

ALAMO GROUP INC  
Form 10-Q  
November 08, 2006

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, 2006

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)

**1502 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).

☐ No ☒

Yes

At NOVEMBER 1, 2006, 9,761,509 shares of common stock, \$.10 par value, of the Registrant were outstanding.

**Alamo Group Inc. and Subsidiaries**

INDEX

|          | PAGE  |
|----------|---|
| PART I.  | FINANCIAL INFORMATION   |
| Item 1.  | Interim Condensed Consolidated Financial Statements (Unaudited)   |
|          | <u>Interim Condensed Consolidated Balance Sheets</u><br>September 30, 2006 and December 31, 2005 3  |
|          | <u>Interim Condensed Consolidated Statements of Income</u><br>Three months and Nine months ended September 30, 2006<br>and September 30, 2005 4 |
|          | <u>Interim Condensed Consolidated Statements of Cash Flows</u><br>Nine months ended September 30, 2006 and September 30, 2005 5                 |
|          | <u>Notes to Interim Condensed Consolidated Financial Statements</u> 6   |
| Item 2.  | <u>Management's Discussion and Analysis of Financial Condition</u><br>and Results of Operations 14  |
| Item 3.  | <u>Quantitative and Qualitative Disclosures about Market Risks</u> 21   |
| Item 4.  | <u>Controls and Procedures</u> 22   |
| PART II. | <u>OTHER INFORMATION</u> 23   |
| Item 1.  | None  |
| Item 2.  | None  |
| Item 3.  | None  |
| Item 4.  | None  |
| Item 5.  | <u>Other Information</u>  |
| Item 6.  | <u>Exhibits and Reports on Form 8-K</u>   |
|          | <u>SIGNATURES</u>   |

**Alamo Group Inc. and Subsidiaries**  
**Interim Condensed Consolidated Balance Sheets**

| (in thousands, except share amounts)  | September 30,<br>2006<br>(Unaudited) | December 31,<br>2005<br>(Audited) |
|---|--------------------------------------|-----------------------------------|
| <b>ASSETS</b>   |                                      |                                   |
| Current assets:   |                                      |                                   |
| Cash and cash equivalents   | \$ 7,290                             | \$ 7,073                          |
| Accounts receivable, net  | 97,864                               | 85,368                            |
| Inventories   | 122,116                              | 77,013                            |
| Deferred income taxes   | 5,513                                | 2,296                             |
| Prepaid expenses  | 3,624                                | 2,331                             |
| Total current assets  | 236,407                              | 174,081                           |
| Property, plant and equipment   | 111,709                              | 95,318                            |
| Less: Accumulated depreciation  | (54,530)                             | (52,790)                          |
|   | 57,179                               | 42,528                            |
| Goodwill  | 40,404                               | 26,416                            |
| Intangible assets   | 4,211                                | 689                               |
| Assets held for sale  | 722                                  | 721                               |
| Other assets  | 1,889                                | 1,781                             |
| Total assets  | \$ 340,812                           | \$ 246,216                        |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                      |                                   |
| Current liabilities:  |                                      |                                   |
| Trade accounts payable  | 42,148                               | 26,518                            |
| Income taxes payable  | (596)                                | 807                               |
| Accrued liabilities   | 24,816                               | 18,608                            |
| Current maturities of long-term debt  | 2,832                                | 2,997                             |
| Total current liabilities   | 69,200                               | 48,930                            |
| Long-term debt, net of current maturities   | 83,622                               | 30,912                            |
| Deferred pension liability  | 4,755                                | -                                 |
| Other long-term liabilities   | 2,112                                | -                                 |
| Deferred income taxes   | 3,133                                | 2,898                             |
| Stockholders' equity:   |                                      |                                   |
| Common stock, \$.10 par value, 20,000,000 shares authorized;<br>9,804,109 and 9,792,759 issued and outstanding at<br>September 30, 2006 and December 31, 2005, respectively | 980                                  | 979                               |
| Additional paid-in capital  | 52,269                               | 51,736                            |
| Treasury stock, at cost; 42,600 shares at September 30, 2006<br>and December 31, 2005   | (426)                                | (426)                             |
| Retained earnings   | 112,852                              | 104,261                           |
| Accumulated other comprehensive income  | 12,315                               | 6,926                             |
| Total stockholders' equity  | 177,990                              | 163,476                           |
| Total liabilities and stockholders' equity  | \$ 340,812                           | \$ 246,216                        |

See accompanying notes.

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

| (in thousands, except per share amounts)    | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2006                                | 2005      | 2006                               | 2005      |
| Net sales:                                  |                                     |           |                                    |           |
| North American                              |                                     |           |                                    |           |
| Industrial                                  | \$ 58,637                           | \$ 32,782 | \$ 172,241                         | \$ 97,723 |
| Agricultural                                | 25,780                              | 33,671    | 82,631                             | 98,134    |
| European                                    | 30,321                              | 29,355    | 89,702                             | 89,624    |
| Total net sales                             | 114,738                             | 95,808    | 344,574                            | 285,481   |
| Cost of sales                               | 91,484                              | 74,222    | 274,464                            | 223,124   |
| Gross profit                                | 23,254                              | 21,586    | 70,110                             | 62,357    |
| Selling, general and administrative expense | 17,415                              | 14,626    | 50,247                             | 44,127    |
| Income from operations                      | 5,839                               | 6,960     | 19,863                             | 18,230    |
| Interest expense                            | (1,812)                             | (840)     | (5,010)                            | (2,332)   |
| Interest income                             | 188                                 | 177       | 545                                | 600       |
| Other income (expense), net                 | 66                                  | 38        | (102)                              | 137       |
| Income before income taxes                  | 4,281                               | 6,335     | 15,296                             | 16,635    |
| Provision for income taxes                  | 1,215                               | 1,951     | 4,949                              | 5,468     |
| Net income                                  | \$ 3,066                            | \$ 4,384  | \$ 10,347                          | \$ 11,167 |
| Net income per common share:                |                                     |           |                                    |           |
| Basic                                       | \$ 0.31                             | \$ 0.45   | \$ 1.06                            | \$ 1.15   |
| Diluted                                     | \$ 0.31                             | \$ 0.44   | \$ 1.04                            | \$ 1.13   |
| Average common shares                       |                                     |           |                                    |           |
| Basic                                       | 9,760                               | 9,747     | 9,754                              | 9,745     |
| Diluted                                     | 9,930                               | 9,892     | 9,922                              | 9,910     |
| Dividends declared                          | \$ 0.06                             | \$ 0.06   | \$ 0.18                            | \$ 0.18   |

See accompanying notes.

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

|  | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|--|-------------|
| (in thousands, except per share amounts)   | <b>2006</b>                                | <b>2005</b> |
| <b>Operating Activities</b>  |  |             |
| Net income   | \$ 10,347                                  | \$ 11,167   |
| Adjustment to reconcile net income to net cash provided by operating activities: |  |             |
| Provision for doubtful accounts  | 910  | 522         |
| Depreciation   | 6,781                                      | 4,707       |
| Amortization   | 95   | 170         |
| Provision for deferred income tax benefit  | 114  | (122)       |
| Realized (gain) loss on sale of property   | -  | -           |
| Gain on sale of property, plant and equipment                                    | (260)                                      | (109)       |
| Changes in operating assets and liabilities:                                     |  |             |
| Accounts receivable  | (3,459)                                    | (7,335)     |
| Inventories  | (16,023)                                   | (8,919)     |
| Prepaid expenses and other assets  | 1,227                                      | 43          |
| Trade accounts payable and accrued liabilities                                   | 7,591                                      | 5,354       |
| Income taxes payable   | (1,512)                                    | 456         |
| Other long-term liabilities  | (152)                                      | -           |
| Net cash provided by operating activities  | 5,659                                      | 5,934       |
| <b>Investing Activities</b>  |  |             |
| Acquisitions, net of cash acquired   | (48,716)                                   | (5,742)     |
| Purchase of property, plant and equipment  | (10,159)                                   | (7,080)     |
| Proceeds from sale of property, plant and equipment                              | 976  | 190         |
| Proceeds from long-term investment   | 352  | -           |
| Net cash used by investing activities  | (57,547)                                   | (12,632)    |
| <b>Financing Activities</b>  |  |             |
| Net change in bank revolving credit facility                                     | 53,000                                     | 22,000      |
| Principal payments on long-term debt and capital leases                          | (868)                                      | (1,376)     |
| Dividends paid   | (1,756)                                    | (1,754)     |
| Proceeds from sale of common stock   | 541  | 125         |
| Net cash provided by financing activities  | 50,917                                     | 18,995      |
| Effect of exchange rate changes on cash  | 1,188                                      | (421)       |
| Net change in cash and cash equivalents  | 217  | 11,876      |
| Cash and cash equivalents at beginning of the period                             | 7,073                                      | 2,580       |
| Cash and cash equivalents at end of the period                                   | \$ 7,290                                   | \$ 14,456   |
| Cash paid during the period for:   |  |             |
| Interest   | \$ 4,676                                   | \$ 2,232    |
| Income taxes   | \$ 3,998                                   | \$ 5,579    |

See accompanying notes.

**Alamo Group Inc. and Subsidiaries**  
**Notes to Interim Condensed Consolidated Financial Statements - (Unaudited)**  
**September 30, 2006**

**1. Basis of Financial Statement Presentation**

The accompanying unaudited interim condensed consolidated financial statements of Alamo Group Inc. and its subsidiaries (the "Company") have been prepared in accordance with U.S. Generally Accepted Accounting Principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulations S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. The balance sheet at December 31, 2005, 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, 2005.

**2. Acquisitions**

On February 3, 2006, the Company announced that it had purchased substantially all of the assets and assumed certain liabilities of the Gradall excavator business of JLG Industries, Inc. (NYSE:JLG). The purchase price was \$36.9 million, according to the terms of the Asset Purchase Agreement. The purchase price has preliminarily been allocated to the assets and liabilities acquired and includes trademarks of \$3.6 million and goodwill of approximately \$6.5 million. This acquisition enhances our Industrial market coverage in that over half of its sales are to governmental entities or related contractors. Gradall is a leading manufacturer of both wheeled and crawler telescopic excavators in North America. Gradall's annual sales were approximately \$76.0 million for its fiscal year ending July 31, 2005 and is located in New Philadelphia, Ohio. The assets include a 430,000 square foot facility, machinery, tooling and intellectual property including the *Gradall*® name. The Company also added 405 employees, of which 275 are represented by the International Association of Machinists & Aerospace Workers union. The results of the operations of Gradall have been included in the Company's Consolidated Statement of Income since February 3, 2006.

The unaudited pro forma statement of income of the Company assuming the transaction occurred at January 1, 2005 is as follows:

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2006                                | 2005       | 2006                               | 2005       |
| (In thousands, except per share amounts) |                                     |            |                                    |            |
| Net Sales                                | \$ 114,738                          | \$ 120,760 | \$ 344,574                         | \$ 342,191 |
| Net Income                               | \$ 3,066                            | \$ 4,884   | \$ 10,347                          | \$ 12,303  |
| Diluted Earnings per Share               | \$ 0.31                             | \$ 0.49    | \$ 1.04                            | \$ 1.24    |

The Company also announced on February 3, 2006 that it had entered into an Amended and Restated Revolving Credit Agreement between the Company and its lenders, Bank of America, N.A., JP Morgan Chase Bank and Guaranty Bank to expand its credit facility from \$70.0 million to \$125.0 million. The Company has the ability to increase its commitment by \$25.0 million. In addition, the asset coverage ratio was reduced and interest margins reduced. The final maturity remains the same at August 25, 2009. As of September 30, 2006 the Company had borrowed \$80.0 million under its credit facility and had \$32.7 million available for future borrowings.

On May 24, 2006, the Company announced it had completed the acquisition of the vacuum truck and sweeper lines ("VacAll") from Clean Earth Environmental Group, LLC and Clean Earth Kentucky, LLC ("Clean Earth"). The purchase price of \$8.9 million has preliminarily been allocated to the assets and liabilities acquired and includes approximately \$3.7 million of goodwill. This acquisition will add diversity to our existing offerings in the Industrial Division. Clean Earth's 2005 sales of these products were approximately \$15.8 million and the product line has been moved into the Company's Gradall facility in New Philadelphia,

Edgar Filing: ALAMO GROUP INC - Form 10-Q

Ohio and to a lesser extent its Schwarze facility in Huntsville, Alabama. The results of operations of VacAll have been included in the Company's Consolidated Statement of Income since May 24, 2006.

On July 14, 2006, the Company acquired Nite-Hawk Sweepers, LLC, a manufacturer of truck mounted sweeping equipment primarily for the contract sweeping market. The purchase price of \$3.1 million has preliminarily been allocated to the assets and liabilities acquired and includes goodwill of approximately \$2.7 million. This product expands the Company's direct sales presence and compliments the Schwarze sweeper line. The results of operations of Nite-Hawk have been included in the Company's Consolidated Statement of Income since July 14, 2006.

### 3. Accounts Receivable

Accounts Receivable is shown net of the allowance for doubtful accounts of \$2,020,000 and \$2,064,000 at September 30, 2006 and December 31, 2005, respectively.

### 4. Inventories

Inventories valued at LIFO cost represented 60% and 46% of total inventory at September 30, 2006 and December 31, 2005, respectively. The excess of current costs over LIFO valued inventories was \$7,912,000 at September 30, 2006 and December 31, 2005. Inventory obsolescence reserves were \$6,538,000 at September 30, 2006 and \$5,472,000 at December 31, 2005. The increase in obsolescence reserve was primarily due to currency exchange rate fluctuations. Net inventories consist of the following:

|                 |    | September 30,<br>2006 |    | December 31,<br>2005 |
|-----------------|----|-----------------------|----|----------------------|
| (in thousands)  |    |                       |    |                      |
| Finished goods  | \$ | 102,318               | \$ | 63,611               |
| Work in process |    | 11,569                |    | 6,577                |
| Raw materials   |    | 8,229                 |    | 6,825                |
|                 | \$ | 122,116               | \$ | 77,013               |

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.

### 5. Common Stock and Dividends

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

|                    |    | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|--------------------|----|-------------------------------------|---------|------------------------------------|---------|
|                    |    | 2006                                | 2005    | 2006                               | 2005    |
| Dividends declared | \$ | 0.06                                | \$ 0.06 | \$ 0.18                            | \$ 0.18 |
| Dividends paid     |    | 0.06                                | 0.06    | 0.18                               | 0.18    |

### 6. Stock-Based Compensation

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



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 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 Operations 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). Results for prior periods have not been restated.

As a result of adopting Statement 123(R), the Company's income before income taxes and net income for the nine months ended September 30, 2006, was \$409,000 and \$266,000 lower, respectively, than if the Company had continued to account for share-based compensation under APB 25.

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

The following table illustrates the effect on net income and earnings per share for the three months and nine months ended September 30, 2006 and 2005 as if the Company had applied the fair value recognition provisions of Statement 123 to options granted under the Company's stock option plans in all periods presented. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing model and amortized to expense over the options' vesting periods.

| (In thousands, except per share amounts)          | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2006                                | 2005     | 2006                               | 2005      |
| Net income as reported                            | \$ 3,066                            | \$ 4,384 | \$ 10,347                          | \$ 11,167 |
| Fair Value of<br>Compensation cost (tax affected) | -                                   | (64)     | -                                  | (192)     |
| Pro forma Net Income                              | \$ 3,066                            | \$ 4,320 | \$ 10,347                          | \$ 10,975 |
| Basic Earnings per share (basic)                  |                                     |          |                                    |           |
| As reported                                       | \$ 0.31                             | \$ 0.45  | \$ 1.06                            | \$ 1.15   |
| Fair Value of Compensation Cost                   | -                                   | (0.01)   | -                                  | (0.02)    |
| Pro forma earnings per share (basic)              | \$ 0.31                             | \$ 0.44  | \$ 1.06                            | \$ 1.13   |
| Basic Earnings per share (diluted)                |                                     |          |                                    |           |
| As reported                                       | \$ 0.31                             | \$ 0.44  | \$ 1.04                            | \$ 1.13   |
| Fair Value of Compensation Cost                   | -                                   | (0.01)   | -                                  | (0.02)    |
| Pro forma earnings per share (diluted)            | \$ 0.31                             | \$ 0.43  | \$ 1.04                            | \$ 1.11   |

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

The Company calculated the fair value for these options using a Black-Scholes option pricing model with the following weighted average assumptions for 2006 and 2005:

|                                 | <b>September 30,</b> |             |
|---------------------------------|----------------------|-------------|
|                                 | <b>2006</b>          | <b>2005</b> |
| Risk-free interest rate         | 6.0%                 | 4.5%        |
| Dividend Yield                  | 1.0 - 3.8%           | 1.0 - 3.8%  |
| Volatility Factors              | 24 - 68%             | 24 - 68%    |
| *Weighted Average Expected Life | 5.0 years            | 5.0 years   |

### ***Incentive Options***

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

On April 28, 1994, the stockholders approved the 1994 Incentive Stock Option Plan ("1994 ISO Plan") for key employees. Each option becomes vested and exercisable for up to 20% of the total optioned shares each year after grant. Under the terms of this plan, the exercise price of the shares subject to each option granted would not be less than the fair market value of the common stock at the date the option is granted.

On August 31, 1999, the stockholders of the Company approved amending the 1994 Amended and Restated ISO Plan. During the year ended December 31, 2004, options to purchase 23,000 shares had been granted.

On February 12, 2003, the Board of Directors approved an administrative amendment to the 1994 ISO Plan. The amendment eliminates the mandatory minimum annual purchase requirement and eliminates the one month window to purchase vested options for any new option grants after February 12, 2003. There are 123,400 shares outstanding under this option plan. No further option grants can be made under this plan.

On May 3, 2005, the stockholders of the Company approved the 2005 ISO Plan and the Company reserved 500,000 shares of common stock for these options. During the year ended December 31, 2005, options to purchase 57,000 shares had been granted under this plan. Each option becomes vested and exercisable for up to 20% of the total optioned shares one year following the grant of the option and for an additional 20% of the total optioned shares after each succeeding year until the option is fully exercisable at the end of the fifth year.

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

*For nine months ending September 30, 2006*

|   | <b>2006</b> |                 |
|---|-------------|-----------------|
|   | Shares      | Exercise Price* |
| Options outstanding at beginning of year          | 188,750     |                 |
| Granted   | 31,000      | \$22.39         |
| Exercised   | (5,350)     | \$9.30          |
| Cancelled   | (3,000)     | \$17.85         |
| Options outstanding at September 30, 2006         | 211,400     | \$15.63         |
| Options exercisable at September 30, 2006         | 99,200      | \$12.15         |
| Options available for grant at September 30, 2006 | 412,000     |                 |

*\*Weighted Averages*

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

Options outstanding and exercisable at September 30, 2006 were as follows:

| Qualified Stock Options | Options Outstanding |                                  |                 | Options Exercisable |                 |
|-------------------------|---------------------|----------------------------------|-----------------|---------------------|-----------------|
|                         | Shares              | Remaining Contractual Life(yrs)* | Exercise Price* | Shares              | Exercise Price* |
| Range of Exercise Price |                     |                                  |                 |                     |                 |
| \$8.9375 - \$12.10      | 98,400              | 5.17                             | \$ 10.70        | 75,600              | \$ 10.28        |
| \$14.38 - \$22.39       | 113,000             | 8.94                             | \$ 19.92        | 23,600              | \$ 18.16        |
| Total                   | 211,400             |                                  |                 | 99,200              |                 |

*\*Weighted Averages*

## **Non-qualified Options**

On July 7, 1999, the Company granted options to purchase 200,000 shares of the Company's Common Stock under the 1999 Non-Qualified Stock Option Plan to Mr. Robinson, CEO and President at an exercise price of \$8.9375 per share, being the closing price of the Company's Common Stock on the grant date. Each option becomes vested and exercisable for up to 20% of the total optioned shares one year following the grant of the option and for an additional 20% of the total optioned shares after each succeeding year. During 2005, 2004 and 2003, no shares were exercised.

On May 3, 2001, the stockholders of the Company approved the First Amended and Restated 1999 Non-Qualified Stock Option Plan ("FAR 1999 NQSO Plan") to add non-employee directors as eligible persons to receive grants of stock options. The Company then granted options to purchase 5,000 shares of the Company's Common Stock to each Messrs. Goldress, Morris, Skaggs, and Thomas, at an exercise price of \$13.96 per share, being the closing price of the Company's Common Stock on the grant date. Each option becomes vested and exercisable for up to 20% of the total optioned shares one year following the grant of the option and for an additional 20% of the total optioned shares after each succeeding year until the option is fully exercisable. In 2006, 5,000 shares have been exercised. During 2002 and 2005, 500 shares and 1,000 shares were exercised. No shares were exercised in 2003 or 2004.

On May 12, 2003 the Company granted an additional option under the FAR 1999 NQSO Plan to purchase 5,000 shares of the Company's Common Stock to each Messrs. Goldress, Morris, Skaggs and Thomas, and 50,000 shares to Mr. Robinson at an exercise price of \$12.10 per share, being the closing price of the Company's Common Stock on the grant date. Each option becomes vested and exercisable for up to 20% of the total optioned shares one year following the grant of the option and for an additional 20% of the total optioned shares after each succeeding year until the option is fully exercisable. In 2006, 1,000 shares have been exercised. No shares were exercised in 2004 and 2005.

On May 4, 2005 the Company granted an additional option under the FAR 1999 NQSO Plan to purchase 5,000 shares of the Company's Common Stock to each Messrs. Goldress, Morris, Skaggs and Thomas, at an exercise price of \$19.79 per share, being the closing price of the Company's Common Stock on the grant date. Each option becomes vested and exercisable for up to 20% of the total optioned shares one year following the grant of the option and for an additional 20% of the total optioned shares after each succeeding year until the option is fully exercisable. Currently no shares have been exercised.

On August 8, 2006 the Company granted an option under the FAR 1999 NQSO Plan to purchase 2,500 shares of the Company's Common Stock to Mr. Grzelak at an exercise price of \$25.02 per share, being the closing price of the Company's Common Stock on the grant Date. The option becomes vested and exercisable for up to 20% of the total optioned shares one year following the grant of the option and for an additional 20% of the total optioned shares after each succeeding year until the option is fully exercisable.

# 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:

| <i>For nine months ending September 30, 2006</i>  |         | 2006    | Exercise Price* |
|---|---------|---------|-----------------|
| Options outstanding at beginning of year          | Shares  | 308,500 |                 |
| Granted   | 2,500   |         | \$25.02         |
| Exercised   | (6,000) |         | \$13.65         |
| Cancelled   | -       |         |                 |
| Options outstanding at September 30, 2006         | 305,000 |         | \$10.72         |
| Options exercisable at September 30, 2006         | 258,500 |         | \$ 9.87         |
| Options available for grant at September 30, 2006 | 87,500  |         |                 |

*\*Weighted Averages*

Options outstanding and exercisable at September 30, 2006 were as follows:

| Non-Qualified Stock Options | Options Outstanding |                                  |                 | Options Exercisable |                 |
|-----------------------------|---------------------|----------------------------------|-----------------|---------------------|-----------------|
|                             | Shares              | Remaining Contractual Life(yrs)* | Exercise Price* | Shares              | Exercise Price* |
| Range of Exercise Price     |                     |                                  |                 |                     |                 |
| \$8.9375 - \$12.10          | 269,000             | 4.03                             | \$ 9.75         | 241,000             | \$ 9.48         |
| \$13.96 - \$25.02           | 36,000              | 7.57                             | \$17.97         | 17,500              | \$15.29         |
| Total                       | 305,000             |                                  |                 | 258,500             |                 |

*\*Weighted Averages*

## 7. 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 for basic and diluted calculations do not differ.

| (In thousands, except per share amounts)                         | Three Months Ended September 30, |          | Nine Months Ended September 30, |           |
|--|----------------------------------|----------|---------------------------------|-----------|
|  | 2006                             | 2005     | 2006                            | 2005      |
| Net Income   | \$ 3,066                         | \$ 4,384 | \$ 10,347                       | \$ 11,167 |
| Average Common Shares:   |                                  |          |                                 |           |
| BASIC (weighted-average outstanding shares)                      | 9,760                            | 9,747    | 9,754                           | 9,745     |
| Dilutive potential common shares from stock options and warrants | 170                              | 145      | 168                             | 165       |
| Diluted (weighted-average outstanding shares)                    | 9,930                            | 9,892    | 9,922                           | 9,910     |
| Basic earnings per share   | \$ 0.31                          | \$ 0.45  | \$ 1.06                         | \$ 1.15   |

Edgar Filing: ALAMO GROUP INC - Form 10-Q

|                            |    |      |    |      |    |      |    |      |
|----------------------------|----|------|----|------|----|------|----|------|
| Diluted earnings per share | \$ | 0.31 | \$ | 0.44 | \$ | 1.04 | \$ | 1.13 |
|                            |    | 11   |    |      |    |      |    |      |

---

**8. Segment Reporting**

At September 30, 2006 the following unaudited financial information is segmented:

| (in thousands)                   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|----------------------------------|---|-------------|--|-------------|
|                                  | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| <b>Net Revenue</b>               |   |             |  |             |
| Industrial                       | \$ 58,637                                   | \$ 32,782   | \$ 172,241                                 | \$ 97,723   |
| Agricultural                     | 25,780                                      | 33,671      | 82,631                                     | 98,134      |
| European                         | 30,321                                      | 29,355      | 89,702                                     | 89,624      |
| Consolidated                     | \$ 114,738                                  | \$ 95,808   | \$ 344,574                                 | \$ 285,481  |
| <b>Income From Operations</b>    |   |             |  |             |
| Industrial                       | \$ 3,740                                    | \$ 2,635    | \$ 14,729                                  | \$ 7,104    |
| Agricultural                     | (933)                                       | 965         | (2,260)                                    | 2,881       |
| European                         | 3,032                                       | 3,360       | 7,394                                      | 8,245       |
| Consolidated                     | \$ 5,839                                    | \$ 6,960    | \$ 19,863                                  | \$ 18,230   |
| <b>Goodwill</b>                  |   |             |  |             |
| Industrial                       | \$ 25,184                                   | \$ 12,120   | \$ 25,184                                  | \$ 12,120   |
| Agricultural                     | 5,379                                       | 5,227       | 5,379                                      | 5,227       |
| European                         | 9,841                                       | 9,280       | 9,841                                      | 9,280       |
| Consolidated                     | \$ 40,404                                   | \$ 26,626   | \$ 40,404                                  | \$ 26,626   |
| <b>Total Identifiable Assets</b> |   |             |  |             |
| Industrial                       | \$ 158,749                                  | \$ 75,470   | \$ 158,749                                 | \$ 75,470   |
| Agricultural                     | 80,545                                      | 92,420      | 80,545                                     | 92,420      |
| European                         | 101,518                                     | 92,526      | 101,518                                    | 92,526      |
| Consolidated                     | \$ 340,812                                  | \$ 260,416  | \$ 340,812                                 | \$ 260,416  |

**9. Accounting Standards and Disclosures**

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109," ("FIN 48") FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, as well as accounting in interim periods, disclosure and transition. The Company is required to adopt the provisions of FIN 48 during the first fiscal year beginning after December 15, 2006. The Company is currently evaluating the impact of FIN 48 on its consolidated results of operations and financial position.

**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.

**10. Comprehensive Income**

During the third quarter of 2006 and 2005, Comprehensive Income amounted to \$3,432,000 and \$4,329,000, respectively.





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

| (in thousands)                          | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2006                                | 2005     | 2006                               | 2005      |
| Net Income                              | \$ 3,066                            | \$ 4,384 | \$ 10,347                          | \$ 11,167 |
| Foreign currency translation adjustment | 366                                 | (55)     | 5,389                              | (5,168)   |
| Comprehensive Income                    | \$ 3,432                            | \$ 4,329 | \$ 15,736                          | \$ 5,999  |

The components of Accumulated Other Comprehensive Income as shown on the Balance Sheet are solely comprised of foreign currency translation adjustments of \$12,315,000 and \$6,926,000 at September 30, 2006 and December 31, 2005, respectively:

| (in thousands)                         | September 30,<br>2006<br>(Unaudited) | December 31,<br>2005<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
|  | 2006                                 | 2005                              |
| Foreign currency translation           | \$ 12,315                            | \$ 6,926                          |
| Accumulated other comprehensive income | \$ 12,315                            | \$ 6,926                          |

## 11. 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. While amounts claimed might be substantial and the ultimate liability with respect to such litigation cannot be determined at this time, the Company believes that the ultimate outcome of these matters will not have a material adverse effect on the Company's consolidated financial position or results of operations.

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 affect that changes to such laws and regulations may have on the Company in the future. Like other industrial concerns, the Company's manufacturing operations entail the risk of noncompliance, and there can be no assurance that the Company will not incur material costs or other liabilities as a result thereof.

The Company knows that its Indianola, Iowa property is contaminated with chromium which most likely resulted from chrome plating operations which were discontinued several years 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 has completed its remediation program in June 2006. The work was accomplished within the Company's environmental liability reserve balance. We have requested a "no further action" classification from the state, The State of Iowa has asked for some additional testing information which the Company will provide.

The Company also preliminarily established an environmental reserve in the amount of \$1,939,000 related to the acquisition of Gradall's facility in Ohio. Three specific remediation projects that were identified prior to the acquisition are in process and estimated to be \$400,000. The balance of \$1,539,000 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. This situation, along with a potential asbestos issue, is in the process of being evaluated.

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.

## 12. Restructuring Cost

On December 5, 2005, the Company announced that as a part of its ongoing effort to reduce costs and improve efficiencies, it was closing its Holton, Kansas facility which produced agricultural mowing equipment and relocating this production to its Gibson City, Illinois plant. The closure was completed in the second quarter of 2006.

The Company expensed \$489,000 for restructuring costs in the fourth quarter of 2005. This amount is comprised of severance and performance bonuses. As of September 30, 2006, the balance in the reserve for restructuring costs was zero.

## 13. Pension Benefits

On February 3, 2006, the Company assumed the *Gradall Company Employees' Retirement Plan* and the *Gradall Company Hourly Pension Plan* from the Gradall acquisition. An evaluation was prepared of the accumulated benefit obligations (ABO) as of February 4, 2006 and the results are presented in the following table:

|                                      | <b>Salaried<br/>Retirement<br/>Plan</b> | <b>Hourly<br/>Pension<br/>Plan</b> | <b>Totals</b> |
|--------------------------------------|---|------------------------------------|---------------|
| Accumulated benefit obligation (ABO) | \$13,538,000                            | \$ 8,184,000                       | \$ 21,722,000 |
| Plan assets                          | 9,805,000                               | 7,162,000                          | 16,967,000    |
| Unfunded ABO at February 4, 2006     | \$ 3,733,000                            | \$ 1,022,000                       | \$ 4,755,000  |

## 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:

| (Sales Data In Percentages) | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|-----------------------------|---|-------------|--|-------------|
|                             | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| North American              |   |             |  |             |
| Industrial                  | 51.1 %                                      | 34.2 %      | 50.0 %                                     | 34.2 %      |
| Agricultural                | 22.5 %                                      | 35.1 %      | 24.0 %                                     | 34.4 %      |
| European                    | 26.4 %                                      | 30.7 %      | 26.0 %                                     | 31.4 %      |
| Total sales, net            | 100.0 %                                     | 100.0 %     | 100.0 %                                    | 100.0 %     |

| (Cost Trends and Profit Margin, as Percentages of Net Sales) | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| Gross margin   | 20.3 %                                      | 22.5 %      | 20.3 %                                     | 21.8 %      |
| Income from operations                                       | 5.1 %                                       | 7.3 %       | 5.8 %                                      | 6.4 %       |
| Income before income taxes                                   | 3.7 %                                       | 6.6 %       | 4.4 %                                      | 5.8 %       |
| Net income   | 2.7 %                                       | 4.6 %       | 3.0 %                                      | 3.9 %       |

## 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.*

In the first nine months of 2006 the Company experienced mixed results. We achieved improvements in our Industrial segment which we believe will continue for the rest of 2006. Weakness in our North American Agricultural Division, which began during the third quarter of 2005, has continued to affect both sales and earnings. Our European Division has held steady despite soft market conditions.

While our outlook remains positive, we are concerned that our markets could be negatively affected by a variety of factors such as a downturn in the overall economy, inflation, particularly with raw materials such as steel; increased levels of government regulations both in the U.S. and other countries in which we operate; changes in farm incomes due to commodity prices or governmental aid programs; adverse situations that could affect our customers such as epidemics like avian flu, weather conditions such as droughts and floods and higher fuel costs which affect operating expenses; and, budget constraints or revenue shortfalls in governmental entities to which the Company sells its products.

## Results of Operations

*Three Months Ended September 30, 2006 vs. Three Months Ended September 30, 2005*

Net sales for the third quarter of 2006 were \$114,738,000, an increase of \$18,930,000 or 19.8% compared to \$95,808,000 for the third quarter of 2005. The increase was primarily attributable to the acquisitions of Gradall Industries, Inc. ("Gradall") and VacAll in the amount of \$21,064,000 and Nite-Hawk Sweepers ("Nite-Hawk"), Inc. in the amount of \$1,328,000, improved markets in the sweeper division and increased sales of multiple unit orders from states in the Industrial Division. The Company continued to experience significant weakness in its Agricultural markets and to a lesser extent in European markets.

Net North American Industrial sales increased during the third quarter by \$25,855,000 or 78.9% to \$58,637,000 for 2006 compared to \$32,782,000 during the same period in 2005. The majority of the increase came from the acquisitions of Gradall and VacAll (\$21,064,000) and Nite-Hawk (\$1,328,000) along with increased demand for Industrial products. Sales of Schwarze sweepers have also increased over 2005 with dealer and direct sales accounting for the majority of the increase.

Net North American Agricultural sales were \$25,780,000 in 2006 compared to \$33,671,000 for the same period in 2005, a decrease of \$7,891,000 or 23.4%. The decrease was a result of continuing softness in the agricultural market due to higher fuel and fertilizer prices which have impacted farmers spending on new capital equipment.

Net European Sales for the third quarter of 2006 were \$30,321,000 an increase of \$966,000 or 3.3% compared to \$29,355,000 during the third quarter of 2005. The majority of the increase was primarily a result in some improvement from farm subsidy payments from the European Union and increased export sales. The European markets remain soft and competition in our core products continues to be strong.

Gross profit for the third quarter of 2006 was \$23,254,000 (20.3% of net sales) compared to \$21,586,000 (22.5% of net sales) during the same period in 2005, an increase of \$1,668,000. The increase was primarily from higher sales from our Gradall and Nite-Hawk acquisitions. The Company's margin percentage was negatively impacted during the quarter by continued inefficiencies due to the reorganization efforts relating to the closure and relocation of the Company's facility in Holton, Kansas into its Gibson City facility which was previously announced in the fourth quarter of 2005. A few minor capital improvements remain to be completed in the fourth quarter of 2006 along with training requirements for all new employees as well as new product introductions.



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

Selling, general and administrative expense ("SG&A") was \$17,415,000 (15.2% of net sales) during the third quarter of 2006 compared to \$14,626,000 (15.3% of net sales) during the same period of 2005, an increase of \$2,789,000. The increase in SG&A was primarily from the additions of Gradall, VacAll, and Nite-Hawk in the amounts of \$3,121,000, \$782,000 and \$180,000, respectively.

Interest expense was \$1,812,000 for the third quarter of 2006 compared to \$840,000 during the same period in 2005, an increase of \$972,000. This increase was from higher interest rates and increased borrowings in 2006.

Other income (expense) was \$66,000 of income during the third quarter of 2006 compared to \$38,000 of income in the third quarter of 2005. The gain on the sale of the Holton facility in the amount of \$517,000 offset by the loss on the sale of machinery and equipment at Holton totaling \$336,000 were the primary reason for the income in 2006 along with exchange rate losses from foreign currency contracts covering accounts receivable in our European operations. Income in 2005 was from exchange rate gains from foreign currency contracts covering accounts receivable in our European operations.

Income tax expense for the third quarter of 2006 was \$1,215,000 (28.4% of income before taxes) compared to \$1,951,000 (30.8% of income before taxes) in the third quarter of 2005. The decrease in the effective tax rate for 2006 was from final adjustments to the 2005 tax return that was filed in September of 2006. The effective tax rate in the third quarter of 2005 also had a final adjustment for the 2004 tax return which was filed in September of 2005.

The Company's net income after tax was \$3,066,000 or \$.31 per share on a diluted basis for the third quarter of 2006 compared to \$4,384,000 or \$.44 per share on a diluted basis for the third quarter of 2005. The decrease of \$1,318,000 resulted from the factors described above.

### *Nine Months Ended September 30, 2006 vs. Nine Months Ended September 30, 2005*

Net sales for the first nine months of 2006 were \$344,574,000, an increase of \$59,093,000 or 20.7% compared to \$285,481,000 for the first nine months of 2005. The increase was primarily attributable to the acquisitions of Gradall, VacAll and Nite-Hawk in the amounts of \$64,743,000 and \$1,328,000, respectively, and continued market improvement in the Industrial division. Sales were negatively affected by the soft market conditions primarily in the Agricultural sector.

Net North American Industrial sales increased during the first nine months by \$74,518,000 or 76.3% to \$172,241,000 for 2006 compared to \$97,723,000 during the same period in 2005. The majority of the increase came from the acquisitions of Gradall, VacAll and Nite-Hawk. Also, increased demand for both sweeper and mowing equipment has continued to reflect growth from governmental entities and contractors.

Net North American Agricultural sales were \$82,631,000 in 2006 compared to \$98,134,000 for the same period in 2005, a decrease of \$15,503,000 or 15.8%. The softness in the Company's agricultural market at the beginning of the year resulted in lower pre-season orders. Higher fuel and fertilizer prices have continued throughout the year and have affected farmers spending on capital equipment. Also affecting sales were areas in parts of the U.S. that experienced drought conditions.

Net European Sales for the first nine months of 2006 were \$89,702,000, an increase of \$78,000 or less than 1% compared to \$89,624,000 during the same period of 2005. This modest increase was a result of weaker market conditions that began during the third quarter of 2005. Sales continue to be hampered by changing governmental regulations concerning farm programs in the U.K. and European Union. Without the sales of Spearhead, sales decreased by 1.6%.

Gross profit for the first nine months of 2006 was \$70,110,000 (20.3% of net sales) compared to \$62,357,000 (21.8% of net sales) during the same period in 2005, an increase of \$7,753,000. The increase was mainly attributable to the acquisitions of Gradall, VacAll and Nite-Hawk and higher sales levels in our Industrial division. Negatively affecting the Company's gross margin percent were lower margins on production parts produced by Gradall for JLG Industries, previous owner of Gradall, as part of a six month transition supply agreement which was signed at acquisition and inefficiencies from the consolidation of the Company's Holton

facility.

Selling, general and administrative expense ("SG&A") were \$50,247,000 (14.6% of net sales) during the first nine months of 2006 compared to \$44,127,000 (15.5% of net sales) during the same period of 2005, an increase of \$6,120,000. The increase in SG&A for the first nine months of 2006 primarily came from the addition of Gradall, VacAll and Nite-Hawk in the amount of \$6,939,000.

Interest expense was \$5,010,000 for the first nine months of 2006 compared to \$2,332,000 during the same period in 2005, an increase of \$2,678,000. The increase was due to higher interest rates in 2006 along with increased borrowings to support the acquisitions of Gradall, VacAll, and Nite-Hawk along with higher levels of working capital.

Other income (expense) was \$102,000 of expense during the first nine months of 2006 compared to \$137,000 of income in the first nine months of 2005. The expense in 2006 is from losses in exchange rate fluctuation and a gain on the sale of the Holton facility in the amount of \$517,000 offset by the loss on the sale of machinery and equipment at Holton totaling \$336,000. Income in 2005 was from exchange rate gains from foreign currency contracts covering accounts receivable in our European operations.

Income tax expense for the third quarter of 2006 was \$4,949,000 (32.4% of income before taxes) compared to \$5,468,000 (32.9% of income before taxes) in the third quarter of 2005. The decrease in the effective tax rate for 2006 was from final adjustments to the 2005 tax return that was filed in September of 2006. The effective tax rate in the third quarter of 2005 also had a final adjustment for the 2004 tax return which was filed in September of 2005.

The Company's net income after tax was \$10,347,000 or \$1.04 per share on a diluted basis for the first nine months of 2006 compared to \$11,167,000 or \$1.13 per share on a diluted basis for the first nine months of 2005. The decrease of \$820,000 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 expand 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 enhance the Company's production flow during the off season.

As of September 30, 2006, the Company had working capital of \$167,207,000, which represents an increase of \$42,056,000 from working capital of \$125,151,000 as of December 31, 2005. The increase in working capital was primarily from higher accounts receivable and inventory levels due to the acquisitions of Gradall, VacAll and Nite-Hawk and seasonality.

Capital expenditures were \$10,159,000 for the first nine months of 2006, compared to \$7,080,000 during the first nine months of 2005. Capital expenditures for 2006 are expected to be above those of 2005 mainly due to the previously announced expansion, reorganization and upgrade of our Gibson City facility estimated at \$3,700,000 and also capital improvements at our newly acquired Gradall facility which is expected to be approximately \$1,500,000. 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 repurchased during 2005 or in the first nine months of 2006. The authorization to repurchase up to 1,000,000 shares remains available less 42,600 shares, previously purchased.

Net cash provided by financing activities was \$50,917,000 during the nine-month period ending September 30, 2006, compared to \$18,995,000 net cash used by financing activities for the same period in 2005. The increase was from additional borrowings for the acquisition of Gradall, VacAll and Nite-Hawk and higher accounts receivable and inventory levels due to seasonality.

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

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

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

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

As of September 30, 2006, there was \$80,000,000 borrowed under the revolving credit facility. At September 30, 2006, \$2,746,000 of the revolver capacity was committed to irrevocable standby letters of credit issued in the ordinary course of business as required by vendors' contracts.

There are three smaller additional lines of credit; one for the Company's European operation in the amount of 4,000,000 British pounds, one for our Canadian operation in the amount of 3,500,000 Canadian dollars, and one for our Australian operation in the amount of 1,300,000 Australian dollars. As of September 30, 2006 there were no British pounds borrowed against the European line of credit, 1,010,000 Canadian dollars were outstanding on the Canadian line of credit and 800,000 Australian dollars were outstanding under its facility. The Canadian revolving credit facility is guaranteed by the Company. The Australian facility is secured by a letter of credit issued by the Company. The Company's borrowing levels for working capital are seasonal with the greatest utilization generally occurring in the first quarter and early spring. As of September 30, 2006, the Company is in compliance with the terms and conditions of its credit facilities.

Management believes that the bank credit facility 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.

### Critical Accounting Estimates

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

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



## Critical Accounting Policies

### *Allowance for Doubtful Accounts*

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

The Company evaluates all aged receivables that are over 60 days old and will reserve specifically on a 90-day basis. The Company has a secured interest in most of its wholegood sales. This allows the Company, in the event of nonpayment or deteriorating financial condition, to repossess the customer's inventory. This also allows Alamo Group to maintain only a reserve over its cost which usually represents the margin on the original sales price.

The bad debt reserve balance was \$2,020,000 at September 30, 2006 and \$2,064,000 on December 31, 2005. The Company does not believe that there are any collectibility concerns within these reserves outside the normal course of business.

### *Sales Discounts*

At September 30, 2006 the Company had \$5,530,000 in reserves for sales discounts compared to \$7,533,000 at December 31, 2005 on product shipped to our customers under various promotional programs. The decrease was due primarily to additional discounts taken on the Company's *Rhino* and *M&W* products which are ordered during the pre-season, from July to December of each year and are shipped through the second quarter of 2005. The Company reviews the reserve quarterly based on the analysis made on each program in effect at the time.

The Company bases its reserves on historical data relating to discounts taken by customers 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 Inventory*

The Company had \$6,538,000 at September 30, 2006 and \$5,472,000 at December 31, 2005 in reserves to cover obsolescence and slow moving inventory. The increase was due primarily to currency exchange rate fluctuations. The obsolescence and slow moving policy states that the reserve in general 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 may be 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.

The reserve is reviewed and, if necessary, adjustments are 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 wholegood units and 90 days for parts.

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

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

The warranty reserve balance was \$4,137,000 at September 30, 2006 and \$2,833,000 at December 31, 2005. The increase was related to the acquisition of Gradall, VacAll and Nite-Hawk along with higher sales levels in the Industrial Division.

### *Product Liability*

At September 30, 2006 the Company had accrued \$240,000 in reserves for product liability cases compared to \$279,000 at December 31, 2005. The Company accrues primarily on a case-by-case basis and adjusts the balance quarterly.

During most of 2005, the self insured retention (S.I.R.) for U.S. product liability coverage was \$500,000 per claim. On September 30, 2005, the S.I.R. for rotary mowers remained at \$500,000 while the S.I.R. for all other products was reduced to \$100,000 per claim. On September 30, 2006 the S.I.R. for rotary mowers was reduced to \$250,000 while the S.I.R. for all other products continued to be \$100,000 per claim. The S.I.R. levels for the current policy period remain the same. The Company also carries product liability coverage in Europe, Canada and Australia which contain substantially lower S.I.R.'s or deductibles.

### **Forward-Looking Information**

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

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

Forward-looking statements involve risks and uncertainties. These uncertainties include factors that affect all businesses operating in a global market, as well as matters specific to the Company and the markets it serves. Particular risks and uncertainties facing the Company at the present include changes in market conditions; increased competition; decreases in the prices of agricultural commodities, which could affect our customer's income levels; budget constraints or income shortfalls which could affect the purchases of our type of equipment by governmental customers; 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; increased cost of new regulations such as Sarbanes-Oxley which effect public companies; the potential effects on the buying habits of our customers due to diseases such as mad cow and bird flu; 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 market risks. Market risk is the potential loss 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*

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

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 United Kingdom, 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 international operations are exported and are denominated in other 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 effect 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 their future net foreign currency sales transactions over a period of nine months. As of September 30, 2006, the Company had £1,252,000 outstanding in forward exchange contracts related to accounts receivable. A 15% fluctuation in exchange rates for these currencies would change the fair value by approximately \$354,000. 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 as a Result of International Sales*

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

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, 2006, 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 \$3,067,000 for the period ending September 30, 2006. 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 \$3,151,000 for the period ended September 30, 2005. 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 2006 was a gain of \$366,000. On September 30, 2006, the British pound closed at .5341 relative to 1.00 U.S. dollar, and the Euro closed at .7886 relative to 1.00 US dollar. At December 31, 2005 the British pound closed at .5812 relative to 1.00 U.S. dollar and the Euro closed at .8446 relative to 1.00 U.S. dollar. By comparison, on September 30, 2005, the British pound closed at .5670 relative to 1.00 U.S. dollar, and the Euro closed at .8319 relative to 1.00 U.S. dollar. No assurance can be given as to future valuation of the British pound or Euro or how further movements in those or other currencies could affect future earnings or the financial position of the Company.

### Interest Rate Risk

The Company's long-term debt bears interest at variable rates. Accordingly, the Company's net income is affected by changes in interest rates. Assuming the current level of borrowings at variable rates and a two percentage point change in the third quarter 2006 average interest rate under these borrowings, the Company's interest expense would have changed by approximately \$1,200,000 for the first nine months of the year. 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 affects 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**

An evaluation was carried out under the supervision and with the participation of Alamo's management, including our President and Chief Executive Officer and Vice-President, 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 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**

(a) Reports on Form 8-K

November 3, 2006 - Press Release announcing third quarter fiscal 2006 earnings

(b) Other Information

None

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

(a) Exhibits

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

(b) Reports on Form 8-K

**Alamo Group Inc. and Subsidiaries**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Alamo Group Inc.  
(Registrant)  
/s/ Ronald A. Robinson  
Ronald A. Robinson  
President and CEO

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