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MSA - Q1 2020 MSA Safety Inc Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the MSA Q1 2020 Earnings Conference Call. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference over to Elyse Lorenzato. Please go ahead.

Elyse Lorenzato - *MSA Safety Incorporated - Director of IR*

Thank you, Brandon. Good morning, everyone, and welcome to MSA's First Quarter Earnings Conference Call for 2020. Joining me on the call today are Nish Vartanian, President and CEO; and Ken Krause, Senior Vice President, CFO and Treasurer.

Before we begin, I'd like to remind everyone that the matters discussed on this call, excluding historical information, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, all projections and anticipated levels of future performance. Forward-looking statements involve risks, uncertainties and other factors that may cause our actual results to differ materially from those discussed here. These risks, uncertainties and other factors are detailed in our filings with the SEC, including our most recent Form 10-K filed in February of this year. MSA undertakes no duty to publicly update any forward-looking statements made on this call, except as required by law.

We've included certain non-GAAP financial measures as part of our discussion this morning, and the non-GAAP reconciliations as well as our Q1 press release are available on our Investor Relations website at investors.msasafety.com.

With that, I'll turn the call over to our President and CEO, Nish Vartanian.

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Thanks, Elyse, and good morning, everyone. Since our last earnings call in February, the COVID-19 pandemic has impacted our families, our communities, our workplaces, our economy and our world. Like you, we all hope we're beginning to move towards the downside of this crisis. As we navigate through this environment, I want to start off by expressing my deep appreciation to the associates of MSA. As I've said many times before, our mission is the foundation of our success. The importance of our mission and our employees' dedication to it is today more relevant and more clear than it's ever been. The reaction by our people, working with speed and agility across the enterprise has been a reflection of a highly engaged workforce, ensuring operations continued through the crisis with minimal disruptions to providing essential product, service and support for our customers.

As a leader in safety, MSA is an essential business. Each and every day that our associates come to work in our plants around the world, with great pride they're making equipment that is helping to protect the world's first responders, energy and utility workers and so many others who are on the frontlines of this COVID-19 outbreak. During our Investors Conference last year, I highlighted with the world's increasing focus on environmental and social issues, including safety, protecting workers will become an even greater priority for our businesses. The situation with COVID-19 sharply underscores that living and working safely has a profound impact on business conditions and that there's a very basic human desire to protect the world's workers. That is MSA's mission, and it's never been more important.

To say I'm proud of our entire MSA team would be an understatement. I would also like to thank our supply chain partners, who are also essential stakeholders in protecting the world's workers. In just a moment, I'll provide insight into how we're managing our business through this crisis and the near-term priorities we've set. This effort dates back to January when our team in China began to assess and address the situation, and we're in active communication with our corporate headquarters. On issues like employee protection protocols, business continuity and supply chain as well as potential mitigations. After that, we expanded our COVID-19 rapid response team to be global in scope. Our early start had a clear and positive impact on our first quarter results and positioned us to better respond to the situation.

For the first quarter, our revenue grew by 7%. Air-purifying respirators were a key source of growth in the quarter, which is largely reflective of the global PPE shortage from COVID-19. Fixed gas and flame detection was a strong performer in the quarter. And our SCBA, portable instruments and head protection lines also performed well, with low single-digit growth. I'm also pleased that the International segment margins continue to expand and reflect the great progress we've made on commercial excellence and cost structure programs.

Against those highlights, I'll now provide more texture on how we're managing through the COVID-19 situation and the priorities we've rallied around. Let me begin by saying that we're seeing the benefits of having a seasoned executive team in place and leaders at all levels of the organization who have steered the company through a number of macroeconomic downturns before, such as the recessions of 2009 and 2015. Our teams also responded in the wake of the tragic events of 9/11, where many of our associates were directly involved in helping first responders at Ground Zero and the ramp-up effort to help fortify national stockpiles with gas masks. With those experiences in mind, we are responding to this pandemic and operating our business around 4 key priorities.

First, the health and safety of our workforce is our top priority. Our second priority is business continuity. Third, we're focused on expanding manufacturing capacity of our existing air-purifying respirator products. And our fourth priority, which Ken will cover in greater detail, we're focusing on managing our capital structure and expenses. We prepared cost levers to respond to various potential scenarios in the business while still investing at planned levels for new product development.

Focusing first on the health and safety of our workforce. Know that tens of millions of workers rely on MSA products every day, and we're dedicated to safely getting our products into the hands of those who need them most. Consistent with our mission and internal safety culture, we've taken a number of steps to provide a safe environment for our associates who are continuing this essential work. In our factories and work sites, we continue to follow CDC recommendations for social distancing and disinfecting. We've enhanced cleaning protocols, instituted temperature monitoring, modified work cells to ensure proper distancing. Our back office and administrative teams have been working from home since mid-March and are leveraging technology to effectively drive productivity. Despite the distance, our people are staying connected with each other and with our customers. I'm heartened by the fact that the number of interactions with customer service have actually increased, and our level of customer support is at the same levels pre-COVID-19. This is a real complement to our customer service management and IT teams.

We've also taken proactive steps to protect the health and safety in our local communities through this crisis. To support this effort, MSA donated or is in the process of donating more than 140,000 disposable masks sourced from third parties to hospitals and health care systems and communities where we operate around the world.

Regarding our second priority, business continuity, our teams around the world have been hard at work to keep our factories running and our supply chains moving. All MSA factories throughout the world are open and running. We continue to work closely with our suppliers, and supplier disruptions have been handled on a case-by-case basis as needed. Our corporate and local teams have done an excellent job in managing through these challenges and our focus is ongoing in this area.

The third area I want to discuss is MSA's manufacturing response regard to air-purifying respirators. While the disposable N95s, that are mentioned so often in the news, are not manufactured by MSA, we produce advanced air-purifying respirators, such as elastomeric half mask, full facepiece respirators and powered air-purifying respirators with a full complement of filtration capability. These products have been part of MSA's portfolio for many years, and they've been used in industrial applications.

These air-purifying respirator products reflected 8% of total sales in the first quarter and increased by more than 60% in dollar terms from a year ago. Later in the quarter, we saw higher levels of demand for respiratory products, largely from our existing industrial and first responder customer base.

With the urgent market needs and related surge in respiratory orders that we've seen in March and in April, we've made the decision to invest $11 million to $13 million of CapEx to expand manufacturing capacity for respiratory products at the Jacksonville, North Carolina plant. We've started to make investments and have already hired and trained dozens of workers to support this project. We're doing everything we can to reach our goal levels of capacity later this year. While the APR backlog is strong and growing, the fulfillment will shake out over the next several quarters.

I've often said, MSA's portfolio has a defensive element to it based on our diversified exposure across many end markets and geographies. I think this attribute is evident again, particularly against the backdrop of this challenging environment. For example, in April, incoming orders are up more than 10% overall, as strength in our respiratory business and fire service was more than enough to offset declines in industrial products. Accordingly, we intend to invest in our respiratory business and increase our output substantially there. We've lowered our near-term growth expectations for industrial and energy-based PPE products that are tied to employment and protecting the individual worker like portable gas detection, head protection and fall protection.

April orders for fire service products were healthy, and we built some backlog so far in Q2. As always, with the fire service, these products can have longer lead times and take a couple of quarters to deliver. So when you look at the business from a high level, April orders were healthy. We built backlogs in areas that typically have longer lead times or will require manufacturing investment to deliver, while employment-driven PPE business has weakened.

The extent of economic damage from the virus and timing of recovery is unclear. However, our first quarter was reflective of a highly engaged workforce that has a clear connection with our purpose and mission. And looking forward, it's encouraging to see our diversified portfolio supporting our overall business, despite the downturn in certain end markets.

With that, I'll now turn the call over to Ken to continue to review our COVID-19 priority areas and provide more insight into the impacts on our business in the near term. Ken?

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

Thanks, Nish, and good morning, everyone. Before I begin the P&L review and discuss the cost structure and liquidity aspects of our COVID-19 response plans, I want to step back and provide a few performance highlights.

First, we started the year very strong with 7% revenue growth in constant currency. We had a good growth across a substantial portion of the portfolio, driven by a very strong finish in March. While we have seen a shift in product mix within the order book late in the quarter and into April, orders in April were healthy in total, and we have a sizable backlog of business to start the second quarter. We remained favorable on the price cost equation and saw healthy product margins in the quarter. Coupled with diligent cost control, we realized incremental margins of 37%. Adjusted operating income was up 10% on a reported basis or 2x the revenue growth rate.

We continue to execute around the balanced capital allocation strategy. During the first quarter, we funded $16 million of dividends to shareholders and deployed $20 million to repurchase 175,000 shares to offset dilution. Leverage remains very manageable at 1.3x EBITDA or less than 1x on a net debt basis. Our efforts and responsible approach to leverage as we finish 2019 and started 2020 has positioned us well to maintain a very balanced approach to capital allocation.

Now I'd like to walk you through our first quarter results and provide more insight into how we are managing our cost structure and balance sheet through these uncertain times. Total revenue increased 7% on a constant currency basis on growth across much of the core product portfolio as well as strong growth in air-purifying respirators, or APR, which are complementary to our core offering and included in what is defined as noncore in our public filings.

In the fire service, we realized solid growth in the Americas SCBA area as we worked down our backlog from the pent-up demand associated with the approval delays last fall. We had indicated that revenue would shake out over a couple of quarters, and that's exactly what happened. Demand remains relatively healthy in this area in April.

Fixed gas and flame detection had a strong quarter with good momentum on our new products across the U.S. and the Middle East. The FGFD line is a very global line with strong market share in both the U.S. and in the Middle East as well as a sizable recurring revenue stream on the installed base, and those qualities continue to help us navigate a challenging energy market. This business continues to hold up well and has held up well and past slowdowns.

Emerging market revenue was up 12% in the quarter. While China had a slow start due to the COVID-19 outbreak, we realized very strong growth in the Middle East FGFD and Latin American fire service and head protection product lines. China has started to rebound in March, and we are seeing improved results in April in that area of our business.

From an FX perspective, we had a 2% headwind on revenue related to the weaker Euro and Brazilian real compared to this time a year ago. Gross profit increased 10 basis points in the quarter, as pricing held up nicely and offset higher indirect costs, such as COVID-related expenses of about $800,000. It was particularly encouraging to see strong product margins in our International segment this quarter.

As we discussed at Investor Day back in November, strategic pricing has been a major focus for our European business. And it's good to see the traction there in both the second half of 2019 and again here in the first quarter. It's good to see pricing holding up well as we continue to provide customers a cost of ownership advantage.

SG&A expense of $80 million was up 2% on a reported basis or 3% in constant currency organic terms on the mid-single-digit revenue growth. We continue to realize the expected returns from previously executed restructuring programs, particularly in International, where operating margin is up 170 basis points. In that area of our business, constant currency SG&A was down 4% in the segment on revenue growth of 1%, and we continue to see solid leverage in the Americas segment as well.

As we had discussed in our year-end call in February, we entered 2020 with a focus on productivity and back office cost rationalization based on the uneven environment. When we started to see the economic downturn in March related to coronavirus, we became even more active in identifying a number of short-term cost reduction measures. In addition to savings from reduced travel costs, we implemented a hiring freeze with very minimal exceptions. We also have expense controls in place around professional service engagements and other discretionary costs.

Controlling our cost structure is a key priority of our COVID response plan, so we are watching this area very closely. We plan to maintain hiring and discretionary cost controls through the second quarter as we manage through this uncertainty.

There are a number of other short-term cost reduction measures that we currently have prepared and are on the shelf. We can and will pull those levers as needed based on the order book, which we monitor daily.

From a longer-term perspective, we plan to continue to execute our road map of European cost reductions that we laid out at Investor Day. We also continue to evaluate programs to improve our global footprint and optimize our business structure.

Strong product margins and cost control drove an 80 basis point improvement in adjusted operating margin from a year ago, with improvements across both the International and Americas segments. Also, our most recent acquisition, Sierra Monitor, which we acquired in the second quarter of 2019, has become accretive to the MSA consolidated operating margins in less than a year. In addition to inventory step-up rolling off after Q4, we've been able to drive efficiencies throughout that business.

Our adjusted effective tax rate was 25% in the quarter, which increased about 100 basis points from a year ago as we had higher losses in jurisdictions where we cannot take tax benefits. Adjusted earnings were $1.18 per share or 4% higher than a year ago. We indicated on the February call that we expected an $8 million full year headwind in 2020 from noncash pension expense. That had a $0.04 impact on adjusted earnings in the quarter as expected. Similar to many companies, we added discrete costs associated with the virus back to adjusted operating margin and adjusted earnings metrics.

As Nish had mentioned, managing our liquidity position is a key focus area for our team in response to the economic downturn. Our balance sheet is strong and positions us well moving forward. The level set on our position at the end of March, we have cash on the balance sheet of $123 million. Our current debt balance is $372 million or less than 1x on a net debt basis versus a covenant of 3.5x. Our next principal payment on our senior notes is $20 million in the fourth quarter of this year, which is not overly material to our cash flow. We have ample capacity on our credit facilities and shelf facility agreements as well.

At the end of the quarter, we have more than 2 turns of EBITDA available on our covenants, which provides plenty of flexibility. To manage cash flow, we have already begun applying best practices to drive improvements in receivables and payables. Working capital ended the quarter at 26.1% of sales, relatively consistent with a year ago. The increase from year-end is primarily related to the timing of receivables as we had our strongest invoicing month of the quarter in March, combined with an increase in inventory, which was partially offset by improvements in AP. We have not noted any material credit issues to date, and we have a team that is closely monitoring this area.

The balance sheet is very strong, and our capital allocation priorities remain very much intact. We remain focused on investing in our business and funding our dividend, while maintaining an investment-grade balance sheet. Nish had mentioned the investments we plan to make for the respirator manufacturing ramp up, and we plan to continue funding R&D in line with previous expectations in 2020. We are positioned well to manage the challenges we all are facing and to pursue growth opportunities when appropriate.

To wrap up, let me step back and summarize the operating environment as it stands today. Our factories are open and our supply chains are moving. We do continue to work through logistics and materials challenges, but we have not seen any major disruptions to date. Our diversified portfolio positions us better than most in this environment. Just looking at our April orders, we have seen significant declines in short-cycle industrial and energy-related products. However, that is being more than offset by higher demand for firefighter safety products and respirators.

So in total, after a strong March, April orders are up more than 10% versus a year ago as we see this shift in product mix play out. While this can change quickly and it will take some time and investment to ramp up our respirator capacity and get that backlog out the door in coming quarters, our business is very much holding up in April. The defensive nature of the portfolio that we've built is providing great support to finish the first quarter and to start the second.

While the business continues to hold up well through April, there is a great deal of uncertainty in many moving pieces, among them are the conditions in the energy market. The timing of when construction products may resume, when the broader economy might open up and how the demand patterns evolve for respirators in the back half of the year. Like many others, our line of sight for the full year is just not clear. This makes it very difficult to provide expectations for the full year growth rate. What we do know, however, at this point is we've had a great growth in the first quarter, which was heavily influenced by healthy orders and strong invoicing in March. Orders are strong in total for April, notably in our respirator and fire service lines where we're building backlog. This is helping to offset weakness in hard hats, fall protection and portable gas, areas that often book and ship very quickly. Backlog levels are healthy and should provide support in coming months and quarters.

When you think about the composition of backlog and how the impacts the near term, it's important to note it will most likely take us into the third quarter before we are able to see backlog moderate in fire service and respirators. For respirators, in particular, we expect to make progress on that front as we ramp up our manufacturing capacity in the coming months. We've modeled a number of scenarios internally for 2020, and we have a playbook ready for a range of potential outcomes. We have a number of initiatives that we are executing and can launch to improve productivity and reduce our cost structure. While there is a great deal of uncertainty in the global economy, we had a strong start to the year with 7% revenue growth and 37% incremental operating margins. Our business leaders are executing our growth and productivity plans across both of our operating segments, and we're seeing very strong results.

Looking ahead, we have a response plan in place to manage our cost structure and liquidity position through the economic downturn. As always, we are committed to being proactive operators through this crisis and controlling the controllable. We are well positioned with a flexible cost structure and strong balance sheet to manage through and maintain our solid fundamentals over the long term.

With that, I'll turn the call back over to Nish for some concluding commentary. Nish?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Thanks, Ken. The strong revenue growth and incremental margin profile in the first quarter provide a solid foundation to start the year. Our portfolio is diversified. We're well positioned from a cost structure and balance sheet perspective to manage through these times. We'll continue to focus on protecting the health and safety of our workforce, enabling business continuity in our plants and throughout our supply chain and ramp up our manufacturing of our existing respiratory portfolio to do our part in supplying much-needed PPE.

Over our long history, MSA has faced many periods of turmoil and economic challenge, but we've always emerged a stronger organization, and I'm confident that we're going to do that again.

At this time, Ken and I will be glad to take any questions you may have. Please remember that MSA does not give guidance. Having said that, we'll now open up the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Stanley Elliott with Stifel.

Stanley Stoker Elliott - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP & Analyst*

Question for you guys. Could you all -- you kind of talking about -- let me switch gears. So on the municipal customers, have you heard anything concerns around funding at that level as it relates to the fire service piece, given kind of what you've seen with sales tax receipts? I know you mentioned good visibility through third quarter. And then also kind of as a corollary, is there anything within the CARES Act that could either help that segment of the market or benefit MSA as a whole?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Sure. Yes, Stanley. There's -- actually, in the CARES Act, there's $100 million addition to the assistance to firefighter grant. And that's for COVID-related products, and we're well positioned for that to pick up some business with APR adapters for our G1 facepiece and M7 facepieces also has an APR adapter. So we're well positioned for that and some other opportunities within the fire service. So there's that $100 million that was added. We haven't seen any pullback at all from the fire service. As mentioned, our bookings for fire service was quite strong in the month of April. We picked up some real nice business, some good conversions with the G1 and the backlog really built there. And that's across all 3 product lines. The bookings for not only breathing apparatus, but also our turnout gear and fire helmets were quite strong in the month of April. There's always that concern with tax receipts, and tax receipts pinching those municipal budgets a bit, but let's not lose sight of the fact. And we've said this in the past, and we've seen it in 2009, 2015 and other periods, when you're protecting firefighters, our product protect the lives of firefighters. And in this new day, so to speak, of awareness around safety, that's a top priority for municipalities is making sure that they're protecting those frontline first responders. So we've always seen fire departments find the money, so to speak, to replace breathing apparatus and make those purchases.

Are we concerned? Sure. We look at that closely. What we may see is municipalities can't have meetings to approve something. So unless they start doing that from a remote standpoint, you might see some things delayed or we might see some evaluations delayed a bit. But the overall health of the fire service is really strong. And we're really optimistic with, obviously, our position in the marketplace and the products we have going in. So we have a pretty positive outlook for that -- for the balance of the year.

Stanley Stoker Elliott - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP & Analyst*

Perfect. And I appreciate the April commentary. Is there any way to give a little more color about kind of what down substantially would mean for either the head protection or some of the employment driven? And then kind of as a second shot -- offshoot with more of -- kind of the respirators taking a bigger chunk of the revenues in the back part of the year, how do we think about incrementals, or I guess, decrementals as it were for that with the additional product coming in?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Well, let me just characterize the business, Stanley, and maybe that will help you a bit. It might be worth, if you go back and you look at 2015 and see what happened with our business in 2015 and '16. And I wouldn't be surprised if on those short-cycle PPE products that we see something similar to that in declines in business. And that's for industrial head protection, that's for, obviously, portable gas detection and fall protection. So those are the 3 areas that will be impacted by what we've seen in the slowdown. Now not only have we seen in the month of April, the slowdown with oil and gas, construction sites across the country and world have shut down. And so that really impacted, obviously, hard hats and fall protection. And I don't think that will be the case for the balance of the year.

So what we saw in April might be the low point, right? So as construction sites open up here in the spring, we could see head protection, fall protection bounce back, probably not the portable gas detection. So maybe take a look at 2015, '16, and that might give you an idea as to what happened with those short-cycle products that we book and bill in the same quarter. The orders we saw in April and in the back half of March and where we built the majority of our backlog, those are really across fixed gas and flame detection, self-contained breathing apparatus, the fire service products across the board and air-purifying respirators. In the first 2 categories, fixed gas and flame and fire service products, those typically ship out over multiple quarters, 2, 3 quarters, we'll see those products ship. And then, of course, we're building our capacity with air-purifying respirators. So hopefully, that gives you a little better insight into what we're seeing and where we are.

Operator

Our next question comes from Richard Eastman with Robert Baird.

Richard Charles Eastman - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Very nice quarter, congrats to your whole team, Nish.

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Thanks.

Richard Charles Eastman - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Nish, a couple of things that you had mentioned around backlog and strength. Does the same strength in the same product lines apply to the International business? Or will we, going forward, see some bifurcation between growth rates between International and North America?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Off the top of my head, Rick, and I think Ken might have more insight into this, it was fairly consistent. We saw more strength in the air-purifying respiratory products here in the Americas than we did internationally. But internationally, we also saw some good buildup and ramp-up of the APR products. So we saw some consistency there. Really the fixed gas and flame detection products were stronger in International from a booking standpoint, and that's really on the strength of the Middle East. The Middle East, we've seen really good activity for our new transmitter. The X&S 5000 has performed really well in that market as customers have a good understanding of the cost savings they can have when they get that product in place, and it's been taking some share and doing a nice job. In fact, one of our biggest customers just approved a new technology that we acquired a couple of years ago with Senscient, open path, hydrogen sulfide detection, which was a big breakthrough for us. Getting that new technology into that major customer of ours, that was about a year testing that they had performed on that product, and it was really exciting that they didn't back off that in this downturn for oil and gas. So International saw more with fixed gas and flame. I would say, that the Americas a little bit stronger on the APR products. But on short-cycle products from a booking standpoint, they all declined fairly similar across the board. From an invoicing standpoint in the first quarter, the International fall protection was off significantly, where I think the Americas was up maybe 1% or down 1%. The International is down so much, and that's really the nature of the business there. But there's a lot of engineered systems that are sold, especially in Europe, and that's kind of construction-type business that we weren't able to install. So that's why you saw a much deeper decline in fall protection in the first quarter than you had in the first quarter for the Americas.

Richard Charles Eastman - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I see. Okay. Okay. And then I did want to just to recon, again, with that sales mix going forward, does gross margin get pressured a bit just by the sales mix? I'm kind of pegging off of Ken's comments where he emphasized that a little bit. But our general feeling is SCBA, and clearly, the APRs would not have a gross margin perhaps that -- anything on the short-cycle might have. I'm just curious, is that something to just pay attention to here as we start to model out the mid-section of the year?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

No. Rick, the APR is actually a pretty good gross margin product line. That's right in line with the rest of our business. It's actually better than the fire service business, not quite as good as the gas detection, but no, that's a good, healthy margin business for us.

Richard Charles Eastman - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. Okay. And just the last thing and just around APR. Is the end market for that APR products -- I consider that more an SSC than a PPE, but is the end market for that, again, industrial? And what is the end market for that? And then also the capacity that you're adding, it sounds like you have enough capacity in-house to not quite double the business year-over-year, but I think you said it was up 60%. And so the capacity that we're going to bring online would essentially fulfill growth in the second half of the year. I mean growth above or consistent with like 60%. Is that the cadence there?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Let's see. On the APR side as far as the ramp-up, obviously, we don't give guidance, but we're ramping up significantly. That 60% number is -- I don't want to say, it's conservative because really you didn't get a full quarter in the first quarter. I mean that's just the reality of the situation. So doubling of the business, I don't think, is unrealistic as we look out for the full year. And the application for the product is really broad. It's across all manufacturing type applications. I saw a video clip of some workers decontaminating an airplane, and they happen to be wearing our Advantage 200 mask while they were doing that. So it's -- the use for our half mask full facepiece and powered air-purifying respirators, the APR adapters for firefighters, those products are used in a very broad range of industries, whether it's utilities or general industrial. That's across a very broad range.

Richard Charles Eastman - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I see. Okay. Okay. Very good. And that meets all standards for what we'd find in Europe as well?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Correct. We -- so we have products that meet both CE and NIOSH standards.

Operator

Our next question comes from Larry de Maria with William Blair.

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

Just staying on this APR for a second. Can you -- just for clarification, with most of this generally outsourced and noncore and now you're ramping production capacity and it will become core. And as you ramp production capacity, just give us a handle on how big this business potential on the capacity output is going to be? And do you expect to kind of make this a sustainable business as opposed to a short- to medium-term bump? That's the first question.

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

So as far as core and noncore, we really haven't thought about moving air-purifying respirators into our core, what we would find or how you define core products. And I really don't look across our portfolio in that regard any longer. When we started talking about core and noncore products, core products represented about 55%, 60% of our overall revenue. Today, it's between 85% and 90% of our revenue. And the noncore products or those adjacent products, the majority of that include air-purifying respirators and the ballistic helmets we sell internationally. And those are both very good gross margin product lines. When there's opportunity to invest in those product areas, we will do so when there's a good business opportunity to do so.

But as far as thinking about moving that into core or not core, it's -- that's somewhat irrelevant from an internal standpoint. From a priority standpoint, as far as investment is concerned, longer term, as I look out 3, 5 years, even 7 years, the priority -- in really prioritizing where we invest from a new NPD standpoint, new product development, we have other priorities. The other priorities are really in that gas detection, breathing apparatus, fall protection. Those are areas where we've proven where we can really differentiate our product, drive improved margins, grow our market share and bring value to our customers and shareholders, of course. So maybe that's another way to look at it as we -- after we get through this cycle, so to speak, and we get through cycle here on what we have. Those core products that you traditionally know, that's where the vast majority of our investment will go.

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

To your question, too, Larry, you had asked about manufacturing. We do manufacture these respirators. We've historically manufactured these. The disposable respirator is something we do not manufacture, but we do manufacture the ballistic helmet that Nish spoke to as well as this respirator line. Part of the investment we're making on the CapEx side is just modernizing our equipment as well. We certainly see the opportunity and we see the demand coming through for respirators, but we also see the opportunity to update and modernize our manufacturing facility. And so that's part of the process as well.

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

Okay. And with the incremental capacity modernization, et cetera, can you maybe just give us a handle what was APR in 2019? And what is max capacity kind of run rate, once we're done with this ramping cycle?

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

Yes. We're in the process of looking at the max capacity. But I'll tell you that for the month of March, we saw, call it, between $7 million and $10 million of additional business come through in that month. So that was about what we saw come through. So that's -- it's meaningful, right? It's a meaningful growth opportunity for us, and we continue to see those orders improve as we go through April. So -- but in terms of max capacity and max potential, I'll just tell you that $11 million to $13 million investment, we certainly are able to justify that with the demand that we're seeing over the last, say, 6 weeks.

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

Okay. Fair enough. That's helpful. Now maybe address the energy elephant in the room, which you talked a little bit about, if I can go back to 2015, I guess. But this project's in place, and we're probably not seeing the potential for downside in energy, given where oil prices are. Can you give us a better idea of how maybe you think that plays out if oil may not stay where it is right now, but it's not to say also going to go back to $50 either, which would be positive. So if it stays in this, anywhere from $10 to $30 range, it's going to be a net negative, I would think, overall, obviously. So how do you see that play out? When does that impact you guys more? Is it second half? Or is it 2021? And if you could just talk a little bit more holistically about the energy exposure so we, investors, can get a better handle on how this plays out over time if energy prices stay depressed if this structurally impacted or not?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Sure. So Larry, the energy business -- and again, you go back to '15 and '16, that's the last down cycle. And as you know, there's -- the energy market goes through a number of down cycles, whether price goes up to $120 down to $40, back up to $140, I think, and down to $40. And now we're down significant lows. At some point in the future, the supply will tighten up, and demand will come back and the market will come back. The one thing to keep in mind is that the majority of our business in that oil and gas and in that entire system is downstream. So we're in those refineries. And the refineries will continue to run and operate. And so they'll continue to need equipment. They'll continue to do turnarounds and maintenance work in those refineries, which is where the bulk of our product goes in when they spike up in the fall and -- in the spring and in the fall for, what we would call, plant turnarounds. So there's still going to be some nice opportunity there. Upstream will certainly be impacted. And as far as capital expense and capital expenditures around pipelines or new refinery or capacity, that will be impacted. So we will see some tightness in the business around those short-cycle products in head protection, fall protection and portable gas detection. But keep in mind, the construction market is a real good market for us for fall protection and head protection.

So if there is this pent-up demand for construction and a lot of government funding coming through, the fall could be a real good time frame or time period for us for head protection and fall protection. That's when we look at the wide range of possibilities and what could happen with our business. The construction market could be a real nice space for us to offset some of the downside we would see with oil and gas. The one area that we would be challenged with is portable gas detection. The market for that in construction is much smaller than oil and gas. But for head protection and fall protection, in fall protection, we're gaining some nice market share. We could see there's the potential for a nice pop there come the fall.

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

Just adding a little bit of texture there, Larry, with respect to our growth rates in the past, and as Nish keeps referring to 2015 and '16. And when we look at what we're dealing with right now, we don't necessarily compare this to the great recession of 2008, '09. But what we do is we look at it, and we say this is a combination of 2015 and '16 with the energy market declines combined with 9/11, where we saw a great demand for a number of our safety products. So it's a combination of those two. There's not one particular recession that we can look at. But if we do look at the industrial recession of 2015, when oil went from well north of $100 a barrel down to $37 in the fourth quarter of '15, our fixed gas and flame detection business held in there. It was flat in '15 and '16. And part of the reason it was flat was because of the global nature of the portfolio, and I spoke about that in my prepared comments. What we did see was weakness in portables and head protection. Portable is at the worst point down around 15 -- 13% to 15%, and head protection was off double digits as well. April now -- of course, in April, it's hard to compare April to any other period because the economy is effectively in a coma. But with that said, we certainly do see weakness in those short-cycle employment-related products. But what's good to see is the fixed gas business holding in there.

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

Okay. And then just -- I don't want to -- last question, I don't want put words in you guys' mouth. But given your comments on April, and that seems like the short-term is fairly okay, given some of the offsets. So is it safe to say that we're looking for organic growth in the first half overall and then second half declines as we start some of the stuff that plays out? Is that what you're trying to imply?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Well, shorter term, I think when you think about growth shorter-term in the second quarter, I think that's somewhat difficult because of the nature of the backlog we have, Larry. When you -- we talked about the fact that the backlog we have, which our backlog is at an all-time record. We have a record backlog. It's up, I think, 10% from a year ago at this point. What's in that backlog will ship out over 2 and 3 quarters. What's not in that backlog is a tremendous amount with head protection, fall protection, portable gas detection. And again, those are the things that we book and bill in the same quarter. So that's where you're going to see -- a little bit of softness is probably here in the second quarter. Line of sight to the overall business as you get into the second half of the year, that gets really difficult. We have a real wide range of possibilities of what could happen with our business as we'll get into the second half of the year. And it's just tough to predict. You've heard that from probably every investor's call. Line of sight in the second half of the year is really tough because you don't know if this thing falls into the background, and we get back to business as usual and get a real good recovery and good things could happen or does COVID-19 come back stronger in the fall and as that creates some more problems for us. And so we just don't have good line of sight to that, and it's real hard for us to have confidence in saying that we'll have organic growth throughout the year or in any one particular quarter, that's challenging for us. The management team's done an excellent job here in pivoting and getting product out the door for air-purifying respirator products and filling the gap. And those factors that we control, we've done a nice job of, and I know we're going to continue to do that. It's just those macroeconomic conditions that give us some real pause.

Operator

(Operator Instructions) Our next question comes from Edward Marshall with Sidoti.

Edward James Marshall - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Well, good job operating in one of the more difficult environments we've seen. And I guess we've just come to expect a high-performance from you guys. I wanted to get back to APR for a second. I think it was the longest time on any call that I can remember, we can focus on noncore product line, and that kind of goes to the root of my question. As you spend what looks like, I guess, 30% of your average CapEx spend over the last couple of years on a project, I wanted to understand -- and you're not shifting in R&D spend and the margins, let's just call it, okay, kind of in line with the rest of the business. Just wanted to get your sense as to the decision to spend kind of what could be a short-term improvement in the sales line? Or do you see this kind of a shift in the overall way people do business, and therefore, the string of revenues behind that is a much longer term?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Yes. And I think when we -- and I'll answer the first part from a market standpoint, maybe Ken can add a bit around how we're looking at our CapEx and some of the thought around that. But when we look at what we're seeing with demand for air-purifying respirator products, we believe -- and Ken mentioned it, we believe that, that there is going to be a build of stockpile. There's going to be demand that could continue into 2021 at an elevated level and maybe even longer. I think the attitude around what occurred and the damage it's done to our economy is going to have a significant shift and how we're looking at respiratory protection products and making sure -- business is making sure that they have stockpiles and available product going into the future. So we see demand that would probably continue at an elevated level into 2021. And a lot of this CapEx is, quite frankly, updating a lot of equipment that we have in our plant. It was, to a degree, in our CapEx plan. We do a 5-year outlook plan on CapEx. And really what we're doing is we're pulling a lot of these projects forward. So we're able to get this ramped up quickly for this spike in demand, and hopefully, this continues into 2021. And then as things go back to normal and I think the back to normal will be elevated from past history, and we'll be in a much better position from an operations standpoint to support that as we go forward.

As far as the CapEx and how we're looking at that, Ken, maybe you can provide more color on that?

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

Yes, sure. As I spoke about one of the questions previously, we are certainly compelled to make this investment. And the reason I say we're compelled is because when we see -- look at the returns, for example, in the month of March, my reference to $7 million to $10 million of additional revenue in that month. If we just play that forward and use that as a run rate going forward, which oftentimes can be hard to do. But even if you just look at the order pattern, in April, this investment has an opportunity to pay for itself in a very short time period. And so we couldn't pass up that opportunity to make this investment in a line where margins are very healthy. And so we decided to go forward and make this investment into an area that needed some investment, it was an area that we saw an opportunity to modernize and upgrade some of our equipment.

Edward James Marshall - *Sidoti & Company, LLC - Senior Equity Research Analyst*

So it sounds like it meets all the hurdles as well is it just -- it's refreshing, I guess, get the sense that it's accelerating plans that are already in place. Yes. So I wanted to ask, I guess, about there's been manufacturing, construction, et cetera, layouts furloughs. Can you talk about the new spend as those workers come back? I mean do they just pick up their helmet and go back to work? I mean, kind of talking through kind of how the spend works as blue-collar workers start to come back to the line?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Ed, that's a really interesting question. And you bring up a good point. And what we've seen, again, when you go back and you look at the different cycles we go through with those short-cycle products. What we see is in the declines, the declines are always greater than the GDP decline. It's just the way it works, right? The supply chain stops. People really slowdown on buying hard hats, replacement suspensions and fall protection, et cetera, then the whole supply chain behind that slows down. And we see this accelerated slowdown. When things come back, they bounce back. They bounce back hard because what you said isn't true. The construction worker does not keep their hard hat. They typically -- the fall protection products aren't kept. So when they come back to work, they buy a new hard hat, they get some new fault protection product. And that's -- and then the supply chain begins to fill, and you get the synergistic effect in the business where end users are building their inventory, channel partners build their inventory, and that supply chain builds and we get that nice lift in growth and bounce back in head protection. So when you go back and you look at our growth patterns with -- for hard hats, and I would say, fall protection in a similar category, you'll see that. Fact of the matter is, as we may see depressed sales to a degree with portable gas detection, but we know that market is going to come back. And when it comes back and they have a little extra money, they're going to replace their entire fleet of portable gas detection when it comes to oil and gas. So that will bounce back strong at some point. It could be '21, could be '22. I'm not quite sure when that will be. But no, you'll see a bounce back, so to speak, on those short-cycle products.

And what's really interesting, Ed, as we look at safety and we look at head protection and we look at what's happening, standards might change a bit, which could shift in our favor. So 2 interesting things that occurred here in the last couple of weeks. The country of France, to go back in construction. They're going to require face shields on all construction workers when they go back to work. Well, MSA is really well positioned with a product called the V-Gard 950. The V-Gard 950 is made in Chatillon France for our European market, and that product has this integral facepiece. It folds up inside the helmet, which is really a slick design. It's a real elegant design. And we think that there's some nice opportunity for that product, which is 5x the cost of a normal hard hat and a real good example where someone put that in place, there's a YouTube video that Shell put out for their Rotterdam Refinery. And the Rotterdam Refinery, when they brought their people back into work there, they used the competitors hard hat and they bought those V-Gard 950s for every single worker at that refinery. And the YouTube video shows the plant manager describing the situation and the importance of their business and how they're an essential business to keep the economy running. And what he'll do during that is he'll flip down the face shield and talk about how they're protecting the workers. So there may be some nice opportunity on the upside going forward with the change in how we think about safety.

Edward James Marshall - *Sidoti & Company, LLC - Senior Equity Research Analyst*

There's a lot of thought process to go into that. Something for me to kind of really dig into for a while. But the final one for me, as I think about distributors, we've sat on a few calls this earnings season, talked about destocking. When I look at your supply chain and I look at your product lines, it doesn't look like you're actually seeing signs of destocking. Is that something that you expect coming down the line? Or is it that health and safety is more of a, as we've talked about several times, defensive product, and therefore, kind of skip that destocking stage on the supply chain?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Yes. We didn't see any -- there's not any destocking that we've seen in our products. In fact, what was really interesting to us and we were a little surprised, quite frankly, is the strength of hard hats during the first quarter. If you look at our hard hat business, it was, I believe, up 1% overall. We were really surprised by that. We would assume that there would have been some destocking, and there would have been -- the business would have declined some. But we're not seeing that. And there are some distributors who are well funded and in a good position. They're also talking about the fact that we could see a bounce back in construction, and they want to be positioned with product going forward. So there are a couple of distributors who are looking out ahead and trying to position themselves if there is somewhat of a bounce back from a construction standpoint.

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

Yes. And just adding on that, there's just not a tremendous amount of inventory in the channel. There's a lot of it -- a lot of our business books and ships and gets to the end user in a pretty quick manner. And so there isn't a tremendous amount of inventory sitting out there in those channels.

Edward James Marshall - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Got it. Got it. And I want to actually -- I thought I could squeeze one more in. Opportunistically, you guys, I think, do a lot of most transactions with M&A and that you drip on privately held businesses. As we go through maybe a difficult time with -- over the next 12 months, is -- are you looking opportunistically? Do you expect that some of those family-run businesses that you look at from time to time may look at the next 12 months as that's it, we're going to -- where are you on some of those M&A discussions? And how do you think about using your balance sheet aggressively in an environment that could see some weakness for the next 12 months?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

We continue. Actually, we have a meeting on our M&A pipeline after this meeting here today just to update on where we are and what's happening with that pipeline. So we continue to cultivate that, analyze the pipeline and look at that. MSA's balance sheet is a real source of strength to help us in uncertain times. We know how to batten down the hatches and get through a storm. We'll certainly use our resources and the strength in that balance sheet to expand our business when the opportunity presents itself. One of the great moves we made when you think back in the history was 2009, when we didn't quite know if we were out of the Great recession, we went out maybe largest acquisition we ever made and acquiring General Monitors I think we've levered up to 3.5, 4x our EBITDA at that time and did make a dynamic change in the business in doing so. So we're in this for the long term, and we're going to look at things carefully and spend our money wisely. So we can serve our customers, carry out our mission and provide a good return for our investors.

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

The same goes for Latchways in 2015 when we acquired Latchways. It was during the industrial recession. And so we've taken the opportunity during past downturns to use our balance sheet. And we are positioned well to go on the offensive when appropriate, when we see that opportunity and have that clarity in terms of go-forward direction.

Operator

Our next question comes from Garo Norian with Palisade Capital Management.

Garo Norian - *Palisade Capital Management LLC - SVP of Research*

Just had 2 quick questions on the APR investments. First, how certain, I guess, is the line of sight on both getting the equipment you want to install and kind of ability to get that with whatever service people, whatever needs to happen to get it into the facility? And then second, is it right to think about it as a series of different investments, so that it's not like the ramp-up is nothing, nothing, nothing, and then all of a sudden, the big bang when you get to having everything in place?

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

So Garo, what I'll do is I'll answer some of this and Steve Blanco joined us. And Steve, as most of you know, is Vice President of MSA Operations for several years before becoming President of the Americas. And Steve's obviously been intimately involved in this and has real depth of knowledge around what we're doing with the investment. But what I'll say, Garo, is we've got a lot of senior people, veteran people, who are on this project. One person, in particular, has been with us for 35 years. He started, I think, a month or 2 before I did. And he's intimately involved in what we're doing. And in fact, we're actually bringing a couple of retirees who have tremendous knowledge in building the line of APR, and they're here to help us, which is fantastic. So we have a high degree of confidence of being able to do this. Originally, we thought it would be a 4- to 6-month period to ramp up. And I'll let Steve comment more around that. We're just looking now like around 4.5 months. We're already seeing some investment show some yield improvements. So there's a series of investments that we're making that will help over a period of time. There's one component of it, which will make a significant improvement, and that will be somewhat the last piece that will come later this summer. But why don't I have Steve chime in here and give a little more color around that.

Steven C. Blanco - *MSA Safety Incorporated - VP & President of Americas*

Yes. Thanks, Nish. And Garo, I think when you think about our ramp up, I think you're right to look at it in phases. It really is a phased approach that is going to extend out through into and throughout the third quarter, maybe a little bit into the fourth quarter. And you look at it, it's not only the capital equipment because the team has done a great job with employees as well. Nish mentioned early on in his prepared remarks, we've hired dozens of new employees, and I think we've done a great job there. And that will continue. Training is a critical aspect of that. And we want to make sure that we get the right people doing the right work. So I see that and I think the team expects that throughout the year.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Nish Vartanian for any closing remarks.

Nishan J. Vartanian - *MSA Safety Incorporated - President, CEO & Director*

Yes. I would like to conclude today's call by providing just a few closing thoughts and comments. First, I want to thank everyone for your interest in MSA, and we never take that for granted. Second, it goes without saying that we're living in a very different time than our last earnings call in February. Our team did a great job of pivoting and executing in Q1, but the business conditions are challenging. And like so many other organizations, our line of sight into the second half is not as clear as it was entering the year.

That said, I do know this. MSA has a diversified portfolio of products and end markets that we serve. We know that defense development has served us well in the past in market downturns, the most recent being 2015. We know that our brand and market position has never been stronger. Our product portfolio and NPD pipeline has never been more robust. Our balance sheet has never been stronger. Our talent and level of employee engagement is as strong today as it's ever been, and our mission of protecting people's lives as never, in 106 years, been more important or more relevant throughout the world than it is today. And the world hasn't stopped spinning, and the need for safety equipment has not diminished. In fact, it's front and center more than ever before. For example, the recently enacted CARES Act that added $100 million to the fire service for COVID-19-related products is a good example of that. In organizations and companies across the world in a diverse range of markets are buying safety equipment every day, and it's our job to make sure it's MSA.

So once again, thank you for joining us this morning, and please stay safe, everyone.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.
