

Consolidated Balance Sheets

	December 31	
<i>(In thousands of dollars)</i>	1998	1997
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 39,095	\$ 46,562
Marketable securities	311	10,194
Accounts receivable (less allowances of \$3,563 in 1998; \$3,071 in 1997)	167,830	163,437
Inventories		
Raw materials and in-process	82,030	80,606
Finished goods	104,291	97,962
	186,321	178,568
Deferred income taxes	17,751	15,868
Other current assets	25,533	18,914
TOTAL CURRENT ASSETS	436,841	433,543
Property, Plant and Equipment		
Land	11,447	11,520
Buildings	115,538	111,353
Machinery, tools and equipment	424,307	349,085
	551,292	471,958
Less: accumulated depreciation and amortization	291,501	269,923
	259,791	202,035
Other Assets		
Goodwill	35,747	34,751
Other	50,527	41,861
	86,274	76,612
TOTAL ASSETS	\$782,906	\$712,190

December 31

(In thousands of dollars, except share data)

	1998	1997
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	\$ 2,792	\$ 1,968
Trade accounts payable	60,502	52,497
Salaries, wages and amounts withheld	19,366	18,742
Taxes, including income taxes	38,434	40,284
Dividend payable	5,770	4,922
Other current liabilities	57,147	56,138
Current portion of long-term debt	11,100	9,971
TOTAL CURRENT LIABILITIES	195,111	184,522
Long-term debt, less current portion	46,766	54,360
Deferred income taxes	23,158	11,024
Other long-term liabilities	26,938	25,113
Shareholders' Equity		
Preferred Shares, without par value – at stated capital amount:		
Authorized – 5,000,000 shares in 1998 and none in 1997;		
Issued and Outstanding – none		
	—	—
Common Shares, without par value – at stated capital amount:		
Authorized – 120,000,000 shares in 1998 and 60,000,000 shares in 1997;		
Issued – 49,283,950 shares in 1998 and 21,542,014 shares in 1997;		
Outstanding – 48,083,246 shares in 1998 and 21,542,014 shares in 1997		
	4,928	2,154
Class A Common Shares (non-voting), without par value – at stated capital amount:		
Authorized – none in 1998 and 60,000,000 shares in 1997;		
Issued and Outstanding – none in 1998 and 27,676,726 shares in 1997		
	—	2,768
Additional paid-in capital	104,641	103,722
Retained earnings	432,283	359,639
Accumulated other comprehensive income	(28,251)	(31,112)
Treasury shares, at cost – 1,200,704 shares in 1998, none in 1997	(22,668)	—
TOTAL SHAREHOLDERS' EQUITY	490,933	437,171
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$782,906	\$712,190

See notes to these consolidated financial statements.

Consolidated Statements of Income

	Year Ended December 31		
<i>(In thousands of dollars, except per share data)</i>	1998	1997	1996
Net sales	\$1,186,679	\$1,159,067	\$1,109,144
Cost of goods sold	729,613	718,385	686,545
Gross profit	457,066	440,682	422,599
Distribution cost/selling, general & administrative expenses	309,658	305,820	310,258
Operating income	147,408	134,862	112,341
Other income (expense):			
Interest income	4,119	5,877	2,832
Other income	1,213	770	10,421
Interest expense	(5,676)	(6,349)	(7,731)
	(344)	298	5,522
Income before income taxes	147,064	135,160	117,863
Income taxes	53,345	49,746	43,610
Net income	\$ 93,719	\$ 85,414	\$ 74,253
Basic earnings per share	\$ 1.92	\$ 1.73	\$ 1.49
Diluted earnings per share	\$ 1.91	\$ 1.73	\$ 1.49

See notes to these consolidated financial statements.

Consolidated Statements of Shareholders' Equity

<i>(In thousands of dollars, except per share data)</i>	Common Shares	Class A Common Shares	Class B Common Shares	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Shares	Total
Balance, January 1, 1996	\$2,104	\$2,776	\$97	\$102,652	\$228,555	\$ (6,238)	\$ —	\$329,946
Comprehensive income:								
Net income					74,253			74,253
Currency translation adjustment						(920)		(920)
Total comprehensive income								73,333
Cash dividends declared – \$0.24 per share					(11,931)			(11,931)
Repurchase of Class B Shares				(4)				(4)
Shares issued to non-employee directors	1			136				137
Shares repurchased under Incentive Equity Plan	(8)	(8)		(629)	(625)			(1,270)
Options issued in settlement of litigation				1,565				1,565
Balance, December 31, 1996	2,097	2,768	97	103,720	290,252	(7,158)	—	391,776
Comprehensive income:								
Net income					85,414			85,414
Currency translation adjustment						(23,954)		(23,954)
Total comprehensive income								61,460
Cash dividends declared – \$0.325 per share					(16,027)			(16,027)
Shares issued to non-employee directors	1			112				113
Conversion of Class B Common Shares to Common Shares	56		(97)	(153)				(194)
Exercise of non-qualified stock options				43				43
Balance, December 31, 1997	2,154	2,768	—	103,722	359,639	(31,112)	—	437,171
Comprehensive income:								
Net income					93,719			93,719
Currency translation adjustment						2,861		2,861
Total comprehensive income								96,580
Cash dividends declared – \$0.42 per share					(20,442)			(20,442)
Shares issued to non-employee directors	1			110				111
Purchase of shares for treasury							(23,823)	(23,823)
Exercise of non-qualified stock options	3	4		1,635	(173)		1,155	2,624
Conversion of Class A Common Shares to Common Shares	2,772	(2,772)		(779)				(779)
Retirement of Common Shares	(2)			(47)	(460)			(509)
Balance, December 31, 1998	\$4,928	\$ —	\$ —	\$104,641	\$432,283	\$(28,251)	\$(22,668)	\$490,933

See notes to these consolidated financial statements.

Consolidated Statements of Cash Flows

	Year Ended December 31		
<i>(In thousands of dollars)</i>	1998	1997	1996
OPERATING ACTIVITIES			
Net income	\$ 93,719	\$ 85,414	\$ 74,253
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	28,079	28,431	29,488
Deferred income taxes	10,199	987	(3,083)
(Gain) loss on sale of fixed assets and businesses	(292)	166	(8,892)
Changes in operating assets and liabilities net of effects from acquisitions:			
(Increase) in accounts receivable	(2,167)	(22,089)	(11,167)
(Increase) decrease in inventories	(6,007)	(18,361)	9,591
(Increase) decrease in other current assets	(6,120)	(10,115)	4,287
Increase (decrease) in accounts payable	5,768	(2,135)	2,834
(Decrease) increase in other current liabilities	(1,467)	23,591	10,511
Gross change in other long-term assets and liabilities	1,770	1,135	(2,095)
Other, net	(1,397)	1,886	2,106
NET CASH PROVIDED BY OPERATING ACTIVITIES	122,085	88,910	107,833
INVESTING ACTIVITIES			
Capital expenditures	(81,411)	(37,296)	(34,257)
Acquisitions of businesses and equity investments	(10,820)	—	(5,520)
Purchases of marketable securities and other investments	(910)	(66,260)	—
Proceeds from sale of marketable securities	10,872	44,364	—
Proceeds from sale of fixed assets and businesses	4,577	909	22,375
NET CASH (USED) BY INVESTING ACTIVITIES	(77,692)	(58,283)	(17,402)
FINANCING ACTIVITIES			
Short-term borrowings – net	(87)	(524)	(27,366)
Long-term borrowings – net	(11,004)	(10,230)	(20,338)
Net (purchase) issuance of shares for treasury	(22,668)	—	—
Cash dividends paid	(19,594)	(14,082)	(11,942)
Other	124	—	(1,138)
NET CASH (USED) BY FINANCING ACTIVITIES	(53,229)	(24,836)	(60,784)
Effect of exchange rate changes on cash and cash equivalents	1,369	280	757
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(7,467)	6,071	30,404
Cash and cash equivalents at beginning of year	46,562	40,491	10,087
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 39,095	\$ 46,562	\$ 40,491

See notes to these consolidated financial statements.

Notes to Consolidated Financial Statements

(In thousands of dollars, except per share data)

December 31, 1998

NOTE A — SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of Lincoln Electric Holdings, Inc. and its wholly owned and majority-owned subsidiaries (the "Company") after elimination of all significant intercompany accounts, transactions and profits. Minority ownership interest in consolidated subsidiaries, which is not material, is recorded in Other Long-term Liabilities in the Consolidated Balance Sheet.

Cash Equivalents and Marketable Securities: The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Investments with maturities between three and twelve months are considered to be marketable securities classified as held-to-maturity. Marketable securities are carried at cost, with realized gains and losses recorded to income.

Inventories: Inventories are valued at the lower of cost or market. For 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. At December 31, 1998 and 1997, approximately 63% and 67%, respectively, of total inventories were valued using the LIFO method. The excess of current cost over LIFO cost amounted to \$50,240 at December 31, 1998 and \$52,860 at December 31, 1997.

Equity Investments: Investments in businesses in which the Company holds between a 20% and 50% ownership interest are accounted for using the equity method of accounting. Under the equity method, the investment is carried at cost plus the Company's proportionate share of the net income or loss of the business since the date of acquisition.

Property, Plant and Equipment: Property, plant and equipment are stated at cost and include improvements that significantly extend the useful lives of existing plant and equipment. Depreciation and amortization are computed by both accelerated and straight-line methods over useful lives ranging from 3 to 20 years for machinery, tools and equipment, and up to 50 years for buildings. Net gains or losses related to asset dispositions are recognized in earnings in the period in which dispositions occur.

Goodwill: The excess of the purchase price over the fair value of net assets acquired is amortized on a straight-line basis over periods not exceeding 40 years. Amounts are stated net of accumulated amortization of \$10,323 and \$8,852 in 1998 and 1997, respectively.

Long-lived Assets: The carrying value of long-lived assets is reviewed if facts and circumstances indicate a potential impairment of carrying value may have occurred utilizing relevant cash flow and profitability information.

Revenue Recognition: The Company recognizes revenue at the time of product shipment.

Translation of Foreign Currencies: Asset and liability accounts are translated into U.S. dollars using exchange rates in effect at the date of the consolidated balance sheet; revenue and expense accounts are translated at monthly exchange rates. Translation adjustments are reflected as a component of shareholders' equity. For subsidiaries operating in highly inflationary economies, both historical and current exchange rates are used in translating balance sheet accounts, and translation adjustments are included in net income.

Transaction gains and losses are included in the consolidated statements of income in distribution cost/selling, general & administrative expenses and were not material.

Financial Instruments: The Company, on a limited basis, uses forward exchange contracts to hedge exposure to exchange rate fluctuations on certain intercompany loans, purchase and sales transactions and other intercompany commitments. Contracts are written on a short-term basis and are not held for trading or speculation purposes. Gains and losses on all forward exchange contracts are recognized in the consolidated statements of income.

Research and Development: Research and development costs, which are expensed as incurred, were \$17,719 in 1998, \$16,547 in 1997 and \$19,800 in 1996. Included in research and development costs for 1996 was \$2,040 related to in-process research and development acquired with the purchase of Electronic Welding Systems.

Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions in certain circumstances that affect the amounts reported in the accompanying consolidated financial statements and notes. Actual results could differ from these estimates.

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). All periods presented have been adjusted for the reorganization (see Note B), which had the economic effect of a two-for-one stock split.

	1998	1997	1996
Numerator:			
Net income	\$93,719	\$85,414	\$74,253
Denominator:			
Denominator for basic earnings per share –			
Weighted-average shares	48,935	49,384	49,723
Effect of dilutive securities – Employee stock options	135	148	—
Denominator for diluted earnings per share –			
Adjusted weighted-average shares	49,070	49,532	49,723
Basic earnings per share	\$ 1.92	\$ 1.73	\$ 1.49
Diluted earnings per share	\$ 1.91	\$ 1.73	\$ 1.49

Other: Included in distribution cost/selling, general & administrative expenses are the costs related to the Company's discretionary employee bonus, net of hospitalization costs, of \$76,491 in 1998, \$74,953 in 1997 and \$66,681 in 1996.

NOTE B — SHAREHOLDERS' EQUITY

On May 19, 1998, shareholders approved a reorganization of the capital and corporate structure of The Lincoln Electric Company (the "reorganization"). As a result of the reorganization, a new holding company, Lincoln Electric Holdings, Inc., was created. Each Common Share and each Class A Common Share (non-voting) of The Lincoln Electric Company was converted into two voting common shares of Lincoln Electric Holdings, Inc., which also had the economic effect of a two-for-one stock split. The reorganization also resulted in the authorization of 5,000,000 Preferred Shares, none of which was issued or outstanding at December 31, 1998. The Preferred Shares were authorized to provide the Company flexibility in future financing or acquisitions, and to render or discourage an attempt by another person or entity to obtain control of the Company. The Company's Articles of Incorporation allow the Board of Directors the discretion to issue one or more series of Preferred Shares with terms that the Board feels meet the needs of a particular transaction. Each issuance of Preferred Shares may have distinct dividend rights, conversion rights and liquidation preferences. The historical share and per share amounts disclosed in these consolidated financial statements have been restated to reflect the share conversion.

In September 1998, the Board of Directors authorized a share repurchase of up to 5,000,000 shares of the Company's outstanding Common Shares to satisfy obligations under its stock plans. Through December 31, 1998, the Company purchased 1,263,900 shares at an average cost of \$18.85 per share.

Effective May 28, 1997, certain changes in the Company's capital structure were implemented. Class B Common Shares were eliminated, and the 486,772 outstanding Class B Common Shares were converted into 282,747 Common Shares. Additionally, the authorized capital was increased to 60 million Common Shares and 60 million Class A Common Shares. Subsequent to the reorganization in 1998, the authorized common capital consisted of 120,000,000 Common Shares.

NOTE C — STOCK PLANS

The 1998 Stock Option Plan ("Stock Option Plan") was adopted by the shareholders to replace The Lincoln Electric Company 1988 Incentive Equity Plan ("Incentive Equity Plan"), which expired in May 1998. The Stock Option plan provides for the grant of options for 5,000,000 shares of Company stock to key employees over a ten-year period. The following table summarizes the option activity for the three years ended December 31, 1998 under both the Stock Option Plan and the Incentive Equity Plan:

	Options	Exercise Prices
Balance, January 1, 1996	—	
Granted	891,180	\$13.63 - \$17.00
Exercised	—	
Balance, December 31, 1996	891,180	\$13.63 - \$17.00
Granted	193,000	17.63 - 19.19
Exercised	(2,664)	13.63 - 15.00
Canceled	(36,936)	15.00 - 17.00
Balance, December 31, 1997	1,044,580	\$13.63 - \$19.19
Granted	294,700	22.375
Exercised	(144,416)	13.63 - 17.00
Canceled	(8,334)	13.63 - 19.19
Balance, December 31, 1998	1,186,530	\$13.63 - \$22.38
Options exercisable at December 31, 1998	654,466	\$13.63 - \$19.19

Included in the preceding table are options for 335,180 shares, at exercise prices of \$15.00 and \$17.00 per share, which were granted in 1996 to current employees in settlement of a lawsuit over performance awards relating to prior years. The estimated fair value of these options was charged to income in 1996. These options are exercisable over five- and ten-year periods and are fully vested, non-qualified and non-transferable. At December 31, 1998, there were 225,162 of these options outstanding.

All other options granted under both the Stock Option Plan and the Incentive Equity Plan are outstanding for a term of ten years from the date of grant. Incentive Equity Plan options and 270,700 options granted under the Stock Option Plan vest ratably over a period of three years from the grant date and options totaling 24,000 shares granted in 1998 under the Stock Option Plan vest one year from the grant date. The exercise prices of all options were equal to the fair market value of the Company's shares at the date of grant. As permitted under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), the Company has continued to record stock-based compensation in accordance with the intrinsic value method established by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"). Under the intrinsic method, compensation expense is measured as the excess, if any, of the market price at the date of grant over the exercise price of the options. Accordingly, no compensation expense was recognized upon the award of these stock options.

SFAS 123 requires pro forma disclosure of the effect on net income and earnings per share when applying the fair value method of valuing stock-based compensation. The following table sets forth the pro forma disclosure of net income and earnings per share using the Black-Scholes option pricing model. For purposes of this pro forma disclosure, the estimated fair value of the options is amortized ratably over the vesting periods.

	1998		1997		1996	
	Pro Forma	Reported	Pro Forma	Reported	Pro Forma	Reported
Net income	\$ 92,763	\$ 93,719	\$ 84,740	\$ 85,414	\$ 74,092	\$ 74,253
Basic earnings per share	1.90	1.92	1.72	1.73	1.49	1.49
Diluted earnings per share	1.89	1.91	1.71	1.73	1.49	1.49

In estimating the fair value of options granted, an expected option life of ten years was used and the other weighted average assumptions were as follows:

	1998	1997	1996
Expected volatility	30.80%	22.55%	26.25%
Dividend yield	2.16%	2.14%	2.05%
Risk-free interest rate	4.66%	5.74%	6.85%

For the three years ended December 31, 1998, there were no awards or sales of shares associated with the Incentive Equity Plan. At December 31, 1998, there were 4,705,300 Common Shares reserved for future issuance under the Stock Option Plan.

The Lincoln Electric Company Employee Stock Ownership Plan (the "ESOP") was established as a noncontributory profit-sharing plan to provide deferred compensation benefits for all eligible employees. Restricted stock in the form of Class B Common Shares was awarded through contributions to an employee stock ownership trust. In 1997 and 1996, no shares were issued to the ESOP, and the Company has since discontinued awards under this plan. In May 1997, the ESOP received Common Shares in exchange for the Class B Common Shares the plan previously held. The assets of the ESOP were subsequently merged in July 1997 with The Lincoln Electric Company Employee Savings Plan.

The Lincoln Non-Employee Directors' Restricted Stock Plan ("Non-Employee Directors' Plan") was adopted in May 1995. The Non-Employee Directors' Plan provides for distributions of ten thousand dollars worth of Common Shares to each non-employee Director as part of an annual retainer. Shares issued in connection with this plan were 5,654 in 1998, 7,930 in 1997 and 11,468 in 1996. In 1997, 1,236 shares were forfeited under the service requirements of the plan.

The 1995 Lincoln Stock Purchase Plan provides employees the ability to purchase open market shares on a commission-free basis up to a limit of ten thousand dollars annually. Under this plan, there were 7,619 shares purchased in 1998, 13,352 shares purchased in 1997, and 8,484 shares purchased in 1996.

NOTE D — SHORT-TERM AND LONG-TERM DEBT

	1998	1997
Short-term debt:		
Notes payable to banks at interest rates from 5.0% to 7.98% (4.5% to 8.75% in 1997)	\$ 2,792	\$ 1,968
Long-term debt:		
8.73% Senior Note due 2003 (five equal annual principal payments remaining)	\$46,875	\$56,250
Other borrowings due through 2023, interest at 2.00% to 12.00%	10,991	8,081
	57,866	64,331
Less current portion	11,100	9,971
Total	\$46,766	\$54,360

The Company's \$200 million unsecured, multi-currency Credit Agreement expires June 30, 2002. The terms of the Credit Agreement provide for annual extensions. The interest rate on outstanding borrowings is determined based upon defined leverage rates for the pricing options selected. The interest rate can range from the London Interbank Offered Rate ("LIBOR") plus 0.165% to LIBOR plus 0.25% depending upon the defined leverage rate. The agreement also provides for a facility fee ranging from 0.085% to 0.15% per annum based upon the daily aggregate amount of the commitment. The Credit Agreement and the 8.73% Senior Note due in 2003 contain financial covenants that require the same interest coverage and funded debt-to-capital ratios.

In August 1997, the Company entered into an interest rate swap agreement to convert its fixed rate 8.73% Senior Note due 2003 to a floating rate based on a three-month LIBOR basket swap plus a spread of 381 basis points. The agreement caps the floating rate, including the spread, at 10%. The floating rate in effect at December 31, 1998 was 8.37%. The arrangement provides for the receipt or payment of interest, on a quarterly basis, through the loan expiration date. The notional value of the agreement, which decreases in future years with annual debt payments, was \$46,875 at December 31, 1998. Net receipts or payments under the agreement are recognized as an adjustment to interest expense.

Maturities of long-term debt for the five years succeeding December 31, 1998 are \$11,100 in 1999, \$11,458 in 2000, \$12,146 in 2001, \$9,699 in 2002, \$9,698 in 2003 and \$3,765 thereafter.

Total interest paid was \$5,593 in 1998, \$6,329 in 1997 and \$7,800 in 1996. Weighted-average interest rates on notes payable to banks at December 31, 1998 and 1997 were 6.7% and 6.2%, respectively.

NOTE E — INCOME TAXES

The components of income before income taxes are as follows:

	1998	1997	1996
U.S.	\$123,586	\$112,411	\$ 94,951
Non-U.S.	23,478	22,749	22,912
Total	\$147,064	\$135,160	\$117,863

Components of income tax expense (benefit) are as follows:

	1998	1997	1996
Current:			
Federal	\$26,724	\$32,060	\$33,484
Non-U.S.	9,020	8,909	6,197
State and local	7,402	7,790	7,012
	43,146	48,759	46,693
Deferred:			
Federal	11,016	3,215	(2,735)
Non-U.S.	(817)	(2,228)	(348)
	10,199	987	(3,083)
Total	\$53,345	\$49,746	\$43,610

The differences between total income tax expense and the amount computed by applying the statutory Federal income tax rate to income before income taxes were as follows:

	1998	1997	1996
Statutory rate of 35% applied to pre-tax income	\$51,472	\$47,306	\$41,252
Effect of state and local income taxes, net of Federal tax benefit	4,811	5,063	4,558
Taxes in excess of (less than) the U.S. tax rate on non-U.S. earnings, including utilization of tax loss carryforwards and losses with no benefit	(14)	(1,281)	(2,663)
Foreign sales corporation	(1,975)	(1,235)	(1,220)
Other – net	(949)	(107)	1,683
Total	\$ 53,345	\$ 49,746	\$43,610
Effective tax rate	36.3%	36.8%	37.0%

Total income tax payments, net of refunds, were \$44,432 in 1998, \$44,648 in 1997 and \$36,764 in 1996.

At December 31, 1998, certain non-U.S. subsidiaries have tax loss carryforwards of approximately \$41,806 that expire in various years from 1999 through 2008, except for \$18,200 for which there is no expiration date.

Significant components of deferred tax assets and liabilities at December 31, 1998 and 1997, are as follows:

	1998	1997
Deferred tax assets:		
Tax loss and credit carryforwards	\$15,199	\$16,832
State income taxes	2,873	3,506
Inventory	5,022	4,635
Other accruals	11,516	13,861
Employee benefits	5,490	4,792
Pension obligations	4,049	3,224
Other	9,614	9,141
	53,763	55,991
Valuation allowance	(14,351)	(14,760)
	39,412	41,231
Deferred tax liabilities:		
Property, plant and equipment	(21,763)	(19,519)
Pension obligations	(12,779)	(10,247)
Other	(9,287)	(5,605)
	(43,829)	(35,371)
Total	\$ (4,417)	\$ 5,860

The Company does not provide deferred income taxes on unremitted earnings of non-U.S. subsidiaries, as such funds are deemed permanently reinvested in properties, plant and working capital. It is not practicable to calculate the deferred taxes associated with the remittance of these investments.

NOTE F — RETIREMENT ANNUITY AND GUARANTEED CONTINUOUS EMPLOYMENT PLANS

In February 1998, the FASB issued Statement of Financial Accounting Standards No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*. This Statement amends and eliminates certain previously required disclosures, as well as adding new disclosure. Statement No. 132 does not change the way pension costs and liabilities are measured or recognized. The Company has presented and, where necessary, amended its disclosure in these consolidated financial statements to conform to Statement No. 132.

The Company and its subsidiaries maintain a number of defined benefit and defined contribution plans to provide retirement benefits for employees in the United States, 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, 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 supplemental executive retirement plan for certain key employees. Substantially all U.S. employees are covered under a 401(k) savings plan in which they may invest 1% or more of eligible compensation, limited to maximum amounts as determined by the Internal Revenue Service. In 1997, the plan began providing for Company matching contributions of 25% of the first 6% of employee compensation contributed to the plan. Also in 1997, the plan incorporated a feature in which participants could elect to receive an annual Company contribution of 2% of their base pay in exchange for forfeiting accelerated benefits under the pension plan.

The changes in the pension plans' benefit obligations were as follows:

	1998	1997
Obligation at January 1	\$394,104	\$360,581
Service cost	13,013	11,319
Interest cost	28,180	26,906
Participant contributions	4,488	628
Plan amendments	883	2,130
Actuarial loss	19,184	17,877
Benefit payments	(20,013)	(20,617)
Settlements	178	—
Currency translation	(1,313)	(4,720)
Obligation at December 31	\$438,704	\$394,104

The changes in the fair values of the pension plans' assets were as follows:

	1998	1997
Plan assets at January 1	\$389,669	\$345,547
Actual return on plan assets	42,598	53,414
Employer contributions	15,963	15,924
Participant contributions	4,488	628
Benefit payments	(20,013)	(20,617)
Currency translation	(1,544)	(5,227)
Plan assets at December 31	\$431,161	\$389,669

The funded status of the pension plans at December 31, 1998 and 1997 was as follows:

	1998	1997
Plan assets in excess of (less than) projected benefit obligations	\$ (7,543)	\$ (4,435)
Unrecognized net loss	18,322	7,502
Unrecognized prior service cost	11,041	11,396
Unrecognized transition (assets) obligation, net	(2,176)	(2,762)
Prepaid pension expense recognized in the balance sheet	\$19,644	\$11,701

The net prepaid pension expense recognized in the consolidated balance sheets was composed of:

	1998	1997
Prepaid pension cost	\$27,581	\$18,684
Accrued pension liability	(10,164)	(7,842)
Intangible asset	2,227	859
Prepaid pension expense recognized in the balance sheet	\$19,644	\$11,701

A domestic non-qualified pension plan comprised the largest portion of the pension plans in which the accumulated benefit obligation (ABO) exceeded plan assets at December 31, 1998 and 1997. The aggregate ABO of such plans at December 31, 1998 and 1997 was \$9,872 and \$7,265, respectively; the aggregate fair value of plan assets was \$0 and \$1,594 at December 31, 1998 and 1997, respectively.

A summary of the components of total pension expense was as follows:

	1998	1997	1996
Service cost – benefits earned during the year	\$13,013	\$11,319	\$11,056
Interest cost on projected benefit obligation	28,180	26,906	25,727
Expected return on plan assets	(34,494)	(30,286)	(28,232)
Amortization of transition (asset) obligation	(452)	(472)	(255)
Amortization of prior service cost	1,123	775	2,673
Amortization of net loss (gain)	318	89	(18)
Net pension cost of defined benefit plans	7,688	8,331	10,951
Settlement, curtailments and special termination benefits	178	393	1,876
Defined contribution plans	2,090	2,255	839
Total pension expense	\$ 9,956	\$10,979	\$13,666

Weighted average assumptions used in accounting for the defined benefit plans as of December 31, 1998 and 1997 were as follows:

	1998	1997
Discount rate	7.0%	7.2%
Rate of increase in compensation	4.9%	5.2%
Expected return on plan assets	8.9%	8.9%

U.S. plan assets consist of fixed income and equity securities. Non-U.S. plan assets are invested in non-U.S. insurance contracts and non-U.S. equity and fixed income securities. The Company does not have, and does not provide for, any postretirement or postemployment benefits other than pensions.

The Cleveland, Ohio, area operations have a Guaranteed Continuous Employment Plan covering substantially all employees which, in general, provides that the Company will provide work for at least 75% of every standard work week (presently 40 hours). This plan does not guarantee employment when the Company's ability to continue normal operations is seriously restricted by events beyond the control of the Company. The Company has reserved the right to terminate this plan effective at the end of a calendar year by giving notice of such termination not less than six months prior to the end of such year.

NOTE G — SEGMENT INFORMATION

In June 1997, the FASB issued Statement of Financial Accounting Standards No. 131, *Disclosures About Segments of an Enterprise and Related Information*. This Statement requires disclosure of selected financial and descriptive information for each operating segment based on management's internal organizational decision-making structure. Additional information is required on a company-wide basis for revenues by product or service, revenues and identifiable assets by geographic location and information about significant customers. As required by the Statement, the Company has presented all periods in these consolidated financial statements in conformity with this Statement.

The Company's primary business is the design, manufacture and sale, in the U.S. and international markets, of arc, cutting and other welding products. The Company also designs, manufactures and sells integral horsepower industrial electric motors. The Company manages its operations by geographic location and has three reportable segments: operations located in the United States, Europe and all other foreign countries. Each operating unit is managed separately because each faces a distinct economic environment, a different customer base and a varying level of competition and market sophistication. Segment performance and resource allocation are measured based on income before interest and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Financial information for the reportable segments follows:

	United States	Europe	Other Countries	Eliminations	Consolidated
1998:					
Net sales to unaffiliated customers	\$816,562	\$208,782	\$161,335	\$ —	\$1,186,679
Inter-segment sales	69,586	9,775	12,030	(91,391)	—
Total	\$886,148	\$218,557	\$173,365	\$(91,391)	\$1,186,679
Income before interest and income taxes	\$125,693	\$ 14,935	\$ 10,191	\$ (2,198)	\$ 148,621
Interest income					4,119
Interest expense					(5,676)
Income before income taxes					\$ 147,064
Total assets	\$542,462	\$186,666	\$119,344	\$(65,566)	\$ 782,906
Capital expenditures, excluding acquisitions	52,632	11,109	19,542	(1,872)	81,411
Depreciation and amortization	18,431	6,704	3,485	(541)	28,079

	United States	Europe	Other Countries	Eliminations	Consolidated
1997:					
Net sales to unaffiliated customers	\$799,442	\$204,858	\$154,767	\$ —	\$1,159,067
Inter-segment sales	65,812	11,475	8,033	(85,320)	—
Total	\$865,254	\$216,333	\$162,800	\$(85,320)	\$1,159,067
Income before interest and income taxes	\$112,565	\$ 10,014	\$ 14,427	\$(1,374)	\$ 135,632
Interest income					5,877
Interest expense					(6,349)
Income before income taxes					\$ 135,160
Total assets	\$489,431	\$163,519	\$ 96,850	\$(37,610)	\$ 712,190
Capital expenditures, excluding acquisitions	23,632	5,264	8,418	(18)	37,296
Depreciation and amortization	18,812	7,713	2,376	(470)	28,431
1996:					
Net sales to unaffiliated customers	\$752,952	\$219,436	\$136,756	\$ —	\$1,109,144
Inter-geographic sales	55,942	10,786	9,219	(75,947)	—
Total	\$808,894	\$230,222	\$145,975	\$(75,947)	\$1,109,144
Income before interest and income taxes	\$101,236	\$ 10,264	\$ 12,867	\$(1,605)	\$ 122,762
Interest income					2,832
Interest expense					(7,731)
Income before income taxes					\$ 117,863
Total assets	\$416,911	\$183,938	\$ 87,808	\$(41,458)	\$ 647,199
Capital expenditures, excluding acquisitions	25,613	6,500	3,267	(1,123)	34,257
Depreciation and amortization	20,176	7,601	2,166	(455)	29,488

Intercompany sales between reportable segments are accounted for at prices comparable to normal, customer sales and are eliminated in consolidation. Export sales (excluding intercompany sales) from the United States were \$92,461 in 1998, \$105,464 in 1997 and \$90,706 in 1996. No individual customer comprised more than 10% of the Company's total revenues for the three years ended December 31, 1998.

The geographic split of the Company's revenues, based on customer location, and property, plant and equipment was as follows:

	1998	1997	1996
Revenues:			
United States	\$ 724,101	\$ 693,979	\$ 662,246
Foreign countries	462,578	465,088	446,898
Total	\$1,186,679	\$1,159,067	\$1,109,144
Property, plant and equipment:			
United States	\$ 174,188	\$ 138,935	\$ 132,631
Foreign countries	89,375	65,454	71,326
Eliminations	(3,772)	(2,354)	(2,718)
Total	\$ 259,791	\$ 202,035	\$ 201,239

Revenues derived from customers and property, plant and equipment in any individual foreign country were not material for disclosure.

NOTE H — ACQUISITIONS AND DIVESTITURES

During the first quarter of 1998, the Company's Canadian subsidiary acquired a 75% interest in Indalco Alloys, Inc. of Canada. The purchase price was not significant. Indalco is a premier supplier of aluminum welding wire and related products. The acquisition was accounted for as a purchase.

In April 1998, a German subsidiary of the Company purchased the assets and business of Uhrhan & Schwill GmbH, located in Germany, a leader in the design and installation of welding systems for pipe mills. The purchase price was not significant.

In July 1998, a French subsidiary of the Company acquired a 50% equity interest in AS Kaynak, a market-leading welding products manufacturing subsidiary of Eczacibasi Holdings, headquartered in Istanbul, Turkey. The purchase price was not significant. The Company accounts for its investment in AS Kaynak under the equity method. Equity earnings (losses) of this investment were not material and are recorded under the caption Other Income in the Consolidated Statement of Income.

In July 1996, the Company acquired Electronic Welding Systems (EWS), a designer and supplier of welding power supplies and plasma cutting equipment, based in Italy. The acquisition was accounted for as a purchase. The purchase price was not significant.

The results of operations, which were not material, of the aforementioned acquisitions were included in the consolidated statements of income from their respective dates of acquisition.

Also during 1996, the Company sold its Louisiana and Alaska gas distribution businesses for net cash proceeds of \$17,343. The Company realized a gain on disposal of these businesses of \$8,365 (\$5,093 after-tax, or \$0.10 per share (basic and diluted)), which is included in Other Income. The results of operations from these businesses were not material to the Company for the year ended December 31, 1996.

NOTE I — FAIR VALUES OF FINANCIAL INSTRUMENTS

The Company has various financial instruments, including cash, cash equivalents, marketable securities, short- and long-term debt, forward contracts, and an interest rate swap. The Company has determined the estimated fair value of these financial instruments by using available market information and appropriate valuation methodologies that require judgment.

The Company enters into forward exchange contracts to hedge foreign currency transactions on a continuing basis for periods consistent with its committed exposures. This hedging minimizes the impact of foreign exchange rate movements on the Company's operating results. The total notional value of forward currency exchange contracts was \$24,592 at December 31, 1998 and \$26,896 at December 31, 1997, which approximated fair value.

The carrying amounts and estimated fair value of the Company's significant financial instruments at December 31, 1998 and 1997 were as follows:

	December 31, 1998		December 31, 1997	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
Cash and cash equivalents	\$39,095	\$39,095	\$46,562	\$46,562
Marketable securities	311	311	10,194	10,197
Notes payable to banks	2,792	2,792	1,968	1,968
Long-term debt (including current portion)	57,866	59,911	64,331	67,464

NOTE J — OPERATING LEASES

The Company leases sales offices, warehouses and distribution centers, office equipment and data processing equipment. Such leases, some of which are noncancelable and, in many cases, include renewals, expire at various dates. The Company pays most maintenance, insurance and taxes relating to leased assets. Rental expense was \$7,297 in 1998, \$7,851 in 1997 and \$8,345 in 1996.

At December 31, 1998, total minimum lease payments for noncancelable operating leases were as follows:

1999	\$ 6,237
2000	4,916
2001	2,525
2002	1,238
2003	813
Thereafter	712
Total	\$16,441

NOTE K — CONTINGENCIES

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, health, safety and environmental claims and employment-related actions.

The Company is a defendant or co-defendant in ten lawsuits filed against the Company in the Superior Court of California by building owners or insurers in Los Angeles County arising from alleged property damage claimed to have been discovered after the Northridge earthquake of January 1994. These cases include claims for compensatory damages and punitive damages, often without specification of amount, relating to the sale and use of the E70T-4 category of welding electrode. One of the complaints includes a fraud claim, as well as a claim under California's Unfair Business Practices Act. The latter claim demands, inter alia, restitution of all amounts paid by the purchasers for the Company's E70T-4 electrode, with interest, plus a permanent injunction requiring the Company to inspect all steel-framed buildings in "Greater Los Angeles" and to remove and replace any E70T-4 welds.

The Company has also been a defendant or co-defendant in ten other similar cases involving steel-framed buildings in Greater Los Angeles following the Northridge earthquake. Five of those cases were voluntarily dismissed and the Company has agreed to settle the five other cases.

The Company is unable to make a meaningful estimate of the amount or range of possible losses that could result from an unfavorable outcome of the remaining pending or future steel frame building cases. The Company's results of operations or cash flows in one or more interim or annual periods could be materially affected by unfavorable results in one or more of these

cases. Management believes the Company has substantial defenses and intends to contest such suits vigorously, that the Company has applicable insurance and that other potential defendants and their respective insurers will be identified as the lawsuits proceed.

Based on information known to the Company, and subject to the factors and contingencies noted herein, management believes the outcome of the Company's litigation should not have a material adverse effect upon the consolidated financial position of the Company. However, if the Company is unsuccessful in defending or otherwise satisfactorily resolving this litigation, and if insurance coverage is unavailable or inadequate, then the litigation could have a material adverse impact on the Company's financial position.

NOTE L — QUARTERLY FINANCIAL DATA (UNAUDITED)

1998	Mar 31	Jun 30	Sep 30	Dec 31
Net sales	\$302,962	\$310,930	\$288,106	\$284,681
Gross profit	117,083	120,554	111,189	108,240
Income before income taxes	38,081	40,567	36,737	31,679
Net income	23,730	25,245	23,294	21,450
Basic earnings per share	\$ 0.48	\$ 0.51	\$ 0.47	\$ 0.45
Diluted earnings per share	\$ 0.48	\$ 0.51	\$ 0.47	\$ 0.44

1997	Mar 31	Jun 30	Sep 30	Dec 31
Net sales	\$280,721	\$299,635	\$291,567	\$287,144
Gross profit	107,763	114,003	110,523	108,393
Income before income taxes	33,857	36,040	33,776	31,487
Net income	21,049	22,651	21,510	20,204
Basic earnings per share	\$ 0.42	\$ 0.46	\$ 0.44	\$ 0.41
Diluted earnings per share	\$ 0.42	\$ 0.46	\$ 0.44	\$ 0.41

Note: The quarterly earnings per share (EPS) amounts are each calculated independently. Therefore, the sum of the quarterly EPS amounts for 1998 do not equal the totals for the year due to share transactions that occurred during 1998.

Report of Independent Auditors

**SHAREHOLDERS AND BOARD OF DIRECTORS
LINCOLN ELECTRIC HOLDINGS, INC.**

We have audited the consolidated balance sheets of Lincoln Electric Holdings, Inc. (successor to The Lincoln Electric Company) and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lincoln Electric Holdings, Inc. and subsidiaries at December 31, 1998 and 1997, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Cleveland, Ohio
February 2, 1999

Ernst + Young LLP