

ALAMO GROUP INC
Form 10-Q
November 05, 2010

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, 2010

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.

Edgar Filing: ALAMO GROUP INC - Form 10-Q

(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, 2010, 11,810,379 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, 2010 and December 31, 2009 | 3 |
| <u>Interim Condensed Consolidated Statements of Income</u> Three months and Nine months ended September 30, 2010 and September 30, 2009 | 4 |
| <u>Interim Condensed Consolidated Statements of Cash Flows</u> Nine months ended September 30, 2010 and September 30, 2009 | 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> | 23 |
| Item 4. <u>Controls and Procedures</u> | 24 |
| PART II. <u>OTHER INFORMATION</u> | 25 |
| Item 1. None | |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | |
| Item 3. None | |
| Item 4. None | |

Item 5.

Other Information

Item 6.

Exhibits and Reports on Form 8-K

SIGNATURES

Alamo Group Inc. and Subsidiaries

Interim Condensed Consolidated Balance Sheets

(Unaudited)

| (in thousands, except share amounts) | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$24,382 | \$ 17,774 |
| Accounts receivable, net | 127,610 | 112,309 |
| Inventories | 104,433 | 124,622 |
| Deferred income taxes | 2,232 | 3,118 |
| Prepaid expenses | 3,343 | 3,579 |
| Income Tax Receivables | 1,195 | 1,195 |
| Total current assets | 263,195 | 262,597 |
| Property, plant and equipment | 139,784 | 141,644 |
| Less: Accumulated depreciation | (76,896) | (72,162) |
| | 62,888 | 69,482 |
| Goodwill | 34,598 | 35,207 |
| Intangible assets | 5,744 | 5,803 |
| Deferred income taxes | 2,899 | 4,158 |
| Other assets | 971 | 1,201 |
| Total assets | \$370,295 | \$ 378,448 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Trade accounts payable | 46,195 | 36,786 |
| Income taxes payable | 244 | 2,688 |
| Accrued liabilities | 32,684 | 31,010 |
| Current maturities of long-term debt | 2,512 | 5,453 |
| Deferred income tax | 866 | 3,164 |
| Total current liabilities | 82,501 | 79,101 |
| Long-term debt, net of current maturities | 23,122 | 44,336 |
| Deferred pension liability | 6,355 | 7,640 |
| Other long-term liabilities | 2,348 | 3,665 |
| Deferred income taxes | 6,452 | 7,581 |

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Stockholders' equity:

Common stock, \$.10 par value, 20,000,000 shares authorized;

| | | |
|--|----------------|----------------|
| 11,852,979 and 11,789,529 issued and outstanding at September 30, 2010 and December 31, 2009, respectively | 1,185 | 1,179 |
| Additional paid-in capital | 83,906 | 82,721 |
| Treasury stock, at cost; 42,600 shares at September 30, 2010 and December 31, 2009 | (426) | (426) |
| Retained earnings | 162,400 | 147,504 |
| Accumulated other comprehensive income | 2,452 | 5,147 |
| Total stockholders' equity | 249,517 | 236,125 |
| Total liabilities and stockholders' equity | \$370,295 | \$ 378,448 |

See accompanying notes.

Alamo Group Inc. and Subsidiaries

Interim Condensed Consolidated Statements of Income

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-----------|-------------------|------------|
| | September 30, | | September 30, | |
| (in thousands, except per share amounts) | 2010 | 2009 | 2010 | 2009 |
| Net sales: | | | | |
| North American | | | | |
| Industrial | \$ 46,846 | \$ 45,547 | \$ 141,434 | \$ 134,737 |
| Agricultural | 48,880 | 20,158 | 134,009 | 63,263 |
| European | 36,572 | 44,613 | 119,578 | 135,704 |
| Total net sales | 132,298 | 110,318 | 395,021 | 333,704 |
| Cost of sales | 99,908 | 84,669 | 305,815 | 261,999 |
| Gross profit | 32,390 | 25,649 | 89,206 | 71,705 |
| Selling, general and administrative expense | 21,273 | 17,983 | 64,296 | 55,478 |
| Income from operations | 11,117 | 7,666 | 24,910 | 16,227 |
| Interest expense | (888) | (1,005) | (3,162) | (3,248) |
| Interest income | 418 | 15 | 1,535 | 337 |
| Other income (expense), net | 112 | 134 | 77 | 130 |
| Income before income taxes | 10,759 | 6,810 | 23,360 | 13,446 |
| Provision for income taxes | 2,609 | 2,227 | 6,347 | 4,328 |
| Net income | \$ 8,150 | \$ 4,583 | \$ 17,013 | \$ 9,118 |
| Net income per common share: | | | | |
| Basic | \$.69 | \$.46 | \$ 1.45 | \$.91 |
| Diluted | \$.68 | \$.46 | \$ 1.43 | \$.91 |
| Average common shares | | | | |

Edgar Filing: ALAMO GROUP INC - Form 10-Q

| | | | | |
|--------------------|---------|---------|---------|---------|
| Basic | 11,803 | 10,047 | 11,769 | 9,988 |
| Diluted | 11,906 | 10,086 | 11,874 | 10,012 |
| 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)

| | Nine Months Ended | |
|---|-------------------|----------|
| | September 30, | |
| (in thousands, except per share amounts) | 2010 | 2009 |
| Operating Activities | | |
| Net income | \$ 17,013 | \$ 9,118 |
| Adjustment to reconcile net income to net cash | | |
| provided by operating activities: | | |
| Provision for doubtful accounts | 792 | 392 |
| Depreciation | 7,944 | 6,050 |
| Amortization of intangibles | 254 | 59 |
| Amortization of debt issuance | 281 | |
| Stock-based compensation expense | 474 | 429 |
| Excess tax benefits from stock-based payment arrangements | (46) | (43) |
| Provision (benefit) for deferred income tax benefit | (1,166) | 529 |
| Gain on sale of property, plant and equipment | (946) | (22) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (17,660) | 22,869 |
| Inventories | 19,506 | 22,019 |
| Prepaid expenses and other assets | (203) | 136 |
| Trade accounts payable and accrued liabilities | 12,535 | (15,232) |
| Income taxes payable | (2,327) | 2,211 |
| Other long-term liabilities | (2,105) | (784) |
| Net cash provided by operating activities | 34,346 | 47,731 |
| Investing Activities | | |
| Acquisitions, net of cash acquired | (428) | |
| Purchase of property, plant and equipment | (3,579) | (2,661) |
| Proceeds from sale of property, plant and equipment | 1,861 | 95 |
| Net cash used by investing activities | (2,146) | (2,566) |
| Financing Activities | | |
| Net change in bank revolving credit facility | (20,000) | (36,000) |
| Principal payments on long-term debt and capital leases | (4,147) | (1,670) |
| Proceeds from issuance of long-term debt | 196 | 1,497 |
| Dividends paid | (2,117) | (1,796) |

Edgar Filing: ALAMO GROUP INC - Form 10-Q

| | | |
|---|-----------|-----------|
| Proceeds from sale of common stock | 717 | 1,117 |
| Excess tax benefits from stock-based payment arrangements | 46 | 43 |
| Net cash provided by financing activities | (25,305) | (36,809) |
| Effect of exchange rate changes on cash | (287) | 586 |
| Net change in cash and cash equivalents | 6,608 | 8,942 |
| Cash and cash equivalents at beginning of the period | 17,774 | 4,532 |
| Cash and cash equivalents at end of the period | \$ 24,382 | \$ 13,474 |
| Cash paid during the period for: | | |
| Interest | \$ 3,042 | \$ 3,659 |
| Income taxes | \$ 6,878 | \$ 1,906 |

See accompanying notes.

Alamo Group Inc. and Subsidiaries

Notes to Interim Condensed Consolidated Financial Statements - (Unaudited)

September 30, 2010

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, 2010. The balance sheet at December 31, 2009, 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, 2009.

Certain changes to prior year balance sheet amounts have been made in accordance with the accounting guidance for business combinations to reflect adjustments made during the measurement period to provisional amounts recorded for assets acquired and liabilities assumed from Bush Hog, LLC, a Delaware limited liability company (Bush Hog) on October 22, 2009.

2. Acquisitions

On October 22, 2009 (Closing Date), the Company acquired the majority of the assets and assumed certain liabilities of Bush Hog located in Selma, Alabama. The purchase included substantially all of the ongoing business of Bush Hog, including the Bush Hog brand name and all related product names and trademarks (the Acquisition). The purchase price consideration was 1.7 million unregistered shares of Alamo Group common stock which represented approximately 14.5% of the outstanding stock of Alamo Group. The fair value of the 1.7 million shares was based on the public market price of Alamo common stock less a discount for lack of marketability associated with the 6-month holding period. We utilized an Asian put option model to measure the discount for lack of marketability. An Asian put option is an option that entitles the holder to a payoff based on the average price of an underlying asset, over a predetermined period. The closing price on October 22, 2009 was \$16.09 per share.

The Acquisition has been accounted for in accordance with ASC Topic 805, *Business Combinations* (ASC Topic 805). Accordingly, the total purchase price has been allocated on a provisional basis to assets acquired and net liabilities assumed in connection with the Acquisition based on their estimated fair values as of the completion of the Acquisition. These allocations reflect various provisional estimates that were available at the time and are subject to change during the purchase price allocation period as valuations are finalized.

Edgar Filing: ALAMO GROUP INC - Form 10-Q

The Company believes that it was able to acquire *Bush Hog* for less than the fair value of its assets because of (i) the Company's unique position as a market leader in this industry segment and (ii) the seller's intent to exit its *Bush Hog* operations. *Bush Hog* was an unprofitable venture, and the seller through its independent broker, approached the Company in an effort to sell *Bush Hog* and exit the agricultural equipment manufacturing business that no longer fit its strategy. With the seller's intent to exit the agricultural manufacturing business segment and the Company's position as a market leader, the Company was able to agree on a favorable purchase price.

The primary reason for the *Bush Hog* acquisition was to help the Company further the goal of becoming the largest manufacturer of agricultural mowers in the world. This acquisition enabled the Company to expand its market presence and product offerings.

Edgar Filing: ALAMO GROUP INC - Form 10-Q

The following table summarizes the fair values of the assets acquired and liabilities assumed from Bush Hog on October 22, 2009. Since the acquisition, net adjustments of \$1,206,000 were made to the fair value of the assets acquired and liabilities assumed with a corresponding adjustment to the gain on bargain purchase. The balance sheet at December 31, 2009 has been retroactively adjusted to reflect these adjustments as required by the accounting guidance for business combinations. The Company continues to evaluate the purchase price allocation, including the opening fair value of inventory, accounts receivable, property, plant & equipment, accrued liabilities and deferred taxes, which may require the Company to adjust the recorded gain. These adjustments are summarized in the table below (in thousands):

| | Initial | | September 30, |
|---|-----------|-------------|---------------|
| | Valuation | Adjustments | 2010 |
| Accounts receivable | \$ 25,571 | \$ 282 | \$ 25,853 |
| Inventory | 21,875 | 300 | 22,175 |
| Prepaid expenses | 395 | | 395 |
| Property, plant & equipment | 12,743 | (379) | 12,364 |
| Other liabilities | (9,357) | 1,003 | (8,354) |
| Net assets acquired | 51,227 | 1,206 | 52,433 |
| Intangible assets | | | |
| Bush Hog trade name | 1,900 | | 1,900 |
| Total assets acquired | 53,127 | 1,206 | 54,333 |
| Less: Fair value of 1.7 million unregistered shares | 25,438 | | 25,438 |
| Gain on bargain purchase | \$ 27,689 | \$ 1,206 | \$ 28,895 |

Under 805-10, acquisition related costs (i.e., advisory, legal, valuation and other professional fees) are not included as a component of consideration transferred, but are accounted for as expenses in the periods in which the costs are incurred. The Company incurred \$828,000 of acquisition related costs. The Company will incur integration expenses during 2010 relating to manufacturing process changes and computer conversion, but it is expected to be immaterial.

In the period between the Closing Date and December 31, 2009, *Bush Hog* generated approximately \$10.9 million of net revenue and \$1.5 million net loss. The Company has included the operating results of *Bush Hog* in its consolidated financial statements since the Closing Date.

The unaudited pro forma statement of income of the Company assuming this transaction occurred at January 1, 2009 is as follows:

Nine Months Ended

September 30, 2010

Edgar Filing: ALAMO GROUP INC - Form 10-Q

| (In thousands, except per share amounts) | September 30 | |
|--|--------------|------------|
| | 2010 | 2009 |
| Net Sales | \$ 395,021 | \$ 408,918 |
| Net Income | \$ 17,013 | \$ 9,252 |
| Diluted Earnings per Share | \$ 1.43 | \$ 0.92 |

The unaudited pro forma financial information is presented for informational purposes only and is not intended to represent or be indicative of the consolidated results of operations of the Company that would have been reported had the acquisition been completed as of the beginning of the periods presented, and should not be taken as being representative of the future consolidated results of operations of the Company.

3. Accounts Receivable

Accounts Receivable is shown less allowance for doubtful accounts of \$2,819,000 and \$2,548,000 at September 30, 2010 and December 31, 2009, respectively.

4. Inventories

Inventories valued at LIFO cost represented 57% and 63% of total inventory at September 30, 2010 and December 31, 2009, respectively. The excess of current costs over LIFO valued inventories was \$8,016,000 at September 30, 2010 and \$9,106,000 at December 31, 2009. The LIFO reserve through September 30, 2010 has been reduced by \$1,090,000 due to volume reduction in U.S. inventory. Inventory obsolescence reserves were \$9,075,000 at September 30, 2010 and \$9,060,000 at December 31, 2009. Net inventories consist of the following:

| (in thousands) | September 30, 2010 | December 31, 2009 |
|-----------------|-----------------------|----------------------|
| Finished goods | \$ 84,154 | \$102,981 |
| Work in process | 10,260 | 10,611 |
| Raw materials | 10,019 | 11,030 |
| | \$ 104,433 | \$124,622 |

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 JPMorgan that hedge future cash flows related to its outstanding debt obligations. One swap had a three-year term and fixed the LIBOR base rate at 4.910% covering \$20 million of this debt which expired on

March 31, 2010. The other swap has a four-year term and fixed the LIBOR base rate at 4.935% covering an additional \$20 million of these variable rate borrowings and expires on March 31, 2011. On November 5, 2009, JPMorgan transferred the swap transactions to Bank of America. The terms of the hedging instrument remain the same. As of September 30, 2010, the Company had \$21 million outstanding under its revolving credit facility and one interest rate swap contract designated as cash flow hedge which is effectively hedging \$20 million of these borrowings from changes in underlying LIBOR base rates. The fair market value of this hedge, which is the amount that would have been paid or received by the Company had it prematurely terminated this swap contract at September 30, 2010, was a \$465,000 liability. This is included in Accrued liabilities with an offset in Accumulated other comprehensive income, net of taxes. At September 30, 2010, ineffectiveness related to the interest rate swap agreement 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 \$465,000 as of September 30, 2010.

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 \$54,000 loss as of September 30, 2010.

7. Common Stock and Dividends

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

| | Nine Months Ended | |
|--------------------|--------------------------|-------------|
| | September 30, | |
| | 2010 | 2009 |
| 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 \$474,000 and \$429,000 for the quarter ended September 30, 2010 and 2009, respectively.

Qualified Options

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

For nine months ending September 30, 2010

| | Shares | Exercise Price* |
|---|---------|-----------------|
| Options outstanding at beginning of year | 345,480 | |
| Granted | 19,000 | \$24.69 |
| Exercised | (4,350) | \$12.98 |
| Cancelled | | |
| Options outstanding at September 30, 2010 | 360,130 | \$18.29 |
| Options exercisable at September 30, 2010 | 212,080 | \$18.78 |
| Options available for grant at September 30, 2010 | 195,500 | |

*Weighted Averages

Options outstanding and exercisable at September 30, 2010 were as follows:

| Qualified Stock Options | Options Outstanding | | | Options Exercisable | |
|-------------------------|---------------------|----------------------|-----------------------------|---------------------|-----------------|
| | Shares | Remaining Life(yrs)* | Contractual Exercise Price* | Shares | Exercise Price* |
| Range of Exercise Price | | | | | |
| \$11.45 - \$17.85 | 153,130 | 6.80 | \$ 12.24 | 77,680 | \$ 13.02 |
| \$19.79 - \$25.18 | 207,000 | 6.75 | \$ 22.77 | 134,400 | \$ 22.10 |
| Total | 360,130 | | | 212,080 | |

*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, 2010

| | Shares | Exercise Price* |
|---|----------|-----------------|
| Options outstanding at beginning of year | 186,000 | |
| Granted | | |
| Exercised | (59,100) | \$ 12.01 |
| Cancelled | | |
| Options outstanding at September 30, 2010 | 126,900 | \$ 15.76 |
| Options exercisable at September 30, 2010 | 81,500 | \$ 16.27 |
| Options available for grant at September 30, 2010 | 364,000 | |

*Weighted Averages

Options outstanding and exercisable at September 30, 2010 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 | 80,900 | 8.70 | \$11.48 | 48,000 | \$11.87 |
| \$13.96 - \$19.79 | 13,500 | 4.26 | \$18.71 | 13,500 | \$18.71 |
| \$25.02 - \$25.18 | 32,500 | 6.92 | \$25.17 | 20,000 | \$25.16 |
| Total | 126,900 | | | 81,500 | |

*Weighted Averages

Restricted Stock Units

Following is a summary of activity in the Restricted Stock Units for the periods indicated:

For nine months ending September 30, 2010

| | Shares | Weighted- average remaining contractual term (in years) |
|--|---------|---|
| Options outstanding at beginning of year | 8,000 | 4.00 |
| Granted | 3,000 | |
| Exercised | (2,000) | |
| Cancelled | | |
| Options outstanding at end of year | 9,000 | 3.33 |

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) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|----------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Net Income | \$ 8,150 | \$ 4,583 | \$ 17,013 | \$ 9,118 |
| Average Common Shares: | | | | |
| Basic (weighted-average outstanding shares) | 11,803 | 10,047 | 11,769 | 9,988 |

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Dilutive potential common shares from stock

| | | | | |
|---|---------|---------|---------|---------|
| options and warrants | 103 | 39 | 105 | 24 |
| Diluted (weighted-average outstanding shares) | 11,906 | 10,086 | 11,874 | 10,012 |
| Basic earnings per share | \$ 0.69 | \$ 0.46 | \$ 1.45 | \$ 0.91 |
| Diluted earnings per share | \$ 0.68 | \$ 0.46 | \$ 1.43 | \$ 0.91 |

10. Segment Reporting

At September 30, 2010 and September 30, 2009 the following unaudited financial information is segmented:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|----------------------------------|-----------------------|------------|-----------------------|------------|
| | September 30, 2010 | 2009 | September 30, 2010 | 2009 |
| Net Revenue | | | | |
| Industrial | \$ 46,846 | \$ 45,547 | \$ 141,434 | \$ 134,737 |
| Agricultural | 48,880 | 20,158 | 134,009 | 63,263 |
| European | 36,572 | 44,613 | 119,578 | 135,704 |
| Consolidated | \$ 132,298 | \$ 110,318 | \$ 395,021 | \$ 333,704 |
| Income From Operations | | | | |
| Industrial | \$ 2,454 | \$ 947 | \$ 6,354 | \$ 415 |
| Agricultural | 5,216 | 1,528 | 8,140 | 2,988 |
| European | 3,447 | 5,191 | 10,416 | 12,824 |
| Consolidated | \$ 11,117 | \$ 7,666 | \$ 24,910 | \$ 16,227 |
| Goodwill | | | | |
| Industrial | \$ 13,525 | \$ 27,168 | \$ 13,525 | \$ 27,168 |
| Agricultural | | | | |
| European | 21,073 | 22,281 | 21,073 | 22,281 |
| Consolidated | \$ 34,598 | \$ 49,449 | \$ 34,598 | \$ 49,449 |
| Total Identifiable Assets | | | | |
| Industrial | \$ 120,036 | \$ 151,226 | \$ 120,036 | \$ 151,226 |
| Agricultural | 114,309 | 61,859 | 114,309 | 61,859 |
| European | 135,950 | 140,853 | 135,950 | 140,853 |
| Consolidated | \$ 370,295 | \$ 353,938 | \$ 370,295 | \$ 353,938 |

11. Off-Balance Sheet Arrangements

Net Revenue

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

12. Comprehensive Income

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

| (in thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Net Income | \$ 8,150 | \$ 4,583 | \$ 17,013 | \$ 9,118 |
| Cash flow derivatives, net of taxes | 114 | 142 | 497 | 476 |
| Amortization of actuarial net gain | 19 | 38 | 57 | 116 |
| Foreign currency translation adjustment | 8,530 | 2,568 | (3,249) | 7,109 |
| Comprehensive Income | \$ 16,813 | \$ 7,331 | \$ 14,318 | \$ 16,819 |

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

| | September 30, 2010 (Unaudited) | December 31, 2009 (Audited) |
|--|--|---|
| (in thousands) | 2010 | 2009 |
| Foreign currency translation adjustment | \$ 4,940 | \$ 8,148 |
| Derivatives, net of taxes | (288) | (744) |
| Actuarial gain on defined benefit pension plan | \$ (2,200) | \$ (2,257) |
| Accumulated other comprehensive income | \$ 2,452 | \$ 5,147 |

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 relate 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 voluntarily worked 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.

Edgar Filing: ALAMO GROUP INC - Form 10-Q

At September 30, 2010, the Company had an environmental reserve in the amount of \$1,602,000 related to the acquisition of *Gradall* facility in New Philadelphia, Ohio. Three specific remediation projects that were identified prior to the acquisition are in process of remediation with a remaining reserve balance of \$137,000. 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.

The company knows that *Bush Hog*'s main manufacturing property in Selma, Alabama was contaminated with chlorinated volatile organic compounds which most likely resulted from painting and cleaning operations during the 1960's and '70s. The contaminated areas were primarily in the location of underground storage tanks and underneath the former waste storage area. Under the Asset Purchase Agreement, *Bush Hog*'s prior owner agreed to and has removed the underground storage tanks at its cost and has remedied the identified contamination in accordance with the regulations of the Alabama Department of Environmental Management. An environmental consulting firm was retained by the prior owner and is administering the cleanup and will monitor the sites on an ongoing basis.

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 costs 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 affect 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 \$50,000 and pension income was \$138,000 for the three months ended September 30, 2010 and 2009, respectively. The Company is required to make contributions in the amount of \$1,561,000 to the pension plans for 2010 of which \$1,344,000 has been paid through September 30, 2010.

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., and all foreign jurisdictions in which we have entities, 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. There are no income tax examinations currently in process. 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.

During the third quarter of 2010, the Company completed a research and development credit study (R&D study) related to prior year tax returns. The R&D study resulted in tax credits of approximately \$1,100,000. The Company has recorded an unrecognized tax benefit in the amount of approximately \$190,000.

16. Recent Accounting Pronouncements

Amendments to FASB Interpretation No. 46(R)

In December 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2009-17, which codified Statement of Financial Accounting Standard (SFAS) 167, Amendments to FASB Interpretation No. 46(R), issued in June 2009. This guidance amends FASB Interpretation No. 46 (revised December 2003) to address the elimination of the concept of a qualifying special purpose entity. ASU 2009-17 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, ASU 2009-17 provides more timely and useful information about an enterprise's involvement with a variable interest entity. ASU 2009-17 became effective for the Company on January 1, 2010. This ASU did not have a material impact on our consolidated financial statements.

Fair Value Measurements and Disclosures

In January 2010, the FASB issued ASU 2010-06, Fair Value Measurements and Disclosures, which amends the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). ASU 2010-06 became effective for us on January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for us in the first annual reporting period that begins after December 15, 2010 and for interim periods within that first annual reporting period. Other than requiring additional disclosures, adoption of this new guidance will not have a material impact on our financial statements.

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

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

| (As Percentages of Net Sales) | Three Months Ended | | Nine Months Ended | |
|-------------------------------|--------------------|--------|-------------------|--------|
| | September 30, | | September 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| North American | | | | |
| Industrial | 35.4% | 41.3% | 35.8% | 40.4% |
| Agricultural | 37.0% | 18.3% | 33.9% | 18.9% |
| European | 27.6% | 40.4% | 30.3% | 40.7% |
| 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, | |
| | 2010 | 2009 | 2010 | 2009 |
| Gross margin | 24.5% | 23.3% | 22.6% | 21.5% |
| Income from operations | 8.4% | 6.9% | 6.3% | 4.9% |
| Income before income taxes | 8.1% | 6.2% | 5.9% | 4.0% |
| Net income | 6.2% | 4.2% | 4.3% | 2.7% |

Overview

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

In the third quarter of 2010 the Company's net income was up 78% compared to the third quarter of 2009 due to the Company's continued efforts with cost control initiatives, tax credits related to prior years' research and development, and the acquisition of Bush Hog which was accretive to our sales and net income during the third quarter. The weakness in the worldwide economy remains a concern as market conditions in our European operations, specifically in France, have continued to be soft.

The Industrial Division sales increased 3% during the third quarter of 2010 due to increases in the replacement parts business; however, budgets of governmental entities and related contractors continue to be constrained.

The Agricultural Division saw a 142% increase in sales versus the third quarter of 2009, most of it relating to the Bush Hog acquisition along with some improvement in market conditions due to higher commodity prices and growth in farm income. We expect some gradual improvement in this Division for the remainder of the year and into 2011.

European Division sales were down 18% in U.S. dollars and 13% in local currency compared to the third quarter of 2009 as their markets reflected the overall decline in the European economy. We expect this decline in the European Division will continue to impact our results for the remainder of the year. Offsetting some of these declines for the Company were benefits from cost controls and restructuring measures implemented in 2009 as these savings have contributed to steady improvements in our profits for 2010.

The Company is concerned that our markets for the remainder of 2010 could continue to be negatively affected by a variety of factors such as continued weakness in the overall economy, credit availability, increased levels of government regulations; changes in farm incomes due to commodity prices or governmental aid programs; adverse situations that could affect our customers including weather conditions such as droughts and floods; budget constraints or revenue shortfalls in governmental entities, and changes in our customer buying habits due to lack of confidence in the economic outlook.

Results of Operations

Three Months Ended September 30, 2010 vs. Three Months Ended September 30, 2009

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Net sales for the third quarter of 2010 were \$132,298,000, an increase of \$21,980,000 or 19.9% compared to \$110,318,000 for the third quarter of 2009. The increase was attributable to the acquisition of Bush Hog, offset by the continued weakness in the worldwide economy which affects the markets which the Company serves.

Net North American Industrial sales increased during the third quarter by \$1,299,000 or 2.9% to \$46,846,000 for 2010 compared to \$45,547,000 during the same period in 2009. The majority of the increase came primarily from higher sales of replacement parts to governmental entities and related contractors. Governmental buyers continue to cope with budget constraints as market conditions remained weak. Compared to 2009, sales to state agencies remained steadier than those to cities and counties.

Net North American Agricultural sales for the third quarter were \$48,880,000 in 2010 compared to \$20,158,000 for the same period in 2009, an increase of \$28,722,000 or 142.5%. The increase was primarily from the acquisition of Bush Hog in the amount of \$25,659,000 and some improvement in market conditions over 2009.

Net European Sales for the third quarter of 2010 were \$36,572,000, a decrease of \$8,041,000 or 18.0% compared to \$44,613,000 during the third quarter of 2009. The majority of the decrease was primarily due to continued softness in French markets offset somewhat by the weaker U.S. dollar.

Gross profit for the third quarter of 2010 was \$32,390,000 (24.5% of net sales) compared to \$25,649,000 (23.3% of net sales) during the same period in 2009, an increase of \$6,741,000. The increase in gross margin was from the acquisition of Bush Hog in the amount of \$6,793,000. The increase in gross margin percentage was a result of higher sales of replacement parts and ongoing cost saving initiatives.

Selling, general and administrative expense (SG&A) was \$21,273,000 (16.1% of net sales) during the third quarter of 2010 compared to \$17,983,000 (16.3% of net sales) during the same period of 2009, an increase of \$3,290,000. The acquisition of Bush Hog added \$3,776,000 to SG&A expenses. Excluding Bush Hog, SG&A expenses were lower due to ongoing cost control initiatives.

Interest expense was \$888,000 for the third quarter of 2010 compared to \$1,005,000 during the same period in 2009, a decrease of \$117,000. The decrease was from lower borrowings in 2010 compared to 2009. The 2010 interest expense includes \$94,000 in amortization of bank fees from the amendment to our Company's revolving credit agreement in November of 2009.

Other income (expense) was \$112,000 of income during the third quarter of 2010 compared to \$134,000 of income in the third quarter of 2009. The gains in both 2010 and 2009 are entirely from changes in exchange rates.

Provision for income taxes was \$2,609,000 (24.2% of income before taxes) for the third quarter of 2010 compared to \$2,227,000 (32.7% of income before taxes) in the third quarter of 2009. Included in the 2010 tax provision is an \$898,000 tax credit related to prior years' research and development expenses.

The Company's net income after tax was \$8,150,000 or \$.68 per share on a diluted basis for the third quarter of 2010 compared to \$4,583,000 or \$.46 per share on a diluted basis for the third quarter of 2009. The increase of \$3,567,000 resulted from the factors described above.

Nine Months Ended September 30, 2010 vs. Nine Months Ended September 30, 2009

Net sales for the first nine months of 2010 were \$395,021,000, an increase of \$61,317,000 or 18.4% compared to \$333,704,000 for the first nine months of 2009. The increase was mainly from the acquisition of Bush Hog. Sales in the Company's core business were negatively affected by the weakness in the worldwide economy.

Net North American Industrial sales increased during the first nine months by \$6,697,000 or 5.0% to \$141,434,000 for 2010 compared to \$134,737,000 during the same period in 2009. The increase was due from higher sales of replacement parts and to a lesser extent a slight improvement in sales of excavator, vacuum truck, sweeper and mowing equipment products. Governmental entities continue to be affected by budget constraints and revenue shortfalls.

Net North American Agricultural sales were \$134,009,000 in 2010 compared to \$63,263,000 for the same period in 2009, an increase of \$70,746,000 or 111.8%. The increase was mainly from the acquisition of Bush Hog in the amount of \$69,763,000. The agricultural market was soft during the first six months of 2010 due to the weakness in the overall economy, thus leading to dealer reluctance to stock farm equipment. During the third quarter of 2010, market conditions reflected some improvement due to higher commodity prices and growing farm income.

Net European Sales for the first nine months of 2010 were \$119,578,000, a decrease of \$16,126,000 or 11.9% compared to \$135,704,000 during the same period of 2009. The decrease was mainly from weak market conditions caused by the slowdown in the European economy, specifically in France offset somewhat by the weaker U.S. dollar.

Gross profit for the first nine months of 2010 was \$89,206,000 (22.6% of net sales) compared to \$71,705,000 (21.5% of net sales) during the same period in 2009, a increase of \$17,501,000. The increase was mainly due to the acquisition of Bush Hog in the amount of \$15,619,000. Increases in replacement part sales supported higher margins as well as improved margin percentages. Gross margin percentages also improved over 2009 as a result of ongoing control initiatives which helped lower manufacturing costs.

Selling, general and administrative expense (SG&A) were \$64,296,000 (16.3% of net sales) during the first nine months of 2010 compared to \$55,478,000 (16.6% of net sales) during the same period of 2009, an increase of \$8,818,000. The increase in SG&A for the nine months of 2010 was due to the acquisition of Bush Hog which added \$10,999,000. Without Bush Hog, SG&A declined \$2,181,000 mainly from the benefit of the 2009 reductions in workforce along with other cost saving initiatives.

Interest expense was \$3,162,000 for the first nine months of 2010 compared to \$3,248,000 during the same period in 2009, a decrease of \$86,000. The decrease was due to reduced borrowings in 2010 compared to 2009. The 2010 interest expense also includes \$281,000 in amortization of bank fees from the amendment to our Company's revolving credit agreement in November of 2009.

Other income (expense) was \$77,000 of income during the first nine months of 2010 compared to \$130,000 of income in the first nine months of 2009. The gains in both 2010 and 2009 are entirely from changes in exchange rates.

Provision for income taxes was \$6,347,000 (27.2% of income before taxes) for 2010 compared to \$4,328,000 (32.2% of income before taxes) in 2009. Included in the 2010 tax provision is an \$898,000 tax credit related to prior years' research and development expenses.

The Company's net income after tax was \$17,013,000 or \$1.43 per share on a diluted basis for the first nine months of 2010 compared to \$9,118,000 or \$.91 per share on a diluted basis for the first nine months of 2009. The increase of \$7,895,000 resulted from the factors described above.

Liquidity and Capital Resources

Edgar Filing: ALAMO GROUP INC - Form 10-Q

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, particularly related to our agricultural products. 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 though with the soft economy this affect is less pronounced. These sales level the Company's production during the off season.

As of September 30, 2010, the Company had working capital of \$180,694,000 which represents a decrease of \$2,802,000 from working capital of \$183,496,000 as of December 31, 2009. The decrease in working capital was primarily from lower inventory levels from reduced levels of activity and higher trade payables.

Capital expenditures were \$3,579,000 for the first nine months of 2010, compared to \$2,661,000 during the first nine months of 2009. Capital expenditures for 2010 are expected to be above 2009 though still below depreciation 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 2009 or the nine months of 2010. The authorization to repurchase up to 1,000,000 shares remains available less 42,600 shares previously repurchased.

During the third quarter of 2010, the Company closed its manufacturing facility located in Orleans, France and incurred \$924,000 in redundancy and closure costs. The Company also sold the Orleans facility and recorded a gain of \$885,000. Production was relocated to the manufacturing facility in Lyon, France.

Net cash used by financing activities was \$25,305,000 during the nine month period ending September 30, 2010, compared to net cash used of \$36,809,000 for the same period in 2009. The decrease in financing activities in 2010 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

Edgar Filing: ALAMO GROUP INC - Form 10-Q

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 June 30, 2010. Beginning June 30, 2010, *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.

As of September 30, 2010, there was \$21,000,000 borrowed under the revolving credit facility. At September 30, 2010, \$926,000 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 \$103,000,000 in available borrowings.

On May 13, 2008, Alamo Group Europe Limited expanded its overdraft facility with Lloyd's TSB Bank plc from 1,000,000 British pounds to 5,500,000 million British pounds. The facility was renewed on November 1, 2009 and outstandings currently bear interest at Lloyd's Base Rate plus 1.4% per annum. The facility is unsecured but guaranteed by the U.K. subsidiaries of Alamo Group Europe Limited. As of September 30, 2010, there were no British pounds borrowed against the U.K. overdraft facility.

There are additional lines of credit, for the Company's French operations in the amount of 6,200,000 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, 2010, no Euros were borrowed against the French line of credit, no Canadian dollars were outstanding on the Canadian line of credit and 400,000 Australian dollars were outstanding under its facility. The Canadian and Australian revolving credit facilities are guaranteed by the Company.

As of September 30, 2010, the Company is 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

Edgar Filing: ALAMO GROUP INC - Form 10-Q

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 Consolidated 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 \$2,819,000 at September 30, 2010 and \$2,548,000 at December 31, 2009.

Sales Discounts

At September 30, 2010 the Company had \$11,536,000 in reserves for sales discounts compared to \$3,803,000 at December 31, 2009 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 generally 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 \$9,075,000 at September 30, 2010 and \$9,060,000 at December 31, 2009 in reserve to cover obsolescence and slow moving inventory. The obsolescence and slow moving policy states that the reserve is to be calculated on a basis of: 1) no inventory usage over a three year period and inventory with quantity on hand is deemed obsolete and reserved at 100 percent and 2) slow moving inventory with little usage requires a 100 percent reserve on items that have a quantity greater than a three year supply. There are exceptions to the obsolete and slow moving classifications if approved by an officer of the Company based on specific identification of an item or items that are deemed to be either included or excluded from this classification. In cases where there is no historical data, management makes a judgment based on a specific review of the inventory in question to determine what reserves, if any are appropriate. New products or parts are generally excluded from the reserve policy until a three year history has been established.

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

Warranty

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

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 an end-user takes approximately 90 days to six months from the receipt of the unit to file a 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 \$5,977,000 at September 30, 2010 and \$5,973,000 at December 31, 2009.

Product Liability

At September 30, 2010 the Company had accrued \$440,000 in reserves for product liability cases compared to \$387,000 at December 31, 2009. The Company accrues primarily on a case by case basis and adjusts the balance quarterly.

During most of 2010, the self insured retention (S.I.R.) for U.S. product liability coverage for all products was at \$100,000 per claim. The S.I.R. for all Bush Hog products was set at the date of acquisition at \$250,000 per claim. On September 30, 2010 the Company renewed its insurance coverage and the S.I.R. for all U.S. products was \$100,000 per claim. The Company also carries product liability coverage in Europe, Canada and Australia which contain substantially lower S.I.R. s or deductibles.

Goodwill

Goodwill 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 for purchase accounting, 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 estimates the fair value of its reporting units using 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 in the North American Industrial segment of \$14,104,000 in 2009 and \$5,010,000 in the North American Agricultural segment in 2008. During the 2009 impairment analysis review, it was noted that even though the *Schwarze* reporting unit s fair value was above carrying value it was not materially different. At December 31, 2009, there was approximately \$6.8 million of goodwill related to the *Schwarze* reporting unit. This reporting unit would be most likely affected by changes in the Company s assumptions and estimates. As of September 30, 2010, the Company had \$34,598,000 of goodwill, which represents 9% of total assets. The calculation of fair value could increase or decrease depending on changes in the inputs and assumptions used, such as changes in the reporting unit s future growth rates, discount rates, etc.

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; 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; weakness 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, 2010, the Company had \$3,845,000 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 \$385,000. 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, 2010, 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 \$3,425,000 for the period ending September 30, 2010. 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 \$3,781,000 for the period ended September 30, 2009. 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 2010 was a gain of \$8,530,000. On September 30, 2010, the British pound closed at .6365 relative to 1.00 U.S. dollar, and the Euro dollar closed at .7335 relative to 1.00 U.S. dollar. At December 31, 2009 the British pound closed at .6187 relative to 1.00 U.S. dollar and the Euro dollar closed at .6985 relative to 1.00 U.S. dollar. By comparison, 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. 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 2010 average interest rate under these borrowings, the Company's interest expense would have changed by approximately \$315,000. 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 the Chief Executive Officer, the Chief Financial Officer and the Vice-President, Corporate Controller, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to paragraph (b) of Exchange Act Rules 13a-15 or 15d-15. Based upon the evaluation, the Chief Executive Officer, the Chief Financial Officer and the Vice-President, Corporate Controller, concluded that the Company's 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

(a) Reports on Form 8-K

November 2, 2010 Announced Retirement of David H. Morris from the Board

November 5, 2010 Press Release announcing third quarter fiscal 2010 earnings

(b) Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

| | | |
|------|---|----------------|
| 31.1 | Certification by Ronald A. Robinson under Section 302 of the Sarbanes-Oxley Act of 2002 | Filed 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 & Chief Executive Officer

/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)

