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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day, and welcome to the MSA Safety second-quarter 2024 earnings conference call. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference over to Larry de Maria. Please go ahead.

Larry De Maria - *MSA Safety - Executive Director of Investor Relations*

Thank you. Good morning, and welcome to MSA Safety's second-quarter 2024 earnings conference call. This is Larry de Maria, Executive Director of Investor Relations. I'm joined by Steve Blanco, President and CEO; Lee McChesney, Senior Vice President and CFO; and Stephane Sciullo, President of our Americas segment.

During today's call, we'll discuss MSA's second-quarter financial results and provide an update on our full-year 2024 outlook. On slide 2, I'd like to remind everyone that the matters discussed during this call may include 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 a number of risks, uncertainties, and other factors that may cause our actual results to differ materially from those discussed today. These risks, uncertainties, and other factors are detailed in our SEC filings. MSA Safety undertakes no duty to publicly update any forward-looking statements made on this call except as required by law.

Turning to slide three, we've included certain non-GAAP financial measures as part of our discussions this morning, and non-GAAP reconciliations are available in the appendix of today's presentation. The presentation and press release are available on our Investor Relations website at investors.msasafety.com.

I'd now like to turn the call over to Steve Blanco. Steve?

Steve Blanco - *MSA Safety - Chief Executive Officer*

Thanks, Larry, and good morning, everyone. I'm on slide four. In June, we celebrated our 110th year as a purpose-driven company. Over that time, we remain steadfast in our mission that men and women may work in safety, and that they, their families, and their communities may live in health throughout the world. And I'd like to thank our more than 5,000 associates around the world who are inspired by the singular purpose of safety for our customers each and every day.

This was an exciting quarter. Driven by our mission, we delivered solid commercial and operational results in the business through excellent execution and utilization of the MSA businesses. I'm pleased with the continued work on our product launches and operational accomplishments. In May, we held our Investor Day where we discussed our strategy for profitable growth and capital deployment going forward as well as identifying our long-term targets for 2028.

Also earlier this week, we released our 2023 Impact Report, which I will highlight in a couple of minutes. First, let's review some highlights from the quarter. During our earnings call in April, we discussed supply chain issues that resulted in an elevated backlog for Detection and Industrial PPE. I'm pleased to report that the team overcame these challenges during the second quarter and reduced our backlog to normalized levels. Previously, we discussed our efforts to optimize our manufacturing footprint as part of our operational excellence initiatives.

This quarter, we made significant progress in production transfers at some of our factories in the UK, Morocco, and Mexico. These changes better position us for growth by enabling a more efficient and productive structure to deliver and serve our customers across the globe. All of these efforts resulted in our ability to maintain our positive momentum through the first half of the year. This is building on strong performance from recent years. The team executed well and delivered net sales growth of three percent, organic constant currency sales growth of four percent, and adjusted earnings growth of 10%.

Moving to our product categories and innovation, sales in Fire Service were up mid-single digits in the quarter, with notable growth in turnout gear and fire helmets. The new Cairns 1836 has been very well received by the market, and performance of Globe and Bristol continue to strengthen. We continue to see excellent momentum in international markets with our M1 SCBA and have a solid global commercial pipeline going into the second half of the year.

The Fire Service market remains resilient and the environment for funding around the world is healthy. I'm pleased to note that this month, we were awarded the second tranche of the U.S. Air Force order, which is about $28 million. Our sales in Detection were up high single digits, with solid growth in both fixed and portable detection. The new FL5000 Multi Spectrum Flame Detector launch continues to go well, with positive customer feedback leading to a strong start in orders.

Portable detection continues to grow both in traditional and connected devices. The io4 continues to gain traction, with the expansion in new geographies and new customers, both existing and for new applications. Industrial PPE sales overall were slightly negative on a year-over-year basis. Our head and fall protection products continue to grow and are offset by headwinds in other PPE products, such as ballistic helmets and International, as well as respirators. I'm excited by our opportunity to grow our fall protection business where we continue to see healthy demand.

The footprint changes I mentioned earlier will help us better serve our customers in this specific growing category. In May, we continued our leadership in head protection with the launch of the new V-Gard H2 Safety Helmet, which provides superior comfort and versatility while incorporating the latest technology to help protect against lateral impacts, and features the optional MIPS technology.

Turning to slide five, I would like to review some of the key points from our 2023 Impact Report, which I noted earlier. This was released this week. As a safety company, our commitment to operating as a sustainable business is evidenced by our initiatives across the MSA Safety pillars of products and solutions, people, and planet, and is captured in the MSA impact metric.

This impact metric represents the average number of global workers that use our products and solutions each year. We estimate that MSA helps to protect more than 40 million people annually. Here are a few examples of what can be found in the report. The products and solutions we develop are at the core of our approach to creating positive impacts. Our solutions use technology and connect and detect for safety and sustainability, helping to make work safer and easier as well as more productive.

For example, our SCBA simplifies maintenance and reduces waste, and Bacharach refrigeration detection solutions help food and beverage customers reduce their carbon footprint and operating costs. We're also on track to meet our commitments towards our 2030 emissions goals. As you would expect from MSA Safety, we maintain world-class employee safety metrics within our facilities.

Additionally, we collectively shared that MSA Safety was recognized as one of Newsweek's Most Responsible Companies, USA TODAY Americas' Climate Leaders, and Forbes' Best Employers for Diversity. There are many more highlights in this report, so please visit our Corporate Responsibility section on our website to learn more.

On slide six, I also note to you the 2028 financial targets we launched in May at our Investor Day, underpinned by our strategy to drive profitable growth and create value for our customers and shareholders. We highlighted a set of actions that we believe will enable us to continue to grow the top and bottom line over the near and long term by leveraging such key enablers as the MSA businesses.

These include capitalizing on secular trends, targeting growth accelerators, developing additional solutions with recurring revenue streams, and utilizing our strong balance sheet for strategic capital deployment. We look forward to sharing our progress against these targets over the coming years.

With that, I will turn the call over to Lee, who will discuss our financial results for the second quarter. Lee?

Lee McChesney - *MSA Safety - Chief Financial Officer*

Thank you, Steve, and good morning, everyone. We appreciate you joining the call today. I will now review our performance in the second quarter and provide an update on our full-year outlook. Let's just start on slide seven with the quarterly results. Sales were $462 million, up four percent on an organic constant currency basis and three percent on a reported basis over the prior year, with a balanced contribution from volume and price. Currency translation was a one percent headwind.

Across our product categories, Detection and Fire Services contributed healthy growth, up eight percent and four percent respectively, partially offset by a two percent contraction in industrial PPE. Globally, it was also encouraging to see the sales trends fueling our Americas and international results.

Overall, orders were healthy in the quarter across our business, though there were some trend changes within the months. As I've noted in the past, this is not unusual for our business, and orders can vary from quarter to quarter. Our commercial pipeline is encouraging across our product categories and in most of our regions, and we have a nice continuation of activity we're seeing so far in July. In the second quarter, our book-to-bill was slightly below one times, but above the prior year period, and is just below one times for the first half of the year.

As we had hoped, our backlog was reduced in the quarter to more normalized levels, principally due to good progress in Fire Services and Detection. Our margin performance continues to be very resilient, and our team's commitment to the MSA business system is evident from our results. Gross profit margin in the quarter was 48.2%, up 40 basis points over the prior year.

Operating margin on a GAAP basis was 21.6% in the quarter, up 40 basis points over the prior year. Slightly higher SG&A reflects volume, inflation, investments in professional services, and a one-time cost related to a legal matter. Adjusted operating margin was 23.4%, up 20 basis points over the prior year, and incremental operating margin was 29%. Margin expansion was largely driven by volume leverage, productivity, and cost price management.

GAAP net income in the quarter was $72 million, or $1.83 per diluted share. On an adjusted basis, diluted earnings per share were $2.01, up 10% over the prior year. The increase is primarily due to operating profit and lower nonoperating expenses.

Now moving on to our segment performance. In our Americas segment, sales increased two percent year over year with high single-digit growth in Detection and mid-single-digit growth in our Industrial PPE, partially offset by a modest decline in Fire Service. The adjusted operating margin was 31.3%, up 60 basis points compared to the prior year. Margin expansion was driven largely by volume leverage, productivity, and cost price dynamics.

In our international segment, sales increased six percent year over year. Strong double-digit growth in Fire Service and Detection was partially offset by declines in Industrial PPE. Currency translation was a one percent headwind in the quarter. Adjusted operating margin was 16.4%, a strong increase of 70 basis points year over year, driven by volume and SG&A leverage, partially offset by modest FX headwinds.

Now turning to slide eight. Free cash flow in the quarter was $39 million, representing a conversion rate of 49% of adjusted earnings. Second quarter cash flow reflected inventory investments and increased capital expenditures, and we remain on track to deliver our full-year cash flow objectives of 90% to 100%. As a reminder, we typically generate more cash flow in the second half of each year.

Consistent with our strong capital allocation history and our Investor Day goals, capital expenditures were $14 million in the second quarter, including investments to drive productivity and execute production transfers as part of our strategic manufacturing programs. We also repaid $8 million in debt, returned $20 million in dividends to shareholders, and repurchased $10 million in common stock.

Net debt at the end of the quarter was $441 million, and our cash balance was $147 million. Our net leverage ratio at quarter end further improved to 0.9 times. Adjusted EBITDA for the trailing 12-months ended June 30 at $466 million or 25.7% of net sales.

Now I'd like to move to our full-year outlook on slide nine. We ended the second half with good momentum, but are mindful of the dynamics of order timing and macro and geopolitical risks. Our end markets are generally healthy, demand trends lean positive, and we have executed initiatives to bring our backlog down to more normalized levels.

Our business has broad diversification across products, geographic regions, and markets, and there remains attractive underlying market trends in the safety industry, leading to the resilience we have delivered over time. We remain close to our customers, disciplined on costs, and focused on executing our strategy to deliver profitable growth and generate strong cash flow. Should macro conditions change, we will adapt as needed.

As you look forward to full-year 2024, we are maintaining our sales outlook of mid-single digit growth, which compounds on top of the 17% growth we delivered in 2023. We believe our second-half growth rates will likely be similar to the first half. We do have to be cognizant of the timing of orders, primarily related to the AFG funding cycle and customer delivery timing as we work through the details of large orders, like the U.S. Air Force order, which implies growth may be skewed towards the latter part of the year.

Our business is healthy, our pipeline is strong, and we look forward to executing our second-half plans and the long-term profitable growth strategy outlined at our Investor Day. With that said, I also want to reiterate my thanks to our associates across the globe who are focused on supporting our customers passionately each and every day. Your continued focus on driving improvement is yielding significant impacts for all of our stakeholders. Well done.

With that, I'll now turn the call back over to Steve for concluding remarks.

Steve Blanco - *MSA Safety - Chief Executive Officer*

Thank you, Lee. I want to reiterate the resiliency of our business, which continues to benefit from the broad diversity of our products, geographies, and markets. With attractive industry fundamentals, our proven innovation process, and leading positions in our markets, I'm excited by our future. I believe we have the best team in the industry. And with our mindset around continuous improvement and the commitment to the MSA business system, we're well positioned to create value over the long term for all of our stakeholders.

With that, I'll now turn the call back over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Stanley Elliott, Stifel.

Stanley Elliot - *Stifel, Nicolaus & Company, Inc. - Analyst*

Good morning, everybody, and thank you for taking the question. Could you just talk a little bit more about kind of the full year? The mid-single-digit guide kind of implies a consistent run rate, maybe a slight acceleration in the second half. I know seasonally, the business picks up in 4Q, but it sounds like, not necessarily for you all but other data points we've been watching, the overall economy might be slowing a little bit. And your order books, a little more normalized. Where is the confidence kind of coming in to be able to hit that second half run rate?

Steve Blanco - *MSA Safety - Chief Executive Officer*

Yes. Thanks for the question, Stanley. And maybe I'll start here and, Lee, you can jump in if you have some commentary. I think it's the diversity of the business that really helps us. We're a little different than maybe most industrials, as you know. But when we look at our business, I would say that the demand in the end markets remains healthy. Certainly, fire service, energy, and utilities are healthy and stable. And we see a really solid pipeline in Fire Service and Detection.

Timing can be lumpy as we've seen before, but the fundamentals are good and the pipeline solid. From a macro, we think these markets are resilient. We've seen that in the past, they've been resilient. We've been comfortable with that. Industrial PPE, certainly a bit more cyclical as we saw in the first half, and that's likely to continue. But it's really where the diversity of our markets and geographies help. So, if the performance continues, if we're able to turn that pipeline into orders, we feel really good about the second half continuing to be a growth category.

Lee, you got anything you want to add?

Lee McChesney - *MSA Safety - Chief Financial Officer*

Yes, I think that's a good summary. Stanley, as I said in my comments there, we think the back half will be similar to the first half. I think if we were going back to the beginning year, maybe we're hopefully will be even better than that. But that's just the reality, which I think you just mentioned, but we're still in a good place. I do think you'll see what we just experienced in the first half where you have some segments be really strong in one quarter, maybe a bit weaker in the other quarter.

So, we can manage that. We'll probably lean a little bit towards the fourth quarter being stronger [VPY] than the third quarter. And as Steve said, we're in a good place for nice diverse mix. I've said this all year, when we deliver three percent growth, four percent growth, we're doing it on top of the 17% growth last year. So, I just think that puts it in perspective. Everything we're doing this year is compensating for that. So, it actually says we're even doing better on the orders front than we are on the sales front.

Stanley Elliot - *Stifel, Nicolaus & Company, Inc. - Analyst*

Yeah, no doubt. It kind of speaks to the breadth of the portfolio. You did mention one thing interesting, that if the macro conditions change, you guys could adapt as needed. How quickly could you react if we were to see something? I mean, I think now with the market kind of looking more towards to some rate cuts in the back part of this year into next year, I'm not sure that necessarily we would see that. But just give us kind of like the playbook in terms of how you would react.

Steve Blanco - *MSA Safety - Chief Executive Officer*

Yes. That's a good question, Stanley. I mean, we've done that in the past. I would say, it'd be pretty quick. Certainly, we're going to protect our profitability and margin profile. And we have a list of levers that we can pull, if we needed to pull, to make sure we protected ourselves. And I think we've talked before about our incrementals are 30% to 40%, but we manage our decrementals at a lower level and we would expect that to be the same if we needed to pivot.

Stanley Elliot - *Stifel, Nicolaus & Company, Inc. - Analyst*

And the very strong quarter in the Detection side of the business, what's driving these gains? Is that more just kind of a product availability and the backlogs getting worked down? And then you also had some interesting comments around some of the new revenue models and the traditional versus connected devices. Really interested to see how this connected device platform is starting to shape up.

Steve Blanco - *MSA Safety - Chief Executive Officer*

Thanks to that question as well. Certainly, we were pleased that we were able to ship that elevated backlog to deliver to our customers. That business, when you think of Detection, and I talked a little bit about it earlier when you asked about our confidence in the second half. But you break it down, that longer cycle, fixed monitoring, our position is really good. Strong installed base supported by the energy needs, including, as we discussed, the future clean energy needs we have, and the pipeline of business is really solid there.

For portables, a little more cyclical because it's tied to employment levels. But we feel like our approach of providing the market different options with the traditional platforms through our 4XR and our 5XR, added by the connected io4, just a tremendous combination for our customers to choose from. And that's what we're seeing.

We're seeing this io4. I think the take rate right now is we're still seeing 50%-plus of the take rate from customers that are new to us, which has really been a nice add. But you put those two together and that's why we have confidence in Detection.

Operator

Rob Mason, Baird.

Rob Mason - *Robert W. Baird & Co. Inc - Analyst*

Yes, good morning. Thanks for taking the question. Steve, you kind of mentioned your incrementals at this 30% to 40% range. Is that the growth profile that you are expecting in the second half? I'm just curious how your confidence level is either around the upper or lower bounds of that range. Is that the expectation?

Steve Blanco - *MSA Safety - Chief Executive Officer*

Lee, you want to hit that?

Lee McChesney - *MSA Safety - Chief Financial Officer*

Yes, Rob, good morning. I think like we said throughout the first half this year, you do have some interesting comps. So, just give you a reminder there, we had this incremental 70% the first quarter, 29% in the second quarter. You're going to see that same type of volatility in the back half. The third quarter [2023] was a very strong quarter, certainly very good revenue quarter, but our absolute highest margin. There is some backlog and mix help that went into that last year that you won't see this year. So, you'll see a lower incremental in 3Q and then you'll see a nice rebound in 4Q.

Overall, our 30% to 40% goal. And we're certainly on track to being in that range. And based on where we are so far in the year, maybe slightly higher, but we'll see how it plays out.

Rob Mason - *Robert W. Baird & Co. Inc - Analyst*

Sure. Maybe relatedly, you made mention of the progress that you've made getting some of your manufacturing footprint reconfigured. Is all of the work that's in motion, is that complete? And I'm just curious how you feel about this current scaling of those operations and potential opportunity to see more leverage from those specific moves.

Steve Blanco - *MSA Safety - Chief Executive Officer*

Rob, maybe I'll take a stab at that. So, it's not complete yet. We're more than halfway through that activity, but there's still a lot of work to be done on that in the second half. What we're doing is really trying to make sure that we continue on our strategy of manufacturing in region for region and providing the opportunity for us to have kind of a best cost and best delivery option available for the customer base through our manufacturing footprint.

And operational performance of this is really a big part of what we're doing with this. And it's really going to have a nice impact, especially in things like fall protection with the moves to Mexico and the plant transitions or shutdowns that we've had. So, it's better than halfway but we're not quite done yet. We got more work to do through this second half.

Rob Mason - *Robert W. Baird & Co. Inc - Analyst*

I see. And just the last question. You mentioned your price/volume was roughly equal in the quarter. I'm curious, as you got to mid-year, did you do anything different on price in your price adjustments? Or how are you viewing the inflationary impacts right now?

Steve Blanco - *MSA Safety - Chief Executive Officer*

We had our price increase at the beginning of the year. One region did a price increase early in Q2, but typically that's consistent where we're at. This year is more of a normalized pricing. We're following the inflationary environment, the potential of any tariffs, certainly we're going to continue to track. And as we've done in the past, if we need to pivot and adjust, we will.

I would add. That's, for us, part of the reason we continue to lean in on the Business System and continuous improvement. And these operational footprint changes, bear that in mind, is to make sure that if we need to offset, we'll offset internally and get what we need to on price to make sure we protect our margins, which I think we've done a nice job of in the past.

Operator

(Operator Instructions) Ross Sparenblek, William Blair.

Ross Sparenblek - *William Blair - Analyst*

Good morning, guys. Coming back to the second-half revenue guidance, we're seeing positive read throughs on order rates for the Detection and Fire Business. I mean, it's implying a reacceleration in the second half and you guys are clearly taking share. So, can you maybe just further delineate what some of these watch items are and what is maybe tempering your expectations for the second half?

Steve Blanco - *MSA Safety - Chief Executive Officer*

Yes. Thanks for the question, Ross. So, we do feel good about where we're at in the market in both of those spaces, and we think the pipeline is solid. Part of it is just timing. The order timing can be lumpy as we've seen in past years. So, we think that there's good opportunity, if we get some of that order, the pipeline to flush through in the orders. But part of it is the funding environment, or do they have the funds, the environment is good. But for example, AFG, the Assistance to Firefighter Grants. Last year, they started releasing funds much earlier than this year. This year, they just did the first couple of tranches last week.

So about $62 million of the $325 million available has been released. So obviously, for those that are expecting to use that funding vehicle, they have to have that available to them. So, that's the thing that we just want to make sure those things come through. I would look at that. Lee?

Lee McChesney - *MSA Safety - Chief Financial Officer*

Yes. Ross, I'd just add a couple of things. So again, you have a dynamic in the back half where last year, we had some really nice wins. If you remember, things like we were shipping LA last year in the third quarter on the SCBA side. In Bacharach, we had nice large wins that had some big chunky orders to it. This year, it looks like some of those things will be more in the fourth quarter than the third quarter. So that's just a subtlety to some of the outlook being a little bit more back half of the second half just to counter it as you kind of look at your model.

Ross Sparenblek - *William Blair - Analyst*

Okay. Can you maybe just update us on the supply chain bottlenecks of the first quarter? I believe there are 100 basis points slipping into second half and then on that fourth quarter comment, if we could dig into the margins there because it almost seems to imply with the guidance that we could see a nice stepdown in the third quarter in gross margins.

Lee McChesney - *MSA Safety - Chief Financial Officer*

Yes. I mean, Ross, obviously, lots of moving pieces. I think as you talked about the back half in terms of maintaining the kind of similar levels of growth, that includes all of that in there. I think in terms of margins, you have a nice continuation. We've talked about this 48 [percent margin] type of level kind of being in the plus or minus of that for the year. Our outlook for the back half is we will maintain that. Last year, you had a very strong third quarter. That won't repeat itself. But if you look at where we are in the second quarter in the mid-48s [percent margin], you'll have a step down because you have things like Europe holidays and things like that that factor in, and then you'll have an improvement again in the fourth quarter. So, we're in a good place.

I think to the question earlier on the incrementals, obviously, we're at the halfway point slightly higher than our range on incrementals, and we'll still be in a good place in the back half. But the back half comp on margin is harder than the first half. So just one of the factors.

Ross Sparenblek - *William Blair - Analyst*

Okay. That's helpful. And then maybe can you just give us a sense of where the recurring revenue shook out as a contribution in the quarter? And maybe help parse out also what those growth rates look like? It sounds like it's pretty meaningful.

Lee McChesney - *MSA Safety - Chief Financial Officer*

I appreciate the question. Well, I would tell you this, we've shared that we sit today in the 15% zone. We obviously have a lot of initiatives to drive that into a better place. We talked about at Investor Day eventually getting into the 20% zone. I would say there wasn't a material change in the third quarter towards that.

But we had some nice wins in the io4 space, in the MSA+ space, just globally. So, we continue to make progress and keep building out that book of business. And it certainly helped the growth rate in portables for the first half of the year. And it certainly is one of those factors, that, again, goes into why be optimistic. Well, we booked for the last year and a half these good three- and four-year contracts on the io4.

Ross Sparenblek - *William Blair - Analyst*

All right. I mean maybe then just on the mix, if we can get a sense of what the impact was from International. Because it does sound like the recurring might have offset a bit of that on the gross margin side.

Lee McChesney - *MSA Safety - Chief Financial Officer*

Yes. I would say mix is a pretty neutral story. I mean it's interesting. Think about the margins in the second quarter. They are our record, certainly margin rate record, in Americas ever in any quarter. So, that's really coming from the Business System, the focus on productivity, continued management of price and cost, and then certainly the new product innovation helping and being a nice lift as well. So, it's those elements. Mix, again, pretty neutral for us. I think it's going to be a bit of a headwind in the back half, again, because we had a really strong lean into Detection last year as we clear that backlog.

Steve Blanco - *MSA Safety - Chief Executive Officer*

Ross, you're pointing to something on International as you think of what we've been doing at the least point on the innovation front. And we're seeing the Fire Service do what we expected. So, Fire Service and Detection in International have been really nice growth categories that, we expect in the coming years, we'll kind of shift that mix. While we'll grow Industrial, we expect those to really play a nice role in International's growth.

Ross Sparenblek - *William Blair - Analyst*

Got it. So Industrial should probably have a seasonally higher step-up in the second half despite the ballistic helmets in the second quarter?

Steve Blanco - *MSA Safety - Chief Executive Officer*

I mean, it's going to be market-driven. I wouldn't necessarily expect the Industrial space to have a higher lift in the second half. We're expecting that it's probably going to be somewhat similar to the first half. Unless the economy accelerates or changes materially, I would expect it to be fairly or very consistent with the first half. We have some tough comps on the ballistic side for international. So, I would say it's probably going to be fairly consistent.

Operator

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

Larry De Maria - *MSA Safety - Executive Director of Investor Relations*

Thank you. We appreciate you joining the call this morning and for your continued interest in MSA Safety. If you missed a portion of today's call, an audio replay will be made available later today on our Investor Relations website and will be available for the next 90 days. We look forward to updating you on our continued progress again next quarter.

Operator

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