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MSA - Q4 2014 MSA Safety Inc Earnings Call

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PRESENTATION

Operator

Welcome to the MSA fourth-quarter and year-end earnings conference call. My name is John, and I will be your operator for today's call. (Operator Instructions)

Please note that the conference is being recorded. I will now turn the call over to Ken Krause. Ken, you may begin.

Ken Krause - *MSA Safety Incorporated - Executive Director of Global Finance, Assistant Treasurer*

Thank you, Johan. Good morning, everyone, and welcome to our fourth-quarter earnings conference call for 2014. I'm Ken Krause, Executive Director of Global Finance and Assistant Treasurer for MSA. Joining me on the call this morning are Bill Lambert, President and Chief Executive Officer; Stacy McMahan, Senior Vice President and Chief Financial Officer; Ron Herring, President of MSA Europe; Nish Vartanian, President of MSA North America; and Kerry Bove, President of MSA International.

Our fourth-quarter press release was issued last night and is available on our website at www.msasafety.com. This morning Bill Lambert will provide his commentary on our quarter. Stacy will then review our financials, and Bill will conclude with his closing comments. After that we will open up the call for your questions.

Before we begin, I need 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 detailed in our filings with the Securities and Exchange Commission, including our most recent Form 10-K, which was filed on February 24, 2014. You are strongly urged to review all such filings for a more detailed discussion of such risks. Our SEC filings can be obtained at no charge at www.sec.gov and on our Investor Relations website.

MSA undertakes no duty to publicly update any forward-looking statements made on this call except as required by law. In addition we have included certain non-GAAP financial measures as part of our discussion today. These non-GAAP financial measures should not be considered replacements for GAAP results. Reconciliations to the most directly comparable GAAP measures are available on our Investor Relations website at investors.msasafety.com within the Quarterly Results section under the Financial Information header.

With that, let me introduce MSA's President and Chief Executive Officer, Bill Lambert.

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Thank you, Ken; and good morning, everyone. As always, I want to begin by saying thank you for joining us this morning on this conference call and for your continued interest in MSA. I want you to know that we never take that for granted.

Presumably all of you have seen our fourth-quarter press release issued last night and have our financial figures, with all comparisons corresponding to the equivalent period in 2013. I'll begin this morning by reviewing the highlights of our fourth quarter. I also will share with you further details about our recent launch of the G1 SCBA and give you more detail on our Europe 2.0 initiative, which reached a significant milestone since our last call. After that I will turn the call over to Stacy for a review of our financial results, and then we'll open up the call for your questions.

I am pleased to report that we had a very solid finish to 2014, which was our centennial year in business. The team demonstrated many of our core values in delivering a very strong quarter. As you saw in our press release, sales in the fourth quarter from continuing operations were $311 million, which was a record quarter for MSA, reflecting an 11% increase in currency-neutral terms.

Operating margin was 16.4%, 220 basis points ahead of the same period a year ago, while earnings from continuing operations increased 38% on a currency-neutral basis. For the full year our sales results were also a record high from continuing operations, totaling $1.13 billion, reflecting local currency growth of 4%.

Our performance was clearly driven by our continued focus on core product revenue growth. In the fourth quarter, sales from our core product lines comprised 74% of total revenue, reflecting local currency growth of 13% from the core. We saw strong results across all four product categories.

For the year the core increased 4%; but when you exclude SCBA, which felt the brunt of the regulatory-related delays up until November, core products increased 8%. Our strategy and the related investments we continue to make in these core product areas are clearly helping to drive a higher level of value for our shareholders.

Looking closer at the fourth quarter, our fixed gas and flame detection line was the clear growth leader for the quarter, increasing 24% from a year ago as we shipped meaningful amounts of backlog during the fourth quarter. Additionally, we saw a 19% increase in the sale of fall protection products, while portable gas detection and SCBA each grew 8%. Head protection sales increased 5%, all in local currency terms.

As you know, a key pillar of our corporate strategy involves investing in and generating growth in emerging markets. We saw a mixed story in the quarter across these markets and ended with 6% quarterly sales growth in emerging markets. While this quarter we benefited from very strong results and increased large shipment orders in Asia, Mexico, and the Middle East, we saw declines in key markets such as Latin America, stemming primarily from the continued weakness and the recessionary conditions in Brazil.

While we remain very committed to the emerging safety markets of the world, the economic conditions in these markets have been uneven over the past year. And now the strong dollar and weakness in commodity prices are presenting headwinds as we start 2015.

On the new product development front, of course our brand-new G1 SCBA was front and center this quarter, as we received key government agency and NFPA certifications in November. This was truly a milestone event for all of us here at MSA, and I can't express how pleased I am about this significant accomplishment.

Launching the largest engineering project in MSA's history was no easy feat, and my thanks go out to the MSA product development and operational excellence teams who made it happen. I especially want to recognize and thank the hundreds of firefighters who participated in our voice-of-customer process to provide us with the critical information and feedback that served as the foundation of our product design and execution. The G1 would not have happened without that firefighter input, so it's fitting that our marketing message proudly proclaims that the G1 is an SCBA designed side-by-side with firefighters.

After we received approval for shipping in November, we continued to see strong demand for the G1, and order activity has been robust. Our current total global SCBA backlog is approximately $80 million. That's up $10 million from the third quarter and about double our normal level of SCBA backlog.

This strong book of business is reflective of new orders, primarily for the G1, as we realize success in the US fire service. In previous calls and in our investor day last year, we discussed the expected uptick in SCBA demand associated with a replacement cycle opportunity that we first saw -- and we are seeing it. We continue to ramp up our production and delivery efforts on the G1, and we expect to make progress against our growing backlog throughout the first half of 2015.

Across the core product portfolio, our investments in R&D are paying solid returns as 2014 yielded impressive results in sales vitality. We call it sales vitality -- those are products introduced over the past five years, and they accounted for 32% of our core product sales and 27% of our total sales. That compares very favorably to 21% last year.

Many of the new products that we've discussed on past calls, such as the M7XT SCBA and the Fas-Trac III helmet suspension are driving strength in our product vitality metric. In addition, portable gas detection continues to be a bright spot for the vitality metric, with 60% of sales in 2014 derived from products developed and introduced over the past five years. In fact, portable gas detection was one of our fastest-growing products in 2014, up 9% and showing margin improvement of 220 basis points, largely on the success of our ALTAIR platform of products introduced over the past few years.

Our investments in research and development are clearly driving value for our shareholders. And now that the G1 SCBA is shipping in volume, we fully expect to see that product vitality metric continue to improve further.

Now I'd like to provide an update on our Europe 2.0 project, a multifaceted initiative that is designed to drive improvements throughout the P&L and streamline the way that we do business in Europe. We reviewed this project in detail during our investor day in 2014, and we touched upon it during our last earnings call. So this morning, for anyone who is new to MSA, I would like to provide a brief high-level overview of this undertaking.

Europe 2.0 is a transformational initiative. It's a strategic project encompassing two phases, and our overall goal is to move away from the pre-EU structure of independently managed affiliates to one based on common data and a broad range of standardized processes. And the linchpins for this transformation are a new pan-European IT platform, based on SAP; and a single and transparent logistics system working out of one location.

Phase I of the project, which was completed by Q3 of last year, focused on, one, driving improvements in our cost structure; while, two, converting our largest affiliates to a common IT system under SAP; three, moving to a functionally managed organization; four, streamlining and validating over 70 core business processes; and five, making solid progress in warehouse consolidation. During the fourth quarter of last year Phase II was our main focus, and it involved establishing a principal operating company, or POC, business model based in Rapperswil-Jona, Switzerland. I am pleased to announce that we held the grand opening of our new Swiss office in December, and our entire European leadership team now operates from a consolidated location in Switzerland, helping to more efficiently drive what is now a pan-European segment for MSA.

Most importantly, we completed the go-live of our new principal operating company model in early January, on schedule and with great success. We now have our four largest European affiliates -- Germany, France, Italy, and Spain -- running under the principal operating company model, and we should begin to see financial impacts from the new structure throughout 2015. The remaining smaller affiliates of Europe will be brought into the POC in Q3 and Q4 of this year. The restructuring investments we made during this phase of the transformation over the past several years in Europe is most certainly yielding strong results.

For the year in Europe we saw segment revenue increase 10% with operating margin of 11%, an increase of 40 basis points despite the increased investment in the project. In fact, looking at European operating margins, we have seen an increase of more than 800 basis points compared to 2009, providing further evidence that our investments in restructuring have clearly driven value for our shareholders. We've talked before about the benefits of establishing a principal operating company model, but in short, it not only provides us with centralized leadership in a business-friendly environment; it allows our European organization to drive optimal performance and leverage the benefits we've achieved under the Europe 2.0 restructuring programs thus far.

Executing a transformational project like this one requires significant investment to create long-term value. We have invested in restructuring dollars that have yielded strong results over the past several years. However, it's important to recognize that implementing the principal operating company will result in MSA incurring exit taxes during the first quarter of 2015.

As I mentioned on our last call, exiting certain affiliates and streamlining our European structure into a Switzerland-based principal operating company model was expected to trigger charges related to exit taxes. With 2014 results finalized, I can now say that we expect to incur between $8 million and $10 million of nonrecurring exit tax charges in the first quarter of this year, raising our first-quarter and full-year effective tax rate from normalized levels.

This amount will be reflected in the provision for income tax line on the income statement. As we discussed at investor day, the POC model has longer-term benefits. And beginning in 2016, we expect to start to realize a 200 to 300 basis point reduction in MSA's consolidated effective tax rate as a result of implementing the principal operating company model in Europe. This more than offsets the initial investments and charges that we have made.

Clearly, executing this strategic project has been an ongoing focus of ours, but the best barometer of success lies in our European performance. And I'm pleased to report that even in the midst of this significant initiative -- and, by most accounts, a relatively stagnant European economic environment -- our European business has continuously improved. And that is a real testament to the strength, the skills, and dedication of our European team. Indeed, Europe was a great story for us in 2014, but we firmly believe that the best is yet to come.

At this point I'd like to now turn the call over to our CFO, Stacy McMahan, to provide an overview of our fourth-quarter financial performance. After Stacy finishes with her report, I'll provide some closing comments. Then we'll open up the call for your questions. Stacy?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

Thank you, Bill, and good morning. I will now share some further insight into our fourth-quarter financial performance. Additional information will be available when we file our Form 10-K with the Securities and Exchange Commission later this month.

As Bill mentioned, sales from continuing operations in the third quarter were $311 million, up $20 million or 7% from the prior year on a reported basis and up 11% on a local currency basis. Excluding the increase in large orders, local currency revenues were up 6%. As Bill commented, we saw a robust 13% local currency growth across our core products during the quarter.

Looking at the sequential-quarter comparison, local currency sales have increased by 16% compared to the third quarter on improvements across all reporting segments. We shipped more large orders in the fourth quarter, especially in fixed gas and flame detection. Excluding large orders, local currency sequential-quarter revenue was up 9%.

I would like to provide more insight into our exposure to oil and gas markets. Before I do that, however, I would like to emphasize that although we do have exposure to these markets, we have a very broad and diversified business. MSA has a strong position across an array of end markets -- notably, our position in fire service, and the introduction of and market response to our G1 SCBA continues to provide a sense of optimism for 2015.

In addition, about two-thirds of our FGFD business in the energy sector is related to day-to-day operations and the maintenance, repair, and replacement of sensors and instruments. Finally, our geographic footprint allows us to participate in a wide variety of growth opportunities as safety grows in importance around the globe. These factors offset challenges to our energy-related business and allow us to navigate economic headwinds.

With that said, let's dive into what we are seeing in the oil and gas markets. In total we estimate approximately 35% of our business is in the energy market vertical. About 10% to 15% of our consolidated revenue -- primarily in industrial head protection and portable gas detection -- is more exposed to a pullback in employment trends across the energy market. We have seen weaker order patterns in these products in North America.

Another 5% to 10% of our total revenue, primarily in the FGFD product line, is exposed to a pullback in capital equipment spending. Our FGFD order book remains healthy at the moment as projects complete through the first half of the year; however, it may be that we see a slowdown in the back half of the year.

While I will give a high-level review of our sales today, please refer to the exhibit in our press release highlighting quarterly and yearly growth by segment and product for additional detail. As Bill already reviewed our consolidated core product results with you, let's jump into the quarterly segment performance now.

In North America sales in the fourth quarter were $148 million, increasing 14% from the same quarter a year ago. Core sales comprised 83% of total segment sales and were up 20% from a year ago on a strong increase in FGFD revenue, as we invoiced a higher level of large orders -- primarily in Mexico -- and also saw increase in SCBA as we shipped large M7XT orders.

As Bill mentioned, SCBA backlog continues to grow and should help mitigate the slowdown in other end markets. Across the rest of the core, industrial head protection invoicing increased 8% as our Fas-Trac product continues to generate demand. Additionally, fall protection revenues were up 19%.

While Q4 of last year was soft, driven by the recall a year ago, we have and continue to make investments in our fall protection business that are helping drive the improved growth. Non-core sales representing 17% of the North American business were down 7% on lower sales of thermal imaging cameras and fire helmets.

Moving on, our European segment reported fourth-quarter sales of $92 million, up 15% in local currency terms. Core sales comprised 64% of total sales in this segment and increased 10%, driven by higher shipments of FGFD systems, large order of shipments of breathing apparatus throughout the segment, and an improvement in portable gas detection invoicing. Non-core sales, representing 36% of Europe's overall revenue, were up 28% on growth in fire helmets generated by strong market demand for our new F1XF helmets and continued shipments of ballistic helmets on the large military order received this year. We hold approximately $12 million of remaining backlog on this order and expect to clear it in the first half of 2015.

Lastly, continuing sales of $72 million in our international segment were up 3% in local currency terms on a difficult comparison, as Q4 a year ago was very strong in key emerging markets. Core sales comprised 69% of total sales and increased 2% on large-order FGFD shipments and growth in portable gas detection in Asia; partially offset by lower large orders in SCBA and weaker conditions in Brazil, with the ongoing recession. Non-core products, representing 31% of sales in this segment, are up 4% in the quarter on a higher level of fire helmet sales, as we won and shipped a large F1XF order in China, partially offset by lower sales of mining-related products.

Our gross profit rate for this quarter was 45% of sales, an increase of 40 basis points from last year. But excluding the significant uptick in lower-margin large orders, margins were up over 100 basis points. Core product margins continued to be a bright spot, increasing 150 basis points from a year ago on improvements within nearly every product, as well as a strong mix weighted toward gas detection products. The cadence of new product introductions, our ability to price the MSA brand more effectively and to lower manufacturing costs all contributed to full-year gross profit improvement of 70 basis points.

Selling, general, and administrative costs were $77 million in the quarter -- relatively flat from a year ago, benefiting from the stronger US dollar. As we look ahead to Q1 of 2015, I would expect the same historical pattern to continue for SG&A that we have seen in recent years, with higher totals related to stock compensation and other payroll-related expenses that are incurred in the first quarter.

Looking at the full year in 2015, the low interest rate environment creates about a $5 million headwind, as we anticipate production in non-cash pension income recorded on our overfunded defined-benefit plan for the year.

Our investment in research and development this quarter was $12 million, flat with a year ago. As Bill mentioned, we've seen a number of new products driving sales recently from our R&D investment throughout the year, with our vitality metric reaching 36% in core products for the quarter and 32% for the full year. We recorded $2 million in restructuring expense in our international segment in the quarter as we worked to streamline our footprint and cost structure across mining economies, such as those of South Africa and Australia. As Bill indicated in his discussion about Europe, our restructuring programs continue to be successful in driving value for shareholders.

I am very pleased to report that operating margin in the fourth quarter was 16.4% of sales, a 220 basis point increase from a year ago. As reported, operating income increased 23% on the 7% growth in quarterly revenues. Certainly, these are solid results and reflect how well we are able to leverage additional volume through the income statement. Our consolidated tax rate this quarter was 31.7%, down from our run rate during the first three quarters of the year, as we recognize the full-year benefit related to the reinstatement of the R&D tax credit in December. Our year-to-date effective tax rate finished just above 32%, in line with our expectations.

Net income from continuing operations was $33 million in the fourth quarter or $0.88 per basic share. Excluding $3 million of pretax restructuring, foreign-exchange losses, self-insured legal settlement charges, and asset-related gains, adjusted earnings were $35 million or $0.94 per basic share, increasing nearly 25% from a year ago.

Foreign currency and, notably, the stronger dollar continue to get headlines on a daily basis. As you probably know, over half of our total revenue is generated outside of the United States. While this has afforded us a number of opportunities to drive value for our shareholders, the stronger US dollar is presenting headwinds to our quarterly results.

Based upon more recent rates, we would expect to see foreign-exchange headwinds of 5% to 6% in revenue and approximately 2% to 3% in earnings in 2015. As you know, North America is our most profitable segment and generates a significantly higher amount of income. As a result, while foreign exchange poses headwinds to revenue, the impact on earnings is more moderated.

Free cash flow was $47 million in the quarter, approximately 140% of net income. For the full year we were able to convert 83% of net income to free cash flow, pay $46 million of dividends, and pay down $16 million of debt. At the end of the quarter total debt approximated $252 million, while cash was $106 million, comprised substantially of balances outside of the United States.

Looking closer at the balance sheet, many of you probably noticed a significant swing in other noncurrent assets and both current and noncurrent liabilities this quarter. During January 2015, we settled a significant number of pending product liability lawsuits. These claims vary in severity and included many lawsuits seeking substantial damages. These settlements increased the product liability reserve to $75 million and will be paid equally over four quarters, beginning in the third-quarter 2015 and ending in the second-quarter 2016.

Substantially all of the claims settled are insured, and amounts associated with the insured items have been added to the insurance receivable. As many of you know, product liability is inherently unpredictable, and this development gives us an opportunity to gain certainty around this area in the coming years while at the same time reducing future exposure.

In summary, we had an excellent finish to a challenging year as strong shipments of core products drove record sales volume in the quarter. Coupled with continued margin expansion and controlled SG&A expenses, we recognized strong operating margin and double-digit growth in quarterly earnings. I am certainly pleased by the strong push this quarter and I see real runway ahead for growth with our G1 SCBA.

However, we are navigating through headwinds associated with weakness in commodity-based end markets. As a result we enter 2015 continuing to closely manage additional investments and our cost structure. Thank you for your attention. I will now return the microphone to Bill.

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Thank you, Stacy. I am extremely proud of the MSA team for executing the strong results we posted in the fourth quarter. We saw double-digit revenue growth, exceeded our operating margin target, set a new earnings record, drove higher levels of cash flow, and we launched our most innovative product to date that is generating a solid book of business.

Our associates, exciting and differentiated products, and execution to our corporate strategy continue to be instrumental in creating shareholder value, even as we both various headwinds in our end markets and geographies. As Stacy indicated, 2015 unquestionably poses challenges. While

I fully expect lower commodity prices to have an impact on head protection and portable gas detection sales in the first half of 2015 as our energy-related customers in North America reduce employment and pare back expenses, we are not seeing a significant impact on fixed gas and flame detection orders.

While we could expect headwinds associated with oil and gas to persist in 2015, I am confident that our success in launching the G1 -- as evidenced by our significant backlog -- along with the strength and the continued interest we are seeing in all of our new products will most definitely help us offset and weather these conditions. As we close the book on our 100th year in business, our mission of protecting the health and safety of people around the world continues to be the driving force in all that we do. And we look forward to writing the next chapter in our Company's successful history.

Thank you for your attention and interest in MSA this morning. At this time Nish Vartanian, Kerry Bove, and Ron Herring have joined Stacy, Ken, and me. And we will be happy to take any questions that you might have. Please remember that MSA does not give what is referred to as guidance, and that precludes most discussion related to our expectations for future sales and earnings. Having said that, we will now open the call to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Edward Marshall, Sidoti & Company.

Edward Marshall - *Sidoti & Company - Analyst*

So I wanted to ask about the European business, if I could, because the sales number there was pretty strong. And I think what I've noticed over the last three years is there's been some seasonal strength in the -- developing in the fourth quarter. And I wanted to know if you could kind of parse that out -- maybe what's causing that. And was it also related to the large shipments in FGFD?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Sure. I'll provide initial commentary, Ed, and then I'll to Stacy or Ken to maybe put a finer point on it. But we did have strong order performance and shipments in the fourth quarter out of Europe. As Stacy indicated, some of that was related to the large ballistic helmet order that we have with the French defense forces under CESCOF.

We also had strong performance out of the Middle East, where we saw some nice fixed gas and flame detection orders and shipments there. But when you look at the business overall -- when you look at how we did in Central Europe and Southern Europe -- overall, we still had good, solid, strong performance and grew the business in those parts of Europe as well.

But the big drivers really were: Middle East, where we saw 38% growth year over year for the full year in the Middle East and India region; and then we had the large ballistic helmet order that Stacy talked about in her comments. So I'll look to Ken or Stacy for any additional input there.

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

Essentially core products grew for Europe at a really nice double-digit rate, at just 10%, and it was a really strong mix of growth across the core product areas. And then on top of that, we had the non-core product growth of the helmet sales. So it really provided a very nice result for Europe.

Edward Marshall - *Sidoti & Company - Analyst*

Okay. When we talk about -- maybe if we could -- the stronger growth in the fall equipment, and especially in Europe and the emerging markets -- and I know this has been an area of focus for you, so maybe it's the first of achievement; but I'm also curious if there was anything off maybe just a small base that is kind of skewing the overall percentage change?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Well, it's a small base when you compare it to the other core product areas that we have, Ed. But it continues to show good growth from our affiliate companies around the world. That's all organic growth. None of that was inorganic. And so I think it reinforces the belief that we have that this is a growing market; it's an opportunity for MSA, and it's an area that continues to receive our focus and attention.

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

The growth was also lifted, Ed, because last quarter -- last year's final quarter of the year was impacted because we had had a product recall, and that lowered the base comparison.

Edward Marshall - *Sidoti & Company - Analyst*

Okay. And on the product liability claims, I wanted to ask -- there is no insurance coverage now for product liability claims, correct? You have incurred all of those liabilities yourself?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

No.

Edward Marshall - *Sidoti & Company - Analyst*

Is that right?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

That's incorrect. That's incorrect. Let me restate: we have quite a bit of insurance that is over and above any product liability that we have registered that is in force for claims that occurred before -- where injury occurred before -- I'm sorry -- I'm getting my years wrong. Go ahead, Ken.

Ken Krause - *MSA Safety Incorporated - Executive Director of Global Finance, Assistant Treasurer*

So from a product liability perspective, Ed, we definitely have sufficient product liability insurance coverage still in place that's in excess of our claims that have been incurred to date and that have been recorded in our insurance receivable. Those claims are prior to 1986.

So there was a change in insurance law, and so those items after 1986 we're effectively self-insured on. And so in our adjusted earnings table, you can see that we had right about $3 million to $4 million incurred for those post-1986 claims in the year that directly hit the P&L. But for those things that are prior to 1986, we record those as part of our insurance receivable, as we've talk about a number of times and fully disclose in our 10-K. And we've get sufficient level of coverage in place for those.

Edward Marshall - *Sidoti & Company - Analyst*

Okay. Thanks, guys.

Ken Krause - *MSA Safety Incorporated - Executive Director of Global Finance, Assistant Treasurer*

Ed, the only thing I would want to double-click on in that European growth rate, just to give you guys a little bit more clarity in that European growth rate is -- Bill and Stacy had talked a lot about the growth in FGFD and ballistic helmets. So if you step back, and you look at the full year, and you think about the year, we grew about 10%.

If you exclude some of that large order activity and you exclude some of those ballistic helmet orders, we are more in the mid-single-digit range in terms of growth in Europe, which is probably more in line with what you might expect to see coming out of those markets.

Edward Marshall - *Sidoti & Company - Analyst*

Okay. And have you noticed any change as we kind of moved into the first quarter here in order patterns? Has that slowed down at all? I mean some of the weaker economic figures that are coming out of Europe -- have you seen any change there as of yet? Or in the strengthening dollar?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

I think it's still too early to tell. The incoming order book that we're looking at and the results are actually slightly above the planned numbers that we put in place for ourselves and the targets we've set. So we are not seeing a dramatic change or shift in that regard, Ed.

Edward Marshall - *Sidoti & Company - Analyst*

Okay. Great. Thanks, guys.

Operator

Rudy Hokanson, Barrington Research.

Rudy Hokanson - *Barrington Research Associates, Inc. - Analyst*

Thank you. Both of my questions are related to the energy sector. And I was just wondering -- did I hear correctly, Bill, that you said that right now you haven't seen any real slowdown on the fixed gas and flame detection sales into the energy sector thus far, but you are cautious about what might evolve over the second half of the year?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Yes, I think that's well stated, Rudy. Our fixed gas and flame detection business -- we are not seeing yet that ripple effect from capital spending cuts that may occur. A lot of projects that are in place or that are far enough along in that end market has not yet affected us.

But it's obviously a very uncertain environment, and so we are not completely sure how the back half of the year or into the third and fourth quarter -- how that will go. Where we are seeing an immediate pullback, and as Stacy mentioned, is really on those elements of energy that relate to employment levels. So we have seen a pullback from our distributors that provide product to the energy industry in head protection and in portable gas detection.

That was pretty immediate. When you saw some of the announcements by those who provide services to the oil and gas industry and the cutbacks there, then that really had to do with employment levels, which directly affects head protection, directly affects portable instruments. But not on the FGFD side -- we are not seeing it just yet.

Rudy Hokanson - *Barrington Research Associates, Inc. - Analyst*

Okay. And then, along those lines, looking at the financials or expectations on the financials -- the FGFD is among your higher-margin product. And I was just wondering if you can account for -- or if there is a way to understand -- the contribution to the margin improvement in 2014 related to FGFD that may be vulnerable if there is a slowing.

I'm being sort of very large-picture and a bit vague, because you don't break it out on each product line. But I was just wondering if we could understand, as we're looking for margin improvements going forward, what kind of improvements there may be? And how much of that improvement in 2014 was really related more to the sales of FGFD?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

Yes -- I'm sorry.

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Let me jump in, and then I'll ask for some specifics from Stacy on that percent margin improvement there. But I think it's important to keep in mind that roughly two-thirds of our FGFD business is really recurring sales. So it's not the sales of the new installations, but rather the replacement of sensors and product that's already installed in the field. And we don't see that decreasing, really.

It's the new project business. It's the new greenfield sites that could be subject to some of that decline or some of those delays in the projects and get pushed out into 2016 or 2017.

So I just want to keep it in that context -- that roughly two-thirds of that business is really strong, recurring business. And we've got a meaningful part of that business that is not oil and gas, but rather is chemical, and wastewater treatment, and other facilities that rely on fixed gas and flame detection as well for protection.

But having said all that, we did have a really strong year in FGFD. And I'll look to Stacy and Ken to maybe comment on how that impacted our operating margins for last year.

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

From a profitability standpoint, Rudy, the recurring revenue stream in FGFD is the most profitable element of that. And with such a large portion of the revenue coming from that profitability element, it gives us a bit of a buffer on profitability for the project business that can be at a lower margin. And it's that project business going forward that -- potentially -- we haven't seen it yet, but we could see a slowdown in the back half of the year.

Rudy Hokanson - *Barrington Research Associates, Inc. - Analyst*

Okay. Just to repeat what you just said, to make sure I've got it clear, is that if there is a slowdown with new projects, those are usually at a lower margin than the repeat business?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

Yes.

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Absolutely. Absolutely correct.

Rudy Hokanson - *Barrington Research Associates, Inc. - Analyst*

Thank you. That helps a lot. That's all I've got.

Operator

Walter Liptak, Global Hunter.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Stacy, at the beginning of your presentation, you talked about the LNG exposure. So just to follow on Rudy's question: the thing that you were presenting there was that the businesses that could slow or are slowing look like they represent 20%, 25% of revenue? Is that right? The head protection and then some CapEx?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

10% to 15% of revenue, which is the head protection and the portable gas detection.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. Got it. And then 5% to 10% of FGFD that could slow -- you are not seeing slow, but could slow.

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

Yes. That's a part of our FGFD project-oriented business. That's more capital equipment -- spending sensitive.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. Got it. Have you ever looked at the business based on upstream, midstream, or downstream? I guess I'm wondering how much of your O&G exposure is upstream?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

Yes, we have looked at the business, and you know, basically estimates are that our FGFD products -- particularly those that we acquired through General Monitors -- are more in the upstream and midstream categories. Roughly it's evenly split between the total business -- upstream, midstream, and downstream. So we have exposure sort of evenly throughout the value chain in energy production.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. Great. That helps. I wanted to ask about the tax rate. So excluding the exit tax in the first quarter, are we looking at, like, a 29%, 30% tax rate for 2015?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

I think you consider our base as roughly what we realized for the year in 2014.

Ken Krause - *MSA Safety Incorporated - Executive Director of Global Finance, Assistant Treasurer*

The headwind you have there, Walt, is the R&D tax credit is only renewed on -- it was only renewed for 2014. So we are going to be at the mercy of that again. And the other thing that kind of plays into 2014 a bit is the mix -- you know, when you think about the business globally. So those would probably be the two biggest items. But this rate of around 32% is probably a reasonable expectation.

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

And realizing that we will have the extra bump in the first quarter from the exit taxes for Europe.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. Sounds good. And then the nice backlog that you've got of SCBA and the G1 -- I wondered about when you are expecting shipments to go out? Does that $80 million go out in the first half? What does the throughput look like on production lines and profitability expectations for that?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Well, as I indicated to you, the $80 million in total SCBA backlog that we have currently is about double what we normally see. So our efforts are to reduce that back down to more normalized levels. So we are increasing production, increasing throughput. But we continue to see a very strong book of business.

And the G1 is converting competitive accounts, which is just what we had hoped that it would do. And we are starting to realize some real inroads, if you will, into that replacement cycle market that we have talked about in the past.

From a profitability perspective, the G1 -- as any new product that you might experience -- it comes online and efficiencies continually improve as we come up the learning curve, as our suppliers develop improved techniques. So we would only expect to see that profitability improve. But we are very pleased that profitability is right where we targeted it so far, with the new orders and with the competitive conversions that we are making.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. At what point in the year do you think you will be back to a normal SCBA backlog?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Well, Walt, obviously that depends on just how strong the incoming order book continues to build. So I think in my commentary, I said that for the first half of the year, we expect to make meaningful progress against that backlog; and that I would think that by the third quarter, we will get back down into that normalized range, assuming everything goes according to plan. And I would expect the third quarter we would be back there.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. Great. Thank you.

Operator

Richard Eastman, Robert W. Baird.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Just a quick question -- on the portable gas business, it looks like maybe you are attributing about half of that business to the energy sector. Is that about -- you know, is that close?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

I think that's close, Rick.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Okay.

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Yes, I think that's very close.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Yes. And then, Bill, when you look at -- when you think about 2015, and you think about the core product segments, are there enough puts and takes to deliver mid-single digit out of the core products? You've got the SCBA up. It looks like the fall protection business now -- you are at least back to recording revenue there. And, obviously, we have the O&G offsets. But is that the way you're kind of budgeting for the core products for 2015?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

That's right, Rick. I do think there are enough puts and takes that right now, we can still see that mid-single-digit growth overall for the core product areas.

I mean, while we have talked about the upstream side of oil and gas -- the exploration, the drilling, the development, and the impacts there, and to the industries and service support groups in that sector, you still have, though, the chemical processing industry that's taking great advantage of low feedstocks.

You have got the metals and minerals area, the industrial manufacturing industries, the US automobile and truck industry, and even industrial construction is up. And so we continue to see some strength in those other types of markets and the channels that support those markets for us. And then you layer on top of that what we're seeing in the fire service, and just the great strength that we are seeing there with our product portfolio.

I think the answer to your question is yes. I think there are enough puts and takes that we can continue to see the mid-single-digit growth from our core product areas when we have this call this time next year.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Fair enough. And then, Bill, I'm curious -- the G1 -- we talked a little bit about the SCBA backlog overall, but it strikes me that you have to be somewhat pleased with the uptake on the M7XT and the orders that you've seen there. Is the G1 available outside the US, or is the rest-of-world growth in the SCBA backlog really coming out of the M7XT? And does that stay a driver for 2015?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Well, Keep in mind, Rick, that in addition to the G1 SCBA and the M7XT, we also have a line of SCBA that are produced in Germany for the European market segment, as well as a line of SCBA produced in China for the Asian market. So we have a nice portfolio of SCBA products, depending on the particular markets that we are going after.

The G1 does have applicability and interest outside of North America. We had a very good, strong sale in the Middle East late last year; in December we shipped that order into the Middle East. And in Latin America, where NFPA-compliant SCBA are required in parts of Latin America, we also have strong opportunity for the G1 down there.

But if I were to go back to the original part of your question, I'm very pleased by the M7XT. That product is a very solid product. We thought that the transition might be faster than it has been from customers who are using the M7 product, and that they would move to the G1. But nicely, the M7XT continues to sell. And the G1 is really advancing our initiatives on that competitive front, and it's enabling us to take competitive market share.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And then, Bill, could I just address -- or maybe you could just speak for a minute to the op profit in Europe in the quarter? I mean, it was very nice, very solid, very good op profit.

So as we move through 2015, I'm not sure how many -- how much of this fourth-quarter benefit we'll be able to hold and sustain. But how do you view the op margin progression here, with such a substantially strong fourth-quarter profitability in Europe? Can we sustain that over the next four quarters, before we pick up the tax benefit?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Well, I think that the fourth quarter of 2014 was certainly a really strong quarter for us, driven a lot by volume. We had a lot of volume that went through MSA Europe with regard to fixed gas and flame detection into the Middle East, into Central Europe, and also with regard to the non-core product area of ballistic helmets.

Some of that continues into the first and second quarter, as Stacy indicated in her commentary, where we continue to ship ballistic helmets in Europe against that contract for the first and second quarter. And as I indicated, the fixed gas and flame detection market end into the Middle East has been very strong.

Interestingly, the North American market for energy has really seen a pullback and expense reduction, but we are not seeing that out of the Middle East. The Middle East continues to be an area of strength for us, and so we have some solid expectations for continued growth in the Middle East.

So whether or not we may be able to maintain the operating margins that we saw in 2014's fourth quarter -- can we maintain that into 2015? I think it's a little uncertain, but it's absolutely better than it has been in previous years.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Okay. So overall, for 2015 we should see our op margin -- well, as you define it, net margin improve without the tax benefit. And then in 2016 we pick up the tax benefit in Switzerland?

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

Yes, I think that's accurate.

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

Rick, the only thing that I would add to that would be just -- we just need to watch the strength of the dollar and its impact on the profitability of the segment. So right now we did pretty well at the end of the quarter with the strengthening dollar. We just continue to watch that, because it certainly has an impact on that.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Understood. Okay. Well, thank you, and nice finish to the year.

Operator

Stanley Elliott, Stifel.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Congratulations on the quarter. A quick question -- can you help to square up the momentum that you are seeing on the G1 -- and then, also, I believe you talked about kind of a slowdown in some of the helmets and some of the thermal imaging cameras. Is that more product specific? Or is the reason here that -- the health of the municipal budgets out there are -- they are still a little reluctant to spend? Anything you could help with that.

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

I think that the helmets that Stacy was referring to in her commentary was really primarily related to the North American segment, where we just don't see the replacement cycle that we have described to you in the past on SCBA. We know that the number of firefighters every year gets more and more challenged as to the actual number of firefighters in the North American market. So I think that's where Stacy was referring to -- that helmet -- those revenues declining.

When we look at overall fire helmet sales, though, which include the European-style helmet, the F1XF helmet that Stacy mentioned, I think we are seeing some very, very nice growth in that product line on a global basis. So into the Asian market, into European markets, and most recently into the Australian market.

Ken Krause - *MSA Safety Incorporated - Executive Director of Global Finance, Assistant Treasurer*

Stanley, you had mentioned municipal budgets. And we are finding the municipal budgets are quite -- we don't want to say healthy, but the dollars are there for SCBA purchases. They are coming up on the end of lifecycle on SCBA, and the fire chiefs, the departments are certainly finding the money within the budgets to replace the SCBA. So we are not seeing a lot of problem there. So the market is quite healthy from a funding standpoint.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Perfect. And then from the settlement that you will reach -- what does that do to the cumulative kind of loss number that you guys had on your balance sheet? Does that make a move to more of like a 140 to a 210 type number? And then I guess the other piece to that is: does that make reaching a settlement with those insurance companies eventually much easier?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

Well, it certainly adds pressure to the insurance companies in settling with our legal challenges to them. You are correct -- your numbers are roughly correct in terms of what happens to their insurance receivable. You can see that reflected on the balance sheet in the asset section.

We are very pleased, because we actually have a definitive, more transparent way of looking at this for the next basically two full years. We actually are able to recognize some of that liability going forward and have a feeling on it, so we know that we have settled in very favorable terms a host of lawsuits. That is meaningful.

Stanley Elliott - *Stifel Nicolaus - Analyst*

That's great. And what are the plans for the balance sheet as far as kind of debt levels that you guys feel comfortable with -- ballpark, below 1 times on an EBITDA basis right now. Is that where you want to stay, or -- just how you are thinking about the capital structure right now?

Stacy McMahan - *MSA Safety Incorporated - SVP and CFO*

I will invite Ken to make further comment, but we are pretty comfortable at the 1 to 1.5 times EBITDA level on the debt. We target, you know, to be considered -- even though we are not rated -- but be considered a very highly rated debt offering, should we ever do that. And that's sort of the ratios that we compare against.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Perfect. Thank you for taking the questions and best of luck.

Operator

Richard Eastman, Robert Baird.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Just one bit of detail. Stacy or Ken, could you just provide for the full year either the percent or dollar amount of the revenue from the five -- the core product lines? Is that possible to quickly --?

Ken Krause - *MSA Safety Incorporated - Executive Director of Global Finance, Assistant Treasurer*

I think Bill had disclosed in his script that we have 74% of our business in the core product offering. So I think in his prepared comments we had disclosed that ratio -- or in the press release, I think on the --.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

I understand that, but the specific product lines. In other words, head protection was 15% of year-end sales. Just we can get a sense of how to weight growth rates there?

Ken Krause - *MSA Safety Incorporated - Executive Director of Global Finance, Assistant Treasurer*

Yes, that's a good point. So when we look at the business -- and actually, in our 10-K, which will be published later this month, we've actually included the breakdown of the core offering throughout our business. So I could probably give that to you.

So when we look at the full year from a consolidated perspective, Rick, and we think about the business, we did roughly $832 million in core for the full year, of which $210 million is breathing apparatus; roughly $150 million is in head protection; roughly $160 million is in portable gas detection. Our fixed gas and flame detection was $260 million or so. And then fall protection was just under $50 million. So that gives you a sense of -- to the breakdown. And like I say, it's fully disclosed in our 10-K, which we'll be issuing here later this month.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And, Bill, just a quick question for you. I think in the December, if not November or December, one of your bigger competitors -- Tyco, in fact -- acquired this gas and flame detection business, Industrial Safety Technologies. I'm sure you saw that.

They now claim to be the biggest in the world, which is amusing. But I'm a little bit curious -- if that hits your radar screen; maybe if you have any opinion on that acquisition. It does obviously put Tyco now in the game with Honeywell and yourselves. Was that something that you looked at? I'm just curious about your opinion on that acquisition.

Bill Lambert - *MSA Safety Incorporated - President, CEO, and Director*

We did take a look at that, obviously, and we felt that our shareholders would be better served by us continuing to develop the technologies that we have here. We did not see them as being accretive to our growth potential and what we need to do for our business here. So we looked at them, and we didn't take it any further.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Okay. Fair enough. Thank you.

Operator

That's our final question. I'll turn it back over to Ken for closing remarks.

Ken Krause - *MSA Safety Incorporated - Executive Director of Global Finance, Assistant Treasurer*

Thank you, John. And with that, seeing that we have no more questions, that concludes this morning's call. If you missed a portion of the conference, an audio replay will be available on our website for the next 90 days, as will the transcript of the call.

On behalf of our entire team here, I want to thank you again for joining us, and we look forward to talking with you again soon. Have a great day. Goodbye.

Operator

Thank you, ladies and gentlemen. That concludes today's conference. Thank you for participating. You may now disconnect.
