

ALAMO GROUP INC  
Form 10-Q  
August 10, 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 JUNE 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 AUGUST 1, 2009, 10,046,929 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 Consolidated Financial Statements
	<u>Interim Consolidated Balance Sheets</u> 3
	June 30, 2009 (Unaudited) and December 31, 2008 (Audited)
	<u>Interim Consolidated Statements of Income</u> 4
	Three months and Six months ended June 30, 2009 and June 30, 2008
	<u>Interim Consolidated Statements of Cash Flows</u> 5
	Six months ended June 30, 2009 and June 30, 2008
	<u>Notes to Interim Consolidated Financial Statements</u> 6
Item 2.	<u>Management's Discussion and Analysis of Financial Condition</u> 15
	and Results of Operations
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risks</u> 23
Item 4.	<u>Controls and Procedures</u> 24
PART II.	OTHER INFORMATION 24

- Item 1. None
- Item 2. None
- Item 3. None
- Item 4. None
- Item 5. Other Information
- Item 6. Exhibits

SIGNATURES

## Alamo Group Inc. and Subsidiaries

### Interim Consolidated Balance Sheets

(in thousands, except share amounts)	<b>June 30,</b>	
	<b>2009</b>	<b>December 31, 2008</b>
	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,074	\$ 4,532
Accounts receivable, net	124,733	124,197
Inventories	125,114	132,248
Deferred income taxes	2,646	2,671
Prepaid expenses	3,108	2,377
Total current assets	261,675	266,025
Property, plant and equipment	128,486	125,952
Less: Accumulated depreciation	(68,124)	(64,168)
	60,362	61,784
Goodwill	48,696	48,107
Intangible assets	3,942	3,982
Deferred income taxes	2,463	2,463
Assets held for sale	426	291
Other assets	1,309	1,702
Total assets	\$ 378,873	\$ 384,354
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Trade accounts payable	\$ 45,308	\$ 54,598
Income taxes payable	1,971	841
Accrued liabilities	28,755	26,059
Current maturities of long-term debt	3,913	4,186
Total current liabilities	79,947	85,684

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Long-term debt, net of current maturities	91,257	99,884
Deferred pension liability	8,651	8,682
Other long-term liabilities	4,422	5,139
Deferred income taxes	940	653
Stockholders' equity:		
Common stock, \$.10 par value, 20,000,000 shares authorized;		
10,053,754 and 9,964,529 issued and outstanding at June 30, 2009 and December 31, 2008	1,005	996
Additional paid-in capital	56,724	55,683
Treasury stock, at cost; 42,600 shares at June 30, 2009 and December 31, 2008	(426)	(426)
Retained earnings	135,405	132,064
Accumulated other comprehensive income	948	(4,005)
Total stockholders' equity	193,656	184,312
Total liabilities and stockholders' equity	\$ 378,873	\$ 384,354

See accompanying notes.

## Alamo Group Inc. and Subsidiaries

### Interim Consolidated Statements of Income

(Unaudited)

(in thousands, except per share amounts)	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net sales:				
North American				
Industrial	\$ 46,038	\$ 72,452	\$ 89,190	\$ 135,063
Agricultural	19,274	32,768	43,105	65,271
European	47,931	46,940	91,091	85,607
Total net sales	113,243	152,160	223,386	285,941
Cost of sales	88,914	121,656	177,330	230,456
Gross profit	24,329	30,504	46,056	55,485
Selling, general and administrative expense	18,945	21,104	37,495	40,723
Income from operations	5,384	9,400	8,561	14,762
Interest expense	(1,147)	(1,889)	(2,243)	(3,724)
Interest income	162	529	322	939
Other income (expense), net	(49)	408	(4)	659
Income before income taxes	4,350	8,448	6,636	12,636
Provision for income taxes	1,358	2,883	2,101	4,239
Net income	\$ 2,992	\$ 5,565	\$ 4,535	\$ 8,397
Net income per common share:				
Basic	\$ 0.30	\$ 0.57	\$ 0.46	\$ 0.86
Diluted	\$ 0.30	\$ 0.56	\$ 0.45	\$ 0.84
Average common shares				
Basic	9,977	9,799	9,958	9,798
Diluted	9,986	9,957	9,975	9,939
Dividends declared	\$ 0.06	\$ 0.06	\$ 0.12	\$ 0.12



See accompanying notes.

# Alamo Group Inc. and Subsidiaries

## Interim Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	Six Months Ended	
	June 30, 2009	2008
<b>Operating Activities</b>		
Net income	\$ 4,535	\$ 8,397
Adjustment to reconcile net income to net cash provided (used) by operating activities:		
Provision for doubtful accounts	193	82
Depreciation	4,053	4,598
Amortization	39	52
Stock-based compensation expense	253	322
Excess tax benefits from stock-based payment arrangements	(15)	(42)
Provision for deferred income tax benefit	338	201
Gain on sale of equipment	(27)	(110)
Changes in operating assets and liabilities:		
Accounts receivable	1,794	(29,756)
Inventories	8,564	(660)
Prepaid expenses and other assets	(99)	359
Trade accounts payable and accrued liabilities	(7,628)	15,428
Income taxes payable	883	1,098
Other long term liabilities	(440)	(1,074)
Net cash provided (used) by operating activities	12,443	(1,105)
<b>Investing Activities</b>		
Acquisitions, net of cash acquired		(22,184)
Purchase of property, plant and equipment	(1,852)	(3,594)
Proceeds from sale of property, plant and equipment	65	170
Net cash provided (used) by investing activities	(1,787)	(25,608)
<b>Financing Activities</b>		
Net change in bank revolving credit facility	(8,000)	24,000
Principal payments / proceeds on long-term debt and capital leases	(1,439)	(649)
Proceeds from issuance of long term debt	545	2,720

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Dividends paid	(1,194)	(1,176)
Proceeds from sale of common stock	797	223
Excess tax benefits from stock-based payment arrangements	15	42
Net cash provided (used) by financing activities	(9,276)	25,160
Effect of exchange rate changes on cash	162	428
Net change in cash and cash equivalents	1,542	(1,125)
Cash and cash equivalents at beginning of the period	4,532	4,459
Cash and cash equivalents at end of the period	\$ 6,074	\$ 3,334
Cash paid during the period for:		
Interest	\$ 2,538	\$ 3,798
Income taxes	\$ 1,958	\$ 2,227

See accompanying notes.

**Alamo Group Inc. and Subsidiaries**

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

**June 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 the recently issued Statement of Financial Standards No. (SFAS) 165, Subsequent Events, the Company evaluated subsequent events after the balance sheet date of June 30, 2009 through August 7, 2009 and had nothing to disclose.

**2. Acquisitions**

The acquisition described below was accounted for as a business combination 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 company are included with the Company's results of operations since acquisition date.

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 €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 (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)	Six Months Ended	
	June 30, 2009	2008
Net Sales	\$ 223,386	\$ 311,774
Net Income	\$ 4,535	\$ 10,049
Diluted Earnings per Share	\$ 0.45	\$ 1.01

### 3. Accounts Receivable

Accounts Receivable is shown less allowance for doubtful accounts of \$2,393,000 and \$2,430,000 at June 30, 2009 and December 31, 2008, respectively.

#### 4. Inventories

Inventories are valued at last in first out (LIFO) cost represented 56% and 57% of total inventory at June 30, 2009 and December 31, 2008, respectively. The excess of current costs over LIFO valued inventories were \$12,791,000 at June 30, 2009 and December 31, 2008. Inventory obsolescence reserves were \$8,553,000 at June 30, 2009 and \$8,978,000 at December 31, 2008. Net inventories consist of the following:

	<b>June 30,</b>	<b>December 31,</b>
(in thousands)	<b>2009</b>	<b>2008</b>
Finished goods	\$ 102,872	\$ 104,819
Work in process	11,738	16,247
Raw materials	10,504	11,182
	<b>\$ 125,114</b>	<b>\$ 132,248</b>

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 on management's estimates.

#### 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 June 30, 2009, the Company had \$87 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 which expires in 2010 and fixes the LIBOR base rate at 4.910% covering \$20 million of this debt. The other has a four year term which expires in 2011 and fixes 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 June 30, 2009, was a \$1,899,000 liability. This is included in Other long-term liabilities with an offset in Accumulated other comprehensive income, net of taxes. At June 30, 2009, 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 \$1,899,000 as of June 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 \$85,000 as of June 30, 2009.

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

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



**Six Months  
Ended**

June 30,

2009

2008

Dividends declared	\$ 0.12	\$ 0.12
Dividends paid	\$ 0.12	\$ 0.12

**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 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 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 is 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 \$253,000 and \$322,000 for the six months ended June 30, 2009 and 2008, 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.

There were 192,000 shares granted during the second quarter of 2009 and 39,000 shares granted in the second 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 six months ending June 30, 2009*

	Shares	Exercise Price*
Options outstanding at beginning of year	253,980	
Granted	99,000	\$11.45
Exercised		
Cancelled		
Options outstanding at June 30, 2009	352,980	\$17.92
Options exercisable at June 30, 2009	159,780	\$18.77
Options available for grant at June 30, 2009	208,000	

*\*Weighted Averages*

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

Qualified Stock Options	Options Outstanding			Options Exercisable	
	Shares	Remaining Contractual Life(yrs)*	Exercise Price*	Shares	Exercise Price*
Range of Exercise Price					
\$11.45 - \$17.85	159,980	7.77	\$ 12.29	60,980	\$ 13.65
\$19.79 - \$25.18	193,000	7.44	\$ 22.58	98,800	\$ 21.93
Total	352,980			159,780	

*\*Weighted Averages*

*Non-qualified Options*

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

*For six months ending June 30, 2009*

	Shares	Exercise Price*
Options outstanding at beginning of year	226,000	
Granted	93,000	
Exercised	(89,225)	\$8.9375
Cancelled		
Options outstanding at June 30, 2009	229,775	\$ 13.58
Options exercisable at June 30, 2009	114,275	\$ 13.18
Options available for grant at June 30, 2009	367,000	

\*Weighted Averages

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

Non-Qualified Stock Options	Options Outstanding			Options Exercisable	
	Remaining	Contractual	Exercise	Exercise	Exercise
	Shares	Life(yrs)*	Price*	Shares	Price*
Range of Exercise Price					
\$8.9375 - \$12.10	183,775	6.00	\$11.16	90,775	\$10.85
\$13.96 - \$19.79	13,500	5.26	\$18.71	10,500	\$18.40
\$25.02 - \$25.18	32,500	7.92	\$25.17	13,000	\$25.17
Total	229,775			114,275	

\*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.

**Three Months Ended**

Six Months Ended

Edgar Filing: ALAMO GROUP INC - Form 10-Q

(In thousands, except per share amounts)	June 30,		Six Months Ended	
	2009	2008	June 30, 2009	2008
Net Income	\$ 2,992	\$ 5,565	\$ 4,535	\$ 8,397
Average Common Shares:				
Basic (weighted-average outstanding shares)	9,977	9,799	9,958	9,798
Dilutive potential common shares from stock				
options	9	158	17	141
Diluted (weighted-average outstanding shares)	9,986	9,957	9,975	9,939
Basic earnings per share	\$ 0.30	\$ 0.57	\$ 0.46	\$ 0.86
Diluted earnings per share	\$ 0.30	\$ 0.56	\$ 0.45	\$ 0.84

**10. Segment Reporting**

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

(In thousands)	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Net Revenue</b>				
Industrial	\$ 46,038	\$ 72,452	\$ 89,190	\$ 135,063
Agricultural	19,274	32,768	43,105	65,271
European	47,931	46,940	91,091	85,607
Consolidated	113,243	152,160	223,386	285,941
<b>Income from Operations</b>				
Industrial	\$ 576	\$ 4,424	\$ (532)	\$ 5,926
Agricultural	219	1,193	1,460	2,105
European	4,589	3,783	7,633	6,731
Consolidated	5,384	9,400	8,561	14,762
<b>Goodwill</b>				
Industrial	\$ 26,895	\$ 27,331	\$ 26,895	\$ 27,331
Agricultural		5,760		5,760
European	21,801	25,566	21,801	25,566
Consolidated	48,696	58,657	48,696	58,657
<b>Total Identifiable Assets</b>				
Industrial	\$ 160,887	\$ 180,158	\$ 160,887	\$ 180,158
Agricultural	80,779	91,920	80,779	91,920
European	137,207	154,758	137,207	154,758
Consolidated	378,873	426,836	378,873	426,836

**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		Six Months Ended	
	June 30, 2009	2008	June 30, 2009	2008
Net Income	\$ 2,992	\$ 5,565	\$ 4,535	\$ 8,397
Cash flow derivatives, net of taxes	173	704	334	(3)
Amortization of actuarial net gain	39	(20)	78	(40)
Foreign currency translation adjustment	8,371	483	4,541	2,002
Comprehensive Income	\$ 11,575	\$ 6,732	\$ 9,488	\$ 10,356

The components of Accumulated Other Comprehensive Income as shown on the Balance Sheet, are as follows:

(in thousands)	June 30, 2009	December 31, 2008
Foreign currency translation	\$ 6,046	\$ 1,553
Derivatives, net of taxes	(1,178)	(1,560)
Actuarial gains related to defined benefit plans	(3,920)	(3,998)
Total Accumulated other comprehensive income	\$ 948	\$ (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 December 31, 2008, 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



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

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 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 June 30, 2009 and 2008, respectively. The Company is required to contribute \$496,000 to the pension plans for 2009.

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

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. The balance at June 30, 2009 was \$456,000. The impact to the Interim Consolidated Statements of Income was zero in the second quarter of 2009 and 2008.

#### **16. Recent Accounting Pronouncements**

Net Revenue

Statement of Financial Accounting Standards No. 141, "Business Combinations (Revised 2007)." Statement 141(R) ) 141R replaces Statement of Financial Accounting Standards No. 141, "Business Combinations," ( Statement 141 ) and applies to all transactions and other events in which one entity obtains control over one or more other businesses. Statement 141(R) 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 Statement 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. Statement 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 Statement 141. Under Statement 141(R), the requirements of Statement of Financial Accounting Standards No. 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 Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies." Statement 141(R) is expected to have a significant impact on the Company's accounting for business combinations closing on or after January 1, 2009.

Statement of Financial Accounting Standards No. 160, "Non-controlling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51." ( Statement 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. Statement 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, Statement 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. Statement 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.

Statement of Financial Accounting Standards No. 161, "Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133." ( Statement 161 ) amends Statement of Financial Accounting No. 133, "Accounting for Derivative Instruments and Hedging Activities," ( Statement 133 ) to amend and expand the disclosure requirements of Statement 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 Statement 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, 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. Statement 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.

In April 2009, the FASB issued three related Staff Positions: (i) FSP 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly. (ii) FSP 115-2 and FSP 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, and (iii) FSP 107 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, which will be effective for interim and annual periods ending after June 15, 2009. FSP 157-4 provides guidance on how to determine the fair value of assets and liabilities under SFAS 157 in the current economic environment and reemphasizes that the objective of a fair value measurement remains an exit price. If we were to conclude that there has been a significant decrease in the volume and level of activity of the asset or liability in relation to normal market activities, quoted market values may not be representative of fair value and we may conclude that a change in valuation technique or the use of multiple valuation techniques may be appropriate. FSP 115-2 and FSP 124-2 modify the requirements for recognizing other-than-temporarily impaired debt securities and revise the existing impairment model for such securities, by modifying the current intent and ability indicator in determining whether a debt security is other-than-temporarily impaired. FSP 107 and APB 28-1 enhance the disclosure of instruments under the scope of SFAS 157 for both interim and annual periods. This statement did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position No. SFAS 107-1 and APB No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, which requires quarterly disclosure of information about the fair value of financial instruments within the scope of SFAS 107, *Disclosures about Fair Value of Financial Instruments*. FSP SFAS 107-1 and APB 28-1 has an effective date requiring adoption by the second quarter of 2009 with early adoption permitted. We adopted the provisions of FSP SFAS 107-1 and APB 28-1 in the second quarter. This statement did not have a material impact on our consolidated financial statements.

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

In May 2009, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 165, Subsequent Events ( SFAS No. 165 ). SFAS No. 165 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. SFAS No. 165 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 is effective for 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 August 10, 2009.

In June 2009, the FASB issued SFAS 167, *Amendments to FASB Interpretation No. 46(R)*, which 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.

In June 2009, the 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 nonauthoritative 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 will be effective for interim or annual periods ending after September 15, 2009. We do not expect this statement to have a material impact on our consolidated 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 data:

As Percentages of Net Sales	Three Months Ended				Six Months Ended			
	June 30, 2009		2008		June 30, 2009		2008	
North American								
Industrial	40.7	%	47.6	%	39.9	%	47.2	%
Agricultural	17.0	%	21.5	%	19.3	%	22.8	%
European	42.3	%	30.9	%	40.8	%	30.0	%
Total sales, net	100.0	%	100.0	%	100.0	%	100.0	%

Cost Trends and Profit Margin, as Percentages of Net Sales	Three Months Ended		Six Months Ended	
	June 30, 2009		June 30, 2008	
Net Revenue				

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

Gross profit	21.5	%	20.0	%	20.6	%	19.4	%
Income from operations	4.8	%	6.2	%	3.8	%	5.2	%
Income before income taxes	3.8	%	5.6	%	3.0	%	4.4	%
Net income	2.6	%	3.7	%	2.0	%	2.9	%

### 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.*

During the first six months of 2009, the Company's net income was down due to the general weakness in the worldwide economy. The acquisition of Rivard continued to be accretive to the Company in sales and net income during both the second quarter and the first half of the year. Sales in the Industrial Division were down 34% during the first six months of 2009 due to budget 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 34% 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 up 3% for the first half of 2009 primarily due to export sales outside of its principal markets and aggressive marketing initiatives.

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; adverse situations that could affect our customers such as animal disease epidemics; 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 June 30, 2009 vs. Three Months Ended June 30, 2008*

Net sales for the second quarter of 2009 were \$113,243,000, a decrease of \$38,917,000, or 25.6% compared to \$152,160,000 for the second quarter of 2008. The decrease was primarily attributable to the decline in the economy which continued to affect the markets which the Company serves.

Net North American Industrial sales decreased during the second quarter by \$26,414,000 or 36.5% to \$46,038,000 for 2009 compared to \$72,452,000 during the same period in 2008. The decrease came primarily from lower sales of excavators, sweepers and mowing equipment to governmental entities and related contractors. Sales to cities and counties were steadier compared to 2008.

Net North American Agricultural sales were \$19,274,000 in 2009 compared to \$32,768,000 for the same period in 2008, a decrease of \$13,494,000 or 41.2%. The decrease was mainly due to continued soft market conditions in the agricultural market as dealers and end users were reluctant to buy at historical levels due to market uncertainty and tighter credit.



Net European Sales for the second quarter of 2009 were \$47,931,000, an increase of \$991,000 or 2.1% compared to \$46,940,000 during the second quarter of 2008. The increase was primarily from the acquisition of *Rivard* which was partially offset by changes in the exchange rates.

Gross profit for the second quarter of 2009 was \$24,329,000 (21.5% of net sales) compared to \$30,504,000 (20.0% of net sales) during the same period in 2008, a decrease of \$6,175,000. The increase in gross margin percentage was a result of favorable pricing of raw materials and purchased components, plus cost savings initiatives despite the affects of lower sales volume.

Selling, general and administrative expense ( SG&A ) was \$18,945,000 (16.7% of net sales) during the second quarter of 2009 compared to \$21,104,000 (13.9% of net sales) during the same period of 2008, a decrease of \$2,159,000. The Company continued to adjust its workforce during the quarter with reductions in headcounts along with lower commissions due to reduced sales volumes.

Interest expense was \$1,147,000 for the second quarter of 2009 compared to \$1,889,000 during the same period in 2008, a decrease of \$742,000. The decrease was from reduced borrowings and lower interest rates in 2009 compared to 2008.

Other income (expense), net was \$49,000 of expense during the second quarter of 2009 compared to \$408,000 of income in the second quarter of 2008. The amount in the second quarters of 2009 and 2008 are all from changes in exchange rates.

Provision for income taxes was \$1,358,000 (31.2%) in the second quarter of 2009 compared to \$2,883,000 (34.1%) during the same period in 2008.

The Company's net income after tax was \$2,992,000 or \$.30 per share on a diluted basis for the second quarter of 2009 compared to \$5,565,000 or \$.56 per share on a diluted basis for the second quarter of 2008. The decrease of \$2,573,000 resulted from the factors described above.

*Six Months Ended June 30, 2009 vs. Six Months Ended June 30, 2008*

Net sales for the first six months of 2009 were \$223,386,000, a decrease of \$62,555,000 or 21.9% compared to \$285,941,000 for the first six months of 2008. The decrease was primarily from the continued weakness in the worldwide economy which has continued since the fourth quarter of 2008.

Net North American Industrial sales decreased during the first six months by \$45,873,000 or 34.0% to \$89,190,000 for 2009 compared to \$135,063,000 during the same period in 2008. The decrease was due from lower sales in the excavator, vacuum truck, sweepers and mowing equipment as governmental authorities, particularly at the state level, continue to be affected by budget shortfalls.

Net North American Agricultural sales were \$43,105,000 in 2009 compared to \$65,271,000 for the same period in 2008, a decrease of \$22,166,000 or 34.0%. 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 six months of 2009 were \$91,091,000, an increase of \$5,484,000 or 6.4% compared to \$85,607,000 during the same period of 2008. The increase was mainly from the *Rivard* acquisition and export sales outside principal markets in Western Europe. This was partially offset by changes in the exchange rates.

Gross profit for the first six months of 2009 was \$46,056,000 (20.6% of net sales) compared to \$55,485,000 (19.4% of net sales) during the same period in 2008, a decrease of \$9,429,000. The decrease was mainly from reduced sales

during the first half of 2009, which was offset by the Rivard acquisition. Gross margin percentages improved over 2008 as a result of continued improvements from efficiency initiatives in our product lines, along with favorable pricing in both raw material and purchased components.

Selling, general and administrative expenses ( SG&A ) were \$37,495,000 (16.8% of net sales) during the first six months of 2009 compared to \$40,723,000 (14.2% of net sales) during the same period of 2008, a decrease of \$3,228,000. The decrease in SG&A for the first six months of 2009 was due to reductions in workforce, savings in audit fees and insurance premiums, reduced commissions on lower sales volumes along with other cost savings initiatives.

Interest expense was \$2,243,000 for the first six months of 2009 compared to \$3,724,000 during the same period in 2008, a decrease of \$1,481,000. The decrease was due to reduced borrowings and lower interest rates in the first half of 2009.

Other income (expense), net was \$4,000 of expense during the first six months of 2009 compared to \$659,000 of income in the first six months of 2008. The expense in 2009 and the income in 2008 were entirely from changes in exchange rates.

Provision for income taxes was \$2,101,000 (31.7%) in the first six months of 2009 compared to \$4,239,000 (33.5%) during the same period in 2008.

The Company's net income after tax was \$4,535,000 or \$0.45 per share on a diluted basis for the first six months of 2009 compared to \$8,397,000 or \$0.84 per share on a diluted basis for the first six months of 2008. The decrease of \$3,862,000 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 June 30, 2009, the Company had working capital of \$181,728,000 which represents an increase of \$1,387,000 from working capital of \$180,341,000 as of December 31, 2008. The increase in working capital was primarily from reductions of current liabilities, mainly trade payables, as the Company reduced purchases for both inventory and expenses compared to 2008 levels.

Capital expenditures were \$1,852,000 for the first six months of 2009, compared to \$3,594,000 during the first six 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 first half of 2009. The authorization to repurchase up to 1,000,000 shares remains available less 42,600 shares previously repurchased.

Net cash use by financing activities was \$9,276,000 during the six month period ending June 30, 2009, compared to net cash provided of \$25,160,000 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 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, 2008 and 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 June 30, 2009, there was no outstanding balance borrowed against the U.K. overdraft facility.

As of June 30, 2009, there was \$87,000,000 borrowed under the Revolving Credit Facility. At June 30, 2009, \$900,000 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 \$21,000,000 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 June 30, 2009, 1,442,000 Euros were borrowed against the French line of credit, 1,573,000 Canadian dollars were outstanding on the Canadian line of credit and 100,000 Australian dollars were outstanding under its facility. The Canadian and Australian revolving credit facilities are guaranteed by the Company.

As of June 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 \$2,393,000 at June 30, 2009 and \$2,430,000 at December 31, 2008.

*Sales Discounts*

At June 30, 2009 the Company had \$7,751,000 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 increase was due primarily from 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 2009. 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*



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

The Company had \$8,553,000 at June 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 \$5,069,000 at June 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 \$284,000 at June 30, 2009 and \$331,000 at December 31, 2008 with a life expectancy of 1 to 5 years.

#### ***Product Liability***

At June 30, 2009 the Company had accrued \$253,000 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 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.

#### ***Goodwill***

Under Statement of Financial Accounting Standards No.142, Goodwill and Other Intangible Assets, 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 June 30, 2009, the Company

had \$48,696,000 of goodwill, which represents 13% 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 six months. As of June 30, 2009, the Company had \$3,470,000 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 \$520,000. 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 June 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 \$2,476,000 for the period ending June 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 \$2,359,000 for the period ended June 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

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

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 2009 was a gain of \$8,371,000. On June 30, 2009, the British pound closed at .6078 relative to 1.00 U.S. dollar, and the Euro closed at .7128 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 closed at .7159 relative to 1.00 U.S. dollar. By comparison, on June 30, 2008, the British pound closed at .5020 relative to 1.00 U.S. dollar, and the Euro closed at .6352 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 \$870,000. 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.

## PART II. OTHER INFORMATION

Item 1. - None

Item 2 - None

Item 3 - None

Item 4 - None

Item 5. Other Information

Forward-Looking Information



(a) Reports on Form 8-K

August 5, 2009 Press Release announcing second quarter fiscal 2009 earnings

(b) Other Information

None

**Item 6. Exhibits**

**Item 6. Exhibits**

(a) Exhibits

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

## 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 & Chief Executive Officer

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

/s/Richard J. Wehrle

Edgar Filing: ALAMO GROUP INC - Form 10-Q

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

25