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# EDITED TRANSCRIPT

MSA.N - MSA Safety Inc at William Blair What's Next for Industrials Conference (Virtual)

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## PRESENTATION

**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Okay. Good morning, everybody. Thank you for joining the MSA Safety Corporation presentation at the second annual What's Next for Industrials Conference. I'm Larry De Maria, research analyst here at William Blair that follows MSA.

Required to inform you that for a full list of research disclosures and potential conflicts of interest, visit our website at [www.williamblair.com](http://www.williamblair.com).

Today from MSA, we have Ken Krause, Senior Vice President and Chief Financial Officer; Gustavo Lopez, General Manager, Gas Detection & Connected Services; and Elyse Lorenzato and Chris Hepler of Investor Relations. We're going to have a presentation from MSA on their technology road map and platforms, which center around the connected worker, connected firefighter and connected infrastructure.

Before we get started, please note that we welcome questions from the audience and encourage you to ask your questions as it arises. There's no need to wait for the Q&A portion of the session to begin. (Operator Instructions)

As you may know, MSA Safety is a global manufacturer of sophisticated safety products that help protect workers and facility infrastructure and is increasingly growing their digital presence as well.

So with that, I'm going to turn it over Ken and Gustavo for their comments and presentation, and then we'll have a discussion at the end. So thank you, ladies and gentlemen, and I'm going to pass it on.

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

Great. Thank you, Larry. Appreciate that. And thank you so much for having us here today at the What's Next for Industrials Conference. I'm Ken Krause. With me today is Gustavo Lopez. As Larry had indicated, he heads up our Gas Detection & Connected Services area of our business.

It's really always great to attend the event and to showcase MSA and all the technologies that we continue to develop and introduce into our core markets.

To start with just a few housekeeping items, as always, just be mindful of the safe harbor here on the slide. And I should note that our event is being recorded today and the replay link will be available on our IR website after the event.

MSA's mission of protecting the world's workers is really the foundation of our success. The importance of our mission and our employees' dedication is really remarkable. The mission of MSA has been constant for 107 years of business. And to me, what that longevity really highlights is how our company embraces change and evolves with the trends in customer demands in the markets. Our people aren't satisfied with the status quo, and we're always looking at how technology can help create a safer world and how we can continue to improve our business model.

For those that don't know MSA Safety, we design and manufacture safety products. I think Larry had mentioned that. And really, it's evolved quite a bit over the years. We always have and will remain focused on safety. But what really has changed over the last several years is our -- the intensity of our focus on technology and how technology can help our customers go to work safer and more productive. We have about 55% of our business here in the U.S. and 20% in Europe. The remainder is really spread across a number of different emerging markets. Our largest single end market is firefighter safety, and we also play in more industrial-oriented markets with our products of gas detection and personal protective equipment.

At MSA, it all starts with our R&D investments and our leading market positions across firefighter safety, gas detection and the industrial PPE, which is -- which includes your hard hats, fall protection-oriented products.

Those market positions are very strong and they all reflect a very large installed base -- a large customer base. Our strategy has been to seed the market heavily with MSA hardware and then layer in and bolt on exciting new technologies and software solutions, really leveraging the data that we have access to.

We've also continued to invest in about 4% of revenue in R&D, organic R&D, to develop new generation of connected products that really help further our strategy and our position in our core safety markets.

While we expect much to change in the world as it continues to establish this new normal after COVID, we're confident that safety has never been more important among our customers and potential customers.

Let me start the conversation this morning with a quick business update. My focus, I'm going to start with the business update, then I'm going to transition into the agenda and quite simply talk about what's next with respect to sustainability and connectivity. First, I'll talk about some of the investments we've made in our ESG programs and our recent acquisition of Bacharach and how that really helps our customers advance their ESG agendas by protecting the environment and workers. Then I'll move into our connected area and talk a little bit more about the connected products and the technology solutions. And Gustavo will come on and join me as we go through that section as he is really responsible for all the work we're doing -- all the exciting work that we're doing in that area we've talked about the last year and we've made exciting progress in these areas over the last 12 months. We really see connected -- connectivity as a really important part of our portfolio as we think about the future.

Starting with the business update here. In support -- first and foremost, in strategic milestones, in support of our growth initiatives, as you know, we've completed the acquisition of Bacharach earlier in the quarter here in early July. And I'll talk about Bacharach's business a bit more in the following slides. We also established -- recently established a partnership with Fotokite to enhance our Connected Firefighter solution. It's a technology investment. It's not overly material at this point, but we are really excited about the drone technology that it could potentially offer to provide real-time situational awareness of a fire scene, and we're really excited about the possibilities of what our products can do together with Fotokite.

And just this past week, we held the ribbon-cutting ceremony for our recently completed expansion of our gas detection facility here in Cranberry just adjacent to our corporate headquarters. This expansion is going to -- we expect it to fully -- to help us create a significant amount of efficiencies across our gas detection manufacturing footprint. We talked about some of those efficiencies on past investor calls when we talked about our Lake Forest site, some of our sites around the world with gas detection and how we might be able to leverage the footprint that we are creating here in Cranberry.

I also want to comment here on this slide about our business trends and really what we're seeing in our market, which I don't think is very much different from what a lot of others are seeing. The demand side of the business is healthy, albeit it's been chopped. It was strong to finish the second quarter, and it's been challenging here in the third quarter with some of the COVID resurgence and the variants that we're dealing with. And we've seen some choppiness in geographies due to those reasons.

With that said, our backlog remains elevated as we face supply chain issues with certain electronic components and labor shortages to a lesser degree. That's driven up lead times and has kept our supply chain team extremely busy procuring components.

With that said, we expect to deliver strong year-over-year revenue growth in Q3 with invoicing levels approaching but not exceeding that of 2019 at this point. We do have the business in backlog, but it is really a challenging environment from a delivery perspective because of some of the issues that I spoke about previously.

We're increasingly meeting with customers and getting good data points that business is looking better going forward, but it's not without its challenges and we'll continue to work through those challenges.

To offset inflation, we're seeing -- that we're seeing in our markets, we've taken price actions and we'll continue to evaluate the price/cost mix as we move forward.

On an SG&A front, we continue to really take a laser focus in our -- into our restructuring programs and efforts, and I expect SG&A to run at about 23.5% of sales in the second half. I think we've mentioned that in the second quarter call as we were preparing for the second half. We expect leverage in SG&A to improve as we move throughout the remainder of the year from Q3 to Q4 based on the seasonal volume that we normally see and the higher volume we normally see in the fourth quarter.

Our share positions in our end markets remain very strong, and we continue to focus on innovating and developing new technologies, and as always, execute with an emphasis on continuous improvement and a strong focus on investing in restructuring programs that are aimed at improving our business model.

Let's focus now on today's agenda and start with a few points on our ongoing focus on ESG. MSA has had an ESG-oriented mission as we are making products and platforms that protect lives. Our approach to ESG centers around continuous improvement, mirroring the approach we take in the rest of our business that I spoke about previously.

I'm proud of what the team has accomplished from an ESG standpoint and excited as we continue to progress towards our goals. We have recently won a number of top workplace awards both locally in the Pittsburgh region and nationally, recognizing MSA for diversity and inclusion and employee engagement.

In our recently announced line of credit that we put together as part of the Bacharach acquisition includes a number of metrics that are focused on diversity and safety in our workforce. Quite simply, our safety technology makes the world a safer place, and our people design that innovative technology. For that reason, we continue to invest in workplace health, safety, diversity, inclusion, development and retention.

As I mentioned earlier, we completed the acquisition of Bacharach in July. Bacharach's business focuses on refrigerants, which can be harmful to the environment. Bacharach participates in several end markets where refrigerants are commonly used, such as cold storage, air conditioning, both automotive and commercial applications. Its technologies can monitor and detect emissions and help customers meet their compliance obligations while also driving cost savings and productivity improvements. Refrigerants are costly to replace when they leak. And I -- and it's good to see the products at Bacharach really helping the customers improve the productivity around that area as well as protecting the environment.

We're excited about adding this well-regarded franchise and brand into MSA and are looking forward to what we might accomplish together. It's interesting. I was just -- just yesterday, I joined an integration team meeting here in Cranberry. And the teams are highly engaged and I'm confident in our ability to drive value through that engagement with this acquisition. It's exciting to look at this acquisition and to think about what it can offer our customers and to do to the portfolio at MSA.

Now on to connectivity and our road map for that area of our business. Specifically, we look at a double-digit market growth expected for connected worker devices over the next decade and the high percentage of companies that are already leveraging connected devices and platforms to drive workforce productivity, reduce operational spend and achieve better safety outcomes. Interestingly, environmental monitoring, wearable devices like portable gas detectors reflect a large portion of the connected device market already.

We also look at the trends in the fire service and how connected products provide cost and ownership benefits for departments by automating the fleet management efforts not to mention offering life-saving technology like search-and-rescue capabilities and edge detection. Wrapping these trends together, the case for investing in connected products and platforms across industrial and firefighter markets is extremely attractive.

Here with me today is Gustavo Lopez. Gustavo heads up -- as I said earlier, heads up our Connected business at MSA. He has a Bachelor of Science degree in computer engineering, a Masters in electrical engineering and he has an MBA from Carnegie Mellon University here in Pittsburgh. Many of you may have had the opportunity to interact with Gustavo at our recent Investor Day. But if you didn't, I'll tell you he's a really impressive guy and he's doing incredible things for MSA. Not only does he lead the efforts that we're going to talk about today, but he's also been responsible for leading the highly successful integration efforts of Sierra Monitors, turning that business into a very strong and profitable business.

Gustavo will provide an overview of some of the initiatives we have going on in our markets and the value our customers obtain from them.

Gustavo, I would turn it over to you now, if you could walk through the remainder of the slides around connectivity.

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**Gustavo Lopez** - MSA Safety Incorporated - GM of Portable Gas Detection, Safety io & Sierra Monitor Integration Leader

Thanks, Ken, and thanks, everybody. Glad to be here. And I really appreciate the opportunity to talk about a topic that I'm very, very passionate about and really has shaped my career at MSA, and again, just something that I personally feel very, very passionate about.

So as we look at connectivity and we look at the safety space, safety really has become and is becoming very complex and complicated. This stems from the various trends from a workforce demographics as you're starting to see different generations, different cultures, communication styles and expectations, obviously, our workforce being -- transitioning over to that. Data is becoming more available. And regulations and compliance, they continue to evolve, right? There's a tremendous amount of standards that our customers have to comply with and various standard operating procedures. So how you simplify that for them is critically important as we look at the future.

And what's interesting is prior to this conversation, we were doing a little bit more research as a guide to some of our investment. And a couple of stats that really jumped out at you tell you that a lot of the processes just aren't completely working right now. So according to the International Labour Organization, there's about 2.7 million deaths in the workplace a year. And more interestingly enough, 374 million lost time incidents were nondeath-related injuries that usually result in lost time for our customers, which clearly goes down to uptime availability within a facility and so forth. And about 80% of all those issues are caused by human error. So it's not just about providing them the personal protective equipment, but it's also about providing them the services and the processes to help them be more efficient and be more effective regarding that.

So on the safety industry leader, we are advancing our product suite as we drive simplicity for our customers. And we really look at it in the various buckets that are shown here on this slide. Our goal is to protect workers, improve their safety metrics, also increase productivity all while reducing operational costs. We recently had a customer that went with our system, went with our Safety io grid services and purchased our gas detection products. And just by doing the implementation and working with us through that, they were able to cut 70% of the costs from -- both from a material perspective and a time perspective. It was taking them over 3 minutes per worker to do all their testing of their products and then they had to keep all their data together. And they didn't have all that visibility.

Going to our automated system, they were able to go from the 3 minutes down to 30 seconds. And then they were also able to maintain all their records digitally and now have a process where they can -- they're basically able to do all of their work in a much safer and efficient manner. And the number that they continue to share with us is they're 70% more efficient with their cost structure today just by going to these services.

And one of the advantages and values that we have is that we are more than just portable gas detection or firefighter safety. We also have the infrastructure capabilities as well. So if you go to the next slide, you'll see how this platform is split and how we look at adding value in each of these verticals and how we're able to spread our investments really across the various verticals because there really are a lot of different -- a lot of similarities with the challenges and the customer pain points that we really are trying to solve.

So as we look at this breadth of offering, we really have 3 major pillars within our verticals. We have our Connected Firefighters, which everybody here, and Ken just mentioned, everything from our most recent launch with LUNAR to the Fotokite relationship and all the work that's being done there. We also have a cloud platform that ties it all together called the FireGrid. And we also look at the connected workers. We really look at the wearable side of it, worker safety and productivity. And also our connected infrastructure, where we take a look at everything that we have, both from a Sierra Monitor acquisition, we're looking now obviously at Bacharach and everything that goes within that and -- but also the MSA more traditional fixed gas detection.

And what that allows us to do is it allows us to take a look at a much broader scale of investment, and we can take a look at developing one backbone that works for all of them. And then really the work and what our teams really spend a lot of time on, on our U.S. teams, our product management teams, our engineering team, they really spend a lot of time with our customers as we really want to understand what are those main pain points that each one of these verticals have. And the fact that we're able to share this investment across all those verticals just really helps us be a heck of a lot more efficient.

And a couple of examples that it helps us do. A lot of times, we find that something that we solve for the industrial worker would really be valuable for the firefighter market and we're able to take those innovations and go back and forth within that. And that really is our vision and tying it all together through our cloud platforms, the Grid and FireGrid and some of the Safety io investments that Ken really has mentioned there.

It really is a very exciting time at MSA. We continue to advance our mission. It's something -- it's a journey that we really started in the early 2010s as we started to add connectivity to all of our devices. And as technology has evolved, as our business has evolved, we're now able to do a lot of great things with all of the technology and all of the engineering capabilities that we have within MSA.

And to showcase that, you can take a look from this slide how the ongoing investment supports a strong margin profile, good results and leading market positions. And as you can see here on the screen, we're devoting more capital to R&D projects than we ever have. And some of that investment is a reallocation of sustaining engineering functions, as you can see from the green bar there. We want to be more products that add value, new products bringing a heck of a lot more value to the organization. And this investment has been a big driver of the shift to the connected products that I've been talking to you for quite some time here.

Moving to -- from stand-alone PPE to connected products and solutions across many of our markets. And to support this evolution, we really have done a great job of shifting the engineering workforce to storage software engineers. Some of this has been done through acquisitions as Sierra Monitor has bolstered some of our engineering expertise. But it's an area that we believe is going to continue to be critical and we will continue to invest in it. And we're always looking for opportunities to continue to shift our engineering function into that as the vast majority of our products now do have a connectivity tie.

This new product R&D and concept of accelerating innovation can be seen clearly when you look at the sheer number of products that we've launched across all our categories recently. We continue to set the bar higher, and we'll continue rolling out new products in the connected months with connectivity, where we look to provide value beyond the widget as we look towards that complete solution. We really believe the connected solutions we are developing provide strong value both to our customers today and sets us up for tremendous success in the coming years as we're going to continue to drive the shift in our value proposition as a solutions provider with deep customer relationships.

So with that in mind, hopefully, this gives you a bit of a flavor of where we're going, and I'll pass it over to Ken to wrap things up.

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**Kenneth D. Krause** - MSA Safety Incorporated - Senior VP, CFO & Treasurer

Okay. Great. Thanks. Thanks, Gustavo. That was a really good overview of what we're doing in the connected area and the connected technologies area.

To wrap up the conversation here and before we go into Q&A, we certainly are seeing challenges like many others on the supply chain. It certainly is a challenging environment. But our market positions remain very strong. And our commitment to investing in new and exciting technologies remains.

The theme of today's event and today's discussion is really what's next. And what I can say with a lot of confidence is safety remains very important. It's more important than it ever has. And going through the pandemic, it's just emphasized -- the pandemic has really reinforced the importance of safety. And so we continue to invest in R&D that will continue to help our customers remain safe while remaining productivity and complying or actually meeting or exceeding their ESG goals that they have for themselves.

When I think about MSA and I think about this conversation today, it really comes down to 3 points. One is innovation. Our focus on innovation has never been any greater. Bringing new innovative products that incorporate the latest cutting-edge technologies into those devices is a really big focus for us.

The second area is productivity, not only productivity in our area of the business or in our business but productivity for our customers. You heard productivity used so many times through the slides. That's a big area of focus for us. How do we make sure our customers are safe and are doing it in as a productive manner as possible.

And last but certainly not least, it's all about continuous improvement. We continue to focus on continuous improvement, whether it be reengineering products that are already out in the market or continuing to look at our business model and how we can improve the efficiency of our business model and our reach into new customers.

With that, I'll turn it over to Larry and -- for any Q&A that we might want to go through.

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## QUESTIONS AND ANSWERS

**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Thanks, Ken and Gustavo. Appreciate your comments. (Operator Instructions) You guys talked a lot about a little bit short term and obviously more on the long term what's next. But let's try to close the loop in the short term first.

Regarding the business update you've provided, what are some of the key successes and challenges you're seeing? And if I have this right, sales below 2019, but up year-over-year in 3Q; no change to the SG&A; a little unclear on price/cost. So can you flesh this out a little bit for us, is that correct? And it sounds like implication of 3Q is a little tougher, but do you have visibility that 4Q gets better?

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

Yes. So let me -- a lot of questions in that one question. But let me parse it out. First, from a standpoint of successes, we continue to invest in the business. We've made significant investments this year with Bristol, the turnout gear company, in January; with Bacharach in July. And we continue, as we talk today, to invest organically in our business through our gas detection Center of Excellence and through our R&D efforts. And so we're really excited about all those investments.

We're also very excited about -- excited is probably not the right word, but we're intensely focused on pricing. And pricing is an area we continue to pursue. We're announcing -- we continue to announce additional price increases, especially here in the U.S. in some of our core markets in the U.S., and we're passing that along. And so we continue to price our products, reflect the value that our products are providing our customers with. And so it's certainly an area of focus.

And I'm proud of what the team continues to do on that side. I'm also -- the third or fourth area that I'm certainly proud about is all the efforts we're seeing in International. Our International margins, I think, in the second quarter were north of 16%. And so we continue to see good results there.

From a challenge perspective, I talked about it earlier. It's all about supply chain. It's all about availability of electronic components. It's all about, to a lesser degree, labor in certain plants. And so that's an area that's certainly very challenging.

When I think about the price/cost equation, what we said back in Q2 is there's going to be periods of time where you're probably not going to fully offset price cost. There's orders in backlog that take a little bit of time to come out. We're carrying a very elevated backlog level. And so there's a little -- there can be, from time to time, an unfortunate mismatch between the price/cost equation. But it's not something that we see longer term. We feel like we continue to see good pricing opportunities. We see an opportunity to continue to improve the margins of this business and in -- while introducing all the exciting technologies that we've recently introduced and launched.

That said, I'm pleased with what we're seeing on the demand front. It's been choppy. But I'm pleased with our market positions and how they continue to remain strong, and all the data that we're seeing indicates that they remain very strong despite going through in these very challenging times on the supply chain.

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**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Thanks, Ken. So it sounds like there's really not a kind of pushback on pricing as you guys can price your value, especially with new technologies, will mean more mismatch than timing. Do you have any view on when some of these supply chain issues will recede? In fairness, I don't think anybody has a great crystal ball on this, but are there any signs that are encouraging? Or is it indefinite at this point from what I get from many companies.

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

It's a challenge. It's -- there are so many different scenarios that we look at in our business with respect to the supply chain and -- but there are so many different variables at play that make it extremely difficult to put a fine point on when we see these challenges abate. There are many folks and many others that are discussing challenges going out in 2023, that could certainly be a scenario. We also could see a scenario where things start to clear up in 2022.

I would certainly, with a high degree of confidence, expect these challenging conditions to persist for the balance of 2021. And so we'll certainly continue to navigate and manage through these challenges for the remainder of the year and hope for some improvement as we move into next year.

But with that said, it's -- the team is executing. They're doing a really good job at sourcing and bringing on supply that will allow us to respond to the customers that -- and the demand we're seeing from a customer base, but it is a challenge that we expect to persist for the balance of 2021.

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**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

That's fair enough and not inconsistent with what we're hearing from other companies. So you guys touched on Bacharach, put a nice slide in there, appreciate that. Obviously, you completed that in the quarter. Can you provide an update on that business, how the integration is going?

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

Certainly. It's going well. The integration and the acquisition of Bacharach was an exciting investment for MSA that we made in July. And we're excited about what we can do with the business. The teams are working very well together. We're taking steps pursuing our additional revenue and cost synergies. We really see an opportunity to grow that business, to reduce the complexity in the business that exists today and to continue to invest in new and exciting technologies that can be introduced into those channels.

As you know, those channels are -- we do have position in certain of those channels, but many of those channels are new for us. And so they offer us a great opportunity to invest and launch new and -- exciting new technologies into those channels.



**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

No. Obviously, it sounds like your business has shifted entirely. You're always selling historically technology and obviously you look back at G1, M1. The product portfolio is always high in technology.

But if we talk about today, we're shifting a little bit to digital.

Curious how that has gone internally, how your maybe historically -- historic engineering workforce has gone about being a certain way and now we need to think about things a new way. How have you guys navigated that internally as we've evolved this higher tech software-oriented portfolio?

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

Yes. The innovation, as I said earlier, is a core value of MSA's and has always been a big focus for MSA's. And in total, we have approximately 400 engineers that are focused on R&D efforts and it's a big part of what we do. Over the past 5 years, we've seen the mix become much more software-focused. If I go back 10 years, you saw a lot more focus on mechanical engineering. And now we've really started to pivot more into the software area. I think we've tripled the number of software engineers over that time and have really increased our emphasis with respect to software.

Gustavo, I don't know if you want to add any color with what you're seeing in the engineering side and how we're pivoting to software from an engineering perspective.

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**Gustavo Lopez** - *MSA Safety Incorporated - GM of Portable Gas Detection, Safety io & Sierra Monitor Integration Leader*

Yes. Those are great comments, Ken, and obviously, it's an area that's a hot topic for us. I think it's over the last 5 years we have tripled the amount of software engineers. And certainly, it's a very competitive field. These are folks that are hard to get as not only us but many other companies. Both from the industrial side and the consumer side are really going after them hard.

I think where we've done a really nice job is to set ourselves up as an employer of choice. We have some nice facility, obviously, in the Cranberry in the Pittsburgh area with tight connections to Carnegie Mellon University of Pittsburgh. We also have a nice facility in Berlin with very, very tight to the start-up community there. And to the Sierra Monitor acquisition, we have a center in Johannesburg that has allowed us to tap into the talent there in South Africa.

So as you look at those 3 beachheads, we've been able to give ourselves a nice position as an employer of choice to attract, recruit and retain top talent as we look at driving these connectivity solutions further.

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**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Can you put that software engineer number in perspective? I mean does it go from 50 to 150? Or just rough, just if could get a sense of how important that magnitude shift has changed.

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

I don't have the actual number with me, Gustavo. I don't know if you have the number but it is...

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**Gustavo Lopez** - MSA Safety Incorporated - GM of Portable Gas Detection, Safety io & Sierra Monitor Integration Leader

Yes. I mean -- I'm sorry, Ken. I believe about 5 years ago, we were about a 40-person software engineering organization and we are over 120 today and growing.

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**Lawrence Tighe De Maria** - William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure

So the pandemic's driven strong growth in digital requirements. Obviously, that's one of the reasons we're here talking about this today. Quite honestly, a lot of your digital products and portfolio and solutions started before the pandemic, right? Maybe it's accelerated in a sense.

So kind of curious when I think of the Connected Fireworker (sic) [Connected Firefighter], for example, which is one of the connected businesses that resonates with most of us, what's the adoption curve look like? Has it changed with the pandemic? Accelerated? And is it different than what you would have expected before?

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**Kenneth D. Krause** - MSA Safety Incorporated - Senior VP, CFO & Treasurer

Yes. It's certainly -- the pandemic has certainly accelerated the adoption of digital solutions. We've seen this show up in strong demand for our connected solutions over the past year, 1.5 years. It's interesting. That -- the focus on technology and software is really the success in that has also been enabled by the success that we've had on some of our hardware-oriented products.

And so a good example that I oftentimes refer to here is the G1. We did a great job launching an incredible product with G1 for our firefighters. And we got in front of the customer. We started to change the conversation to be more focused on technology. And then we follow that on with LUNAR.

And it's interesting. Having the opportunity to interact with the customer base through the G1 opens up these opportunities to then converse around these new and exciting technologies like LUNAR. And we're seeing incredible demand coming through, good demand coming through with respect to the LUNAR and the different software-oriented products.

I don't know, Gustavo, if you want to talk about anything you're seeing in gas detection or even in the fire service.

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**Gustavo Lopez** - MSA Safety Incorporated - GM of Portable Gas Detection, Safety io & Sierra Monitor Integration Leader

Yes. So I mean I think once the pandemic hit and folks obviously weren't able to get on to the site, we actually saw our demand for our software solutions that are tied to our connected products really, really grow. And as I look at the last 18 months, we've seen tremendous growth in our cloud-enabled solutions tied to the hardware. And it's been interesting because I think you're getting to a tipping point where a lot of the customers, they do understand -- have no choice but to go into these type of solutions. And the fact that we're able to offer the breadth of products and the breadth of services that we have just puts us in a really, really good spot to be able to gain those deep customer relationships and continue to advance certainly safety for the industry but also our share within those customers as well.

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**Lawrence Tighe De Maria** - William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure

So it's interesting you mentioned the adoption curve of G1 and then obviously M1 overseas. You guys have been and continue to be very successful with that product and that's been driven by having the right technology, the right product at the right time and then hitting a replacement cycle, right? So you guys hit that really well and had the right product.

Now having these digital offerings, they less likely to have replacement cycle because it didn't really exist before. Does this just make you less reliant on cycles for this going forward in the future and then you can push up for upgrade things? Or is there a big upgrade cycle on top of the G1? Or how do we think about that?

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

I think it's a combination. I think you're always going to have a hardware opportunity. I mean we've historically had a focus on hardware, and you're going to have replacement cycles that exist into the future. But what we're also seeing is -- with software is you're creating a more recurring revenue model, a more day-to-day recurring revenue model. You're really leveraging the hardware solution you have and the strong installed base and then introducing this software component over top of that, which is really exciting. And you see companies like Apple doing that all the time.

And that's -- it's interesting when you move into safety, the adoption curve maybe is not as fast. Safety, I would classify, as a more conservative or traditional market. However, when we're in front of the customer, they're certainly -- and as the customer base shifts and as it becomes younger, you're seeing more and more demand for connectivity. And it will continue to produce and create a more recurring revenue business model.

Today, we have about 15-or-so percent, 20% of our business which is recurring. We feel like that has an opportunity to move north in the years to come.

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**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Would you care to venture a guess where it might be in 5 years?

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

I imagine you would ask the question. It's hard to put a fine point on it, but I'll tell you it will continue to improve. And I can't put a fine point on that today, but it's something we'll continue to monitor and talk about as we report on the results in this business segment going forward.

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**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Okay. And with all the stuff we're talking about today and including the last couple of minutes here the software upgrades, do you think that -- what's the margin impact at the end of the day? I mean obviously, not today or tomorrow morning, but if you think about it at a high level in a few years, are we still talking about your incremental margin framework? Or are we talking about a structurally higher margin business? Or how do you think these digital models, new technology are really going to affect your bottom line in 3, 5 years?

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

Yes. It's going to -- our focus going clear back to 2016 -- 2015, '16, our focus is growing the business, improving margins, growing earnings at a multiple of the revenue growth. And these activities that we talk about today are going to continue to allow us to grow this business and to improve the profitability profile. It's exciting when I look at some of the models and opportunities that we have in front of us for years to come around this area, it will be a big part of driving higher margins.

I think that gross margin -- we've talked about gross margin opportunity. I think this business model and this approach and these products will certainly allow us to enhance that gross margin and then allow it to fall through to the operating and EBITDA margins.

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**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Great. And let's just speak with LUNAR for a second here. Going back there, it's probably a bigger question, but is there an actual material adoption curve going on in LUNAR? Or are we still in the first half of the first inning? What's the real acceptance of LUNAR and the competitive landscape for LUNAR looking like?

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

We are early on in the LUNAR adoption. It's early. We're seeing some sales come through, not overly material to our business at this point. But what we're excited about is the prospect of what's to come and our ability to continue to grow this. And when we think about LUNAR and then we think about what I talked about earlier with Fotokite and the drone technologies around that, bringing that all together could create an exciting offering for our customer base as we think about the future.

It's early though and I don't want to get ahead of ourselves, but -- it is early, but I am excited. It's one of those areas that we continue to get closer with the customer on. And when we interact with the customer, we get the data points from the customer, it tells us that we're heading in the right direction and this is a really big opportunity for us.

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**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Okay. And it's really likely to lead -- I mean I understand it's early, but it's pretty high tech, right? And this is the way the world is going with respect to the competitive landscape on LUNAR. And if things like this -- products and solutions like these are going to lead to more conquest customers, right, you're getting more content probably with LUNAR at a fire department that you're already in. That's part of the goal.

Are you seeing -- or do you expect to see that products and solutions like this will lead to more conquest customers? And we're talking about firefighting, but obviously, it can be in other segments as well.

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**Kenneth D. Krause** - *MSA Safety Incorporated - Senior VP, CFO & Treasurer*

Yes. I think so. Gustavo, I don't know if you want to handle that or respond to that, but I certainly think so. Gustavo?

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**Gustavo Lopez** - *MSA Safety Incorporated - GM of Portable Gas Detection, Safety io & Sierra Monitor Integration Leader*

Yes. So I think as we -- what we've seen so far with the connected solutions is as we get deeper and deeper with these customer relationships, there's all sorts of opportunities that are arising that we've never seen before. So certainly, our wallet share is getting a little bit bigger with our customers. I think when you look at the data sets that we're now able to also obtain from how people are using the products, how safety is improving, that's where we see a lot of value. And we have a data team that's focused right now and working directly with our customers and offering safety insights and everything that happens both in the fire service and on the industrial side.

So there's going to be -- there are a ton of opportunities out there that we really are pursuing. And we started -- we have started to gain some decent successes here. And as Ken said, right, the combination of hardware, software, the breadth of offering that we have and our brand equity are really, really critical in us making this transition. But many, many opportunities that we see, again, to advance our mission but also certainly grow our business as we're doing that.

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**Lawrence Tighe De Maria** - *William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure*

Great. We're coming up on our time here. Last rapid question, I guess. The M&A pipeline, should we more or less assume you guys have done a couple of deals and we're in a digestion mode? Or is there a good pipeline out there? And then I think we'll wrap it up here.

**Kenneth D. Krause** - MSA Safety Incorporated - Senior VP, CFO & Treasurer

Chris is on the call as well. Chris is Head of M&A for MSA and also expanding into Investor Relations as Elyse starts to move more into FP&A. And so he can also comment about that after maybe -- after I'd say a couple of things. But M&A is a big focus for us. We've got a great balance sheet. We have a strong balance sheet. We've used it. I think at the end of Q2, we talked about pro forma leverage of just south of 2x.

And so we pretty well positioned right now. And we feel like at this point, we are digesting what we just recently acquired and we want to create -- make sure that is successful. But with that said, we continue to look at new opportunities. We continue to look at the pipeline and evaluate it. Pricing, obviously, is important. It's an expensive market right now. And so it's something -- we certainly don't want to overpay for acquisitions. And so we're going to be mindful of that.

And so it's digest what we have, continue to look at new and exciting opportunities. We'll be smart, be smart with the balance sheet. And I think we've done that over the last several years and we'll continue to do that going forward. Chris, I don't know if you want to add any color with respect to the M&A?

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**Chris Hepler** - MSA Safety Incorporated - Executive Director of Corporate Development

Ken, the only thing I would add, Larry, it's quite a robust market. There's a lot of activity going on in the market. So we're pleased with what we're seeing. We're absolutely being selective on where we're thinking about spending money on the M&A side at this point in time.

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**Lawrence Tighe De Maria** - William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure

Okay. Well, great. Thank you all very much for doing this. We appreciate it, and thank you for tuning in for MSA Safety. And we'll talk to you again soon. Thank you very much. Appreciate it. Thanks, guys.

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**Kenneth D. Krause** - MSA Safety Incorporated - Senior VP, CFO & Treasurer

Thank you. Have a great day.

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**Gustavo Lopez** - MSA Safety Incorporated - GM of Portable Gas Detection, Safety io & Sierra Monitor Integration Leader

Bye.

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**Lawrence Tighe De Maria** - William Blair & Company L.L.C., Research Division - Co-Group Head of Global Industrial Infrastructure

Thanks. You, too.

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