

LINCOLN ELECTRIC HOLDINGS INC

Form 10-Q

July 25, 2006

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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, 2006**

**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 Securities Exchange Act of 1934.

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, 2006 was 42,580,865.

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(Amounts in thousands of dollars, except per share data)

(UNAUDITED)

	<b>Three Months Ended June</b>		<b>Six Months Ended June</b>	
	<b>30,</b>		<b>30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net sales	\$ 502,510	\$ 405,902	\$ 970,904	\$ 768,805
Cost of goods sold	356,043	291,951	694,371	556,576
Gross profit	146,467	113,951	276,533	212,229
Selling, general & administrative expenses	83,436	71,919	160,107	138,821
Rationalization charges	1,292		2,341	1,250
Operating income	61,739	42,032	114,085	72,158
Other income (expense):				
Interest income	1,400	891	2,594	1,660
Equity earnings in affiliates	2,160	1,030	2,524	1,564
Other income	176	995	549	1,466
Interest expense	(2,438)	(2,186)	(4,839)	(3,868)
Total other income	1,298	730	828	822
Income before income taxes	63,037	42,762	114,913	72,980
Income taxes	20,418	10,650	35,545	18,628
Net income	\$ 42,619	\$ 32,112	\$ 79,368	\$ 54,352
Per share amounts:				
Basic earnings per share	\$ 1.00	\$ 0.77	\$ 1.87	\$ 1.31
Diluted earnings per share	\$ 0.99	\$ 0.77	\$ 1.85	\$ 1.30
Cash dividends declared per share	\$ 0.19	\$ 0.18	\$ 0.38	\$ 0.36

See notes to these consolidated financial statements.

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LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Amounts in thousands of dollars)

	<b>June 30, 2006 (UNAUDITED)</b>	<b>December 31, 2005 (NOTE A)</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 125,427	\$ 108,007
Accounts receivable (less allowance for doubtful accounts of \$8,002 in 2006; \$7,583 in 2005)	304,161	242,093
Inventories		
Raw materials	90,149	80,047
In-process	51,123	33,707
Finished goods	189,771	161,991
	331,043	275,745
Deferred income taxes	9,623	9,069
Other current assets	50,864	41,720
<b>TOTAL CURRENT ASSETS</b>	<b>821,118</b>	<b>676,634</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Land	25,183	23,034
Buildings	205,290	196,639
Machinery and equipment	552,183	536,834
	782,656	756,507
Less: accumulated depreciation and amortization	428,271	415,974
	354,385	340,533
<b>OTHER ASSETS</b>		
Prepaid pension costs	1,913	1,956
Equity investments in affiliates	43,175	39,673
Intangibles, net	41,122	39,232
Goodwill	25,910	25,596
Long-term investments	28,194	27,905
Other	7,991	9,632
	148,305	143,994
<b>TOTAL ASSETS</b>	<b>\$ 1,323,808</b>	<b>\$ 1,161,161</b>

See notes to these consolidated financial statements.

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LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Amounts in thousands of dollars, except share data)

	June 30, 2006 (UNAUDITED)	December 31, 2005 (NOTE A)
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Amounts due banks	\$ 3,662	\$ 7,143
Trade accounts payable	152,754	121,917
Accrued employee compensation and benefits	75,541	40,658
Accrued expenses	20,235	17,597
Accrued taxes, including income taxes	47,794	38,342
Accrued pensions, current	21,279	28,662
Dividends payable	8,084	8,014
Other current liabilities	33,907	30,289
Current portion of long-term debt	41,453	1,020
<b>TOTAL CURRENT LIABILITIES</b>	<b>404,709</b>	<b>293,642</b>
 Long-term debt, less current portion	 111,940	 157,853
Accrued pensions	15,005	14,786
Deferred income taxes	18,162	17,752
Other long-term liabilities	30,170	24,834
 <b>SHAREHOLDERS' EQUITY</b>		
Preferred Shares, without par value at stated capital amount: Authorized - 5,000,000 shares as of June 30, 2006 and December 31, 2005; Issued and Outstanding none		
Common shares, without par value at stated capital amount: Authorized - 120,000,000 shares as of June 30, 2006 and December 31, 2005; Issued - 49,282,306 shares as of June 30, 2006 and December 31, 2005; Outstanding - 42,580,865 shares as of June 30, 2006 and 42,181,021 shares as of December 31, 2005	 4,928	 4,928
Additional paid-in capital	132,111	125,925
Retained earnings	827,954	764,748
Accumulated other comprehensive loss	(76,862)	(91,276)
Treasury shares, at cost - 6,701,441 as of June 30, 2006 and 7,101,285 shares as of December 31, 2005	 (144,309)	 (152,031)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>743,822</b>	<b>652,294</b>
 <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	 <b>\$ 1,323,808</b>	 <b>\$ 1,161,161</b>

See notes to these consolidated financial statements.

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LINCOLN ELECTRIC HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Amounts in thousands of dollars)  
UNAUDITED

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 79,368	\$ 54,352
Adjustments to reconcile net income to net cash provided by operating activities:		
Rationalization charges	2,341	1,250
Depreciation and amortization	22,985	20,866
Equity earnings of affiliates, net	(1,591)	(1,564)
Deferred income taxes	(34)	1,600
Stock-based compensation	1,938	1,897
Amortization of terminated interest rate swaps	(1,050)	(1,050)
Other non-cash items, net	1,624	216
Changes in operating assets and liabilities:		
Increase in accounts receivable	(55,800)	(22,539)
Increase in inventories	(49,428)	(25,055)
(Increase) decrease in other current assets	(8,072)	1,204
Increase in accounts payable	27,824	15,575
Increase in other current liabilities	46,812	31,402
Contributions to pension plans	(16,397)	(21,466)
Increase in accrued pensions	8,637	7,319
Net change in other long-term assets and liabilities	(1,827)	(2,166)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>57,330</b>	<b>61,841</b>
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(32,261)	(21,435)
Acquisitions of businesses, net of cash acquired	(95)	(70,704)
Proceeds from sale of fixed assets	641	846
Sales of marketable securities		65,500
Purchases of marketable securities		(15,000)
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	<b>(31,715)</b>	<b>(40,793)</b>
<b>FINANCING ACTIVITIES</b>		
Proceeds from short-term borrowings	2,035	
Payments on short-term borrowings	(925)	(130)
Amounts due banks, net	(7,138)	4,114
Payments on long-term borrowings	(1,449)	(14,993)
Proceeds from exercise of stock options	8,952	7,592
Tax benefit from the exercise of stock options	3,051	
Purchase of shares for treasury		(12,804)
Cash dividends paid to shareholders	(16,077)	(14,985)
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>(11,551)</b>	<b>(31,206)</b>

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Effect of exchange rate changes on cash and cash equivalents	3,356	(2,277)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	17,420	(12,435)
Cash and cash equivalents at beginning of year	108,007	92,819
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 125,427	\$ 80,384

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 of dollars except share and per share data)

June 30, 2006

**NOTE A BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements of Lincoln Electric Holdings, Inc. (the Company) have been prepared in accordance with accounting principles generally accepted in the United States 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 accounting principles generally accepted in the United States 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, 2006 are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date, but does not include all of the information and notes required by accounting principles generally accepted in the United States 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, 2005.

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 (EPI Plan) which replaces the 1998 Stock Plan, as amended 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. There were 230 and 500 options granted during the six months ended June 30, 2006 and 2005, respectively. There were no TARs, restricted shares or deferred shares granted during the six months ended June 30, 2006 and 2005.

In addition, on April 28, 2006, the shareholders of the Company approved the 2006 Stock Plan for Non-Employee Directors (Director Plan). 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.

The Company issued 365,867 and 365,656 shares of common stock from treasury upon exercise of employee stock options during the six months ended June 30, 2006 and 2005, respectively.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS 123. SFAS No. 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. Pro forma disclosure is no longer an alternative. The Company adopted SFAS No. 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 as the Company previously adopted fair value accounting under SFAS No. 123 on January 1, 2003.

Prior to 2003, the Company applied the intrinsic value method permitted under SFAS No. 123, as defined in Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations, in accounting for the Company's stock option plans. Accordingly, no compensation cost was recognized in years prior to adoption.

Total stock-based compensation expense recognized in the consolidated statement of earnings for the six months ended June 30, 2006 and 2005 was \$1,938 and \$1,897, respectively. The related tax benefit for the six months ended June 30, 2006 and 2005 was \$741 and \$725, respectively.

The following table sets forth the pro forma disclosure of net income and earnings per share as if compensation expense had been recognized for the fair value of options granted prior to January 1, 2003 (date of adoption of SFAS

No. 123). All stock options granted prior to January 1, 2003 were fully vested as of December 31, 2005. Therefore, no pro-forma disclosure is

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necessary for periods ending after December 31, 2005. For purposes of this pro forma disclosure, the estimated fair value of the options granted prior to January 1, 2003 was determined using the Black-Scholes option pricing model and is amortized ratably over the vesting periods.

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Net income, as reported	\$ 32,112	\$ 54,352
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	385	1,169
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards granted, net of related tax effects	(488)	(1,853)
Pro forma net income	\$ 32,009	\$ 53,668
Earnings per share:		
Basic, as reported	\$ 0.77	\$ 1.31
Basic, pro forma	\$ 0.77	\$ 1.29
Diluted, as reported	\$ 0.77	\$ 1.30
Diluted, pro forma	\$ 0.76	\$ 1.28
Weighted-average number of shares outstanding (in thousands):		
Basic	41,477	41,577
Diluted	41,845	41,966

As of June 30, 2006, total unrecognized stock-based compensation expense related to nonvested stock options, restricted shares and deferred shares was \$4,947, which is expected to be recognized over a weighted average period of approximately 27 months.

The following table summarizes nonvested stock options, TARs, restricted and deferred shares for the six months ended June 30, 2006:

	<b>Six Months Ended June 30, 2006</b>	
	<b>Number of Options, TARs, Restricted and Deferred Shares</b>	<b>Weighted-Average Grant Date Fair Value</b>
Balance at beginning of year	746,549	\$ 10.59
Granted	230	\$ 11.11
Vested	10,300	\$ 7.47
Forfeited	900	\$ 9.57
Balance at end of period	735,579	\$ 10.64

The aggregate intrinsic value of options outstanding at June 30, 2006, based on the Company's closing stock price of \$62.65 as of the last business day of the period ended June 30, 2006, which would have been received by the optionees had all options been exercised on that date was \$55,342. The aggregate intrinsic value of options exercisable at June 30, 2006, based on the Company's closing stock price of \$62.65 as of the last business day of the period ended June 30, 2006, which would have been received by the optionees had all options exercisable been exercised on that date was \$36,267. The total intrinsic value of stock options exercised during the six months ended June 30, 2006 and 2005 was \$9,073 and \$3,939, respectively. Intrinsic value is the amount by which the fair value of the underlying stock exceeds the exercise price of the options.

Prior to the adoption of SFAS 123(R) the Company presented all tax benefits resulting from the exercise of stock options as operating cash inflows in the consolidated statements of cash flows, in accordance with the provisions of the Emerging Issues Task Force ( EITF ) Issue No. 00-15, Classification in the Statement of Cash Flows of the Income Tax Benefit Received by

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a Company upon Exercise of a Nonqualified Employee Stock Option. SFAS 123(R) requires the benefits of tax deductions in excess of the compensation cost recognized for those options to be classified as financing cash inflows rather than operating cash inflows, on a prospective basis. This amount was \$3,051 for the six months ended June 30, 2006 and is shown as Tax benefit from the exercise of stock options in the consolidated statement of cash flows.

**NOTE C GOODWILL AND INTANGIBLE ASSETS**

There were no impairments of goodwill during the first half of 2006. Goodwill totaled \$25,910 and \$25,596 at June 30, 2006 and December 31, 2005, respectively. Goodwill by segment at June 30, 2006 was \$9,382 for North America, \$4,848 for Europe and \$11,680 for Other countries.

Gross intangible assets other than goodwill as of June 30, 2006 and December 31, 2005 were \$56,336 and \$52,814, respectively, and included accumulated amortization of \$15,214 and \$13,582, respectively. Aggregate amortization expense was \$299 and \$74 for the six months ended June 30, 2006 and 2005, respectively. Included in the previously mentioned total are intangible assets other than goodwill with indefinite lives totaling \$9,977 at June 30, 2006 and December 31, 2005, respectively.

**NOTE D EARNINGS PER SHARE**

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	2006	2005	2006	2005
Numerator:				
Net income	\$ 42,619	\$ 32,112	\$ 79,368	\$ 54,352
Denominator:				
Denominator for basic earnings per share				
Weighted-average shares outstanding	42,514	41,477	42,397	41,577
Effect of dilutive securities Employee stock options	494	368	477	389
Denominator for diluted earnings per share Adjusted weighted-average shares outstanding	43,008	41,845	42,874	41,966
Basic earnings per share	\$ 1.00	\$ 0.77	\$ 1.87	\$ 1.31
Diluted earnings per share	\$ 0.99	\$ 0.77	\$ 1.85	\$ 1.30

**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>	
	2006	2005	2006	2005
Net income	\$ 42,619	\$ 32,112	\$ 79,368	\$ 54,352
Other comprehensive income:				
Unrealized gain (loss) on derivatives designated and qualified as cash flow hedges, net of tax	1,519	(135)	653	(596)
Currency translation adjustment	10,199	(9,820)	13,761	(18,450)
Comprehensive income	\$ 54,337	\$ 22,157	\$ 93,782	\$ 35,306

**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 \$67,424 at June 30, 2006 and \$62,900 at December 31, 2005.

**Table of Contents****NOTE G ACCRUED EMPLOYEE COMPENSATION AND BENEFITS**

Accrued employee compensation and benefits at June 30, 2006 and June 30, 2005 include accruals for year-end bonuses and related payroll taxes of \$45,774 and \$33,453, respectively, related to Lincoln employees worldwide. The payment of bonuses is discretionary and is subject to approval by the Board of Directors. A majority of annual bonuses are paid in December resulting in an increasing bonus accrual during the Company's fiscal year. The increase in the accrual from June 30, 2005 to June 30, 2006 is due to the increase in profitability of the Company.

**NOTE H SEGMENT INFORMATION**

	<b>North America</b>	<b>Europe</b>	<b>Other Countries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<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)	
Total	\$ 361,386	\$ 98,951	\$ 78,253	\$ (36,080)	\$ 502,510
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
<i>Three months ended June 30, 2005:</i>					
Net sales to unaffiliated customers	\$ 265,359	\$ 78,735	\$ 61,808	\$	\$ 405,902
Inter-segment sales	16,748	6,045	3,467	(26,260)	
Total	\$ 282,107	\$ 84,780	\$ 65,275	\$ (26,260)	\$ 405,902
Income before interest and income taxes	\$ 30,946	\$ 7,346	\$ 5,582	\$ 183	\$ 44,057
Interest income					891
Interest expense					(2,186)
Income before income taxes					\$ 42,762
<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)

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Income before income taxes					\$	114,913
Total assets	\$ 899,927	\$ 318,200	\$ 249,643	\$ (143,962)	\$	1,323,808
<i>Six months ended June 30, 2005:</i>						
Net sales to unaffiliated customers	\$ 496,877	\$ 158,656	\$ 113,272	\$		\$ 768,805
Inter-segment sales	28,365	12,108	5,727	(46,200)		
Total	\$ 525,242	\$ 170,764	\$ 118,999	\$ (46,200)	\$	768,805
Income before interest and income taxes	\$ 53,097	\$ 13,575	\$ 8,203	\$ 313	\$	75,188
Interest income						1,660
Interest expense						(3,868)
Income before income taxes					\$	72,980
Total assets	\$ 738,911	\$ 262,829	\$ 211,047	\$ (104,778)	\$	1,108,009

The Europe segment includes rationalization charges of \$1,292 for the three months ended June 30, 2006 and \$2,341 and \$1,250 for the six months ended June 30, 2006 and 2005, respectively.



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### **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 intends to transfer all manufacturing currently taking place at Harris Ireland to a lower cost facility in Eastern Europe and sell the facility in Ireland.

The Company expects to incur a charge of approximately \$5,000 (pre-tax) associated with employee severance costs, equipment relocation, employee retention and professional services. This charge does not reflect the impact of anticipated proceeds from the planned sale of the facility in Ireland. A total of 66 employees will be impacted by the Ireland Rationalization.

The Company has incurred a total of \$2,852 (pre-tax) in charges related to this plan of which \$2,341 (pre-tax) was incurred in the first half of 2006. Cash expenditures are expected to be paid throughout 2006 with the expected completion of the Ireland Rationalization occurring in the fourth quarter of 2006. As of June 30, 2006, the Company has recorded a liability of \$2,948 for charges related to these efforts.

In 2004, the Company committed to a plan to rationalize machine manufacturing (the French Rationalization) at Lincoln Electric France, S.A.S. (LE France). In connection with the French Rationalization, the Company transferred machine manufacturing performed at LE France to other facilities. The Company committed to the French Rationalization as a result of the region's decreased demand for locally-manufactured machines. In connection with the French Rationalization, the Company incurred a charge of \$2,292 (pre-tax), of which \$1,188 (pre-tax) was incurred in the first half of 2005. Employee severance costs associated with the termination of approximately 40 of LE France's 179 employees were \$2,123 (pre-tax). Costs not relating to employee severance primarily included warehouse relocation costs and professional fees.

### **NOTE J ACQUISITIONS**

On April 29, 2005, the Company acquired all of the outstanding stock of J.W. Harris Co., Inc. (J.W. Harris), a privately held brazing and soldering alloys manufacturer headquartered in Mason, Ohio for approximately \$71,000 in cash and \$15,000 of assumed debt. The Company began consolidating the results of J.W. Harris operations in the Company's consolidated financial statements in May 2005.

The purchase price allocation for this investment resulted in goodwill of \$9,103. Included in the aggregate purchase price is \$4,160 deposited in escrow accounts. Distribution of amounts in escrow is dependent on resolution of pre-closing contingencies. Amounts remaining in escrow as of the second anniversary of the closing date will be distributed to the former shareholders and will result in adjustments to the purchase price allocation.

This acquisition has provided the Company with a strong complementary metals-joining technology and a leading position in the brazing and soldering alloys market. J.W. Harris has manufacturing plants in Ohio and Rhode Island and an international distribution center located in Spain.

### **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 Company believes it has meritorious defenses to these claims and intends to contest such suits vigorously. Although defense costs have been increasing, 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 \$6,250 at June 30, 2006. The guarantee is provided on three separate loan agreements. Two loans are for \$2,000 each, one which expires in October 2006 and the other expiring in May 2007. The other loan is for approximately \$2,250 and expires in October 2010. The loans were undertaken to fund the joint venture's working capital and capital

improvement needs. The Company would

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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. 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, 2006 and 2005 are as follows:

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Balance at beginning of year	\$ 7,728	\$ 6,800
Charged to costs and expenses	4,991	4,526
Deductions	(4,092)	(3,848)
Balance at end of period	\$ 8,627	\$ 7,478

Warranty expense was 0.5% and 0.6% of sales for the six months ended June 30, 2006 and 2005, 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 ratios). As of June 30, 2006, the Company was in compliance with all of its debt covenants.

The maturity and interest rates of the Notes follow (in thousands):

	<b>Amount Due</b>	<b>Matures</b>	<b>Interest Rate</b>
Series A	\$40,000	March 2007	5.58%
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 \$1,050 in the first half of 2006 and 2005 and is expected to reduce annual interest expense by \$2,117 in 2006 and \$1,121 in 2007. At June 30, 2006, \$3,901 remains to be amortized of which \$3,150 is included in the balance sheet caption Long-term debt, less current portion and \$751 is included in the balance sheet caption Current portion of long-term debt. The financing costs related to the \$150,000 private placement are further reduced by the interest income earned on the cash balances. These short-term, highly liquid investments earned approximately \$1,335 during the first half of 2006. 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 included in the balance sheet caption Other long-term liabilities with a corresponding decrease in Long-term debt. The fair value of these swaps at June 30, 2006 was \$6,202.

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Terminated swaps have increased the value of the Series A Notes from \$40,000 to \$40,751 as of June 30, 2006. Active and terminated swaps have increased the value of the Series B Notes from \$30,000 to \$30,533 and decreased the value of the Series C Notes from \$80,000 to \$76,415 as of June 30, 2006. The weighted-average effective rate on the Notes, net of the impact of active and terminated swaps, was 5.11% for the first half of 2006.

**NOTE N NEW ACCOUNTING PRONOUNCEMENTS**

In July 2006, the FASB issued Interpretation No. 48 (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. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt this interpretation as required. The Company is currently evaluating the impact of this Interpretation on its financial statements.

In June 2005, the Financial Accounting Standards Board ( FASB ) issued Staff Position No. 143-1 *Accounting for Electronic Equipment Waste Obligations* ( FSP 143-1 ), which provides guidance on the accounting for obligations associated with the Directive on Waste Electrical and Electronic Equipment (the WEEE Directive ), which was adopted by the European Union. FSP 143-1 provides guidance on accounting for the effects of the WEEE Directive with respect to historical waste and waste associated with products on the market on or before August 13, 2005. FSP 143-1 requires commercial users to account for their WEEE obligation as an asset retirement liability in accordance with FASB Statement No. 143, *Accounting for Asset Retirement Obligations*. FSP 143-1 was required to be applied to the later of the first reporting period ending after June 8, 2005 or the date of the adoption of the WEEE Directive into law by the applicable European Union member country. The WEEE Directive has been adopted into law by the majority of European Union member countries in which the Company has significant operations. The Company adopted the provisions of FSP 143-1 as it relates to these countries with no material impact to its financial statements. The Company will apply the guidance of FSP 143-1 as it relates to the remaining European Union member countries in which it operates when those countries have adopted the WEEE Directive into law.

In March 2005, the FASB issued FASB Interpretation No. 47 ( FIN 47 ) *Accounting for Conditional Asset Retirement Obligations* an interpretation of FASB Statement No. 143. This interpretation defines the term conditional asset retirement obligation as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, as a legal obligation to perform an asset retirement activity, in which the timing, and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 requires that an obligation to perform an asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement. The Company adopted the provisions of FIN 47 as of December 31, 2005 with no material impact to its financial statements.

In November 2004, the FASB issued SFAS No. 151 *Inventory Costs* an amendment of ARB No. 43, Chapter 4. This Statement amends the guidance in Accounting Research Bulletin No. 43 to require idle facility expense, freight, handling costs, and wasted material (spoilage) be recognized as current-period charges. In addition, SFAS No. 151 requires the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company adopted SFAS No. 151 on January 1, 2006 with no material impact to its financial statements.

**NOTE O RETIREMENT ANNUITY PLANS**

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

	Three Months Ended June		Six Months Ended June	
	30,		30,	
	2006	2005	2006	2005
Service cost – benefits earned during the period	\$ 4,813	\$ 4,354	\$ 9,680	\$ 8,857
Interest cost on projected benefit obligation	9,457	8,891	18,997	18,053

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Expected return on plan assets	(12,545)	(11,729)	(25,151)	(23,603)
Amortization of prior service cost	282	743	563	1,349
Amortization of net loss	2,726	2,020	5,260	3,893
Termination benefits				177
Net pension cost of defined benefit plans	\$ 4,733	\$ 4,279	\$ 9,349	\$ 8,726

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The Company previously disclosed in its financial statements for the year ended December 31, 2005, that it expected to voluntarily contribute \$30,000 to its U.S. pension plans during 2006. As of June 30, 2006, \$15,000 has been contributed.

In the first quarter of 2006, the Company modified its retirement benefit programs whereby employees of its 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 the U.S. company made an election to either remain in the company's existing retirement programs or switch to new programs offering enhanced defined contribution benefits, improved vacation and a reduced defined benefit. The Company does not expect 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.

**NOTE P INCOME TAXES**

The effective income tax rates of 30.9% and 25.5% for the six months ended June 30, 2006 and 2005, 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 effective income tax rate for the three months ended June 30, 2006 reflects an adjustment to bring the effective rate for the six months ended June 30, 2006 to the expected full year effective rate. The 2006 quarter also includes a charge for recording a valuation allowance of \$1,071 at a non-U.S. subsidiary. The effective income tax rate for the six months ended June 30, 2005 included an adjustment to state deferred income taxes totaling \$1,807. The deferred tax adjustment reflected the impact of a one-time state income tax benefit related to changes in Ohio tax laws, including the effect of lower tax rates. The anticipated effective rate for 2006 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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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (in thousands of dollars, except share and per share data)**

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, 2005 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. The Company's actual results may differ materially from those indicated in the forward-looking statements. See Risk Factors in Item 1A 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 has been actively increasing 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 provides 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, agents, dealers and product users.

The Company's major end user markets include:

general metal fabrication,

infrastructure including oil and gas pipelines and platforms, buildings, bridges and power generation,

transportation and defense industries (automotive/trucks, rail, ships and aerospace),

equipment manufacturers in construction, farming and mining,

retail resellers, and

rental market.

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

The Company's sales and distribution network, coupled with its manufacturing facilities are reported as three separate reportable segments: North America, Europe and 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.



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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 its major facilities in Canada, Mexico and Europe.

**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, 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.

**RESULTS OF OPERATIONS**

The following table presents the Company's results of operations:

	Three Months Ended June 30,					
	2006	% of		2005	Change	
(Dollars in thousands)	Amount	% of Sales	Amount	% of Sales	Amount	%
Net sales	\$ 502,510	100.0%	\$ 405,902	100.0%	\$ 96,608	23.8%
Costs of goods sold	356,043	70.9%	291,951	71.9%	64,092	22.0%
Gross profit	146,467	29.1%	113,951	28.1%	32,516	28.5%
Selling, general and administrative expenses	83,436	16.6%	71,919	17.7%	11,517	16.0%
Rationalization charges	1,292	0.2%			1,292	N/A
Operating income	61,739	12.3%	42,032	10.4%	19,707	46.9%
Interest income	1,400	0.3%	891	0.2%	509	57.1%
Equity earnings in affiliates	2,160	0.4%	1,030	0.2%	1,130	109.7%
Other income	176	0.0%	995	0.2%	(819)	(82.3%)
Interest expense	(2,438)	(0.5%)	(2,186)	(0.5%)	(252)	11.5%
Income before income taxes	63,037	12.5%	42,762	10.5%	20,275	47.4%
Income taxes	20,418	4.0%	10,650	2.6%	9,768	91.7%
Net income	\$ 42,619	8.5%	\$ 32,112	7.9%	\$ 10,507	32.7%



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	2006			Six Months Ended June 30, 2005		Change	
	(Dollars in thousands)	Amount	% of Sales	Amount	% of Sales	Amount	%
Net sales		\$ 970,904	100.0%	\$ 768,805	100.0%	\$ 202,099	26.3%
Costs of goods sold		694,371	71.5%	556,576	72.4%	137,795	24.8%
Gross profit		276,533	28.5%	212,229	27.6%	64,304	30.3%
Selling, general and administrative expenses		160,107	16.5%	138,821	18.0%	21,286	15.3%
Rationalization charges		2,341	0.2%	1,250	0.2%	1,091	87.3%
Operating income		114,085	11.8%	72,158	9.4%	41,927	58.1%
Interest income		2,594	0.2%	1,660	0.2%	934	56.3%
Equity earnings in affiliates		2,524	0.2%	1,564	0.2%	960	61.4%
Other income		549	0.1%	1,466	0.2%	(917)	(62.6%)
Interest expense		(4,839)	(0.5%)	(3,868)	(0.5%)	(971)	25.1%
Income before income taxes		114,913	11.8%	72,980	9.5%	41,933	57.5%
Income taxes		35,545	3.6%	18,628	2.4%	16,917	90.8%
Net income		\$ 79,368	8.2%	\$ 54,352	7.1%	\$ 25,016	46.0%

**Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005**

**Net Sales.** Net sales for the second quarter of 2006 increased 23.8% to \$502,510 from \$405,902 in the prior year quarter. The increase in net sales reflects a 16.5%, or \$66,871 increase due to volume, a 3.5%, or \$14,085 increase due to the acquisition of J.W. Harris, an increase of 2.2%, or \$9,137 due to price increases, and a 1.6%, or \$6,515 favorable impact of foreign currency exchange rates. Net sales for North American operations increased 26.5% to \$335,717 for 2006 compared to \$265,359 in 2005. This increase reflects an increase of 17.2% or \$45,575 due to volume, an increase of 4.9%, or \$13,134 due to the acquisition of J.W. Harris, an increase of \$8,117, or 3.1% due to price increases and a 1.3%, or \$3,532 favorable impact of foreign currency exchange rates. European sales have increased 17.3% to \$92,355 in 2006 from \$78,735 in the prior year. This increase is due to a 12.9%, or \$10,139 increase due to volume, an increase of 1.2%, or \$943 due to the acquisition of J.W. Harris, and a 3.4% or \$2,709 favorable impact of foreign currency exchange rates. Other Countries sales increased 20.4% to \$74,438 in 2006 from \$61,808 in the prior year. This increase reflects an increase of \$11,157 or 18.1% due to volume and an increase of 1.9%, or \$1,191 due to price increases.

**Gross Profit.** Gross profit increased 28.5% to \$146,467 during the second quarter of 2006 compared to \$113,951 in 2005. As a percentage of net sales, Gross profit increased to 29.1% in the second quarter of 2006 from 28.1% in 2005. This increase was principally driven by increased leverage on improved volume, partially offset by an increase in product liability defense costs of \$2,339. In addition, foreign currency exchange rates had a favorable impact of \$1,624 in the second quarter of 2006.

**Selling, General & Administrative (SG&A) Expenses.** SG&A expenses increased \$11,517, or 16.0%, in the second quarter of 2006, compared with 2005. The increase was primarily due to higher bonus expense of \$5,005, incremental selling, general and administrative expenses from the acquisition of J.W. Harris totaling \$817, and higher selling expenses of \$2,709 resulting from increased sales levels and related selling activity.

**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.

*Equity Earnings in Affiliates.* Equity earnings in affiliates increased to \$2,160 in the second quarter of 2006 from \$1,030 in the second quarter of 2005 primarily due to increased earnings at the Company's joint venture investment in Taiwan.

*Income Taxes.* Income taxes for the second quarter of 2006 were \$20,418 on income before income taxes of \$63,037, an effective rate of 32.4%, as compared with income taxes of \$10,650 on income before income taxes of \$42,762, or an effective rate of 24.9% for the same period in 2005. The effective rate for 2006 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. The increase in the effective tax rate from 2005 to 2006 is primarily because of an increase in earnings in higher tax rate jurisdictions. The effective income tax rate for the three months ended June 30, 2006 reflects an adjustment to bring the effective rate for the six months ended June 30, 2006 to the expected full year effective rate. The current quarter also includes a charge for recording a valuation allowance of \$1,071 at a non-U.S. subsidiary. The second quarter of 2005 included an adjustment to state deferred income taxes totaling \$1,807. The deferred tax adjustment reflected the impact of a one-time state income tax benefit related to changes in Ohio tax laws, including the effect of lower tax rates.

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*Net Income.* Net income for the second quarter of 2006 was \$42,619 compared to \$32,112 last year. Diluted earnings per share for the second quarter of 2006 was \$0.99 compared to \$0.77 per share in 2005. Foreign currency exchange rate movements had a \$511 and \$740 favorable effect on 2006 and 2005 second quarter net income, respectively.

### **Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005**

*Net Sales.* Net sales for the first half of 2006 increased 26.3% to \$970,904 from \$768,805 in the prior year period. The increase in net sales reflects a 16.8%, or \$128,900 increase due to volume, a 6.4%, or \$49,549 increase due to the acquisition of J.W. Harris, an increase of 2.8%, or \$21,418 due to price increases, and a 0.3%, or \$2,232 favorable impact of foreign currency exchange rates. Net sales for North American operations increased 32% to \$655,912 for 2006 compared to \$496,877 in 2005. This increase reflects an increase of 18.2% or \$90,526 due to volume, an increase of 9.4%, or \$46,784 due to the acquisition of J.W. Harris, an increase of \$16,281, or 3.3% due to price increases and a 1.1%, or \$5,444 favorable impact of foreign currency exchange rates. European sales have increased 10.1% to \$174,668 in 2006 from \$158,656 in the prior year. This increase is due to a 10.7%, or \$16,966 increase due to volume, an increase of 1.7%, or \$2,743 due to the acquisition of J.W. Harris, and a 2.2% or \$3,440 unfavorable impact of foreign currency exchange rates. Other Countries sales increased 23.9% to \$140,324 in 2006 from \$113,272 in the prior year. This increase reflects an increase of \$21,408 or 18.9% due to volume, and an increase of 4.8%, or \$5,394 due to price increases.

*Gross Profit.* Gross profit increased 30.3% to \$276,533 during the first half of 2006 compared to \$212,229 in 2005. As a percentage of net sales, Gross profit increased to 28.5% in the first half of 2006 from 27.6% in 2005. This increase was primarily due to favorable leverage on increased volumes. This increase was partially offset by a shift in sales mix to traditionally lower margin geographies and businesses, including the effects of acquisitions, as well as an increase in product liability defense costs of \$4,078. Foreign currency exchange rates did not have a material impact in the first half of 2006.

*Selling, General & Administrative (SG&A) Expenses.* SG&A expenses increased \$21,286, or 15.3%, in the first half of 2006, compared with 2005. The increase was primarily due to higher bonus expense of \$11,081, incremental selling, general and administrative expenses from the acquisition of J.W. Harris totaling \$3,352, and higher selling expenses of \$3,497 resulting from increased sales levels and related selling activity.

*Rationalization Charges.* In the first half of 2006, the Company recorded rationalization charges of \$2,341 (\$2,341 after-tax) primarily related to severance costs covering 66 employees at the Company's facility in Ireland. During the first half of 2005, the Company recorded rationalization charges of \$1,250 (\$848 after-tax) primarily due to employee severance costs related to rationalization efforts in France.

*Equity Earnings in Affiliates.* Equity earnings in affiliates increased to \$2,524 in the first half of 2006 from \$1,564 in the first half of 2005 primarily due to increased earnings at the Company's joint venture investment in Taiwan.

*Interest Expense:* Interest expense increased to \$4,839 in the first half of 2006 from \$3,868 in the comparable 2005 period as a result of higher interest rates.

*Income Taxes.* Income taxes for the first half of 2006 were \$35,545 on income before income taxes of \$114,913, an effective rate of 30.9%, as compared with income taxes of \$18,628 on income before income taxes of \$72,980, or an effective rate of 25.5% for the same period in 2005. The effective rate for 2006 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. The increase in the effective tax rate from 2005 to 2006 is primarily because of an increase in earnings in higher tax rate jurisdictions and the level of related tax deductions. The first half also includes a charge for recording a valuation allowance of \$1,071 at a non-U.S. subsidiary. The first half of 2005 included an adjustment to state deferred income taxes totaling \$1,807. The deferred tax adjustment reflected the impact of a one-time state income tax benefit related to changes in Ohio tax laws, including the effect of lower tax rates.

*Net Income.* Net income for the first half of 2006 was \$79,368 compared to \$54,352 last year. Diluted earnings per share for the first half of 2006 was \$1.85 compared to \$1.30 per share in 2005. Foreign currency exchange rate movements did not have a material effect on net income for 2006, and had a \$1,381 favorable effect on net income in 2005.

## **LIQUIDITY AND CAPITAL RESOURCES**

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

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

The following table reflects changes in key cash flow measures:

(Dollars in thousands)	Six Months Ended June 30,		
	2006	2005	Change
Cash provided by operating activities:	\$ 57,330	\$ 61,841	\$ (4,511)
Cash used by investing activities:	(31,715)	(40,793)	9,078
Capital expenditures	(32,261)	(21,435)	(10,826)
Sales of marketable securities, net		50,500	(50,500)
Acquisitions, net of cash acquired	(95)	(70,704)	70,609
Cash used by financing activities:	(11,551)	(31,206)	19,655
Amounts due banks, net	(7,138)	4,114	(11,252)
Payments on long-term borrowings	(1,449)	(14,993)	13,544
Tax benefit from the exercise of stock options	3,051		3,051
Purchase of shares for treasury		(12,804)	12,804
Cash dividends paid to shareholders	(16,077)	(14,985)	(1,092)
Increase (decrease) in Cash and cash equivalents	17,420	(12,435)	29,855

Cash and cash equivalents increased 16.1%, or \$17,420, to \$125,427 as of June 30, 2006, from \$108,007 as of December 31, 2005. This compares to a \$12,435 decrease in cash and cash equivalents during the same period in 2005.

Cash provided by operating activities decreased by \$4,511 for the first half in 2006 compared to 2005. The decrease was primarily related to an increase in working capital levels when compared to the same period in 2005. Average working capital to sales was 31.3% at June 30, 2006 and December 31, 2005. Average days in accounts payable increased to 44.0 days at June 30, 2006 from 40.2 days at December 31, 2005. Days sales in inventory increased from 114.8 days at December 31, 2005 to 117.8 days at June 30, 2006. Accounts receivable days increased from 56.1 days at December 31, 2005 to 58.0 days at June 30, 2006.

Cash used by investing activities for the first half of 2006 compared to 2005 reflects a decrease in cash used in the acquisition of businesses and a net decrease in the proceeds from the sale of marketable securities of \$50,500. In addition, capital expenditures during the first half of 2006 were \$32,261, a \$10,826 increase from 2005. The Company anticipates capital expenditures in 2006 of approximately \$60,000 to \$70,000. Anticipated capital expenditures reflect the acceleration of 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 either 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 decreased \$19,655 in the first half of 2006 compared to 2005. The decrease was primarily due to a decrease in treasury share purchases of \$12,804, an increase in the tax benefit from the exercise of stock options of \$3,051, and less of a reduction in debt in 2006 of \$3,532.

The Company's debt levels decreased from \$166,016 at December 31, 2005, to \$157,055 at June 30, 2006. Debt to total capitalization decreased to 17.4% at June 30, 2006, from 20.3% at December 31, 2005.

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 10,241,673 shares at a cost of \$216,266 through June 30, 2006.

In April 2006, the Company paid a quarterly cash dividend of 19 cents per share, or \$8,062 to shareholders of record on March 31, 2006.

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### **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 intends to transfer all manufacturing currently taking place at Harris Ireland to a lower cost facility in Eastern Europe and sell the facility in Ireland.

The Company expects to incur a charge of approximately \$5,000 (pre-tax) associated with employee severance costs, equipment relocation, employee retention and professional services. This charge does not reflect the impact of anticipated proceeds from the planned sale of the facility in Ireland. A total of 66 employees will be impacted by the Ireland Rationalization.

The Company has incurred a total of \$2,852 (pre-tax) in charges related to this plan of which \$2,341 (pre-tax) was incurred in the first half of 2006. Cash expenditures are expected to be paid throughout 2006 with the expected completion of the Ireland Rationalization occurring in the fourth quarter of 2006. As of June 30, 2006, the Company has recorded a liability of \$2,948 for charges related to these efforts.

In 2004, the Company committed to a plan to rationalize machine manufacturing (the French Rationalization) at Lincoln Electric France, S.A.S. (LE France). In connection with the French Rationalization, the Company transferred machine manufacturing performed at LE France to other facilities. The Company committed to the French Rationalization as a result of the region's decreased demand for locally-manufactured machines. In connection with the French Rationalization, the Company incurred a charge of \$2,292 (pre-tax), of which \$1,188 (pre-tax) was incurred in the first half of 2005. Employee severance costs associated with the termination of approximately 40 of LE France's 179 employees were \$2,123 (pre-tax). Costs not relating to employee severance primarily included warehouse relocation costs and professional fees.

### **Acquisitions**

On April 29, 2005, the Company acquired all of the outstanding stock of J.W. Harris Co., Inc. (J.W. Harris), a privately held brazing and soldering alloys manufacturer headquartered in Mason, Ohio for approximately \$71,000 in cash and \$15,000 of assumed debt. The Company began consolidating the results of J.W. Harris operations in the Company's consolidated financial statements in May 2005.

The purchase price allocation for this investment resulted in goodwill of \$9,103. Included in the aggregate purchase price is \$4,160 deposited in escrow accounts. Distribution of amounts in escrow is dependent on resolution of pre-closing contingencies. Amounts remaining in escrow as of the second anniversary of the closing date will be distributed to the former shareholders and will result in adjustments to the purchase price allocation.

This acquisition has provided the Company with a strong complementary metals-joining technology and a leading position in the brazing and soldering alloys market. J.W. Harris has manufacturing plants in Ohio and Rhode Island and an international distribution center located in Spain.

The Company continues to expand globally and periodically looks at transactions that would involve significant investments. The Company's operational cash flow can fund the global expansion plans, but a significant acquisition may require access to the 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 ratios). As of June 30, 2006, the Company was in compliance with all of its debt covenants.





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The maturity and interest rates of the Notes follow (in thousands):

	<b>Amount</b>		<b>Interest</b>
	<b>Due</b>	<b>Matures</b>	<b>Rate</b>
Series A	\$40,000	March 2007	5.58%
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 \$1,050 in the first half of 2006 and 2005 and is expected to reduce annual interest expense by \$2,117 in 2006 and \$1,121 in 2007. At June 30, 2006, \$3,901 remains to be amortized of which \$3,150 is included in the balance sheet caption Long-term debt, less current portion and \$751 is included in the balance sheet caption Current portion of long-term debt. The financing costs related to the \$150,000 private placement are further reduced by the interest income earned on the cash balances. These short-term, highly liquid investments earned approximately \$1,335 during the first half of 2006. 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 included in the balance sheet caption Other long-term liabilities with a corresponding decrease in Long-term debt. The fair value of these swaps at June 30, 2006 was \$6,202.

Terminated swaps have increased the value of the Series A Notes from \$40,000 to \$40,751 as of June 30, 2006. Active and terminated swaps have increased the value of the Series B Notes from \$30,000 to \$30,533 and decreased the value of the Series C Notes from \$80,000 to \$76,415 as of June 30, 2006. The weighted-average effective rate on the Notes, net of the impact of active and terminated swaps, was 5.11% for the first half of 2006.

**Stock-based compensation**

On April 28, 2006, the shareholders of the Company approved the 2006 Equity and Performance Incentive Plan ( EPI Plan ) which replaces the 1998 Stock Plan, as amended 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. There were 230 and 500 options granted during the six months ended June 30, 2006 and 2005, respectively. There were no TARs, restricted shares or deferred shares granted during the six months ended June 30, 2006 and 2005.

In addition, on April 28, 2006, the shareholders of the Company approved the 2006 Stock Plan for Non-Employee Directors ( Director Plan ). 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.

The Company issued 365,867 and 365,656 shares of common stock from treasury upon exercise of employee stock options during the six months ended June 30, 2006 and 2005, respectively.

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

*Accounting for Stock Issued to Employees*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS 123. SFAS No. 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. Pro forma disclosure is

no longer an alternative. The Company adopted SFAS No. 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 as the Company previously adopted fair value accounting under SFAS No. 123 on January 1, 2003.

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Prior to 2003, the Company applied the intrinsic value method permitted under SFAS No. 123, as defined in Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations, in accounting for the Company's stock option plans. Accordingly, no compensation cost was recognized in years prior to adoption.

Total stock-based compensation expense recognized in the consolidated statement of earnings for the six months ended June 30, 2006 and 2005 was \$1,938 and \$1,897, respectively. The related tax benefit for the six months ended June 30, 2006 and 2005 was \$741 and \$725, respectively.

As of June 30, 2006, total unrecognized stock-based compensation expense related to nonvested stock options, restricted shares and deferred shares was \$4,947, which is expected to be recognized over a weighted average period of approximately 27 months.

The aggregate intrinsic value of options outstanding at June 30, 2006, based on the Company's closing stock price of \$62.65 as of the last business day of the period ended June 30, 2006, which would have been received by the optionees had all options been exercised on that date was \$55,342. The aggregate intrinsic value of options exercisable at June 30, 2006, based on the Company's closing stock price of \$62.65 as of the last business day of the period ended June 30, 2006, which would have been received by the optionees had all options exercisable been exercised on that date was \$36,267. The total intrinsic value of stock options exercised during the six months ended June 30, 2006 and 2005 was \$9,073 and \$3,939, respectively. Intrinsic value is the amount by which the fair value of the underlying stock exceeds the exercise price of the options.

### **Product liability expense**

Product liability expenses have been increasing, particularly with respect to the increased number of welding fume claims. The costs associated with these claims are predominantly defense costs, which are recognized in the periods incurred. These net expenditures increased \$4,078 in the first half of 2006 compared to the same period in 2005. See Note K. 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 and indemnity payments have been immaterial. If cost sharing dissipates for some currently unforeseen reason, 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.

### **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 \$6,250 at June 30, 2006. The Company believes the likelihood is remote that material payment will be required under this arrangement because of the current financial condition of the joint venture.

### **NEW ACCOUNTING PRONOUNCEMENTS**

In July 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation prescribes a 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. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 16, 2006. The Company is currently evaluating the impact of this Interpretation on its financial statements.

In June 2005, the Financial Accounting Standards Board ( FASB ) issued Staff Position No. 143-1 *Accounting for Electronic Equipment Waste Obligations* ( FSP 143-1 ), which provides guidance on the accounting for obligations associated with the Directive on Waste Electrical and Electronic Equipment (the WEEE Directive ), which was adopted by the European Union. FSP 143-1 provides guidance on accounting for the effects of the WEEE Directive with respect to historical waste and waste associated with products on the market on or before August 13, 2005. FSP

143-1 requires commercial users to account for their WEEE obligation as an asset retirement liability in accordance with FASB Statement No. 143, Accounting for Asset Retirement Obligations. FSP 143-1 was required to be applied to the later of the first reporting period ending after June 8, 2005 or the date of the adoption of the WEEE Directive into law by the applicable European Union member country. The

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WEEE Directive has been adopted into law by the majority of European Union member countries in which the Company has significant operations. The Company adopted the provisions of FSP 143-1 as it relates to these countries with no material impact to its financial statements. The Company will apply the guidance of FSP 143-1 as it relates to the remaining European Union member countries in which it operates when those countries have adopted the WEEE Directive into law.

In March 2005, the FASB issued FASB Interpretation No. 47 ( FIN 47 ) *Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143*. This interpretation defines the term conditional asset retirement obligation as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, as a legal obligation to perform an asset retirement activity, in which the timing, and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 requires that an obligation to perform an asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement. The Company adopted the provisions of FIN 47 as of December 31, 2005 with no material impact to its financial statements.

In November 2004, the FASB issued SFAS No. 151 *Inventory Costs an amendment of ARB No. 43, Chapter 4*. This Statement amends the guidance in Accounting Research Bulletin No. 43 to require idle facility expense, freight, handling costs, and wasted material (spoilage) be recognized as current-period charges. In addition, SFAS No. 151 requires the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company adopted SFAS No. 151 on January 1, 2006 with no material impact to its financial statements.

**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 during the six months ended June 30, 2006. 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 preliminary procedural stages and insufficient information exists upon which judgments can be made as to the validity or ultimate disposition of such actions. Therefore, in many situations a range of possible losses cannot be made at this time. Reserves are adjusted as facts and circumstances change and related management assessments of the underlying merits and the likelihood of outcomes change. Moreover, reserves only cover identified and/or asserted claims. Future claims could, therefore, give rise to increases to such reserves. See Note K to the Consolidated Financial Statements and the Legal Proceedings section of this Quarterly Report on Form 10-Q for further discussion of legal contingencies.

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

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

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### **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. At June 30, 2006, the Company had approximately \$65,815 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, 2006, a valuation allowance of \$18,349 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 and its subsidiaries maintain 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.

The Company accounts for its defined benefit plans in accordance with SFAS No. 87, *Employers' Accounting for Pensions*, which requires amounts recognized in financial statements be determined on an actuarial basis. A substantial portion of the Company's pension amounts relate to its defined benefit plan in the United States. Upon adoption of SFAS No. 87, the market-related value of plan assets could be determined by either fair value or a calculated value recognizing changes in fair value in a systematic and rational manner over not more than five years. The method chosen must be applied consistently year to year. The Company used fair values at December 31 for the market-related value of plan assets.

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, 2005. The assumed long-term rate of return on assets is applied to the market value of plan assets. This produces the expected return on plan assets included in pension expense. The difference between this expected return and the actual return on plan assets is deferred and amortized over the average remaining service period of active employees expected to receive benefits under the plan. The amortization of the net deferral of past losses will increase future pension expense. During 2005, investment returns in the Company's U.S. pension plans were approximately 7.7%. A 25 basis point change in the expected return on plan assets would increase or decrease pension expense by approximately \$1,300.

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 5.7% for its U.S. plans at December 31, 2005. 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 \$31,500 in 2005. Based on current pension funding rules, the Company does not anticipate that contributions to the plans will be required in 2006. The Company has voluntarily contributed \$15,000 for the six months ended June 30, 2006 and expects to contribute a total



of \$30,000 in 2006.

Pension expense relating to the Company's defined benefit plans was \$21,328 in 2005. The Company expects 2006 pension expense to decline by approximately \$2,000.

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In the first quarter of 2006, the Company modified its retirement benefit programs whereby employees of its 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 the U.S. company made an election to either remain in the company's existing retirement programs or switch to new programs offering enhanced defined contribution benefits, improved vacation and a reduced defined benefit. The Company does not expect 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 \$67,424 at June 30, 2006. 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 No. 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 an impairment exists. If an asset is determined to be impaired, the loss is measured based on quoted market prices in active markets, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including the discounted value of estimated future cash flows and established business valuation multiples.

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

### **Impairment of Goodwill and Intangibles**

The Company evaluates the recoverability of goodwill and intangible assets not subject to amortization as required under SFAS No. 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, 2005. See Item 7A in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

### **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



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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, 2006, the Company was a co-defendant in cases alleging asbestos induced illness involving claims by approximately 33,604 plaintiffs, which is a net decrease of 383 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: 20,851 of those claims were dismissed, 9 were tried to defense verdicts, 4 were tried to plaintiff verdicts (2 of which were satisfied and 2 of which are subject to appeal) and 325 were decided in favor of the Company following summary judgment motions.

At June 30, 2006, the Company was a co-defendant in cases alleging manganese induced illness involving claims by approximately 7,189 plaintiffs, which is a net decrease of 1,581 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, 2006, cases involving 3,820 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 class actions seeking medical monitoring in eight state courts, seven of which have been removed to the MDL Court. Since January 1, 1995, the Company has been a co-defendant in similar cases that have been resolved as follows: 7,590 of those claims were dismissed, 9 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 settled for immaterial amounts.

### **Item 1A. Risk Factors**

From time to time, information we provide, statements by our employees or information included in our filings with the Securities and Exchange Commission 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, and accelerating through the first half of 2006, we have also experienced substantial inflation in prices for other raw

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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, 2006, we were a co-defendant in cases alleging manganese induced illness involving claims by approximately 7,189 plaintiffs and a co-defendant in cases alleging asbestos induced illness involving claims by approximately 33,604 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 plaintiff 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: 7,590 of those claims were dismissed, 9 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 settled for immaterial amounts. Since January 1, 1995, we have been a co-defendant in asbestos cases that have been resolved as follows: 20,851 of those claims were dismissed, 9 were tried to defense verdicts, 4 were tried to plaintiff verdicts and 325 were decided in favor of us following summary judgment motions.

Defense costs have been increasing. 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 access, 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 possibility that cost sharing dissipates for some currently unforeseen reason or that our trial experience changes overall.

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

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

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

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

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

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

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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 and performance, warranty, delivery, service and technical support. If our products, services, support and cost structure do not enable us to compete successfully based on any of those criteria, our operations, results and prospects could suffer.

Further, in the past decade, the United States arc welding industry has been subject to increased levels of foreign competition as low cost imports have become more readily available. This foreign competition intensifies as the value of the U.S. dollar falls in relation to other currencies.

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 increase our share in growing international markets, particularly Asia (with emphasis in China), Latin America, Eastern Europe and other developing markets. In recent years, we have expanded our operations abroad by gaining a manufacturing presence in Poland, Venezuela, Colombia and China. 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.

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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 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 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 28, 2006.

(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:

	Votes For	Abstentions/	Broker Non-Votes
For term ending in 2009			

		<b>Votes Against</b>
Harold L. Adams	37,389,619	211,807
Robert J. Knoll	37,480,117	121,309
John M. Stropki, Jr.	37,308,562	292,864

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(ii) Approval of the 2006 Equity and Performance Incentive Plan:

Votes For	30,914,894
Votes Against	2,079,989
Abstentions	391,877
Broker Non-Votes	

(iii) Approval of the 2006 Stock Plan for Non-Employee Directors:

Votes For	31,759,360
Votes Against	1,360,287
Abstentions	267,110
Broker Non-Votes	

(iv) Appointment of Independent Auditors. The shareholders ratified the appointment of the firm of Ernst & Young, LLP as independent auditors to examine the books of account and other records of the Company for the fiscal year ending December 31, 2006.

Votes For	37,433,593
Votes Against	65,080
Abstentions	102,751
Broker Non-Votes	

(d) Not applicable.

**Item 5. Other Information**

- (a) On July 20, 2006 the Board of Directors elected Stephen G. Hanks as a director of Lincoln to serve with a term expiring at the 2007 annual meeting of shareholders. Mr. Hanks is the President and Chief Executive Officer of Washington Group International Inc., a Nasdaq-traded company that provides integrated engineering, construction and management solutions for businesses and governments worldwide. Mr. Hanks will serve on Lincoln's Compensation and Executive Development and Finance Committees of the Board.

A copy of the press release announcing the election of Mr. Hanks as a director of Lincoln is furnished as Exhibit 99.1 to this report and incorporated herein by reference.

- (b) None.

**Item 6. Exhibits**

(a) Exhibits

- 10.1 2006 Equity and Performance Incentive Plan (filed as Appendix B to the Company's Proxy Statement filed with the Commission on March 28, 2006 and incorporated herein by reference).
- 10.2 2006 Stock Plan for Non-Employee Directors (filed as Appendix C to the Company's Proxy Statement filed with the Commission on March 28, 2006 and incorporated herein by reference).
- 10.3 Agreement with Ranko Cucuz effective June 30, 2006 (see Item 1.01 of the Company's Form 8-K filed with the Commission on July 3, 2006 and incorporated herein by reference).
- 31.1 Certification by the Chairman, President and Chief Executive Officer pursuant to Rules 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934.
- 31.2 Certification by the Senior Vice President, Chief Financial Officer and Treasurer pursuant to Rules 13a-14(a)/15d-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.

99.1 Press release dated July 21, 2006 announcing the election of Stephen G. Hanks to Lincoln's Board of Directors.

**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 25, 2006