,037	12.5%	15,484	24.6%
Income taxes	23,272	4.0%	20,418	4.0%	2,854	14.0%
Net income	\$ 55,249	9.4%	\$ 42,619	8.5%	\$ 12,630	29.6%

(In thousands)	Six Months Ended June 30,					
	2007		2006		Change	
	Amount	% of Sales	Amount	% of Sales	Amount	%
Net sales	\$ 1,135,681	100.0%	\$ 970,904	100.0%	\$ 164,777	17.0%
Costs of goods sold	808,797	71.2%	694,371	71.5%	114,426	16.5%
Gross profit	326,884	28.8%	276,533	28.5%	50,351	18.2%
Selling, general and administrative expenses	182,837	16.2%	160,107	16.5%	22,730	14.2%
Rationalization charges	396	0.0%	2,341	0.2%	(1,945)	(83.1%)
Operating income	143,651	12.6%	114,085	11.8%	29,566	25.9%
Interest income	3,149	0.3%	2,594	0.2%	555	21.4%
Equity earnings in affiliates	5,155	0.5%	2,524	0.2%	2,631	104.2%
Other income	1,044	0.1%	549	0.1%	495	90.2%
Interest expense	(5,513)	(0.5%)	(4,839)	(0.5%)	(674)	13.9%
	147,486	13.0%	114,913	11.8%	32,573	28.3%

Income before income taxes						
Income taxes	44,237	3.9%	35,545	3.6%	8,692	24.5%
Net income	\$ 103,249	9.1%	\$ 79,368	8.2%	\$ 23,881	30.1%

### Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006

*Net Sales.* Net sales for the second quarter of 2007 increased 16.7% to \$586,638 from \$502,510 in the prior year quarter. The increase in Net sales reflects a 7.6% or \$38,292 increase due to volume, an increase of 4.4% or \$22,383 in price increases, a 2.0% or \$9,890 increase from acquisitions and a 2.7% or \$13,563 favorable impact as a result of changes in foreign currency exchange rates. Net sales for the North American operations increased 8.4% to \$363,846 for the second quarter 2007 compared to \$335,717 in prior year quarter. This increase reflects an increase of 2.7% or \$9,133 due to volume and an increase of \$17,740 or 5.3% in price increases. European sales have increased 43.2% to \$132,219 in the second quarter of 2007 from \$92,355 in the prior year quarter. This increase is a result of a 21.0% or \$19,414 increase in volume, an increase of 2.6% or \$2,383 in price increases, an increase of 10.7% or \$9,890 relating to acquisitions and an 8.9% or \$8,177 favorable impact as a result of changes in foreign currency exchange rates. Other Countries sales increased 21.7% to \$90,573 in the second quarter of 2007 from \$74,438 in the prior year quarter. This increase reflects an increase of \$9,745 or 13.1% due to volume, an increase of \$4,130 or 5.6% as a result of changes in foreign currency exchange rates and an increase of 3.0% or \$2,260 in price.

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*Gross Profit.* Gross profit increased 15.2% to \$168,668 during the second quarter 2007 compared to \$146,467 in the prior year quarter. As a percentage of net sales, Gross profit decreased to 28.8% during the second quarter 2007 from 29.1% 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 partially offset by favorable volume leverage in several other geographies. 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 \$3,040 favorable impact in second quarter 2007.

*Selling, General & Administrative (SG&A) Expenses.* SG&A expenses increased \$9,881, or 11.8%, in the second quarter 2007, compared with the prior year quarter. The increase was primarily due to higher bonus expense of \$3,573, higher selling expenses of \$1,315 resulting from increased sales activity, incremental Selling, general and administrative expenses from acquisitions totaling \$1,734 and foreign exchange transaction losses of \$326. Foreign currency exchange rates increased SG&A expenses by \$1,707.

*Rationalization Charges.* In the second quarter of 2006, the Company recorded Rationalization charges of \$1,292 (\$1,292 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 second quarter of 2007, Interest income increased to \$1,699 from \$1,400 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 increased to \$3,677 in the second quarter of 2007 from \$2,160 in the prior year quarter as a result of increased earnings at the Company's joint venture investments in Turkey and Taiwan.

*Interest Expense.* Interest expense increased to \$2,786 in the second quarter of 2007 from \$2,438 in the prior year quarter as a result of higher interest rates and a lower level of amortization of the gain associated with previously terminated interest rate swap agreements. See Note M to the Consolidated Financial Statements for further discussion.

*Income Taxes.* Income taxes for the second quarter of 2007 were \$23,272 on Income before income taxes of \$78,521, an effective rate of 29.6%, compared with income taxes of \$20,418 on Income before income taxes of \$63,037, or an effective rate of 32.4% the prior year quarter. The effective rate for second 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 have been previously provided.

*Net Income.* Net income for the second quarter 2007 was \$55,249 compared to \$42,619 in the prior year quarter. Diluted earnings per share for the second quarter of 2007 were \$1.27 compared to \$0.99 per share in 2006. Foreign currency exchange rate movements had a \$1,591 favorable impact on Net income for the second quarter of 2007 and a \$511 favorable impact in 2006.

**Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006**

*Net Sales.* Net sales for the first half of 2007 increased 17.0% to \$1,135,681 from \$970,904 in the prior year period. The increase in Net sales reflects an 8.6% or \$82,930 increase due to volume, an increase of 4.0% or \$39,027 in price increases, a 1.9%, or \$18,230 increase from acquisitions and a 2.5% or \$24,590 favorable impact as a result of changes in foreign currency exchange rates. Net sales for the North American operations increased 8.2% to \$709,566 for the first half 2007 compared to \$655,912 in the prior year period. This increase reflects an increase of 3.7% or \$24,156 due to volume and an increase of \$28,640 or 4.4% in price increases. European sales have increased 45.4% to \$254,000 in the first half of 2007 from \$174,668 in the prior year period. This increase is a result of a 22.1% or \$38,609 increase in volume, an increase of 2.7% or \$4,665 in price increases, an increase of 10.4% or \$18,230 relating to acquisitions and a 10.2% or \$17,828 favorable impact as a result of changes in foreign currency exchange rates. Other Countries sales increased 22.7% to \$172,115 in the first half of 2007 from \$140,324 in the prior year period. This increase reflects an increase of \$20,165 or 14.4% due to volume, an increase of 4.1% or \$5,722 in price and an increase of \$5,904 or 4.2% as a result of changes in foreign currency exchange rates.

*Gross Profit.* Gross profit increased 18.2% to \$326,884 during the first half 2007 compared to \$276,533 in the prior year period. As a percentage of net sales, Gross profit increased to 28.8% during the first half 2007 from 28.5% in the prior year period. This increase was primarily a result of favorable leverage on increased volumes. In addition, foreign currency exchange rates had a \$5,705 favorable impact in first half 2007. This increase was partially offset by a shift

in sales mix to lower margin geographies and businesses.

*Selling, General & Administrative (SG&A) Expenses.* SG&A expenses increased \$22,730, or 14.2%, in the first half 2007, compared with the prior year period. The increase was primarily due to higher bonus expense of \$6,472, higher selling

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expenses of \$4,107 resulting from increased sales activity, incremental Selling, general and administrative expenses from acquisitions totaling \$3,063, higher administrative expense of \$2,979 and foreign exchange transaction losses of \$1,498. Foreign currency exchange rates increased SG&A expenses by \$3,100.

*Rationalization Charges.* In the first half of 2007 and 2006, the Company recorded Rationalization charges of \$396 (\$396 after-tax) and \$2,341 (\$2,341 after-tax), respectively, 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 first half of 2007, Interest income increased to \$3,149 from \$2,594 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 \$5,155 in the first half of 2007 from \$2,524 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 \$5,513 in the first half of 2007 from \$4,839 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. See Note M to the Consolidated Financial Statements for further discussion.

*Income Taxes.* Income taxes for the first half of 2007 were \$44,237 on Income before income taxes of \$147,486, an effective rate of 30.0%, compared with income taxes of \$35,545 on Income before income taxes of \$114,913, or an effective rate of 30.9% the prior year period. The effective rate for first half 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 half 2007 was \$103,249 compared to \$79,368 in the prior year period. Diluted earnings per share for the first half of 2007 were \$2.38 compared to \$1.85 per share in 2006. Foreign currency exchange rate movements had a \$2,495 favorable impact on Net income for the first half of 2007 and did not have a material impact in the first half of 2006.

**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 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>Six Months Ended June 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>Change</b>
Cash provided by operating activities:	\$ 107,452	\$ 57,330	\$ 50,122
Cash used by investing activities:	(33,853)	(31,715)	(2,138)
Capital expenditures	(29,640)	(32,261)	2,621
Acquisitions of businesses, net of cash acquired	(4,414)	(95)	(4,319)
Cash used by financing activities:	(46,999)	(9,047)	(37,952)
Amounts due banks, net	4,348	(4,634)	8,982
Payments on long-term borrowings	(40,307)	(1,449)	(38,858)
Proceeds from exercise of stock options	5,062	8,952	(3,890)
Tax benefit from the exercise of stock options	2,736	3,051	(315)
Cash dividends paid to shareholders	(18,825)	(16,077)	(2,748)
Increase in Cash and cash equivalents	27,769	17,420	10,349

Cash and cash equivalents increased 23.1%, or \$27,769, to \$147,981 as of June 30, 2007, from \$120,212 as of December 31, 2006. This compares to a \$17,420 increase in cash and cash equivalents during the same period in 2006.

Cash provided by operating activities increased by \$50,122 for the first half 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

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working capital to sales was 26.9% at June 30, 2007 compared to 25.8% at December 31, 2006. Days sales in inventory decreased from 117.3 days at December 31, 2006 to 110.5 days at June 30, 2007. Accounts receivable days increased from 57.7 days at December 31, 2006 to 58.3 days at June 30, 2007. Average days in accounts payable decreased to 38.5 days at June 30, 2007 from 38.9 days at December 31, 2006.

Cash used by investing activities for the first half of 2007 compared to 2006 reflects an increase in cash used in the acquisition of Spawmet Sp. z.o.o. ( Spawmet ) of \$4,414. In addition, capital expenditures during the first half of 2007 were \$29,640, a \$2,621 decrease from 2006. The Company anticipates capital expenditures in 2007 of approximately \$65,000 - \$75,000. 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 \$37,952 in first half of 2007 compared to the first half 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 received from stock option exercises of \$3,890.

The Company's debt levels decreased from \$161,099 at December 31, 2006, to \$124,803 at June 30, 2007. Debt to total capitalization decreased to 11.5% at June 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 June 30, 2007.

In April 2007, the Company paid a quarterly cash dividend of \$0.22 per share, or \$9,420 to shareholders of record on March 30, 2007.

**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 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 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. The Company has not yet completed the evaluation and allocation of the purchase price as the appraisal associated with the valuation of certain tangible and intangible assets is not complete. The Company anticipates the final purchase price allocations for this transaction will be completed by the end of 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



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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 were 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 June 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 June 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 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 instrument. The amortization of this gain reduced interest expense by \$639 and \$1,050 in the first half of 2007 and 2006, respectively, and is expected to reduce annual interest expense by \$1,121 in 2007. At June 30, 2007, \$2,195 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 outstanding Notes 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 June 30, 2007 and December 31, 2006 was \$4,318 and \$3,428, respectively. Active and terminated swaps have increased the value of the Series B Notes from \$30,000 to \$30,405 and decreased the value of the Series C Notes from \$80,000 to \$77,471 as of June 30, 2007. The weighted average effective interest

rate on the Notes, net of the impact of active and terminated swaps, was 6.1% for the first six 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,

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distributions, mergers and acquisitions, dispositions of assets, subordinated debt and transactions with affiliates. As of June 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.

There were 541 restricted shares granted during the six months ended June 30, 2007. The Company issued 191,751 and 365,867 shares of common stock from treasury upon exercise of employee stock options during the six months ended June 30, 2007 and 2006, respectively.

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 six months ended June 30, 2007 and 2006 was \$2,229 and \$1,938, respectively. The related tax benefit for the six months ended June 30, 2007 and 2006 was \$852 and \$741, 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 \$8,000 at June 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.

**Table of Contents****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.

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;

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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 have been provided on earnings of \$1,588 million that are not expected to be permanently reinvested. At June 30, 2007, the Company had approximately \$80,191 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 June 30, 2007, a valuation allowance of \$29,019 had been 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 No. 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 No. 158. As a result of adopting SFAS No. 158, the Company recorded liabilities equal to the under funded status of defined benefit plans, and assets equal to the over funded 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

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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.

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 does not anticipate that contributions to the plans would be required in 2007. The Company has voluntarily contributed \$9,000 in the first six months of 2007 and expects to voluntarily contribute a total of \$10,000 to its U.S. plans in 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. The Company did not incur a significant change in retirement costs immediately after the change, however, the Company does expect cost savings in future years as a result of reduced benefits to be accrued for employees hired on or after January 1, 2006.

**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 \$74,925 at June 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.

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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.

### **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 June 30, 2007, the Company was a co-defendant in cases alleging asbestos induced illness involving claims by approximately 31,420 plaintiffs, which is a net decrease of 20 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: 23,763 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 445 were decided in favor of the Company following summary judgment motions.

At June 30, 2007, the Company was a co-defendant in cases alleging manganese induced illness involving claims by approximately 4,553 plaintiffs, which is a net decrease of 310 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 June 30, 2007, cases involving 1,840 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 is pending. Since January 1, 1995, the Company has been a co-defendant in similar cases that have been resolved as follows: 10,550 of those claims were dismissed, 14 were tried to defense verdicts in favor of the Company, 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 (subsequently, however, a motion for a new trial has been granted), and 12 were resolved by agreement for immaterial amounts.

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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.

### **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 June 30, 2007, we were a co-defendant in cases alleging manganese induced illness involving claims by approximately 4,553 plaintiffs and a co-defendant in cases alleging asbestos induced illness involving claims by approximately 31,420 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: 10,550 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: 23,763 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 445 were decided in favor of us following summary judgment motions.

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.

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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 cyclical nature 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 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

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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 have begun to 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 of 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 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

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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**

(a) The Annual Meeting of Lincoln Electric Holdings, Inc. ( Lincoln ) was held on April 27, 2007.

(b) No response is required.

(c) The following matters were voted upon by security holders:

(i) Election of Directors. The shareholders voted in favor of electing the following persons as Directors of the Company:

<b>For term ending in 2010</b>	<b>Votes For</b>	<b>Abstentions/ Votes</b>		<b>Broker Non-Votes</b>
		<b>Against</b>		
Stephen G. Hanks	31,908,158	168,981		
Kathryn Jo Lincoln	31,249,030	828,109		
William E. MacDonald, III	31,894,157	182,982		
George H. Walls, Jr.	31,887,869	189,270		

(ii) Approval of the 2007 Management Incentive Compensation Plan:

Votes For	24,208,864
Votes Against	1,308,455
Abstentions	307,639
Broker Non-Votes	6,252,183

(iii) Ratification of Independent Auditors. The shareholders ratified the appointment of the firm of Ernst & Young, LLP as independent auditors to examine the Company's books of account and other records and internal control over financial reporting for the fiscal year ending December 31, 2007.

Votes For	31,630,248
Votes Against	312,936
Abstentions	133,957
Broker Non-Votes	

(d) Not applicable.

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**Item 5. Other Information**

- (a) On April 27, 2007, the shareholders of the Company approved the 2007 Management Incentive Compensation Plan (the 2007 Incentive Plan ) at the Company s Annual Meeting of Shareholders.

The 2007 Incentive Plan is a cash-based plan that provides for annual and long-term awards based on the achievement of performance goals. The Compensation and Executive Development Committee of the Board of Directors, which administers the 2007 Incentive Plan, designates those employees who are eligible to participate in the plan. The purpose of the 2007 Incentive Plan is to reinforce corporate, organizational and business-development goals, to promote the achievement of year-to-year financial and other business objectives and to reward the performance of eligible employees in fulfilling their individual responsibilities. An additional purpose of the plan is to provide qualified performance-based compensation programs under Section 162(m) of the U.S. Internal Revenue Code in order to preserve the Company s tax deduction for compensation paid under the plan to covered employees. Under the terms of the 2007 Incentive Plan, the maximum payout under an annual award is limited to \$4,000,000, and the maximum payout under a long-term award is also limited to \$4,000,000.

The foregoing is a summary of the 2007 Incentive Plan and not a complete discussion thereof. Accordingly, the foregoing is qualified in its entirety by reference to the full text of the 2007 Incentive Plan, which is listed as Exhibit 10.1 in this report and incorporated herein by reference.

- (b) None.

**Item 6. Exhibits**

(a) Exhibits

- 10.1 Lincoln Electric Holdings, Inc. 2007 Management Incentive Compensation Plan (filed as Appendix A to the Company s Proxy Statement filed on March 29, 2007 and incorporated herein by reference and made a part hereof).
- 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)  
July 30, 2007

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