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MSA.N - Q4 2020 MSA Safety Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 19, 2021 / 1:30PM GMT

OVERVIEW:

Co. reported 4Q20 revenue of $388m.

REFINITIV

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PRESENTATION

Operator

Good day, and welcome to the MSA Fourth Quarter 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, Director of Investor Relations. Please go ahead.

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

Thank you, Drew. Good morning, everyone, and welcome to MSA's Fourth Quarter Earnings Conference Call for 2020. Joining me on the call today are Nish Vartanian, Chairman, 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 Form 10-K filings with the SEC. 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 Q4 press release are available on our Investor Relations website at investors.msasafety.com.

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

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

Thanks, Elyse, and good morning, everyone. I appreciate your interest in MSA. I want to start today by thanking the MSA team for their resiliency as COVID changed the way business is done. I'm tremendously proud of the efforts of our team, which has stayed focused on our mission, our people, our customers and communities. I've often said, our greatest asset is our employee engagement and commitment to our mission of protecting workers' lives. And I've never had greater appreciation for what our company contributes to society each and every day.

We finished a challenging year with a very strong fourth quarter, realizing record-high revenue of $388 million, and double-digit improvements in free cash flow. From a full year perspective, our revenue declined 3%. Strength in our fire service market and air purifying respirators was offset by weakness in industrial products. But there's no question the diversification of our products provided support through the downturn.

Despite the revenue challenges in certain areas, our annual adjusted operating margin reached 18%, that's up 10 basis points from a year ago. We've talked about our long-term aspiration to get our operating margins into the 20% range over the coming years. Our performance in this challenging environment provides me with a great deal of optimism for the future. With that in mind, there are 3 key areas I'd like to discuss today that support my confidence.

First, MSA's innovation engine is stronger than ever. We're launching safety technologies that solve our customers' toughest safety challenges. Second, our continuous improvement culture across all areas of our business is yielding strong results, especially in the International segment. Third, we're committed to using our balance sheet to make strategic acquisitions that strengthen our leadership positions in key markets.

Starting with the first area, MSA's innovation engine and R&D pipeline. The accomplishments of our founders back in 1914 reflects what happens every day in MSA's product development labs around the world. At the turn of the century, they partnered with Thomas Edison to develop a battery-powered miners' cap lamp. This electric lamp helped reduce mining fatalities by 75% over the next 25 years. That same passion for innovation exists throughout MSA today as we continue to invest in new product development to drive organic growth.

We do this to provide our customers with leading safety technologies that solve complex challenges. In 2020, we invested nearly $70 million in R&D to bring the most advanced safety solutions to our global customer base. One example is our new Advantage 290 reusable respirator. The Advantage 290 is the first government-approved reusable respirator designed without an exhalation valve.

It filters both inhaled and exhaled breath. That gives health care workers increased flexibility, adding yet another option to the available supply of respiratory protection, and it can be stored for long periods of time.

The work we're doing in the fire service is another great example. The MSA Connected Firefighter platform includes the breakthrough G1 or M1 SCBA, as well as our soon-to-be-launched LUNAR system. LUNAR is a handheld device that uses cloud technology to deliver breakthrough fire-scene management capabilities for incident commanders. It also uses real-time direction and distance data to help search-and-rescue teams locate a separated firefighter. And it's a personal thermal imaging camera.

While system-oriented products like LUNAR can have a longer adoption period, we continue to be very excited about the future possibilities that this technology has to offer on a global scale. Quite simply, our goal is to protect firefighters from head to toe. The same passion for innovation that led to the G1, the M1 and our LUNAR system is being applied to firefighter software solutions, helmets, turnout gear and boots.

At the end of the day, it comes down to this. We understand our customers at a deep level. We listen, watch and learn from them. With this knowledge, we use the latest technology to keep them safe, solve their problems and simplify their day.

Looking beyond the fire service, I'm also encouraged by the trends associated with our safety mission, a mission, I believe, that is more relevant than ever. As an example, in one of his first acts in office, President Biden signed an executive order calling on OSHA to issue guidelines related to COVID-19 in the workplace. It's reflective of where COVID is bringing safety to the forefront of the national discussion.

The second area I want to highlight this morning is our continuous improvement culture and how it's yielding strong results across our business. An example is our International segment. Our entire International team continues to execute a playbook focused on 3 areas: driving growth in select markets, optimizing our channels' approach, and delivering efficiencies. We've been executing on this international playbook for 3 years now, and it's encouraging to see the continued margin improvement.

As an example, our long-term goal was to improve operating margin in the International segment by 500 basis points over 2017. In 2020, the International segment operating margin rose to 15%. This is a 270 basis point improvement compared to 2019 despite the 3% revenue decline.

And to date, we've achieved 400 basis points of segment margin expansion. With the pipeline of programs we have in place, we're very confident in our ability to surpass our original goal, over time.

And that leads me to the third area I want to discuss today, which is our balance sheet, to make strategic acquisitions that strengthen our leadership position in key markets. In January this year, we closed the acquisition of Bristol Uniforms. Bristol is the U.K. leader for firefighter turnout gear, and so Bristol enhances our position as a global leader in fire service PPE. This acquisition builds on our 2017 [acquisition] (added by company after the call) of North American turnout gear leader, Globe. So it's a great fit strategically and culturally. It also expands our footprint in a defensive area of our portfolio.

Our fire service business increased 10% in the fourth quarter of 2020, even in the face of the pandemic. So we're very excited to welcome Bristol to the MSA family and look forward to serving our European and International customers with even a greater range of head-to-toe solutions.

To summarize, there are 3 key areas that give me confidence in MSA's future. First, MSA's innovation engine is stronger than ever. Second, our continuous improvement culture across all areas of our business is yielding strong results, especially in the International segment. And third, we're effectively using our balance sheet to make strategic acquisitions that strengthen our leadership positions in key markets. Our integration plan for Bristol is well underway. And we continue to move forward with an M&A pipeline focused on evaluating assets that align with our safety mission.

With that, I'll now turn the call over to Ken to take you through our financial results, and he'll also give more texture on the trends and assumptions we're making for 2021. Ken?

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

Thanks, Nish, and good morning, everyone. I'll start the discussion this morning with annual financial highlights centered on our growth, profitability and cash flow, before getting into more detail on the fourth quarter.

First, looking at overall growth. I was very pleased to see the team execute well and deliver record revenue for the fourth quarter despite the challenges we all faced throughout the year. Second, our profitability was strong as adjusted operating margin expanded by 10 basis points. This equates to a 14% decremental operating margin. We delivered on our goal to manage decremental margins at a lower rate than our incremental margins. Improving overall operating margins to 18% on lower revenue volume is another step in the right direction for reaching our long-term margin aspirations.

And third, we generated more than $200 million of operating cash flow in 2020, or 25% higher than a year ago. Through the downturn, we've continued to execute a balanced capital allocation strategy focused on growing our business and returning value to our shareholders. We invested $49 million in CapEx projects. We paid down $44 million of debt. We funded $67 million in dividends to our shareholders and deployed $20 million for share repurchases. And just last month, we deployed approximately $60 million for the acquisition of Bristol uniforms. Our net leverage continues to track below 1x as we enter 2021.

So although 2020 was a year unlike any other, our growth, profitability and cash flow demonstrated the resilience of our business model and the disciplined execution of our teams around the world.

Now let's take a closer look at the financial results in the quarter. Let's start with a focus on growth. Quarterly revenue was a record high of $388 million, growing over 3% from a year ago or 2% in constant currency. From a geographic perspective, revenue increased 5% in the Americas segment and decreased 2% in the International segment in constant currency.

As I had indicated on the October call, we entered the third quarter with a large backlog in SCBA and air purifying respirators. We started to see a recovery in our business especially in the fire service in the latter part of Q3 that carried into Q4. Order activity was healthy to finish the year, and we exited the quarter with a very healthy book-to-bill ratio and an overall backlog that was consistent with the end of Q3, despite the record invoicing.

The fire service market was a key driver of results in the fourth quarter on strong SCBA growth. We continue to convert competitive SCBA accounts in the U.S. and had good order flow in key geographies around the world, including Germany, China and Latin America. While we've had production constraints at Globe due to COVID, we continue to focus on driving operational improvements, and it's great to see continued wins with key pillar cities in the United States.

Firefighter safety is a resilient business and has performed well through various business cycles. We continue to extend the breadth and depth of our market position in fire service through organic and/or inorganic investments like the upcoming launch of LUNAR and the recent acquisition of Bristol.

Shifting gears to the employment-based industrial PPE products, which were down 4% year-over-year after declining by 25% in the third quarter. While we are most likely not out of the woods just yet, it was good to see such sequential growth versus the third quarter.

Our FGFD business was down 7% in the quarter on tough comparisons in both the Americas and International segments. For the full year, we had a 2% decline in FGFD, reflecting the support from the recurring revenue streams in this product line that we've discussed with you previously. With that said, while we have seen a recent uptick in oil prices, which could provide some support for projects going forward, we have a challenging comparison to start the first quarter of 2021.

Revenues from air purifying respirator lines increased 32% from a year ago. As expected, we have largely delivered on our backlog from the pandemic surge of 2020, and we are well prepared to pursue new opportunities with health care and government end markets. In the near term, we are planning for a difficult comparison in the first quarter of 2021. If you recall, our Q1 results a year ago included approximately $10 million of incremental revenue from APR at the onset of the pandemic. The landscape continues to evolve as stimulus packages are allocated to enhance PPE supply for workers in a range of industries, and we stand ready to help and fulfill our mission of protecting workers' life and health.

Turning to profitability and earnings, gross profit declined 350 basis points from a year ago, as we incurred about $11 million of higher costs in the quarter. $5 million of these costs are associated with lower throughput in certain factories, and $6 million is primarily associated with inventory-related charges, which we don't expect to continue into 2021. To a much lesser degree, the less favorable revenue mix was a headwind to margins. These items had the most significant impact on our Americas segment margin in the quarter and for the full year.

SG&A expense of $76 million was down 10% from a year ago. We delivered $6 million to $8 million of savings from previously executed restructuring programs and discretionary cost savings in the quarter, associated with reduced travel, controlled hiring, professional services and other costs and $3 million of savings from variable compensation on a year-over-year basis.

Similar to past cycles, we invested in restructuring programs throughout 2020 to improve our margin profile in the downturn and to position MSA for strong incremental margins during the recovery. We incurred $9 million of quarterly restructuring expense to accrue for cost reduction programs related to footprint rationalization and business model optimization, primarily in the International segment, where operating margin is up 270 basis points for the year.

Together with the programs we've discussed throughout 2020, we expect to deliver approximately $15 million of savings across the income statement in 2021 and annual savings of $20 million thereafter. These savings will partially offset the impact of variable compensation resets and other discretionary costs coming back into the P&L in 2021.

Quarterly adjusted operating margin was flat with the prior year at 17.3% as the cost discipline in SG&A was offset by the gross profit headwinds. International margins were up 320 basis points and were 17.5% in the quarter, which very much reflects the results the teams are driving in pricing and cost reduction initiatives. Americas margins were down 260 basis points and were 20.8%. The $11 million of higher cost and gross profit that I mentioned a moment ago was incurred primarily in the Americas segment. Pricing is holding up well, and we expect improvements in this segment margin going forward.

Just stepping back and looking at margins over the long term. It is good to see improvements each and every year in operating margins since 2015, despite some challenging economic cycles along the way.

From a cash flow and capital allocation perspective, quarterly free cash flow conversion was well north of 100%. We saw strong performance across working capital, which declined 320 basis points as a percentage of sales. As I had indicated on the October call, we were planning for an improvement in the inventory balance through year-end. Our strong balance sheet and inventory position at the end of the third quarter enabled us to deliver record high revenue in the fourth quarter. We continue to focus on improving our performance in A/R and A/P and are seeing very strong results on that front as well.

Consistent with past years, we completed our annual cumulative trauma evaluation in the fourth quarter. As part of that review, we reflected changes in underlying assumptions in our model that increase our product liability reserve and resulted in a pretax charge of $34 million, net of insurance recoveries, on the income statement.

While the timing of cash flows for product liability and insurance receivable vary from quarter-to-quarter in MSA LLC, we've been successful in establishing cash flow streams that have allowed us to fund these liabilities without a material impact on our capital allocation priorities. For example, over the past 5 years, our average cash conversion has exceeded 100% of net income, both with and without the impact of product liability and insurance receivables.

We continue to focus on growth as our primary capital allocation priority, most recently completing the acquisition of Bristol Uniforms in January. We're excited about the opportunity to build our position in turnout gear and expand MSA's addressable market globally. We're also well positioned to realize a range of synergies from the transaction over the coming years.

From a financial standpoint, the acquisition provides attractive returns and aligns with the criteria we've shared in the past. While we are in the midst of finalizing our purchase accounting for the acquisition, we expect earnings accretion in the first year of ownership, excluding acquisition-related amortization of about $0.03 to $0.05 per share. With the closing date of January 25, we'll recognize just over 2 months of Bristol results in our first quarter 2021 financial statements within our International business segment. The acquisition does not have a material impact on our leverage. So we remain very active in pursuing opportunities, as well as funding organic R&D and CapEx projects that drive long-term growth for MSA.

As we turn the page to 2021, we're operating in a very dynamic environment. There's a number of evolving macro level factors that will have an impact on our revenue outlook in 2021. These factors include, amongst other things, the effectiveness of the vaccine rollout, risk of additional COVID lockdowns, the pace of economic recovery, as well as the potential for government stimulus. While the outcome is certainly hard to predict, the steps we are taking to improve our business model positions us to emerge as a much stronger company as macro conditions improve. Our investments in organic and inorganic growth programs are driving an improved market position, and that will be beneficial helping us return to growth as we see conditions improve.

Again, our ability to deliver revenue growth in 2021 is very much influenced by a range of external factors. As a result, we are approaching the first half cautiously and are positioned for a stronger second half of 2021 as compared to the first half. With that said, we remain committed to executing our strategy and advancing our mission, which has never been any more important. We remain confident in our ability to maintain and grow our market share positions, improve our margin profile and drive strong cash flow performance.

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

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

Thanks, Ken. The team delivered a strong Q4 with record revenue and strong working capital improvement. Throughout the year, we funded the R&D portfolio and strategic CapEx projects. We also executed on restructuring programs to make sustainable improvements in our business model. And most recently, we completed an acquisition that positions us as a global leader in firefighter turnout gear.

To wrap up I'm very confident that MSA is well positioned to advance our mission and create value for all of our stakeholders. 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) The first question comes from Stanley Elliott of Stifel.

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

Congratulations on the strong finish to the year. Great progress on the International. I know you've been working hard on the cost side. Was something in there with mix -- I saw, I think it was the fall protection was up a little bit, better flow through. And then the other piece, you had mentioned kind of getting that additional 100 basis points of margin opportunity. Do you have everything in place that you need to get that last kind of piece over the initial target that you all had set? Or kind of help us bridge that, if you could?

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

Sure, we do, Stanley. We've been working on this, as you know, from setting that goal in 2017. And we started working actively then. The first year or so, we got off to a slow start because some of these programs we put in place take time to execute and to actually see it come through the P&L. And that's exactly what we're seeing today.

We're seeing the results of a lot of hard work that we put forth in '18 and '19 and continued into '20. And we think we're very well positioned to get that last 100 points, so to speak, to get to our goal of 500 basis points. And then once we get there, we'll start to set some targets for the future. When you look at the '17, I believe it was about 17.5% of op margin in the fourth quarter.

When you look at that, that just gives us encouragement that we can go beyond the initial targets that we set. We'll set those goals at a later date, but we think we're very well positioned to pick up that 100 basis points.

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

Great. And then as we're sitting here today, I know you don't want to give specific guidance, but looking at kind of what's in the orders coming down the pipe or in the backlog, do we think mix is actually going to be a tailwind in the coming year?

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

When things improve, Stanley, certainly when the economy comes back. And as Ken mentioned, we're looking at the second half of the year to see that improvement, especially around the PPE products, that's when you see some strong mix coming, right? The hard hats, portable gas detection, some of the fall protection products. You get those industrial PPE products coming through the pipeline, and that mix certainly helps our margin profile. So there could certainly be some wind to our back there.

And we're very confident we're going to see that. Never before do I remember us having a better position in the marketplace, a better pipeline of products coming through our NPD process, our sales, our marketing teams, customer service, training, all the customer-facing parts of the organization are just doing a fantastic job in executing. So when the customers get back in a position to start buying back in quantity and numbers, I think we're going to be positioned real well going forward. And Ken, do you want to add to that?

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

Yes. The only thing that I would add, Nish, are just 2 or 3 key points. Specifically, when we think about the first quarter or maybe even the first half. First and foremost, the employment-related products, as I said in my script, we've seen some improvement in the fourth quarter, but I don't know that we're out of the woods just yet. If you remember last year, we didn't enter the recession until, say, the second quarter. So our business held in pretty well during the first quarter. So that will provide a pretty challenging comparison period on the employment-related products, on the FGFD as well, as I had pointed out in my prepared comments. And then we have the respirator line, which is rolling off as well.

But on the positive, we have Bristol coming in. And so there's a number of puts and takes. But the first quarter, because we didn't enter the recession until -- and the pandemic really didn't have a significant impact on our business until the second quarter, the first quarter might be a bit of a tough comparison.

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

Great. And then lastly for me, are you all seeing anything on the supply chain side that should be of concern? I mean, you've done such a nice job of adding sensors and chips, et cetera, into the products to make them more advanced. With kind of the dynamics there, should we be concerned about the availability to get those sorts of technological products?

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

Good question, Stanley. We're watching that closely. There's obviously some -- it's tight in the supply chain around some of the chips and components. But that has not hampered our production. So we have not had any issue with production related to that whatsoever. We're staying close to it, obviously, and have been able to manage through it. And we expect to do so into the future.

Operator

The next question comes from Richard Eastman of Baird.

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

Yes. Nish or Ken, could you perhaps just address maybe -- and throw a little bit more color around your backlog comments. At the end of the fourth quarter, were you referencing the strength in the backlog around SCBA fire service? Or just generally speaking, how does the backlog look in the fixed gas and flame business as well?

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

Sure, Rick. I'll kick it off, and Ken can add some comments, but that's what we've seen, you kind of described it. The fire service product backlog was up significantly as we went into the fourth quarter. We did a nice job in getting product out the door, but we also came into January with a nice backlog of breathing apparatus.

The turnout gear, we continue to have a very good backlog there. And that's been a production issue on our end. That goes back to the protection and safety of our employees and contact tracing. We've done -- we've had some people out and did not get the volume out the door. We had hoped to in the fourth quarter.

So we'll certainly be working hard to make that up here as we go through 2021. In fixed gas and flame detection, the backlog there did come down some. So we saw that natural rotation we anticipated. As we've always talked about, FGFD is that business that lags going into a recession and then lags a bit coming out of the recession.

And so that's exactly what we saw. That business softened up from a booking standpoint. As we went into the fourth quarter, we shipped some backlog. But we do feel confident that, that business will also come out sometime in '21, where we'll start to see those projects book and that business begin to build again as we go forward. Ken, I think I covered it.

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

Yes, you covered the key points. The only thing I'd say is our book-to-bill remains pretty healthy in the fourth quarter of about 1x. But as Nish had indicated, some of those orders will come out of backlog throughout 2021. Some of the business that went in, takes a little bit of time to come out.

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

Got you. Okay. And what was, just out of curiosity, the strength in International in the portable gas business, was that a large order that finished shipping? Or what was -- I'm not necessarily sure that, that was an easy comp, but I'm just curious, that was a pleasant surprise.

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

We picked up a significant piece of business in International, and we shipped that product out the door. But when you look at the PPE products in the fourth quarter, they were a little stronger than anticipated. If you look at our full year finish on those PPE products in the fourth quarter, you saw some strength there. So that was a little bit of a surprise for us.

As you know, those products come in and go out the door, typically in the same quarter. And so we were encouraged by that. But we've had some tough comparables, as Ken mentioned, tough comparables coming ahead here in the first quarter.

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

Sure. I got you. Just a last question for me. And I just -- Ken, could you maybe give a little more perspective around OpEx as we track through '21? Are we looking for the cost save here that you referenced from some of the realignment efforts to largely offset the comp expense and some of the travel expense, things that will come back in the P&L.

So are we looking at kind of an adjusted OpEx number that's in dollars that's roughly flat for the year? Is that what you were trying to maybe signal?

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

So when you step back and look at SG&A operating expenses, I think we did around $290 million for the full year. There are 2 or 3 major buckets there, Rick. One, there was a $15 million cost save associated with just performance-related comp. That comes back. There's really not much control over that coming back, that resets.

There's $15 million of discretionary cost saves, which don't come back until we start to travel, until we start to see business conditions improve. And so that's something we're definitely keeping a tight rein on. And then there's the restructuring that I talked about, the $15 million. Now that $15 million is not all SG&A. Some of that $15 million is associated with footprint rationalization. Some of it's related to affiliate closures. And then some of it is more traditional headcount in SG&A related. And so we're looking to really offset that $15 million that comes back immediately, if that makes sense to you.

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

It does. It does. And then there'll be some -- again, as the year progresses, there'll still be some inflation that shows up. But I'm going to term inflation in the context of the travel and some of the discretionary that comes back in. So there won't be a complete offset there, and that -- is what I'm hearing. And then also, can you just give us a sense of what the Bristol SG&A might be in dollars, just a rough sense?

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

Yes. That's a good question. Their dollars are certainly on a percentage basis, much higher than the MSA overall average. I want to say the Bristol SG&A as a percentage of sales of something close to 30%. And so it's a much higher ratio than what you see at MSA. But there's an opportunity there to help them improve their business model through the sharing of some of our resources. And so we're looking at that much closer and should give us some opportunity to drive accretion that I spoke about in my prepared comments.

Operator

The next question comes from Larry De Maria of William Blair.

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

Nice quarter. I guess my question is on firefighter. Obviously, that market, especially late in the year, can be a function of the timing of when municipalities get their money to spend and also maybe CARES Act funding, spending, et cetera. Ultimately, a pretty big number, and it sounds like you still have backlog. So can you kind of delineate how much was there unusual surprise, maybe onetime boost? And does that create a tough comp? Or is this a nice normal number, which we can grow off of? So just trying to deconstruct that number if there was any stimulus money in there, if it was just pull forward? But then you said you had obviously some more backlog coming into this year.

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

Larry, yes -- no, that fire service number, we anticipated that. We had talked through the year that the fire service -- we had confidence in the fire service business holding up through the pandemic. Those products that firefighters are buying are necessary products for them to do their jobs. They're not nice-to-have items. So we anticipated that coming in. We did maybe a little better job than we anticipated from a delivery standpoint on the breathing apparatus.

The operations team and sales team did a really good job in planning and knowing the orders that were coming in the door and getting those back out. I would characterize it as we finished up where we expected to be, and expected to have a nice backlog going into the first part of the year. And we expect to see a similar pattern as we go into 2021. The municipalities do have money to buy those necessary products, and the products we sell to them for the fire service are required.

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

Okay. That's good. And I guess, can you maybe just talk about the energy markets a little bit more. Are there -- do you see any signs of life other than just normal replacement with that, obviously, oil price is moving higher? Or is there anything that gives you confidence or better outlook over there in the energy side?

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

We do. When we look at our pipeline of business and the opportunities in that pipeline, we're beginning to see some projects resurface, and that pipeline build a bit, especially in the Middle East. There's some activity there that's beginning to perk up a bit. We believe that you're going to get back into stronger levels of employment as demand increases for oil and gas, and that will just drive hardhats, fall protection, and we're really well positioned to pick that business up because our share is strong in those areas and continues to grow with fall protection. So we're optimistic that will bounce back, hopefully a little quicker than we anticipate, maybe the back half of '21.

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

Okay. And then last question, sorry for one more. But you mentioned you're prepared to use the balance sheet. Can you give us a handle on what's the upside of -- let's say, upside on the deal? How big would you go? Are there deals out there, good pipeline? And is there tough competition from SPACs, PE, et cetera? Just trying to kind of calibrate an expectation there.

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

Yes. We thank you for the question, Larry. And we have been very disciplined with the balance sheet over a number of cycles, not just the current cycle that we're in. And we're committed to remaining very disciplined. With that said, we will be opportunistic as we were with Bristol, and we were with past acquisitions. When we see an opportunity to acquire a good business, we will bring it into the fold and help enhance our position with that investment. And so we're certainly looking at that. As I had mentioned, our balance sheet has about 1x leverage on it today.

During past cycles, we've seen that go up to 2 to 3x, depending on where you are in the cycle. But again, we're certainly going to be disciplined and go after the right opportunity. We don't feel a pressure to use the balance sheet, but when we do see the opportunity to use it, we will.

Operator

The next question comes from Brendan Popson of CJS Securities.

Brendan J. Popson - *CJS Securities, Inc. - Analyst*

I just want to ask a quick question on the firefighting business. The -- obviously, SCBAs were really strong and I understand it's a bit different of the sales process, I'm sure, to the helmet and apparel. Can you just talk about that? Is there -- do you expect a strong bounce back there as well? It seems to not quite have that bounce back yet. And obviously, Bristol will play into that, too. But could you just talk some about that space?

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

Sure, Brendan. Thank you. Yes. When you look at the rest of the fire service business outside of SCBA, the helmets -- breaking into 2 pieces. The helmet, part of it. We just didn't see any many large tenders or large orders for the helmets throughout 2020.

(technical difficulty)

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

We're on the line and ready to take the next question.

Operator

(Operator Instructions) The next question comes from Chris McGinnis of Sidoti & Company.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

Nice quarter. I just have 2 questions. One, just -- and if I missed this, I apologize, but just rising raw materials, is there any impact as you look out into '21 or any concern around that?

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

Thanks, Chris. We watch that closely. Obviously, we have our eye on the supply chain and material costs. We've done a really nice job in the past in offsetting that with price and other activities within operations. So we always look at that as somewhat of an opportunity for price increases, and we're pretty effective there. So we haven't seen it at this point, but certainly, we're watching that closely, and we'll react as that occurs.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

Great. And then a second question, just -- and it may be applicable for some of the businesses and maybe not others. But as you look at it across the different geographies, economies are opening up earlier. Is there any lessons you might be able to take away to use with economies opening up later to better position itself for growth to take advantage of that, those opening economies?

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

That's a good point. We have seen some of that shift, so to speak. When China went into their COVID shutdown, we saw that business obviously slowed down quickly. And then when they came back to work, we saw a bounce back. And then we've had some starts and stops here in the U.S. In the U.S., we started to see things bounce back a bit. And then when COVID spread down through the south through the oil patch, we saw that business drop off and then things picked back up. So right now, you're seeing things tighten up in Europe. But we do expect all of that to loosen up during the second half.

Lesson learned is, try to get ourselves in a position from an inventory standpoint. As I've mentioned, those PPE products, those orders come in and go out in the same quarter. We have very strong market share in parts of the world with some of those products. And we just want to make sure that we have the product on the shelf to respond to those customer needs. So we're watching that supply chain very closely. We're staying on top of the order pipeline from a sales organization. And making sure we prepare ourselves for that when the economy bounces back.

Operator

The next question is a follow-up from Richard Eastman of Baird.

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

I just wanted to clarify some comments you made maybe a little bit earlier. Around the International adjusted OP, I have that, I think for the year, it came in at about 15%. And again, maybe I'm thinking that was more at target at this point. But what kind of expectation do you have for them in '21? I know it's somewhat revenue dependent. But is there another 50 to 100 basis points in that international OP for '21? And I'm curious if you're seeing any pricing traction there as you started to look at that mid-year '20.

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

Yes. So Rick, it's Ken. I'll take that one, if that's okay. The business continues to do exceptionally well in International. And the team in International is laser-focused in on all aspects of the P&L. From gross margin improvements we saw this year, despite revenue declines, to leveraging the SG&A, the team is really doing an exceptional job. We do expect continuous improvement in our business. That's one of the key areas that we have in our strategy is operational excellence and continuous improvement.

And so we certainly are looking for further improvement as we move forward. But from time to time, you do have a consolidation period where you're regrouping and you're resetting and you're making additional investments. And so we do expect to see improvement, but it's hard to see 200 to 300 basis points each and every year.

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

Okay. All right. And then just a quick one, and then I am done here. With all the weather-related issues and the gas and oil and energy infrastructure shut down in the Texas area. I mean, that seems to be more of a calamity. But there's been a lot of -- there's been some comments kind of circulating about the infrastructure around the energy infrastructure being potentially damaged with the cold temperatures and the extended cold temperatures there.

But I guess what I'm curious about is in your fixed gas and flame business, there is a solid consumables element to that business. Is there any trigger there with these events for some replacement demand around the consumables? And if there is, can that be more than a blip in terms of your revenue in the short term?

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

Yes. Rick, there is to a degree. But what you're dealing with here is cold, extreme cold. And the fixed gas and flame detection product is designed for and holds up exceptionally well in much colder temperatures than they're faced with there. We're up in Alaska and other parts of the world that have extreme temperatures. What does drive it, at times, is hurricanes.

And when you have some hurricanes and they don't have the opportunity to lock some things down, that will drive sensor replacement. A lot of times they'll go through and just replace all their sensors after a hurricane. I don't think we're going to see that from this cold snap because the product is designed to handle that without a problem.

Operator

And we have Brendan Popson to resume -- to please restate any question that was not answered.

Brendan J. Popson - *CJS Securities, Inc. - Analyst*

Yes, I just want to ask real quick on -- just on the gross margin. It seems like the mix wasn't quite as strong in the past couple of quarters. And looking out to FY '21, should it -- how quickly should we expect it to kind of bounce back to that mid- 40s that you guys normally do and just the cadence there for that?

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

Yes, Brendan, it's Ken. That area is an area that we're focused in on. In my prepared comments, I talked about inventory charges that we took in the quarter. And we did, we took inventory charges, and they're primarily related to an investment that we had made to serve one large customer in response to the pandemic.

Early on, we received a pretty big sizable contracting vehicle from a large potential customer and respiratory products. We invested in inventory to prepare for what we expected would be a meaningful order. And unfortunately, and ultimately, the customer did not pursue the order. So we took a charge associated with inventory this year that weighed down our results. I think it was $6 million roughly in the quarter, roughly $10 million or so for the year.

And so that will certainly -- we don't expect that to repeat as we move forward and go into the new year. And so we feel like that gross margin should certainly come back going forward.

Operator

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

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

On behalf of our entire team here, we want to thank you again for joining us this morning. If you missed a portion of the conference call, an audio replay and transcript will be available on our Investor Relations website for the next 90 days. We look forward to talking with you again soon.

Operator

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