

ALAMO GROUP INC  
Form 10-Q  
November 09, 2009

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, 2009

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, 2009, 11,746,929 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> September 30, 2009 and December 31, 2008 (Audited)	3
<u>Interim Condensed Consolidated Statements of Income</u> Three months and Nine months ended September 30, 2009  and September 30, 2008	4
<u>Interim Condensed Consolidated Statements of Cash Flows</u> Nine months ended September 30, 2009 and September 30, 2008	5
<u>Notes to Interim Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition</u> and Results of Operations	15
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risks</u>	22
Item 4. <u>Controls and Procedures</u>	23
PART II. <u>OTHER INFORMATION</u>	24
Item 1. None	24
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	24
Item 3. None	24
Item 4. None	24

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Item 5.	<u>Other Information</u>	24
Item 6.	<u>Exhibits and Reports on Form 8-K</u>	24
	<u>SIGNATURES</u>	25

# Alamo Group Inc. and Subsidiaries

## Interim Condensed Consolidated Balance Sheets

	September 30, 2009	December 31, 2008
	(Unaudited)	(Audited)
(in thousands, except share amounts)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 13,474	\$ 4,532
Accounts receivable, net	104,156	124,197
Inventories	113,194	132,248
Deferred income taxes	2,513	2,671
Prepaid expenses	3,164	2,377
Total current assets	236,501	266,025
Property, plant and equipment	130,138	125,952
Less: Accumulated depreciation	(70,265)	(64,168)
	59,873	61,784
Goodwill	49,449	48,107
Intangible assets	3,923	3,982
Deferred income taxes	2,463	2,463
Assets held for sale	426	291
Other assets	1,303	1,702
Total assets	\$ 353,938	\$ 384,354
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Trade accounts payable	38,646	54,598
Income taxes payable	3,305	841
Accrued liabilities	28,895	26,059
Current maturities of long-term debt	5,423	4,186
Total current liabilities	76,269	85,684
Long-term debt, net of current maturities	62,928	99,884
Deferred pension liability	8,614	8,682
Other long-term liabilities	4,144	5,139
Deferred income taxes	1,101	653
Stockholders' equity:		
Common stock, \$.10 par value, 20,000,000 shares authorized; 10,089,529 and 9,964,529 issued and outstanding at September 30, 2009 and December 31, 2008, respectively	1,009	996
Additional paid-in capital	57,217	55,683
Treasury stock, at cost; 42,600 shares at September 30, 2009 and December 31, 2008	(426)	(426)
Retained earnings	139,386	132,064
Accumulated other comprehensive income	3,696	(4,005)
Total stockholders' equity	200,882	184,312
Total liabilities and stockholders' equity	\$ 353,938	\$ 384,354

See accompanying notes.

# Alamo Group Inc. and Subsidiaries

## Interim Condensed Consolidated Statements of Income

(Unaudited)

(in thousands, except per share amounts)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
-				
Net sales:				
North American				
Industrial	\$ 45,547	\$ 64,803	\$ 134,737	\$ 199,866
Agricultural	20,158	29,555	63,263	94,826
European	44,613	54,349	135,704	139,956
Total net sales	110,318	148,707	333,704	434,648
Cost of sales	84,669	119,097	261,999	349,553
Gross profit	25,649	29,610	71,705	85,095
Selling, general and administrative expense	17,983	21,795	55,478	62,518
Income from operations	7,666	7,815	16,227	22,577
Interest expense	(1,005)	(2,024)	(3,248)	(5,748)
Interest income	15	691	337	1,630
Other income (expense), net	134	222	130	881
Income before income taxes	6,810	6,704	13,446	19,340
Provision for income taxes	2,227	2,251	4,328	6,490
Net income	\$ 4,583	\$ 4,453	\$ 9,118	\$ 12,850
Net income per common share:				
Basic	\$ .46	\$ .45	\$ .91	\$ 1.31
Diluted	\$ .46	\$ .45	\$ .91	\$ 1.29
Average common shares				
Basic	10,047	9,870	9,988	9,822
Diluted	10,086	9,970	10,012	9,949
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>2009</b>	<b>2008</b>
<b>Operating Activities</b>		
Net income	\$9,118	\$12,850
Adjustment to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	392	318
Depreciation	6,050	6,990
Amortization	59	78
Stock-based compensation expense	429	443
Excess tax benefits from stock-based payment arrangements	(43)	(45)
Provision (benefit) for deferred income tax benefit	529	218
Gain on sale of property, plant and equipment	(22)	(99)
Changes in operating assets and liabilities:		
Accounts receivable	22,869	(14,719)
Inventories	22,019	(4,238)
Prepaid expenses and other assets	136	(1,206)
Trade accounts payable and accrued liabilities	(15,232)	17,068
Income taxes payable	2,211	1,173
Other long-term liabilities	(784)	(833)
Net cash provided by operating activities	47,731	17,998
<b>Investing Activities</b>		
Acquisitions, net of cash acquired		(22,055)
Purchase of property, plant and equipment	(2,661)	(5,052)
Proceeds from sale of property, plant and equipment	95	209
Net cash used by investing activities	(2,566)	(26,898)
<b>Financing Activities</b>		
Net change in bank revolving credit facility	(36,000)	11,000
Principal payments on long-term debt and capital leases	(1,670)	(2,038)
Proceeds from issuance of long-term debt	1,497	1,986
Dividends paid	(1,796)	(1,766)

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Proceeds from sale of common stock	1,117	1,073
Excess tax benefits from stock-based payment arrangements	43	45
Net cash provided by financing activities	(36,809)	10,300
Effect of exchange rate changes on cash	586	(412)
Net change in cash and cash equivalents	8,942	988
Cash and cash equivalents at beginning of the period	4,532	4,459
Cash and cash equivalents at end of the period	\$13,474	\$5,447
Cash paid during the period for:		
Interest	\$3,659	\$5,732
Income taxes	\$1,906	\$2,866

See accompanying notes.

**Alamo Group Inc. and Subsidiaries**

**Notes to Interim Condensed Consolidated Financial Statements - (Unaudited)**

**September 30, 2009**

**1. Basis of Financial Statement Presentation**

The accompanying unaudited interim 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, 2009. The balance sheet at December 31, 2008, 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, 2008.

In connection with the preparation of the consolidated financial statements and in accordance with FASB ASC Topic 855, Subsequent Events, formerly Statement of Financial Standards No. (SFAS) 165, Subsequent Events, the Company evaluated subsequent events after the balance sheet date of September 30, 2009 through November 7, 2009 and has disclosed a subsequent event in footnote 17.

**2. Acquisitions**

On May 30, 2008 the Company purchased Rivard Developpement (*Rivard*), a leading French manufacturer of vacuum trucks, high pressure cleaning systems and trenchers, which was accounted for as a business combination. The purchase price was €15 million (approximately U.S. \$23 million) plus the assumption of certain liabilities. We have allocated the purchase price to the acquired assets and liabilities assumed and recorded goodwill of €9 million

Edgar Filing: ALAMO GROUP INC - Form 10-Q

(approximately U.S. \$13 million) related to this acquisition. 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.

The unaudited pro forma statement of income of the Company assuming these transactions occurred at January 1, 2008 is as follows:

(In thousands, except per share amounts)	Nine Months Ended	
	September 30, 2009	2008
Net Sales	\$ 333,704	\$ 460,481
Net Income	\$ 9,118	\$ 14,502
Diluted Earnings per Share	\$ 0.91	\$ 1.46

**3. Accounts Receivable**

Accounts Receivable is shown less allowance for doubtful accounts of \$2,506,000 and \$2,430,000 at September 30, 2009 and December 31, 2008, respectively.

**4. Inventories**

Inventories valued at LIFO cost represented 52% and 57% of total inventory at September 30, 2009 and December 31, 2008, respectively. The excess of current costs over LIFO valued inventories was \$12,791,000 at September 30, 2009 and December 31, 2008. Inventory obsolescence reserves were \$8,829,000 at September 30, 2009 and \$8,978,000 at December 31, 2008. Net inventories consist of the following:

	<b>September 30,</b>		<b>December 31,</b>	
(in thousands)	<b>2009</b>		<b>2008</b>	
Finished goods	\$	89,881	\$	104,819
Work in process		11,997		16,247
Raw materials		11,316		11,182
	\$	113,194	\$	132,248

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, 2009, the Company had \$59.0 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, 2009, was a \$1,671,000 liability. This is included in Other long-term liabilities with an offset in Accumulated other comprehensive income, net of taxes. At September 30, 2009, ineffectiveness related to the interest rate swap agreements was not material.

## 6. Fair Value Measurements

The Company adopted ASC Subtopic 820-10, (formerly SFAS 157), Fair Value Measurements and Disclosures, as amended as of January 1, 2008. FSAS 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. There is a three-tier 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. 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 \$1,671,000 as of September 30, 2009.

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 \$72,000 loss as of September 30, 2009.

#### **7. Common Stock and Dividends**

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



**Nine Months Ended**

September 30,

**2009****2008**

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 certain 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 his or her employment or relationship with the Company or one of its affiliates other than by retirement, based on certain criteria. 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's stock-based compensation expense was \$429,000 and \$443,000 for the nine months ended September 30, 2009 and 2008, respectively.

There were no shares granted during the third quarter of 2009 and 39,000 shares granted in the third quarter of 2008. The Company calculated the fair value for the 2009 and 2008 options using a Black-Scholes option pricing model using weighted average assumptions. For options granted in the second quarter of 2009 and 2008, they are as follows:

	<u>2009</u>	<u>2008</u>
Risk-free interest rate	2.67%	3.13%
Dividend Yield	1.20%	1.20%
Volatility Factors	42.8%	43.6%
Weighted Average Expected Life	7.5 years	9.0 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, 2009*

	Shares	Exercise Price*
Options outstanding at beginning of year	253,980	
Granted	99,000	\$11.45
Exercised		
Cancelled	(5,000)	\$22.66
Options outstanding at September 30, 2009	347,980	\$17.85
Options exercisable at September 30, 2009	157,580	\$18.74
Options available for grant at September 30, 2009	208,000	

\*Weighted Averages

Options outstanding and exercisable at September 30, 2009 were as follows:

Qualified Stock Options	Options Outstanding			Options Exercisable	
	Shares	Remaining	Contractual	Exercise	Exercise
Life(yrs)*		Price*			
Range of Exercise Price					
\$11.45 - \$17.85	158,980	7.78	\$ 12.25	59,980	\$ 13.58
\$19.79 - \$25.18	189,000	7.42	\$ 22.56	97,600	\$ 21.90
Total	347,980			157,580	

\*Weighted Averages

*Non-qualified Options*

Edgar Filing: ALAMO GROUP INC - Form 10-Q

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

*For nine months ending September 30, 2009*

	Shares	Exercise Price*
Options outstanding at beginning of year	226,000	
Granted	93,000	
Exercised	(125,000)	\$8.9375
Cancelled		
Options outstanding at September 30, 2009	194,000	\$ 14.44
Options exercisable at September 30, 2009	79,000	\$ 15.17
Options available for grant at September 30, 2009	367,000	

\*Weighted Averages

Options outstanding and exercisable at September 30, 2009 were as follows:

Non-Qualified Stock Options	Options Outstanding			Options Exercisable	
	Remaining	Contractual	Exercise	Exercise	
Range of Exercise Price	Shares	Life(yrs)*	Price*	Shares	Price*
\$11.45 - \$12.10	148,000	7.45	\$11.69	55,000	\$12.10
\$13.96 - \$19.79	13,500	5.26	\$18.71	10,500	\$18.40
\$25.02 - \$25.18	32,500	7.92	\$25.17	13,500	\$25.16
Total	194,000			79,000	

\*Weighted Averages

**9. Earnings Per Share**

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 per share 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>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net Income	\$ 4,583	\$ 4,453	\$ 9,118	\$ 12,850
Average Common Shares:				
Basic (weighted-average outstanding shares)	10,047	9,870	9,988	9,822
Dilutive potential common shares from stock				
options and warrants	39	100	24	127
Diluted (weighted-average outstanding shares)	10,086	9,970	10,012	9,949
Basic earnings per share	\$ 0.46	\$ 0.45	\$ 0.91	\$ 1.31
Diluted earnings per share	\$ 0.46	\$ 0.45	\$ 0.91	\$ 1.29

**10. Segment Reporting**

At September 30, 2009 and September 30, 2008 the following unaudited financial information is segmented:

(in thousands)	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>	<b>2008</b>	<b>September 30,</b>	<b>2008</b>
	<b>2009</b>		<b>2009</b>	

**Net Revenue**

Industrial	\$	45,547	\$	64,803	\$	134,737	\$	199,866
Agricultural		20,158		29,555		63,263		94,826
European		44,613		54,349		135,704		139,956
Consolidated	\$	110,318	\$	148,707	\$	333,704	\$	434,648

**Income From Operations**

Industrial	\$	947	\$	2,787	\$	415	\$	8,713
Agricultural		1,528		(248)		2,988		1,857
European		5,191		5,276		12,824		12,007
Consolidated	\$	7,666	\$	7,815	\$	16,227	\$	22,577

**Goodwill**

Industrial	\$	27,168	\$	27,183	\$	27,168	\$	27,183
Agricultural				5,580				5,580
European		22,281		22,744		22,281		22,744
Consolidated	\$	49,449	\$	55,507	\$	49,449	\$	55,507

**Total Identifiable Assets**

Industrial	\$	151,226	\$	176,677	\$	151,226	\$	176,677
Agricultural		61,859		81,841		61,859		81,841
European		140,853		139,765		140,853		139,765
Consolidated	\$	353,938	\$	398,283	\$	353,938	\$	398,283

## 11. Off-Balance Sheet Arrangements

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

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

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net Income	\$ 4,583	\$ 4,453	\$ 9,118	\$ 12,850
Cash flow derivatives, net of taxes	142	4	476	1
Amortization of actuarial net gain	38	(20)	116	(60)
Foreign currency translation adjustment	2,568	(11,713)	7,109	(9,711)
Comprehensive Income	\$ 7,331	\$ (7,276)	\$ 16,819	\$ 3,080

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

(in thousands)	September 30, 2009 (Unaudited)	December 31, 2008 (Audited)
	2009	2008
Foreign currency translation adjustment	\$ 8,614	\$ 1,553
Derivatives, net of taxes	(1,036)	(1,560)
Actuarial gain on defined benefit pension plan	\$ (3,882)	\$(3,998)

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

Accumulated other comprehensive income	\$ 3,696	\$ (4,005)
--	----------	------------

### 13. Contingent Matters

The Company is subject to various unresolved legal actions that arise in the ordinary course of its business. The most prevalent 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.

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 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. We received a conditional "no further action" letter in January of 2009. When we demonstrate stable or improving conditions below residential standards by future monitoring of existing wells, an unconditional "no further action" letter will be requested.

At September 30, 2009, the Company had an environmental reserve in the amount of \$1,608,000 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 remaining reserve balance of \$143,000. The Company has a reserve of \$277,000 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 remediated over time. 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



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

second amendment discontinued all future benefit accruals for all participants effective April 24, 2006.

The Company's pension expense was \$138,000 and pension income was \$89,000 for the three months ended September 30, 2009 and 2008, respectively. The Company is required to contribute \$487,000 to the pension plans for 2009.

### **15. Income Taxes**

We are subject to U.S. federal income tax and various state, local, and international income taxes in numerous jurisdictions. Our domestic and international tax liabilities are subject to the allocation of revenue and expenses in different jurisdictions and the timing of recognizing revenue and expenses. Additionally, the amount of income taxes paid is subject to our interpretation of applicable tax laws in the jurisdictions in which we file.

We currently file income tax returns in the U.S., U.K., France, Canada and Australia, which are periodically under audit by federal, state, and international tax authorities. These audits can involve complex matters that may require an extended period of time for resolution. Although the outcome of open tax audits is uncertain, in management's opinion, adequate provisions for income taxes have been made. If actual outcomes differ materially from these estimates, they could have a material impact on our financial condition and results of operations. Differences between actual results and assumptions, or changes in assumptions in future periods are recorded in the period they become known. To the extent additional information becomes available prior to resolution, such accruals are adjusted to reflect probable outcomes. Our effective tax rate is impacted by earnings being realized in countries where we have lower statutory rates.

## 16. Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued SFAS 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162*. U.S. GAAP will no longer be issued in the form of an accounting standard, but rather as an update to the applicable topic or subtopic within the codification. As such, accounting guidance will be classified as either authoritative or non-authoritative based on its inclusion or exclusion from the codification. The codification will be the single source of authoritative U.S. accounting and reporting standards, except for rules and interpretive releases of the SEC under authority of federal securities laws, which are sources of authoritative GAAP for SEC registrants. The codification of U.S. GAAP became effective for the quarter ending after September 30, 2009. We do not expect this statement to have a material impact on our consolidated financial statements.

In May 2009, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (SFAS No. 165). SFAS No. 165 was subsequently codified in the FASB Accounting Standards Codification Topic 855 (ASC 855). ASC 855 establishes principles and standards related to the accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. ASC 855 requires an entity to recognize, in the financial statements, subsequent events that provide additional information regarding conditions that existed at the balance sheet date. In accordance with this standard, which was effective beginning with the quarter ended June 30, 2009, management has evaluated subsequent events for accounting and disclosure through the date of filing this quarterly report on Form 10-Q, which is November 9, 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), *Business Combinations*, (SFAS 141R), which replaces SFAS 141. SFAS 141R has subsequently been codified in the FASB Accounting Standards Codification Topic 805 (ASC 805). ASC 805 requires most assets acquired and liabilities assumed in a business combination, contingent consideration, and certain acquired contingencies to be measured at their fair values as of the date of acquisition. The new standard also requires that acquisition-related costs and restructuring costs be recognized separately from the business combination. The new standard became effective for the Company on January 1, 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interest in Consolidated Financial Statements*, (SFAS 160). SFAS 160 has subsequently been codified in the FASB Accounting Standards Codification Topic 810 (ASC 810). The new standard amends previous accounting literature to establish new accounting and reporting standards for the noncontrolling

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

interest in a subsidiary and for the deconsolidation of a subsidiary. The new standard is effective for the Company this fiscal year.

The Financial Accounting Standards Board's Emerging Issues Task Force has issued new accounting guidance for revenue arrangements with multiple deliverables. Under current accounting guidance, one of the requirements for recognition of revenue for a delivered item under a multiple element arrangement is that there must be objective and verifiable evidence of the standalone selling price of the undelivered item. The new guidance eliminates that requirement and requires an entity to estimate the selling price of each element in the arrangement. The result will likely be that more arrangements will be separated into multiple elements of accounting than was the case previously.

The new guidance is effective for the Company as of beginning January 1, 2011, and will be applied prospectively to new arrangements entered into beginning on that date. Early adoption is permitted as of the beginning of a fiscal year. If the new guidance is adopted early in other than the first period of the fiscal year, the guidance must be adopted retrospectively to the beginning of the fiscal year of adoption. Retrospective application to prior years is allowed, but not required. In the initial year of application, certain qualitative and quantitative disclosures about the impact of the adoption are required. The Company has not yet determined the impact of adoption.

In March 2008 the FASB issued Statement of Financial Accounting Standards No. 161, "Disclosures About Derivative Instruments and Hedging Activities ( SFAS 161 ) expanding the disclosure requirements 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 and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. SFAS 161 has subsequently been codified in the FASB Accounting Standards Codification Topic 815 ( ASL 815 ). To meet those objectives, Statement 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. The Company adopted SFAS 161 on January 1, 2009 and it did not have a significant impact on the Company's financial statements.

In June 2009, the FASB issued SFAS 167, *Amendments to FASB Interpretation No. 46(R)*, which is to be included in ASC Topic 810, consolidation. This guidance amends FASB Interpretation No. 46(revised December 2003) to address the elimination of the concept of a qualifying special purpose entity. SFAS 167 also replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. Additionally, SFAS 167 provides more timely and useful information about an enterprise's involvement with a variable interest entity. SFAS 167 will become effective in the first quarter of 2010. We are currently evaluating the impact of this standard on our Consolidated Financial Statements.

## **17. Subsequent Events**

On September 4, 2009 the Company announced it has signed an agreement to acquire the majority of the assets and assume certain liabilities of Bush Hog, LLC ( Bush Hog ), a leader in the design, manufacture, distribution and service of rotary cutters and other agricultural implements and equipment. The purchase consideration was 1.7 million shares of Alamo Group Inc. common stock which, after the closing, would represent approximately 14.5% of the outstanding common stock of Alamo Group. The purchase includes substantially all of the ongoing business of Bush Hog, including the Bush Hog brand name and all related product names and trademarks.

On October 22, 2009, the Company announced it had completed the acquisition of the majority of the assets of Bush Hog. As consideration for the assets acquired, the Company issued 1.7 million unregistered shares of Alamo Group Inc. common stock (\$.10 par value) and assumed certain operating liabilities, though no funded debt.

On November 6, 2009, the Company entered into the Seventh Amendment of the Amended and Restated Revolving Credit Agreement with Bank of America, N.A., Wells Fargo Bank, N.A., BBVA Compass Bank, and Rabobank, as its lenders. Prior to the execution of this Amendment, BBVA Compass Bank acquired certain assets of Guaranty Bank which included this credit facility and JPMorgan Chase Bank assigned its interest to Well Fargo Bank, N.A. The purpose of the amendment was to add Bush Hog as a member of the Obligated Group and pledge a first priority security interest in certain U.S. assets (accounts receivable, inventory, equipment, trademarks and trade names) of the Borrower and each member of the Obligated Group. The Lenders agreed to increase the operating leverage ratio during the next three quarters and to add a new EBIT to Interest Expense covenant in exchange for a commitment fee and an increase in the Applicable Interest Margin over LIBOR or Prime Rate advances.

**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,		September 30,	
	2009	2008	2009	2008
North American				
Industrial	41.3%	43.6%	40.4%	46.0%
Agricultural	18.3%	19.9%	18.9%	21.8%
European	40.4%	36.5%	40.7%	32.2%
Total sales, net	100.0%	100.0%	100.0%	100.0%

(Cost Trends and Profit Margin, as Percentages of Net Sales)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Gross margin	23.3%	19.9 %	21.5 %	19.6 %
Income from operations	6.9%	5.3 %	4.9 %	5.2 %
Income before income taxes	6.2%	4.5 %	4.0%	4.5 %
Net income	4.2%	3.0 %	2.7 %	3.0 %

**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.*

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

During the nine months of 2009, the Company's net income was down due to the general weakness in the worldwide economy. The acquisition of Rivard was accretive to the Company in sales and net income during the nine months of the year. Sales in the Industrial Division were down 33% during the first nine months of 2009 due to budget constraints and revenue shortfalls of governmental entities and related contractors. Higher dollar items such as the excavator and sweeper products were particularly affected. The Agricultural Division also saw a 33% decrease as both dealers and end users were reluctant to make commitments due to the uncertainty in the economy. Excluding the acquisition of Rivard, sales in local currency for the European Division were essentially flat for the nine months of 2009.

The Company remains concerned that our markets for the remainder of 2009 could continue to be negatively affected by a variety of factors such as the downturn in the overall economy; constrained credit availability; increase in governmental regulations, changes in farm incomes due to commodity prices or governmental aid programs; outbreak of the H1N1 virus at one or more of the Company's facilities which could affect our manufacturing capabilities; adverse situations that could affect our customers such as cutback on dealer stocking levels; weather conditions such as droughts and floods; budget constraints or revenue shortfalls in governmental entities to which the Company sells its products and changes in our customer's buying habits due to lack of confidence in the economic outlook.

### Results of Operations

*Three Months Ended September 30, 2009 vs. Three Months Ended September 30, 2008*

Net sales for the third quarter of 2009 were \$110,318,000, a decrease of \$38,389,000 or 25.8% compared to \$148,707,000 for the third quarter of 2008. The decrease was primarily attributable to the decline in the worldwide economy which continued to affect the markets which the Company serves.

Net North American Industrial sales decreased during the third quarter by \$19,256,000 or 29.7% to \$45,547,000 for 2009 compared to \$64,803,000 during the same period in 2008. The majority of the decrease came from lower sales to governmental entities and related contractors of excavator, sweeper and mowing products. Compared to 2008, sales to cities and counties remained steadier than those to state agencies.

Net North American Agricultural sales were \$20,158,000 in 2009 compared to \$29,555,000 for the same period in 2008, a decrease of \$9,397,000 or 31.8%. The decrease was the result of continued soft market conditions and lower commodity prices in the agricultural market. Market uncertainty and tighter credit has made dealers reluctant to stock inventory at historic levels.

Net European Sales for the third quarter of 2009 were \$44,613,000, a decrease of \$9,736,000 or 17.9% compared to \$54,349,000 during the third quarter of 2008. The majority of the decrease was primarily due to softness in French markets as well as changes in the exchange rates.

Gross profit for the third quarter of 2009 was \$25,649,000 (23.3% of net sales) compared to \$29,610,000 (19.9% of net sales) during the same period in 2008, a decrease of \$3,961,000. The decrease was due to decline in sales during the third quarter of 2009. The increase in gross margin percentage was a result of cost saving initiatives implemented earlier in the year along with favorable pricing of raw materials and purchased components.

Selling, general and administrative expense ( SG&A ) was \$17,983,000 (16.3% of net sales) during the third quarter of 2009 compared to \$21,795,000 (14.7% of net sales) during the same period of 2008, a decrease of \$3,812,000. The decrease came from reductions in headcounts despite severance costs along with lower commissions due to reduced sales volume.

Interest expense was \$1,005,000 for the third quarter of 2009 compared to \$2,024,000 during the same period in 2008, a decrease of \$1,019,000. The decrease was from lower borrowings and lower interest rates in 2009 compared to 2008.



Other income (expense) was \$134,000 of income during the third quarter of 2009 compared to \$222,000 of income in the third quarter of 2008. The gains in both 2009 and 2008 are entirely from changes in exchange rates.

Provision for income taxes was \$2,227,000 (32.7% of income before taxes) for the third quarter of 2009 compared to \$2,251,000 (33.6% of income before taxes) in the third quarter of 2008.

The Company's net income after tax was \$4,583,000 or \$.46 per share on a diluted basis for the third quarter of 2009 compared to \$4,453,000 or \$.45 per share on a diluted basis for the third quarter of 2008. The increase of \$130,000 resulted from the factors described above.

*Nine Months Ended September 30, 2009 vs. Nine Months Ended September 30, 2008*

Net sales for the first nine months of 2009 were \$333,704,000, a decrease of \$100,944,000 or 23.2% compared to \$434,648,000 for the first nine months of 2008. The decrease was primarily from continued weakness in the economy which has continued since the fourth quarter of 2008.

Net North American Industrial sales decreased during the first nine months by \$65,129,000 or 32.6% to \$134,737,000 for 2009 compared to \$199,866,000 during the same period in 2008. The decrease was due from lower sales of excavator, vacuum truck, sweeper and mowing equipment as governmental entities continue to be affected by budget constraints and revenue shortfalls.

Net North American Agricultural sales were \$63,263,000 in 2009 compared to \$94,826,000 for the same period in 2008, a decrease of \$31,563,000 or 33.3%. The decrease was mainly due to dealer reluctance to stock farm equipment at historical levels as a result of the slowdown in the agricultural sector and concerns about the overall economy.

Net European Sales for the first nine months of 2009 were \$135,704,000, a decrease of \$4,252,000 or 3.0% compared to \$139,956,000 during the same period of 2008. The decrease was primarily due to changes in exchange rates and softness in the French markets. The *Rivard* acquisition added to sales for the year and to a lesser extent higher export sales outside our core markets.

Gross profit for the first nine months of 2009 was \$71,705,000 (21.5% of net sales) compared to \$85,095,000 (19.6% of net sales) during the same period in 2008, a decrease of \$13,390,000. The decrease was mainly due to reduced sales during 2009, which was somewhat offset by the *Rivard* acquisition. Gross margin percentages improved over 2008 as a result of favorable pricing in both raw material and purchased components and continued improvements from efficiency initiatives.

Selling, general and administrative expense ( SG&A ) were \$55,478,000 (16.6% of net sales) during the first nine months of 2009 compared to \$62,518,000 (14.4% of net sales) during the same period of 2008, a decrease of \$7,040,000. The decrease in SG&A for the nine months of 2009 was due to reductions in workforce despite severance costs, reductions in insurance premiums and audit fees, and reduced commissions from lower sales volumes.

Interest expense was \$3,248,000 for the first nine months of 2009 compared to \$5,748,000 during the same period in 2008, a decrease of \$2,500,000. The decrease was due to reduced borrowings and lower interest rates in 2009.

Other income (expense) was \$130,000 of income during the first nine months of 2009 compared to \$881,000 of income in the first nine months of 2008. The gains in both 2009 and 2008 are entirely from changes in exchange rates.

Provision for income taxes was \$4,328,000 (32.2% of income before taxes) for 2009 compared to \$6,490,000 (33.6% of income before taxes) in 2008.

The Company's net income after tax was \$9,118,000 or \$.91 per share on a diluted basis for the first nine months of 2009 compared to \$12,850,000 or \$1.29 per share on a diluted basis for the first nine months of 2008. The decrease of \$3,732,000 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 in certain of our operations. These sales level the Company's production during the off season.

As of September 30, 2009, the Company had working capital of \$160,232,000 which represents a decrease of \$20,109,000 from working capital of \$180,341,000 as of December 31, 2008. The decrease in working capital was primarily from reductions in current assets, mainly trade receivables from a decrease in sales volume compared to 2008 and lower inventory levels from reduced levels of activity.

Capital expenditures were \$2,661,000 for the first nine months of 2009, compared to \$5,052,000 during the first nine months of 2008. Capital expenditures for 2009 are expected to be below 2008 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 2008 or the nine months of 2009. The authorization to repurchase up to 1,000,000 shares remains available less 42,600 shares previously repurchased.

Net cash used by financing activities was \$36,809,000 during the nine month period ending September 30, 2009, compared to net cash provided of \$10,300,000 for the same period in 2008. The decrease in financing activities in 2009 was from paydowns on the bank credit facility due to cash provided by operating activities.

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., JPMorgan 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 million for the fiscal year ending 2006 and \$10 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 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 October 14, 2008, the Company entered into the Sixth Amendment and Waiver under the Amended and Restated Revolving Credit Agreement. The purpose of the amendment and waiver was to clarify company names within the obligated group after merging or dissolving some subsidiaries, to define operating cash flow and defining quarterly operating cash flow for *Rivard* through March 31, 2009. Beginning June 30, 2009, *Rivard*'s actual operating cash flow will be used in the calculation of consolidated operating cash flow.

On November 6, 2009, the Company entered into the Seventh Amendment of the Amended and Restated Revolving Credit Agreement with Bank of America, N.A., Wells Fargo Bank, N.A., BBVA Compass Bank, and Rabobank, as its lenders. Prior to the execution of this Amendment, BBVA Compass Bank acquired certain assets of Guaranty Bank which included this credit facility and JPMorgan Chase Bank assigned its interest to Well Fargo Bank, N.A. The purpose of the amendment was to add Bush Hog as a member of the Obligated Group and pledge a first priority security interest in certain U.S. assets (accounts receivable, inventory, equipment, trademarks and trade names) of the Borrower and each member of the Obligated Group. The Lenders agreed to increase the operating leverage ratio during the next three quarters and to add a new EBIT to Interest Expense covenant in exchange for a commitment fee and an increase in the Applicable Interest Margin over LIBOR or Prime Rate advances.

On May 13, 2008, Alamo Group Europe Limited entered into a £5.5 million overdraft facility with Lloyd's TSB Bank plc. The facility expires on October 31, 2009 and is in the process of being renewed. Outstandings 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, 2009, there was no outstanding balance borrowed against the U.K. overdraft facility.

As of September 30, 2009, there was \$59,000,000 borrowed under the Revolving Credit Facility. At September 30, 2009, \$917,000 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 \$42,000,000 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, 2009, 1,233,000 Euros were borrowed against the French line of credit, 2,593,000 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.

As of September 30, 2009, the Company was in compliance with the terms and conditions of its credit facilities.

Management believes the bank credit facilities and the Company's ability to internally generate funds from operations should be sufficient to meet the Company's cash requirements for the foreseeable future. However, the challenges affecting the banking industry and credit markets in general can potentially cause changes to credit availability which creates a level of uncertainty.

### **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.

## **Critical Accounting Policies**

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.

### *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 agings 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 U.S. operations have Uniform Commercial Code (UCC) filings on practically all wholegoods each dealer 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. This also allows Alamo Group to maintain a reserve over its cost which usually represents the margin on the original sales price.

The bad debt reserve balance was \$2,506,000 at September 30, 2009 and \$2,430,000 at December 31, 2008.

#### ***Sales Discounts***

At September 30, 2009 the Company had \$3,957,000 in reserves for sales discounts compared to \$6,849,000 at December 31, 2008 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 2010. 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 \$8,829,000 at September 30, 2009 and \$8,978,000 at December 31, 2008 in reserve to cover obsolescence and slow moving inventory. The decrease in reserve for obsolescence was mainly due to inventory written off in the Company's European operations. 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, though some products or components may have extended terms.

Warranty reserve, as a percent of sales, is calculated by taking the current twelve months of expenses and prorating that based on twelve months of sales with a six month lag period. The Company's historical experience is that a customer takes approximately ninety days to six 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 \$5,186,000 at September 30, 2009 and \$5,409,000 at December 31, 2008. The majority of the decrease came from lower reserves in the Company's U.S. Industrial Division. The Company has a long-term liability for extended warranty policies sold to customers in the amount of \$299,000 at September 30, 2009 and \$331,000 at December 31, 2008 with a life expectancy of 1 to 5 years.

***Product Liability***

At September 30, 2009 the Company had accrued \$387,000 in reserves for product liability cases compared to \$85,000 at December 31, 2008. The Company accrues primarily on a case by case basis and adjusts the balance quarterly.

During most of 2009, the self insured retention (S.I.R.) for U.S. product liability coverage for all products was at \$100,000 per claim. On September 30, 2009 the Company renewed its insurance coverage and the S.I.R. for all 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.

### **Goodwill**

Under ASC 350, Intangible-Goodwill and Other, goodwill is no longer amortized; however, it must be tested for impairment at least annually. In the fourth quarter of each year, or when events and circumstances warrant such a review, the Company tests the goodwill of all of its reporting units for impairment. The goodwill impairment test is determined using a two-step process. The first step is to identify if a potential impairment exists by comparing the fair value of a reporting unit with its carrying amount, including goodwill (Step 1). If the fair value of a reporting unit exceeds its carrying value amount, goodwill of the reporting unit is not considered to have a potential impairment and the second step is not necessary. However, if the carrying amount of the reporting unit exceeds its fair value, the second step (Step 2) is performed to determine if goodwill is impaired and to measure the amount of impairment loss to recognize, if any. Step 2 compares the implied fair value of goodwill with the carrying amount of goodwill. If the implied value of goodwill is less than the carrying amount of goodwill, then a charge is recorded to reduce goodwill to the implied goodwill. The implied goodwill is calculated based on a hypothetical purchase price allocation similar to the requirements of Statement of Financial Accounting Standards No.141R, Business Combinations, in that it takes the implied fair value of the reporting unit and allocates such fair value to the fair value of the assets and liabilities of the reporting unit.

The Company estimated the fair value of its reporting units using various valuation techniques, with one technique being a discounted cash flow analysis. This analysis requires the Company to make significant assumptions and estimates about the extent and timing of future cash flows, discount rates and growth rates. The cash flows are estimated over a significant future period of time, which makes those estimates and assumptions subject to an even higher degree of uncertainty. The Company also utilizes market valuation models and other financial ratios, which require the Company to make certain assumptions and estimates regarding the applicability of those models to its assets and businesses. The Company believes that the assumptions and estimates used to determine the estimated fair values of each of its reporting units are reasonable. However, different assumptions could materially affect the estimated fair value. The Company recognized goodwill impairment of \$5,010,000 in the Agricultural segment in 2008. No goodwill impairment was recorded in 2007 or 2006. As of September 30, 2009, the Company had \$49,449,000 of goodwill, which represents 14% of total assets.

Management believes that the valuations arrived at are reasonable and consistent with what other marketplace participants would currently use in valuing the Company s components. However, management cannot give any assurance that market values will not change in the future. For example, if higher discount rates are demanded by the market increase, this could lead to a reduction under the income approach. If the Company s projections are not achieved in the future, this could lead management to reassess their assumptions and lead to a reduction under the income approach. If the current market price of the Company s stock decreases, this could cause the Company to reassess the reasonableness of the control premium, which might cause management to assume a higher discount rate under the income approach. If future similar transactions exhibit lower multiples than those observed in the past, this could lead to a reduction under the similar transactions approach. The Company s next regularly scheduled annual impairment test is scheduled for the year ending December 31, 2009, however if there are further triggering events, the Company may be required to perform additional testing at other dates.

**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.

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 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, 2009, the Company had \$3,041,000 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 \$456,000. 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, 2009, 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 \$3,781,000 for the period ending September 30, 2009. 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 \$3,769,000 for the period ended September 30, 2008. 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 third quarter of 2009 was a gain of \$2,568,000. On September 30, 2009, the British pound closed at .6258 relative to 1.00 U.S. dollar, and the Euro dollar closed at .6833 relative to 1.00 U.S. dollar. At December 31, 2008 the British pound closed at .6853 relative to 1.00 U.S. dollar and the Euro dollar closed at .7159 relative to 1.00 U.S. dollar. By comparison, 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. 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 2009 average interest rate under these borrowings, the Company's interest expense would have changed by approximately \$885,000. 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

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

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.

**PART II. OTHER INFORMATION**

**Item 1. - None**

**Item 2. - Unregistered Sales of Equity Securities and Use of Proceeds.**

On October 22, 2009, Alamo Group Inc. (the Company) completed the acquisition of the majority of the assets of Bush Hog, LLC ( Bush Hog ) according to the terms and conditions of an Asset Purchase Agreement, dated September 4, 2009, between the Company and Bush Hog. As consideration for the assets acquired, the Company issued 1.7 million unregistered shares of Alamo Group Inc. common stock (\$.10 par value) and assumed certain operating liabilities, though no funded debt. The shares of common stock were issued to Bush Hog without registration under the Securities Act of 1933 (the Securities Act) in reliance on an exemption provided by Section 4(2) of the Securities Act.

**Item 3. - None**

**Item 4. - None**

**Item 5. Other Information**

(a) Reports on Form 8-K

September 4, 2009 - Press Release announcing, the signing of an agreement to acquire the majority of the assets and assume certain liabilities of Bush Hog LLC



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

September 9, 2009 Asset Purchase Agreement dated September 4, 2009, with Bush Hog, LLC

October 22, 2009 Press Release announcing completion of Bush Hog LLC acquisition

November 4, 2009 Press Release announcing third quarter fiscal 2009 earnings

### (b) Other Information

None

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

### (a) Exhibits

10.1	Seventh Amendment of Amended and Restated Revolving Credit Agreement dated November 5, 2009.	Filed Herewith
31.1	Certification by Ronald A. Robinson under Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
31.2	Certification by Dan E. Malone under Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
31.3	Certification by Richard J. Wehrle under Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
32.1	Certification by Ronald A. Robinson under Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
32.2	Certification by Dan E. Malone under Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
32.3	Certification by Richard J. Wehrle under Section 906 of the Sarbanes-Oxley Act of 2002	Filed 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 & 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)

