

ALAMO GROUP INC  
Form 10-Q  
November 07, 2008

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

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 **0-21220**

## **ALAMO GROUP INC.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

### **DELAWARE**

*(State or other jurisdiction of  
incorporation or organization)*

**74-1621248**

*(I.R.S. Employer  
Identification Number)*

**1627 East Walnut, Seguin, Texas 78155**

*(Address of principal executive offices)*

**830-379-1480**

*(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 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 REQUIREMENT

FOR THE PAST 90 DAYS.

YES  NO

INDICATE BY CHECK MARK WHETHER REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, OR A NON-ACCELERATED FILER. SEE DEFINITION OF ACCELERATED FILER AND LARGE ACCELERATED FILER IN EXCHANGE ACT RULE 12B-2. 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

AT NOVEMBER 1, 2008, 9,921,929 SHARES OF COMMON STOCK, \$.10 PAR VALUE, OF THE REGISTRANT WERE OUTSTANDING.

---

**Alamo Group Inc. and Subsidiaries**

INDEX

|         | PAGE  |
|---------|---|
| PART I. | FINANCIAL INFORMATION   |
| Item 1. | Interim Condensed Consolidated Financial Statements (Unaudited)   |
|         | <u>Interim Condensed Consolidated Balance Sheets</u><br>September 30, 2008 and December 31, 2007 (Audited) 3                                    |
|         | <u>Interim Condensed Consolidated Statements of Income</u><br>Three months and Nine months ended September 30, 2008<br>and September 30, 2007 4 |
|         | <u>Interim Condensed Consolidated Statements of Cash Flows</u><br>Nine months ended September 30, 2008 and September 30, 2007 5                 |
|         | <u>Notes to Interim Condensed Consolidated Financial Statements</u> 6   |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition<br/>and Results of Operations</u> 14   |
| Item 3. | <u>Quantitative and Qualitative Disclosures about Market Risks</u> 21   |
| Item 4. | <u>Controls and Procedures</u> 23   |

|          |   |    |
|----------|---|----|
| PART II. | OTHER INFORMATION                       | 23 |
| Item 1.  | None                                    |    |
| Item 2.  | None                                    |    |
| Item 3.  | None                                    |    |
| Item 4.  | None                                    |    |
| Item 5.  | Other Information                       |    |
| Item 6.  | <u>Exhibits and Reports on Form 8-K</u> |    |

SIGNATURES

## Alamo Group Inc. and Subsidiaries

### Interim Condensed Consolidated Balance Sheets

|   | September 30,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| (in thousands, except share amounts)        | (Unaudited)           | (Audited)            |
| <b>ASSETS</b>                               |                       |                      |
| Current assets:                             |                       |                      |
| Cash and cash equivalents                   | \$ 5,447              | \$ 4,459             |
| Accounts receivable, net                    | 128,323               | 109,260              |
| Inventories                                 | 132,989               | 118,285              |
| Deferred income taxes                       | 1,946                 | 2,131                |
| Prepaid expenses                            | 3,556                 | 2,834                |
| Total current assets                        | 272,261               | 236,969              |
| Property, plant and equipment               | 128,434               | 124,665              |
| Less: Accumulated depreciation              | (63,905)              | (61,513)             |
|   | 64,529                | 63,152               |
| Goodwill                                    | 55,507                | 43,946               |
| Intangible assets                           | 4,003                 | 4,081                |
| Assets held for sale                        | 291                   | 291                  |
| Other assets                                | 1,692                 | 2,191                |
| Total assets                                | \$ 398,283            | \$ 350,630           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                       |                      |
| Current liabilities:                        |                       |                      |
| Trade accounts payable                      | 64,876                | 39,248               |
| Income taxes payable                        | 2,296                 | 2,289                |
| Accrued liabilities                         | 29,744                | 22,673               |
| Current maturities of long-term debt        | 3,377                 | 3,368                |
| Total current liabilities                   | 100,293               | 67,578               |
| Long-term debt, net of current maturities   | 91,500                | 78,527               |
| Deferred pension liability                  | 371                   | 1,040                |
| Other long-term liabilities                 | 3,934                 | 4,100                |

Edgar Filing: ALAMO GROUP INC - Form 10-Q

|  |                |                |
|--|----------------|----------------|
| Deferred income taxes  | 657            | 687            |
| Stockholders' equity:  |                |                |
| Common stock, \$.10 par value, 20,000,000 shares authorized;   |                |                |
| 9,957,229 and 9,839,429 issued and outstanding at September 30, 2008 and December 31, 2007, respectively | 996            | 984            |
| Additional paid-in capital   | 55,115         | 53,610         |
| Treasury stock, at cost; 42,600 shares at September 30, 2008 and December 31, 2007                       | (426)          | (426)          |
| Retained earnings  | 134,509        | 123,426        |
| Accumulated other comprehensive income   | 11,334         | 21,104         |
| Total stockholders' equity   | <b>201,528</b> | <b>198,698</b> |
| Total liabilities and stockholders' equity   | \$ 398,283     | \$ 350,630     |

See accompanying notes.

## Alamo Group Inc. and Subsidiaries

### Interim Condensed Consolidated Statements of Income

(Unaudited)

|   | Three Months Ended |          | Nine Months Ended |           |
|---|--------------------|----------|-------------------|-----------|
|   | September 30,      |          | September 30,     |           |
| (in thousands, except per share amounts)    | 2008               | 2007     | 2008              | 2007      |
| Net sales:                                  |                    |          |                   |           |
| North American                              |                    |          |                   |           |
| Industrial                                  | \$64,803           | \$60,862 | \$199,866         | \$186,510 |
| Agricultural                                | 29,555             | 31,210   | 94,826            | 90,521    |
| European                                    | 54,349             | 33,884   | 139,956           | 101,058   |
| Total net sales                             | 148,707            | 125,956  | 434,648           | 378,089   |
| Cost of sales                               | 119,097            | 99,574   | 349,553           | 303,796   |
| Gross profit                                | 29,610             | 26,382   | 85,095            | 74,293    |
| Selling, general and administrative expense | 21,795             | 18,716   | 62,518            | 55,929    |
| Income from operations                      | 7,815              | 7,666    | 22,577            | 18,364    |
| Interest expense                            | (2,024)            | (2,025)  | (5,748)           | (6,415)   |
| Interest income                             | 691                | 414      | 1,630             | 1,047     |
| Other income (expense), net                 | 222                | 235      | 881               | 469       |
| Income before income taxes                  | 6,704              | 6,290    | 19,340            | 13,465    |
| Provision for income taxes                  | 2,251              | 2,074    | 6,490             | 4,381     |
| Net income                                  | \$4,453            | \$4,216  | \$12,850          | \$9,084   |
| Net income per common share:                |                    |          |                   |           |
| Basic                                       | \$.45              | \$0.43   | \$1.31            | \$0.93    |
| Diluted                                     | \$.45              | \$0.42   | \$1.29            | \$0.91    |
| Average common shares                       |                    |          |                   |           |

Edgar Filing: ALAMO GROUP INC - Form 10-Q

|                    |        |        |        |        |
|--------------------|--------|--------|--------|--------|
| Basic              | 9,870  | 9,790  | 9,822  | 9,775  |
| Diluted            | 9,970  | 9,972  | 9,949  | 9,961  |
| Dividends declared | \$0.06 | \$0.06 | \$0.18 | \$0.18 |

See accompanying notes.



**Alamo Group Inc. and Subsidiaries**  
**Interim Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

|   | <b>Nine Months Ended</b> |             |
|---|--------------------------|-------------|
|   | <b>September 30,</b>     |             |
| (in thousands, except per share amounts)                  | <b>2008</b>              | <b>2007</b> |
| <b>Operating Activities</b>                               |                          |             |
| Net income  | \$12,850                 | \$9,084     |
| Adjustment to reconcile net income to net cash            |                          |             |
| provided by operating activities:                         |                          |             |
| Provision for doubtful accounts                           | 318                      | 492         |
| Depreciation  | 6,990                    | 6,644       |
| Amortization  | 78                       | 80          |
| Stock-based compensation expense                          | 443                      | 477         |
| Excess tax benefits from stock-based payment arrangements | (45)                     | (62)        |
| Provision (benefit) for deferred income tax benefit       | 218                      | (113)       |
| Gain on sale of property, plant and equipment             | (99)                     | (167)       |
| Changes in operating assets and liabilities:              |                          |             |
| Accounts receivable                                       | (14,719)                 | 369         |
| Inventories   | (4,238)                  | (6,275)     |
| Prepaid expenses and other assets                         | (1,206)                  | (42)        |
| Trade accounts payable and accrued liabilities            | 17,068                   | 6,126       |
| Income taxes payable                                      | 1,173                    | 2,423       |
| Other long-term liabilities                               | (833)                    | (489)       |
| Net cash provided by operating activities                 | 17,998                   | 18,547      |
| <b>Investing Activities</b>                               |                          |             |
| Acquisitions, net of cash acquired                        | (22,055)                 | (3,464)     |
| Purchase of property, plant and equipment                 | (5,052)                  | (6,733)     |
| Proceeds from sale of property, plant and equipment       | 209                      | 269         |
| Net cash used by investing activities                     | (26,898)                 | (9,928)     |
| <b>Financing Activities</b>                               |                          |             |

Edgar Filing: ALAMO GROUP INC - Form 10-Q

|   |         |           |
|---|---------|-----------|
| Net change in bank revolving credit facility              | 11,000  | 12,500    |
| Principal payments on long-term debt and capital leases   | (2,038) | (2,053)   |
| Proceeds from issuance of long-term debt                  | 1,986   | 45        |
| Dividends paid  | (1,766) | (1,759)   |
| Proceeds from sale of common stock                        | 1,073   | 466       |
| Excess tax benefits from stock-based payment arrangements | 45      | 62        |
| Net cash provided by financing activities                 | 10,300  | 9,261     |
| Effect of exchange rate changes on cash                   | (412)   | 733       |
| Net change in cash and cash equivalents                   | 988     | 18,613    |
| Cash and cash equivalents at beginning of the period      | 4,459   | 2,169     |
| Cash and cash equivalents at end of the period            | \$5,447 | \$ 20,782 |
| Cash paid during the period for:                          |         |           |
| Interest  | \$5,732 | \$6,880   |
| Income taxes  | \$2,866 | \$ 1,198  |

See accompanying notes.

**Alamo Group Inc. and Subsidiaries**  
**Notes to Interim Condensed Consolidated Financial Statements - (Unaudited)**  
**September 30, 2008**

**1. Basis of Financial Statement Presentation**

The accompanying unaudited interim condensed consolidated financial statements of Alamo Group Inc. and its subsidiaries (the Company) have been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulations S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. The balance sheet at December 31, 2007, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2007.

**1. Acquisitions**

The acquisitions described below were accounted for as business combinations in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations. Accordingly, the purchase price has been allocated to the underlying assets and liabilities based on estimated fair values at the date of acquisition. The operating results of the acquired companies are included with the Company's results of operations since their respective acquisition dates.

On May 30, 2008 the Company purchased Rivard Developpement (*Rivard*), a leading French manufacturer of vacuum trucks, high pressure cleaning systems and trenchers. The purchase price was approximately €15 million (approximately U.S. \$23 million) plus the assumption of certain liabilities. We have preliminarily allocated the purchase price to the acquired assets and liabilities assumed and recorded goodwill of approximately €9 million (approximately U.S. \$15 million) related to this acquisition. Finalization of the purchase price allocation is expected in the fourth quarter of 2008. The majority of the purchase price was funded utilizing the Company's cash reserves in Europe, with the balance from bank credit facilities. *Rivard's* sales in 2007 were €40 million, (approximately U.S. \$62 million) and the company has 275 full-time employees. *Rivard* is located in Daumeray, France and was founded in 1952.

## Edgar Filing: ALAMO GROUP INC - Form 10-Q

On March 6, 2007 the Company purchased outstanding stock of Henke Manufacturing Corporation ( *Henke* ), a manufacturer of specialty snow removal attachments. *Henke*'s products are mounted on both heavy industrial equipment and medium to heavy duty trucks. The primary end users are governmental agencies, related contractors and other industrial users. The purchase price was \$4.8 million which included assumed debt of approximately \$0.6 million and goodwill of zero. The acquisition was accounted for under the purchase method and the results of operations have been included in the Company's Statement of Income from March 2007. *Henke*, which is located in Leavenworth, Kansas, had sales of over \$8 million in their last fiscal year ended June 30, 2006.

The unaudited pro forma statement of income of the Company assuming these transactions occurred at January 1, 2007 is as follows:

| (In thousands, except per share amounts) | Nine Months Ended     |            |
|--|-----------------------|------------|
|  | September 30,<br>2008 | 2007       |
| Net Sales                                | \$ 460,481            | \$ 426,104 |
| Net Income                               | \$ 14,502             | \$ 11,222  |
| Diluted Earnings per Share               | \$ 1.46               | \$ 1.13    |

### 3. Accounts Receivable

Accounts Receivable is shown net of the allowance for doubtful accounts of \$1,809,000 and \$1,922,000 at September 30, 2008 and December 31, 2007, respectively.

### 4. Inventories

Inventories valued at LIFO cost represented 56% and 58% of total inventory at September 30, 2008 and December 31, 2007, respectively. The excess of current costs over LIFO valued inventories was \$9,062,000 at September 30, 2008 and December 31, 2007. Inventory obsolescence reserves were \$8,222,000 at September 30, 2008 and \$8,526,000 at December 31, 2007. Net inventories consist of the following:

|                 |    | September 30, | December 31, |
|-----------------|----|---------------|--------------|
| (in thousands)  |    | 2008          | 2007         |
| Finished goods  | \$ | 99,342        | \$ 96,464    |
| Work in process |    | 17,889        | 14,755       |
| Raw materials   |    | 15,758        | 7,066        |
|                 | \$ | 132,989       | \$ 118,285   |

An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO must necessarily be based to some extent on management's estimates at each quarter end.

### 5. Derivatives and Hedging

Most of the Company's outstanding debt is advanced from a revolving credit facility that accrues interest at a contractual margin over current market interest rates. The Company's financing costs associated with this credit facility can materially change with market increases and decreases of short-term borrowing rates, specifically London Inter Bank Operating Rate ( LIBOR ). During the second quarter of 2007, the Company entered into two interest rate swap agreements with one of its current lenders that hedge future cash flows related to its outstanding debt

obligations. As of September 30, 2008, the Company had \$86.0 million outstanding under its revolving credit facility and two interest rate swap contracts designated as cash flow hedges which are effectively hedging \$40 million of these borrowings from changes in underlying LIBOR base rates. One swap has a three year term and fixes the LIBOR base rate at 4.910% covering \$20 million of this debt. The other has a four year term and fixed the LIBOR base rate at 4.935% covering an additional \$20 million of these variable rate borrowings. The fair market value of these hedges, which is the amount that would have been paid or received by the Company had it prematurely terminated these swap contracts at September 30, 2008, was a \$1,143,000 liability. This is included in Other long-term liabilities with an offset in Accumulated other comprehensive income, net of taxes. At September 30, 2008, ineffectiveness related to the interest rate swap agreements was not material.

#### **6. Fair Value Measurements**

The Company adopted SFAS 157, Fair Value Measurements as of January 1, 2008. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. SFAS 157 also specifies a fair value hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs (highest level) reflect market data obtained from independent sources, while unobservable inputs (lowest level) reflect internally developed market assumptions. In accordance with SFAS 157, fair value measurements are classified under the following hierarchy:

**Level 1** Quoted prices for identical instruments in active markets.

**Level 2** Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs or significant value-drivers are observable in active markets.

**Level 3** Model-derived valuations in which one or more significant inputs or significant value-drivers are unobservable

When available, the Company uses quoted market prices to determine fair value, and the Company classifies such measurements within Level 1. In some cases where market prices are not available, the Company makes use of observable market based inputs to calculate fair value, in which case the measurements are classified with Level 2. If quoted or observable market prices are not available, fair value is based upon internally developed models that use, where possible, current market-based parameters such as interest rates, yield curves, currency rates, etc. These measurements are classified within Level 3.

Fair value measurements are classified to the lowest level input or value-driver that is significant to the valuation. A measurement may therefore be classified within Level 3 even though there may be significant inputs that are readily observable.

### **Derivative financial instruments**

The fair value of interest rate swap derivatives is primarily based on third-party pricing service models. These models use discounted cash flows that utilize the appropriate market-based forward swap curves and zero-coupon interest rates. Interest rate swap derivatives are Level 2 measurements and have a fair value of a negative \$1,143,000.

The fair value of foreign currency forward contracts is based on a valuation model that discounts cash flows resulting from the differential between the contract price and the market-based forward rate and is a Level 2 measurement and has a fair value of \$3,493,000.

**7. Common Stock and Dividends**

Dividends declared and paid on a per share basis were as follows:

|                    |    | <b>September 30,</b>     |             |
|--------------------|----|--------------------------|-------------|
|                    |    | <b>Nine Months Ended</b> |             |
|                    |    | <b>2008</b>              | <b>2007</b> |
| Dividends declared | \$ | 0.18                     | \$ 0.18     |
| Dividends paid     |    | 0.18                     | 0.18        |

**8. Stock-Based Compensation**

The Company has granted options to purchase its common stock to employees and directors of the Company and its affiliates under various stock option plans at no less than the fair market value of the underlying stock on the date of grant. These options are granted for a term not exceeding ten years and are forfeited in the event the employee or director terminates, other than by retirement, his or her employment or relationship with the Company or one of its affiliates. These options generally vest over five years. All option plans contain anti-dilutive provisions that permit an adjustment of the number of shares of the Company's common stock represented by each option for any change in capitalization.



The Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment ( Statement 123(R) ), on January 1, 2006, using the modified-prospective-transition method. The fair value of the options are estimated using a Black-Scholes option-pricing model and are amortized to expense over the options vesting period. Prior to adoption of Statement 123(R), the Company accounted for share based payments under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ), and related Interpretations, as permitted by Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( Statement 123 ). The Company did not recognize employee compensation cost related to its stock option grants in its Consolidated Statement of Income prior to adoption of Statement 123(R), as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. Under the modified-prospective-transition method, compensation cost recognized beginning in 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R).

The Company's stock-based compensation expense was \$121,000 and \$177,000 for the quarter ended September 30, 2008 and 2007, respectively and \$443,000 and \$477,000 for the nine months ended September 30, 2008 and 2007, respectively.

Prior to the adoption of Statement 123(R), the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. Statement 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

For purposes of this disclosure, the value of the options is estimated using a Black-Scholes option-pricing model and amortized to expense over the options vesting periods. The Company calculated the fair value for these options using a Black-Scholes option pricing model with the following weighted average assumptions for 2008 and 2007:

|                         | September 30,<br>2008 | 2007  |
|-------------------------|-----------------------|-------|
| Risk-free interest rate | 3.13%                 | 5.00% |
| Dividend Yield          | 1.20%                 | 0.96% |

|                                 |           |           |
|---------------------------------|-----------|-----------|
| Volatility Factors              | 43.6%     | 34.5%     |
| *Weighted Average Expected Life | 9.0 years | 5.0 years |

*Qualified Options*

Following is a summary of activity in the Incentive Stock Option Plans for the period indicated:

*For nine months ending September 30, 2008*

|   | Shares   | Exercise Price* |
|---|----------|-----------------|
| Options outstanding at beginning of year          | 277,080  |                 |
| Granted   | 39,000   | \$22.55         |
| Exercised   | (41,800) | \$ 9.35         |
| Cancelled   |          |                 |
| Options outstanding at September 30, 2008         | 274,280  | \$20.23         |
| Options exercisable at September 30, 2008         | 130,680  | \$17.30         |
| Options available for grant at September 30, 2008 | 299,000  |                 |

*\*Weighted Averages*

Options outstanding and exercisable at September 30, 2008 were as follows:

| Qualified Stock Options | Options Outstanding |                 |                 | Options Exercisable |                 |
|-------------------------|---------------------|-----------------|-----------------|---------------------|-----------------|
|                         | Shares              | Remaining       |                 | Shares              | Exercise Price* |
| Contractual             |                     | Exercise Price* | Exercise Price* |                     |                 |
| Range of Exercise Price | Life(yrs)*          |                 |                 |                     |                 |
| \$8.9375 - \$12.10      | 49,200              | 5.00            | \$ 12.10        | 49,200              | \$ 12.10        |
| \$14.38 - \$19.79       | 81,080              | 6.57            | \$ 19.03        | 54,280              | \$ 18.80        |
| \$22.39 - \$25.18       | 144,000             | 9.06            | \$ 23.68        | 27,200              | \$ 23.72        |
| Total                   | 274,280             |                 |                 | 130,680             |                 |

*\*Weighted Averages*

*Non-qualified Options*

Following is a summary of activity in the Non-Qualified Stock Option Plans for the period indicated:

*For nine months ending September 30, 2008*

|   | Shares   | Exercise Price* |
|---|----------|-----------------|
| Options outstanding at beginning of year          | 302,000  |                 |
| Granted   |          |                 |
| Exercised   | (76,000) | \$ 8.98         |
| Cancelled   |          |                 |
| Options outstanding at September 30, 2008         | 226,000  | \$ 12.62        |
| Options exercisable at September 30, 2008         | 194,500  | \$ 10.76        |
| Options available for grant at September 30, 2008 | 63,500   |                 |

*\*Weighted Averages*

Options outstanding and exercisable at September 30, 2008 were as follows:

| <b>Non-Qualified Stock Options</b> | <b>Options Outstanding</b> |           |                           | <b>Options Exercisable</b> |                    |
|------------------------------------|----------------------------|-----------|---------------------------|----------------------------|--------------------|
|                                    | Shares                     | Remaining | Contractual<br>Life(yrs)* | Exercise<br>Price*         | Exercise<br>Price* |
| Range of Exercise Price            |                            |           |                           |                            |                    |
| \$8.9375 - \$12.10                 | 180,000                    | 2.22      | \$ 9.90                   | 180,000                    | \$ 9.90            |
| \$13.96 - \$19.79                  | 13,500                     | 6.26      | \$18.71                   | 7,500                      | \$17.85            |
| \$25.02 - \$25.18                  | 32,500                     | 8.92      | \$25.17                   | 7,000                      | \$25.16            |
| Total                              | 226,000                    |           |                           | 194,500                    |                    |

*\*Weighted Averages*

**9. Earnings Per Share**

Edgar Filing: ALAMO GROUP INC - Form 10-Q

The following table sets forth the reconciliation from basic to diluted average common shares and the calculations of net income per common share. Net income is the same for basic and diluted calculations.

| (In thousands, except per share amounts)      | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Net Income                                    | \$ 4,453                  | \$ 4,216    | \$ 12,850                | \$ 9,084    |
| Average Common Shares:                        |                           |             |                          |             |
| Basic (weighted-average outstanding shares)   | 9,870                     | 9,790       | 9,822                    | 9,775       |
| Dilutive potential common shares from stock   |                           |             |                          |             |
| options and warrants                          | 100                       | 182         | 127                      | 186         |
| Diluted (weighted-average outstanding shares) | 9,970                     | 9,972       | 9,949                    | 9,961       |
| Basic earnings per share                      | \$ 0.45                   | \$ 0.43     | \$ 1.31                  | \$ 0.93     |
| Diluted earnings per share                    | \$ 0.45                   | \$ 0.42     | \$ 1.29                  | \$ 0.91     |

**10. Segment Reporting**

At September 30, 2008 and September 30, 2007 the following unaudited financial information is segmented:

| (in thousands)                   | Three Months Ended    |            | Nine Months Ended     |            |
|----------------------------------|-----------------------|------------|-----------------------|------------|
|                                  | September 30,<br>2008 | 2007       | September 30,<br>2008 | 2007       |
| <b>Net Revenue</b>               |                       |            |                       |            |
| Industrial                       | \$ 64,803             | \$ 60,862  | \$ 199,866            | \$ 186,510 |
| Agricultural                     | 29,555                | 31,210     | 94,826                | 90,521     |
| European                         | 54,349                | 33,884     | 139,956               | 101,058    |
| Consolidated                     | \$ 148,707            | \$ 125,956 | \$ 434,648            | \$ 378,089 |
| <b>Income From Operations</b>    |                       |            |                       |            |
| Industrial                       | \$ 2,787              | \$ 3,070   | \$ 8,713              | \$ 7,530   |
| Agricultural                     | (240)                 | 1,006      | 1,857                 | 2,204      |
| European                         | 5,276                 | 3,590      | 12,007                | 8,630      |
| Consolidated                     | \$ 7,815              | \$ 7,666   | \$ 22,577             | \$ 18,364  |
| <b>Goodwill</b>                  |                       |            |                       |            |
| Industrial                       | \$ 27,183             | \$ 27,295  | \$ 27,183             | \$ 27,295  |
| Agricultural                     | 5,580                 | 5,871      | 5,580                 | 5,871      |
| European                         | 22,744                | 10,801     | 22,744                | 10,801     |
| Consolidated                     | \$ 55,507             | \$ 43,967  | \$ 55,507             | \$ 43,967  |
| <b>Total Identifiable Assets</b> |                       |            |                       |            |
| Industrial                       | \$ 176,677            | \$ 163,515 | \$ 176,677            | \$ 163,515 |
| Agricultural                     | 81,841                | 81,738     | 81,841                | 81,738     |
| European                         | 139,765               | 119,334    | 139,765               | 119,334    |
| Consolidated                     | \$ 398,283            | \$ 364,587 | \$ 398,283            | \$ 364,587 |

**11. Off-Balance Sheet Arrangements**

Net Revenue

The Company does not have any obligation under any transaction, agreement or other contractual arrangement to which an entity unconsolidated with the Company is party, that has or is reasonably likely to have a material effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

## 12. Comprehensive Income

During the third quarter of 2008 and 2007, Comprehensive Income amounted to (\$7,276,000) and \$7,108,000, respectively.

The components of Comprehensive Income, net of related tax are as follows:

| (in thousands)                          | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2008                                | 2007     | 2008                               | 2007      |
| Net Income                              | \$ 4,453                            | \$ 4,216 | \$ 12,850                          | \$ 9,084  |
| Cash flow derivatives, net of taxes     | 4                                   | (500)    | 1                                  | (220)     |
| Amortization of actuarial net gain      | (20)                                |          | (60)                               |           |
| Foreign currency translation adjustment | (11,713)                            | 3,392    | (9,711)                            | 6,642     |
| Comprehensive Income                    | \$ (7,276)                          | \$ 7,108 | \$ 3,080                           | \$ 15,506 |

The components of Accumulated other comprehensive income as shown on the Balance Sheet are as follows:

|  | <b>September<br/>30,<br/>2008<br/><br/>(Unaudited)<br/>2008</b> | <b>December 31,<br/>2007<br/><br/>(Audited)<br/>2007</b> |
|--|---|--|
| (in thousands)                                 |   |  |
| Foreign currency translation adjustment        | \$ 9,968  | \$ 19,674  |
| Derivatives, net of taxes                      | (764)   | (760)  |
| Actuarial gain on defined benefit pension plan | \$ 2,130  | \$ 2,190   |
| Accumulated other comprehensive income         | \$ 11,334   | \$ 21,104  |

### 13. Contingent Matters

The Company is subject to various unresolved legal actions that arise in the ordinary course of its business. The most significant of such actions relates to product liability, which is generally covered by insurance after various self-insured retention ( SIR ) amounts. While amounts claimed might be substantial and the liability with respect to such litigation cannot be determined at this time, the Company believes that the outcome of these matters will not have a material adverse effect on the Company's consolidated financial position or results of operations; however, the ultimate resolution cannot be determined at this time.

The Company is subject to numerous environmental laws and regulations concerning air emissions, discharges into waterways, and the generation, handling, storage, transportation, treatment and disposal of waste materials. The Company's policy is to comply with all applicable environmental, health and safety laws and regulations, and the Company believes it is currently in material compliance with all such applicable laws and regulations. These laws and regulations are constantly changing, and it is impossible to predict with accuracy the effect that changes to such laws and regulations may have on the Company in the future. Like other industrial concerns, the Company's manufacturing operations entail the risk of noncompliance, and there can be no assurance that the Company will not incur material costs or other liabilities as a result thereof.

The Company knows that its Indianola, Iowa property is contaminated with chromium which most likely resulted from chrome plating operations which were discontinued before the Company purchased the property. Chlorinated volatile organic compounds have also been

## Edgar Filing: ALAMO GROUP INC - Form 10-Q

detected in water samples on the property, though the source is unknown at this time. The Company has been voluntarily working with an environmental consultant and the State of Iowa with respect to these issues and believes it completed its remediation program in June 2006. The work was accomplished within the Company's environmental liability reserve balance. We requested a no further action classification from the state. The State of Iowa asked for some additional testing information which the Company has provided. The Company expects to receive a qualified no further action letter that will require only that the Company monitors the site in the future. Monitoring will continue until enough data is collected to demonstrate stable or improving conditions, at which time an unconditional no further action letter will be requested.

At September 30, 2008, the Company has an environmental reserve in the amount of \$1,631,000 related to the acquisition of *Gradall's* facility in Ohio. Three specific remediation projects that were identified prior to the acquisition are in process of remediation with a current reserve balance of \$165,000. The Company has a reserve of \$278,000 concerning a potential asbestos issue that is expected to be abated over time. The balance of the reserve, \$1,188,000, is mainly for potential ground water contamination/remediation that was identified before the acquisition and believed to have been generated by a third party company located near the *Gradall* facility. Certain other assets of the Company contain asbestos that may have to be over time future. Management has made its best estimate of the cost to remediate these environmental issues. However, such estimates are difficult to estimate including the timing of such costs. The Company believes that any subsequent change in the liability associated with the asbestos removal will not have a material adverse effect on the Company's consolidated financial position or results of operations.



The Company is subject to various other federal, state, and local laws affecting its business, as well as a variety of regulations relating to such matters as working conditions, equal employment opportunities and product safety. A variety of state laws regulate the Company's contractual relationships with its dealers, some of which impose restrictive standards on the relationship between the Company and its dealers, including events of default, grounds for termination, non-renewal of dealer contracts and equipment repurchase requirements. The Company believes it is currently in material compliance with all such applicable laws and regulations.

#### **14. Pension Benefits**

In connection with the February 3, 2006 purchase of all the net assets of the *Gradall* excavator business, Alamo Group Inc. assumed sponsorship of two *Gradall* non-contributory defined benefit pension plans, both of which were frozen with respect to both future benefit accruals and future new entrants.

The *Gradall* Company Hourly Employees Pension Plan covers approximately 310 former employees and 210 current employees who (i) were formerly employed by the former parent of *Gradall*, (ii) were covered by a collective bargaining agreement and (iii) first participated in the plan before April 6, 1997. An amendment ceasing all future benefit accruals was effective April 6, 1997.

The *Gradall* Company Employees Retirement Plan covers approximately 190 former employees and 150 current employees who (i) were formerly employed by the former parent of *Gradall*, (ii) were not covered by a collective bargaining agreement and (iii) first participated in the plan before December 31, 2004. An amendment ceasing future benefit accruals for certain participants was effective December 31, 2004. A second amendment discontinued all future benefit accruals for all participants effective April 24, 2006.

The Company's pension expense was not material for the nine months ended September 30, 2008 or 2007.

The Company contributed \$497,000 and \$1,003,000 to the Plan for the nine month period ended September 30, 2008 and the year ended December 31, 2007. The Company is not required to make additional contributions in the fourth quarter of 2008.

#### **15. Income Taxes**

## Edgar Filing: ALAMO GROUP INC - Form 10-Q

The Company adopted FASB Interpretation 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ) on January 1, 2007. At January 1, 2007, the Company recognized a liability of approximately \$379,000 for unrecognized tax positions, which includes penalty and interest of \$134,000. During 2007, an unrecognized tax position was resolved in the Company's benefit as a result of an IRS audit and the liability was reduced by \$167,000 and the Company recorded an unrecognized tax position during the year of \$125,000 including penalty and interest of \$16,000. The balance at September 30, 2008 was \$337,000. The impact to the Interim Consolidated Statements of Income was zero in the third quarter of 2008 and 2007.

### 16. Recent Accounting Pronouncements

SFAS No. 141, "Business Combinations (Revised 2007)." SFAS 141R replaces SFAS 141, "Business Combinations," and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," would have to be met by the target in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, "Accounting for Contingencies." SFAS 141R is expected to have a significant impact on the Company's accounting for business combinations closing on or after January 1, 2009.

## Edgar Filing: ALAMO GROUP INC - Form 10-Q

SFAS No. 160, "Non-controlling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51." SFAS 160 amends Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 is effective for the Corporation on January 1, 2009 and is not expected to have a significant impact on the Company's financial statements.

SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133." SFAS 161 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," to amend and expand the disclosure requirements of SFAS 133 to provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. To meet those objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for the Company on January 1, 2009 and is not expected to have a significant impact on the Company's financial statements.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following tables set forth, for the periods indicated, certain financial percentages:

| (As Percentages of Net Sales) | Three Months Ended    |      | Nine Months Ended     |      |                       |      |
|-------------------------------|-----------------------|------|-----------------------|------|-----------------------|------|
|                               | September 30,<br>2008 | 2007 | September 30,<br>2008 | 2007 | September 30,<br>2008 | 2007 |
| North American                |                       |      |                       |      |                       |      |
| Industrial                    | 43.6                  | %    | 48.3                  | %    | 46.0                  | %    |
| Agricultural                  | 19.9                  | %    | 24.8                  | %    | 21.8                  | %    |
| European                      | 36.5                  | %    | 26.9                  | %    | 32.2                  | %    |
| Total sales, net              | 100.0                 | %    | 100.0                 | %    | 100.0                 | %    |

Three Months Ended

Nine Months Ended

December 31, 2007

Edgar Filing: ALAMO GROUP INC - Form 10-Q

| (Cost Trends and Profit Margin, as<br>Percentages of Net Sales) | September 30, |      | September 30, |      |      |   |       |
|---|---------------|------|---------------|------|------|---|-------|
|   | 2008          | 2007 | 2008          | 2007 |      |   |       |
| Gross margin  | 19.9          | %    | 20.9          | %    | 19.6 | % | 19.6% |
| Income from operations  | 5.3           | %    | 6.1           | %    | 5.2  | % | 4.9%  |
| Income before income taxes                                      | 4.5           | %    | 5.0           | %    | 4.5  | % | 3.6%  |
| Net income  | 3.0           | %    | 3.3           | %    | 3.0  | % | 2.4%  |

## Overview

*This report contains forward-looking statements that are based on Alamo Group's current expectations. Actual results in future periods may differ materially from those expressed or implied because of a number of risks and uncertainties which are discussed below and in the Forward-Looking Information section.*

In the first nine months of 2008 the Company's net income increased compared to the first nine months of 2007 primarily due to steady markets during the first half of the year and the benefits from efficiency initiatives we began in 2006. The acquisitions of both Henke and Rivard have been accretive to the Company's net income for 2008. Industrial Division sales without the Henke acquisition were up 6% during the first nine months of 2008 mainly from increased excavator and vacuum truck business which more than offset lower sweeper sales. Sales in the Agricultural Division at the start of the year initially reflected strong market conditions but have since shown some softening during the third quarter of 2008 due to the weakness in the economy and reduced prices for agricultural commodities. Delays in obtaining key components from outside suppliers have also led to continued late deliveries. European sales revenues improved over 2007 primarily due to export sales outside its principal markets and the acquisition of Rivard.

While our outlook remains positive, we are concerned that our markets could be negatively affected by a variety of factors such as the downturn in the overall economy; inflation particularly with raw materials such as steel and energy costs which while coming down, are still above historical levels; increased levels of government regulations; changes in farm incomes due to commodity prices or governmental aid programs; credit availability; adverse situations that could affect our customers such as animal disease epidemics, weather conditions such as droughts and floods; and budget constraints or revenue shortfalls in governmental entities to which the Company sells its products. These and other factors can affect our future business.

## Results of Operations

*Three Months Ended September 30, 2008 vs. Three Months Ended September 30, 2007*

Net sales for the third quarter of 2008 were \$148,707,000, an increase of \$22,751,000 or 18.1% compared to \$125,956,000 for the third quarter of 2007. The increase was primarily attributable to the acquisition of *Rivard* in the amount of \$17,415,000 and a continued steady demand in nearly all segments of the Company's business.

Net North American Industrial sales increased during the third quarter by \$3,941,000 or 6.5% to \$64,803,000 for 2008 compared to \$60,862,000 during the same period in 2007. The majority of the increase came from excavator and vacuum truck business. Sweeper sales continue to be weak, particularly in the parking lot contractor sector.

## Edgar Filing: ALAMO GROUP INC - Form 10-Q

Net North American Agricultural sales were \$29,555,000 in 2008 compared to \$31,210,000 for the same period in 2007, a decrease of \$1,655,000 or 5.3%. The decrease was the result of supply issues that delayed deliveries of key components which led to late shipments. We also saw some softness in market conditions due to lower agricultural commodity prices, credit availability and overall economic weakness.

Net European Sales for the third quarter of 2008 were \$54,349,000, an increase of \$20,465,000 or 60.4% compared to \$33,884,000 during the third quarter of 2007. The majority of the increase was primarily due to the acquisition of *Rivard* and continued improvement in export sales.

Gross profit for the third quarter of 2008 was \$29,610,000 (19.9% of net sales) compared to \$26,382,000 (20.9% of net sales) during the same period in 2007, an increase of \$3,228,000. *Rivard* contributed gross profit of \$3,473,000 for the three months ended September 30, 2008. Offsetting the impact of the *Rivard* acquisition were a small decrease in gross profits due to increases in steel, steel products and energy prices which, while softening, continue to be above historical levels.

Selling, general and administrative expense ( SG&A ) was \$21,795,000 (14.7% of net sales) during the third quarter of 2008 compared to \$18,716,000 (14.9% of net sales) during the same period of 2007, an increase of \$3,079,000. The increase in SG&A was primarily from the addition of *Rivard* in the amount of \$2,212,000.

Interest expense was \$2,024,000 for the third quarter of 2008 compared to \$2,025,000 during the same period in 2007, a decrease of \$1,000.

Other income (expense) was \$222,000 of income during the third quarter of 2008 compared to \$235,000 of income in the third quarter of 2007. The gains in both 2008 and 2007 are entirely from changes in exchange rates.

Provision for income taxes was \$2,251,000 (33.6% of income before taxes) for the third quarter of 2008 compared to \$2,074,000 (33.0% of income before taxes) in the third quarter of 2007.

The Company's net income after tax was \$4,453,000 or \$.45 per share on a diluted basis for the third quarter of 2008 compared to \$4,216,000 or \$.42 per share on a diluted basis for the third quarter of 2007. The increase of \$237,000 resulted from the factors described above.

*Nine Months Ended September 30, 2008 vs. Nine Months Ended September 30, 2007*

Net sales for the first nine months of 2008 were \$434,648,000, an increase of \$56,559,000 or 15.0% compared to \$378,089,000 for the first nine months of 2007. The increase was primarily attributable to the acquisitions of *Rivard* and *Henke* in the amount of \$25,992,000, and continued steady demand for our products in most of the Company's segments

Net North American Industrial sales increased during the first nine months by \$13,356,000 or 7.2% to \$199,866,000 for 2008 compared to \$186,510,000 during the same period in 2007. The increase was due from higher sales in the excavator and vacuum truck business along with the acquisition of *Henke* in the amount of \$1,662,000. Negatively impacting this segment were soft conditions in the sweeper market, specifically the parking lot contractor business.

Net North American Agricultural sales were \$94,826,000 in 2008 compared to \$90,521,000 for the same period in 2007, an increase of \$4,305,000 or 4.8%. The increase was mainly due to steady market conditions, specifically mowing and front-end loader equipment. During

## Edgar Filing: ALAMO GROUP INC - Form 10-Q

the third quarter of 2008, this division experienced delays in deliveries of key components from suppliers which prevented us from meeting commitments to our customers in a timely fashion.

Net European Sales for the first nine months of 2008 were \$139,956,000, an increase of \$38,898,000 or 38.5% compared to \$101,058,000 during the same period of 2007. The increase was primarily due to the *Rivard* acquisition in the amount of \$24,330,000, and to a lesser extent higher export sales outside our core markets, along with improved agricultural market conditions in the first half of 2008.

Gross profit for the first nine months of 2008 was \$85,095,000 (19.6% of net sales) compared to \$74,293,000 (19.6% of net sales) during the same period in 2007, an increase of \$10,802,000. The increase was mainly due to improved market conditions in all three of the Company's segments along with the acquisitions of *Henke* and *Rivard*. Negatively affecting the Company's gross margin were higher steel, steel products and energy prices.

Selling, general and administrative expense ( SG&A ) were \$62,518,000 (14.4% of net sales) during the first nine months of 2008 compared to \$55,929,000 (14.8% of net sales) during the same period of 2007, an increase of \$6,589,000. The increase in SG&A for the first nine months of 2008 primarily came from the additions of *Henke* and *Rivard* in the amount of \$3,362,000 along with increased sales commissions from higher sales.

Interest expense was \$5,748,000 for the first nine months of 2008 compared to \$6,415,000 during the same period in 2007, a decrease of \$667,000. The decrease was due to lower interest rates in the first nine months of 2008.



Other income (expense) was \$881,000 of income during the first nine months of 2008 compared to \$469,000 of income in the first nine months of 2007. The gain in 2008 is from changes in exchange rates and the income in 2007 was a gain of \$150,000 relating to a sale of the Company's investment in a small business investment company and from exchange rate gains in the amount of \$319,000.

Provision for income taxes was \$6,490,000 (33.6% of income before taxes) for the first nine months of 2008 compared to \$4,381,000 (32.5% of income before taxes) in the first nine months of 2007.

The Company's net income after tax was \$12,850,000 or \$1.29 per share on a diluted basis for the first nine months of 2008 compared to \$9,084,000 or \$0.91 per share on a diluted basis for the first nine months of 2007. The increase of \$3,766,000 resulted from the factors described above.

#### **Liquidity and Capital Resources**

In addition to normal operating expenses, the Company has ongoing cash requirements which are necessary to operate the Company's business, including inventory purchases and capital expenditures. The Company's inventory and accounts payable levels typically build in the first half of the year and in the fourth quarter in anticipation of the spring and fall selling seasons. Accounts receivable historically build in the first and fourth quarters of each year as a result of fall preseason sales programs and out of season sales. These sales level the Company's production during the off season.

As of September 30, 2008, the Company had working capital of \$171,968,000 which represents an increase of \$2,577,000 from working capital of \$169,391,000 as of December 31, 2007. The increase in working capital was primarily from higher levels of accounts receivable due to the growth in sales and the acquisition of *Rivard*.

Capital expenditures were \$5,052,000 for the first nine months of 2008, compared to \$6,733,000 during the first nine months of 2007. Capital expenditures for 2008 are expected to be below 2007 levels. The Company expects to fund expenditures from operating cash flows or through its revolving credit facility, described below.

The Company was authorized by its Board of Directors in 1997 to repurchase up to 1,000,000 shares of the Company's common stock to be funded through working capital and credit facility borrowings. There were no shares purchased in 2007 or the nine months of 2008. The authorization to repurchase up to 1,000,000 shares remains available less 42,600 shares previously repurchased.

Net cash provided by financing activities was \$10,300,000 during the nine month period ending September 30, 2008, compared to \$9,261,000 for the same period in 2007. The financing activities were higher in 2008 due to increased pre-season sales and the acquisition of *Rivard*.

On August 25, 2004, the Company entered into a five year \$70 million Amended and Restated Revolving Credit Agreement with its lenders, Bank of America, JPMorgan Chase Bank, and Guaranty Bank. This contractually committed, unsecured facility allows the Company to borrow and repay amounts drawn at floating or fixed interest rates based upon Prime or LIBOR rates. Proceeds may be used for general corporate purposes or, subject to certain limitations, acquisitions. The loan agreement contains among other things the following financial covenants: Minimum Fixed Charge Coverage Ratios, Minimum Consolidated Tangible Net Worth, Consolidated Funded Debt to EBITDA Ratio and Minimum Asset Coverage Ratio, along with limitations on dividends, other indebtedness, liens, investments and capital expenditures.

On February 3, 2006, the Company amended and restated the credit agreement to increase the Company's existing credit facility from \$70 million to \$125 million. Pursuant to the terms of the Amended and Restated Revolving Credit Agreement, the Company has the ability to request an increase in commitments by \$25 million. In addition, the existing credit facility was modified in other respects, including reducing the asset coverage ratio and lowering the interest margins.

On March 30, 2006 the Company entered into the Fourth Amendment of the Amended and Restated Revolving Credit Agreement, dated March 30, 2006 (the "Amended and Restated Revolving Credit Agreement"), between the Company and Bank of America, N.A., J.P. Morgan Chase Bank and Guaranty Bank, as its lenders. Pursuant to the terms of the Amended and Restated Revolving Credit Agreement, the Company added Gradall Industries, Inc., formerly Alamo Group (OH) Inc., and N.P. Real Estate Inc. as members of the Obligated Group. The Amendment also allows for capital expenditures not to exceed \$14.0 million for the fiscal year ending 2006 and \$10.0 million in the aggregate during each fiscal year thereafter.

On May 7, 2007, the Company entered into the Fifth Amended and Restated Revolving Credit Agreement with Bank of America, N.A., JPMorgan Chase Bank, Guaranty Bank and Rabobank, as its lenders. The Amended and Restated Revolving Credit Agreement provides for a \$125 million unsecured revolving line of credit for five years with the ability to expand the facility to \$175 million, subject to bank approval. In addition to the extended term of the loan to 2012, other major changes were improvements in the leverage ratio, minimum asset coverage ratio and an increase in annual allowable capital expenditures up to \$17.5 million. The banks agreed to eliminate the fixed charge coverage ratio and minimum net worth requirement along with a reduction in the applicable interest rate margin. The applicable interest margin fluctuates quarterly, either up or down based upon the Company's leverage ratio.

On May 13, 2008, Alamo Group Europe Limited expanded its overdraft facility with Lloyd's TSB Bank plc from £ 1.0 million to £ 5.5 million. The facility is expected to be renewed on or about October 31, 2008 and outstandings currently bear interest at Lloyd's Base Rate plus 1.1% per annum. The facility is unsecured but guaranteed by the U.K. subsidiaries of Alamo Group Europe Limited. As of September 30, 2008, there were no outstanding balances in British pounds borrowed against the U.K. overdraft facility.

As of September 30, 2008, there was \$86,000,000 borrowed under the revolving credit facility. At September 30, 2008, \$878,000 of the revolver capacity was committed to irrevocable standby letters of credit issued in the ordinary course of business as required by vendors' contracts resulting in approximately \$38,000,000 in available borrowings.

There are additional lines of credit, for the Company's French operations in the amount of 9,300,000 Euros, which includes the Rivard credit facilities, for our Canadian operation in the amount of 3,500,000 Canadian dollars, and for our Australian operation in the amount of 800,000 Australian dollars. As of September 30, 2008, 182,000 Euros were borrowed against the French line of credit, 581,000 Canadian dollars were outstanding on the Canadian line of credit and 500,000 Australian dollars were outstanding under its facility. The Canadian and Australian revolving credit facilities are guaranteed by the Company. The Company's borrowing levels for working capital are seasonal with the greatest utilization generally occurring in the first quarter and early spring.

As of September 30, 2008, the Company is in compliance with the terms and conditions of its credit facilities.

On July 27, 2006, the Company filed a shelf registration statement on Form S-3 with the SEC to register 2,300,000 shares of common stock for offer and sale by the Company from time to time in accordance with the Securities Exchange Act. This filing had a two year life and was withdrawn on May 30, 2008, prior to its cancellation and can be reinstated if deemed appropriate by management.

Management believes that the Company's ability to internally generate funds from operations and secure financing from external sources will be sufficient to meet the Company's cash requirements for the foreseeable future.

### **Critical Accounting Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations are based upon our Consolidated Financial Statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the financial statements. Management believes the following critical accounting policies reflect its more significant estimates and assumptions used in the preparation of the Consolidated Financial Statements. For further information on the critical accounting policies, see Note 1 of our Notes to Consolidate Financial Statements.

## **Critical Accounting Policies**

### *Allowance for Doubtful Accounts*

The Company evaluates the collectibility of its accounts receivable based on a combination of factors. In circumstances where it is aware of a specific customer's inability to meet its financial obligations, it records a specific reserve to reduce the amounts recorded to what it believes will be collected. For all other customers, it recognizes reserves for bad debt based on historical experience of bad debts as a percent of revenues for each business unit, adjusted for relative improvements or deteriorations in the aging and changes in current economic conditions.

The Company evaluates all aged receivables that are over 60 days old and reserves specifically on a 90-day basis. The Company's North American operations have security interest on most wholegoods each customer purchases. This allows the Company in times of a difficult economy when the customer is unable to pay or has filed for bankruptcy (usually Chapter 11), to repossess the customer's inventory. It also allows Alamo Group to maintain a reserve over its cost which usually represents the margin on the original sales price.

In our European operation, the Company purchases credit insurance which covers mainly insolvency for a majority of its accounts receivable in the U.K. and France. Coverage limits range from 60% to 90% of the amount outstanding depending on credit limits set by the insurer.

The bad debt reserve balance was \$1,809,000 at September 30, 2008 and \$1,922,000 at December 31, 2007.

### *Sales Discounts*

## Edgar Filing: ALAMO GROUP INC - Form 10-Q

At September 30, 2008 the Company had \$6,160,000 in reserves for sales discounts compared to \$6,338,000 at December 31, 2007 on products shipped to our customers under various promotional programs. The decrease was due primarily from lower additional discounts reserved on the Company's agricultural products during the pre-season, which runs from September to December of each year and orders are shipped through the first quarter of 2008. The Company reviews the reserve quarterly based on analysis made on each program outstanding at the time.

The Company bases its reserves on historical data relating to discounts taken by the customer under each program. Historically between 85% and 95% of the Company's customers who qualify for each program, actually take the discount that is available.

### *Inventories - Obsolescence and Slow Moving*

The Company had \$8,222,000 at September 30, 2008 and \$8,526,000 at December 31, 2007 in reserve to cover obsolescence and slow moving inventory. The obsolescence and slow moving policy states that the reserve is to be calculated on a basis of: 1) no inventory usage over a three year period and inventory with quantity on hand is deemed obsolete and reserved at 100 percent and 2) slow moving inventory with little usage requires a 100 percent reserve on items that have a quantity greater than a three year supply. There are exceptions to the obsolete and slow moving classifications if approved by an officer of the Company based on specific identification of an item or items that are deemed to be either included or excluded from this classification. In cases where there is no historical data management makes a judgment based on a specific review of the inventory in question to determine what reserves, if any are appropriate. New products or parts are generally excluded from the reserve policy until a three year history has been established.

The reserve is reviewed and if necessary, adjustments made, on a quarterly basis. The Company relies on historical information to support its reserve. Once the inventory is written down, the Company does not adjust the reserve balance until the inventory is sold.

#### *Warranty*

The Company's warranty policy is generally to provide its customers warranty for up to one year on all equipment and 90 days for parts.

Warranty reserve, as a percent of sales, is calculated by taking at the current twelve months of expenses and prorating that based on twelve months of sales with a nine month lag period. The Company's historical experience is that a customer takes approximately ninety days to nine months from the time the unit is received and put into operation to file any warranty claim. A warranty reserve is established for each different marketing group. Reserve balances are evaluated on a quarterly basis and adjustments are made when required.

The current warranty reserve balance was \$5,562,000 at September 30, 2008 and \$4,865,000 at December 31, 2007. The majority of the increase came from the acquisition of *Rivard*. The Company has a long-term liability for extended warranty policies sold to customers in the amount of \$330,000 at September 30, 2008 and \$218,000 at December 31, 2007 existed relating to some of our industrial product lines with a life expectancy of 1 to 5 years.

#### *Product Liability*

At September 30, 2008 the Company had accrued \$135,000 in reserves for product liability cases compared to \$200,000 at December 31, 2007. The Company accrues primarily on a case by case basis and adjusts the balance quarterly.

During most of 2008, the self insured retention (S.I.R.) for U.S. product liability coverage for rotary mowers was \$150,000 while the S.I.R. for all other products was at \$100,000 per claim. On September 30, 2008 the Company renewed its insurance coverage and the S.I.R. for rotary mowers was reduced from \$150,000 to \$100,000. The S.I.R. for all other products remained at \$100,000. The Company also carries product liability coverage in Europe, Canada and Australia which contain substantially lower S.I.R.'s or deductibles.

#### **Forward-Looking Information**

Part I of this Quarterly Report on Form 10-Q and the Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part II of this Quarterly Report contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In addition, forward-looking statements may be made orally or in press releases, conferences, reports or otherwise, in the future by or on behalf of the Company.

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Statements that are not historical are forward-looking. When used by or on behalf of the Company, the words estimate, believe, intend and similar expressions generally identify forward-looking statements made by or on behalf of the Company.



Forward-looking statements involve risks and uncertainties. These uncertainties include factors that affect all businesses operating in a global market, as well as matters specific to the Company and the markets it serves. Particular risks and uncertainties facing the Company at the present include changes in market conditions; increased competition; decreases in the prices of agricultural commodities, which could affect our customer's income levels; budget constraints or income shortfalls which could affect the purchases of our type of equipment by governmental customers; credit availability for both the Company and its customers, adverse weather conditions such as droughts and floods which can affect buying patterns of the Company's customers and related contractors; the price and availability of critical raw materials, particularly steel and steel products; energy cost; increased cost of new governmental regulations which effect corporations; the potential effects on the buying habits of our customers due to diseases such as mad cow; the Company's ability to develop and manufacture new and existing products profitably; market acceptance of new and existing products; the Company's ability to maintain good relations with its employees; and the ability to hire and retain quality employees.

In addition, the Company is subject to risks and uncertainties facing the industry in general, including changes in business and political conditions and the economy in general in both domestic and international markets; weather conditions affecting demand; slower growth in the Company's markets; financial market changes including increases in interest rates and fluctuations in foreign exchange rates; actions of competitors; the inability of the Company's suppliers, customers, creditors, public utility providers and financial service organizations to deliver or provide their products or services to the Company; seasonal factors in the Company's industry; unforeseen litigation; government actions including budget levels, regulations and legislation, primarily relating to the environment, commerce, infrastructure spending, health and safety; and availability of materials.

The Company wishes to caution readers not to place undue reliance on any forward-looking statements and to recognize that the statements are not predictions of actual future results. Actual results could differ materially from those anticipated in the forward-looking statements and from historical results, due to the risks and uncertainties described above, as well as others not now anticipated. The foregoing statements are not exclusive and further information concerning the Company and its businesses, including factors that could potentially materially affect the Company's financial results, may emerge from time to time. It is not possible for management to predict all risk factors or to assess the impact of such risk factors on the Company's businesses.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risks**

The Company is exposed to various markets risks. Market risks are the potential losses arising from adverse changes in market prices and rates. The Company does not enter into derivative or other financial instruments for trading or speculative purposes.

#### **Foreign Currency Risk**

*International Sales*

A portion of the Company's operations consists of manufacturing and sales activities in international jurisdictions. The Company primarily manufactures its products in the United States, the U.K., France, Canada and Australia. The Company sells its products primarily within the markets where the products are produced, but certain of the Company's sales from its U.K. operations are denominated in other European currencies. As a result, the Company's financials, specifically the value of its foreign assets, could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the other markets in which the subsidiaries of the Company distribute their products.

To mitigate the short-term affect of changes in currency exchange rates on the Company's functional currency-based sales, the Company's U.K. subsidiaries regularly hedge by entering into foreign exchange forward contracts to hedge approximately 80% of its future net foreign currency sales transactions over a period of nine months. As of September 30, 2008, the Company had \$2,493,000 outstanding in forward exchange contracts related to accounts receivables. A 15% fluctuation in exchange rates for these currencies would change the fair value by approximately \$374,000. However, since these contracts hedge foreign currency denominated transactions, any change in the fair value of the contracts should be offset by changes in the underlying value of the transaction being hedged.

*Exposure to Exchange Rates*

The Company's earnings are affected by fluctuations in the value of the U.S. dollar as compared to foreign currencies, predominately in European countries, as a result of the sales of its products in international markets. Foreign currency options and forward contracts are used to hedge against the earnings effects of such fluctuations. At September 30, 2008, the result of a uniform 10% strengthening in the value of the dollar relative to the currencies in which the Company's sales are denominated would result in a decrease in gross profit of \$3,769,000 for the period ending September 30, 2008. Comparatively, the result of a uniform 10% strengthening in the value of the dollar relative to the currencies in which the Company's sales are denominated would have resulted in a decrease in gross profit of approximately \$2,959,000 for the period ended September 30, 2007. This calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar. In addition to the direct effects of changes in exchange rates, which are a changed dollar value of the resulting sales, changes in exchange rates may also affect the volume of sales or the foreign currency sales price as competitors' products become more or less attractive. The Company's sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in a potential change in sales levels or local currency prices. The translation adjustment during the second quarter of 2008 was a loss of \$11,713,000. On September 30, 2008, the British pound closed at .5625 relative to 1.00 U.S. dollar, and the Euro dollar closed at .7104 relative to 1.00 U.S. dollar. At December 31, 2007 the British pound closed at .5033 relative to 1.00 U.S. dollar and the Euro dollar closed at .6850 relative to 1.00 U.S. dollar. By comparison, on September 30, 2007, the British pound closed at .4887 relative to 1.00 U.S. dollar, and the Euro dollar closed at .7013 relative to 1.00 U.S. dollar. No assurance can be given as to future valuation of the British pound or Euro or how further movements in those or other currencies could affect future earnings or the financial position of the Company.

**Interest Rate Risk**

The Company's long-term debt bears interest at variable rates. Accordingly, the Company's net income is affected by changes in interest rates. Assuming the current level of borrowings at variable rates and a two percentage point change in the third quarter 2008 average interest rate under these borrowings, the Company's interest expense would have changed by approximately \$1,290,000. In the event of an adverse change in interest rates, management could take actions to mitigate its exposure. However, due to the uncertainty of the actions that would be taken and their possible effects this analysis assumes no such actions. Further this analysis does not consider the effects of the change in the level of overall economic activity that could exist in such an environment.

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures.** An evaluation was carried out under the supervision and with the participation of Alamo's management, including our President and Chief Executive Officer, Executive Vice President and Chief Financial Officer (Principal Financial Officer) and Vice-President and Corporate Controller, (Principal Accounting Officer), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13A-15(e) under the Securities Exchange Act of 1933). Based upon the evaluation, the President and Chief Executive Officer, Executive Vice President and Chief Financial Officer (Principal Financial Officer) and Vice-President, Corporate Controller, (Principal Accounting Officer) concluded that the Company's design and operation of these disclosure controls and procedures were effective at the end of the period covered by this report.



**Changes in Internal Controls over Financial Reporting.** There have not been any changes in Alamo's internal control over financial reporting (as such term is defined by paragraph (d) of Rule 13-a-15) under the Securities Exchange Act, during the first fiscal quarter that have materially affected, or are reasonably likely to materially affect, Alamo's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. - None**

**Item 2 - None**

**Item 3 - None**

**Item 4 - None**

**Item 5. Other Information**

(a) Reports on Form 8-K

November 5, 2008 Press Release announcing third quarter fiscal 2008 earnings

(b) Other Information

None

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

|      |   |                   |
|------|---|-------------------|
| 31.1 | Certification by Ronald A. Robinson under Section 302 of the Sarbanes-Oxley Act of 2002 | Filed<br>Herewith |
| 31.2 | Certification by Dan E. Malone under Section 302 of the Sarbanes-Oxley Act of 2002      | Filed<br>Herewith |
| 31.3 | Certification by Richard J. Wehrle under Section 302 of the Sarbanes-Oxley Act of 2002  | Filed<br>Herewith |
| 32.1 | Certification by Ronald A. Robinson under Section 906 of the Sarbanes-Oxley Act of 2002 | Filed<br>Herewith |
| 32.2 | Certification by Dan E. Malone under Section 906 of the Sarbanes-Oxley Act of 2002      | Filed<br>Herewith |
| 32.3 | Certification by Richard J. Wehrle under Section 906 of the Sarbanes-Oxley Act of 2002  | Filed<br>Herewith |

(b) Reports on Form 8-K

**Alamo Group Inc. and Subsidiaries**

SIGNATURES

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.

Alamo Group Inc.  
(Registrant)

/s/ Ronald A. Robinson  
Ronald A. Robinson  
President and CEO

/s/ Dan E. Malone  
Dan E. Malone  
Executive Vice President, Chief Financial Officer  
(Principal Financial Officer)

/s/ Richard J. Wehrle  
Richard J. Wehrle  
Vice President & Corporate Controller  
(Principal Accounting Officer)

