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PRESENTATION

Operator

Good day, and welcome to the MSA Second 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. Please go ahead.

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

Thanks, Drew. Good morning, everyone, and welcome to MSA's Second 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. And I will note that we are all remote this morning, joining the call from our respective home offices. We don't anticipate any technical issues, but please bear with us, if any should happen.

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

We've included certain non-GAAP financial measures as part of our discussion this morning and the applicable non-GAAP reconciliations as well as our Q2 press release are available on our Investor Relations website at investors.msasafety.com.

And now I will turn the call over to our Chairman, President and CEO, Nish Vartanian.

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

Thanks, Elyse, and good morning, everyone.

This morning, I'll provide an overview of the various demand trends we're seeing across our portfolio and how we're executing in this environment. Then I'll hand it over to Ken for a financial review, and we'll start the Q&A session.

While the COVID-19 pandemic continues to impact our families, our communities, our workplaces and our economy, the team at MSA continues to execute very well. Despite the many challenges we've all faced in the first half of 2020, our associates' dedication to MSA's mission of protecting lives as well as our high-performance culture, was clearly evident in our quarterly financial results. We remain focused on providing our employees with a safe work environment while advancing our mission and providing our customers with products and services they need each and every day, investing in growth opportunities and driving improvements in productivity.

We had a number of accomplishments in the quarter. Despite having a challenging macroeconomic environment, we reported a strong quarterly adjusted operating margin of 18.7%. I'd be pleased with that result in any quarter, but I thought it was particularly noteworthy here because we achieved that performance despite an 8% decline in revenue. The operating leverage was driven by strong results in strategic pricing, discretionary cost controls, reductions to variable compensation and returns from our international segment restructuring programs that we've actioned over the past 12 to 18 months. We did a great job of controlling the controllables, and our results reflect the diversification and resiliency of the MSA business model.

As expected, and as we had indicated on a number of webcasts in June, the industrial PPE area of our business, notably fall protection, head protection and portable gas detection is where we saw the greatest challenges in the quarter. These products protect the individual worker, so they're largely tied to employment levels in the energy, construction, utilities and general industrial markets. These areas were collectively down 25% as work sites shut down and the economy came to a screeching halt.

In the fire service market, our SCBA business was a source of growth. Revenue was up 3% on momentum in China and Europe and solid execution in the U.S. as we worked through several strategic orders. Our order pace was strong to start the quarter, but we did see some delays beginning in May as evaluations and decision processes were pushed back due to social distancing measures. Nonetheless, our pipeline is as strong as it's ever been, both in the U.S. with G1 and internationally with the M1 SCBA. As always, with the fire service, the outlook for the second half will be somewhat dictated by the timing of AFG funding in the third quarter. Our nation's first responders have been instrumental on the lines of the COVID-19 pandemic. For this reason, it's encouraging to see recent government stimulus packages, such as the CARES Act, provide firefighter funding at the federal level. As fire departments resume their evaluations and decision-making processes, we expect they will secure the funds required to purchase mission-critical equipment.

Continuing through the portfolio, our air-purifying respirator line was clearly the standout in the quarter. These products reflect 10% of Q2 sales and increased more than 60% from a year ago.

Year-to-date, air-purifying respirators or APRs as we often refer to them, have provided $23 million of incremental revenue for MSA. While the surge order pace that we saw on the outset of the pandemic moderated through the quarter, we continue to post double-digit order growth through June. We discussed that working down the backlog in this area would take time, and that continues to be the case. Our APR backlog remains elevated and we expect to make further progress in reducing lead times in the second half. While the increase in APR demand is primarily from existing customers and markets, there are a few new growth opportunities we continue to target. First, we made inroads with several health care systems by providing elastomeric respirators for use in hospital settings. There was an interesting article in the New York Times published in May on the many benefits of reusable elastomeric respirators in health care as a complement to N95 masks.

As you may have seen on our website, MSA has invested in a number of marketing initiatives and campaigns to educate potential customers on the advantages of reusable respirators for emergency preparedness applications. And because we manufacture respiratory protection in the United States, Germany and Brazil, we're able to localize manufacturing for each of those markets. The CapEx investments we're making in our APR manufacturing operations will prepare us to respond well to future demand and our payback period on those investments remains very attractive based on our results to date and existing backlog. Most importantly, we're proud to fulfill our mission of protecting lives and health at a time when the world needs it most.

Another area where we're seeing attractive returns on strategic programs is in the International segment of our business. As many of you know, we've been heavily focused on improving commercial excellence and executing a cost reduction road map, mostly in our European region. It's encouraging to see international margin expansion of 240 basis points year-to-date. We have discussed the focus on pricing as part of our international margin improvement plans at our 2019 Investor Day. We are indeed seeing improved price realization across International, and SG&A is declining at a much faster pace than revenue as a result of previous restructuring programs. Bob Leenen and the entire International team have done a great job executing, and we see continued opportunity ahead. And we'll give you more insight into the additional restructuring investments we're making to drive further improvements on our cost structure.

While MSA's long-term growth algorithm remains intact, the near-term outlook is more unclear. Much depends on the timing and shape of an economic recovery. Beyond that, a number of other factors could impact how the second half of the year unfolds. These factors include the extent of a virus resurgence in the U.S. and other parts of the world; conditions in the energy market and employment levels in construction and manufacturing; the timing and extent of AFG funding as well as the passage of additional government stimulus programs; and how the demand patterns evolve for our respiratory protection business as we continue to target new opportunities. What we do know is that MSA has a diversified portfolio and a very strong balance sheet that position us well for these challenges. We're also accelerating certain strategic programs to drive further productivity improvements across our business.

With that, I'll now turn the call over to Ken to take you through our financial results. Ken?

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

Thanks, Nish, and good morning, everyone.

Before I begin the P&L review, I want to step back and provide a few performance highlights. The team executed well in a difficult environment. On the revenue decline of 8%, we drove 30 basis points of adjusted operating margin expansion. Returns from International segment pricing improvements and restructuring programs, global discretionary cost controls and reductions to variable compensation collectively drove strong leverage despite the lighter sales volume. Year-to-date, adjusted operating income is relatively flat on a 3% revenue decline. Great to see both our short-term and long-term cost structure actions helping to mitigate the impact of challenging business conditions across our end markets. We've maintained our balanced approach to capital allocation through this pandemic. And our quarterly cash flow conversion of more than 150% highlights our proactive efforts to manage working capital. We continue to invest heavily in our business, announced an increase to our dividend in May and are maintaining an investment-grade balance sheet. Our strong financial position is allowing us to invest in a number of organic initiatives that positions us well for the long-term as we navigate the challenging business environment. We are positioned very well to go on the offensive in terms of M&A as business conditions and visibility improve.

Now I'd like to walk you through our second quarter results. As reported, revenue was down 10%, while local currency revenues declined 8% on weakness across our industrial portfolio, partially offset by strong shipments of SCBA into fire service and growth in respiratory revenues. The 2% foreign currency headwind on revenue was related to a weaker Brazilian real and euro versus the same quarter a year ago.

While it is hard to predict the shape of the economic recovery and the rebound in shorter cycle areas, our overall backlog remains healthy and should provide support in the second half. Backlog is relatively consistent from the end of the first quarter just as we had expected. While there is uncertainty, especially here in the United States and in Latin America, what I can tell you is that our China-based business has been a bright spot for us in the second quarter. We started to see a rebound back in the latter part of March. Revenues were up 9% in the quarter and incoming orders were up 16%. What is especially encouraging is the growth was broad-based across most of the portfolio, including fire service and FGFD.

Gross profit declined 110 basis points from a year ago as we incurred about $3 million of higher costs related to the pandemic, coupled with a less favorable product mix. These additional costs were related to lower throughput in our factories, higher freight costs and implementing measures associated with COVID safety protocols across our work sites. These items had a significant impact on our Americas segment margin.

Price realization remains very healthy across the business and pricing remains a major focus for our organization. The focus is evidenced by the improvements in margins in the International segment in the quarter. International segment gross margins have improved nearly 200 basis points for the quarter and year-to-date periods.

SG&A expense of $69 million was down 18% on a reported basis or 14% in constant currency organic terms. We continue to realize the expected returns from previously executed restructuring programs, particularly in International where quarterly operating margin is up 310 basis points. For this segment, constant currency SG&A was down 11% on the revenue decline of 4%. And we continue to see solid leverage in the Americas segment SG&A as well. We delivered $6 million of savings from previously executed restructuring programs and discretionary cost savings in the quarter, which includes reduced travel; controlled hiring; reduced advertising and trade show expense; professional services and other costs as well. We plan to maintain discretionary cost controls through the third quarter as we manage through the uncertainty. We also reduced our variable compensation accruals by $5 million in the quarter, with the most significant impact in the Americas and Corporate segments of our business.

From a longer-term perspective, we continue to invest in programs that streamline our cost structure and optimize our footprint. We incurred just under $9 million of restructuring expense in the second quarter related to two areas. The first is the continuation of the European cost reduction activities. We accrued for steps that we plan to take later this year that will drive savings for 2021. These programs are part of the European cost reduction road map that we laid out at Investor Day last fall, and we've accelerated the time line based on COVID demand challenges. As I had indicated earlier, we've seen tremendous returns and leverage from the European restructuring initiatives that we've executed over the past several years.

The other program relates to global manufacturing footprint optimization. If you recall, we had discussed the opportunity to streamline manufacturing operations at our Investor Day last November. And in June, we announced plans to expand our Cranberry Township gas detection center of excellence through the construction of a new facility. As part of the program, we've recently announced to our workforce that we plan to close our Lake Forest, California manufacturing operations in the third quarter of 2021. These steps we are taking to advance our global gas detection global center of excellence are expected to provide $3 million to $4 million of cost savings in [2022] (corrected by company after the call) and will enable further actions in savings in 2023.We continue to evaluate additional programs we can implement and drive further savings in 2021 and beyond. We've often talked about our portfolio of margin expansion opportunities and it's encouraging to see the wheels moving on these important long-term projects.

Quarterly adjusted operating margin improved 30 basis points to 18.7% of sales. Year-to-date adjusted operating margin is running at 18.7%, up 50 basis points despite a number of headwinds that are impeding revenue growth this year. Adjusted earnings were $1.11 per share or 9% lower than a year ago. We indicated on the February call that we expected an $8 million full year headwind in 2020 from noncash pension expense. That had a $0.03 per share impact on adjusted earnings in the quarter as we had expected.

Free cash flow conversion was strong in the quarter at more than 150% of net income. We continue to apply best practices to drive improvements in receivables and payables. These efforts fully offset the investments we are making in inventory as we ramp up our respiratory manufacturing operations. Our second quarter results include $5 million of CapEx investments associated with the respirator ramp-up projects in Jacksonville.

Our balance sheet is very strong, and our capital allocation priorities remain balanced. In the first half, we generated free cash flow of $63 million, paid down debt by $9 million, funded $33 million in dividends and deployed $28 million for share repurchases to offset dilution. Leverage was 1.2x on a gross basis at the end of the quarter or less than 1x on a net debt basis. We remain well positioned to continue to focus on advancing organic opportunities during this downturn that will drive long-term growth and profitability improvement. We also continue to be very active with acquisition pipeline development and are staying close to attractive targets. When the time is right, we will be well prepared to go on the offensive and invest in organic growth.

Doing a quick look back on the Sierra Monitor acquisition, which we lapped here during the second quarter, I'm very pleased to note that this business has reported more than 20% EBIT margins in the second quarter. If you recall in 2018 before the acquisition, Sierra's business had a 60% gross margin, but just barely broke even on the EBIT line.

To wrap up, it was good to see the strong level of profitability in the quarter. From a demand perspective, the environment remains very challenging, and order trends have been choppy for much of the second quarter and into the third. There are shoots of hope in different areas of the business. But with the virus resurgence and related economic challenges, it's difficult to put a fine point on the outlook for the second half. Our backlog continues to be healthy as we enter the second half. But we remain vigilant in managing our cost structure and executing on long-term margin improvement projects. We have been very proactive through this crisis, and we're committed to continuing that approach. We are well positioned to manage through and emerge from this downturn as a stronger organization.

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

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

Thanks, Ken. And to wrap up our formal comments, I'm pleased with our team's strong execution in the second quarter, and we remain very well positioned to manage through this challenging environment. Our mission has never been more important. And we remain committed to investing in our business and executing on productivity initiatives to drive continuous improvement.

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, I'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 nice quarter. I know you don't want to get in too much in the specifics, and you mentioned kind of a choppy order environment. Is there a way to talk about how maybe business cadence trended through the quarter, kind of given all the moving parts? And then you mentioned some green shoots into July, but would be curious to kind of get a flavor for what you're seeing, particularly as it relates to economies reopening and such.

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

Well, I'll answer it first, and Ken, if you want to add something after I answer, feel free to. But Stanley, we had strong order pace in April, as we had talked about and communicated. May was very weak for us. And then we saw some real encouragement in June as the economy started to open up a bit, and you saw workers come back, we saw business pick up. And then -- quite frankly, the early part of July started to soften up a bit. So the business has just been really choppy. And we're encouraged by some of what we saw with head protection, which obviously is directly related to workers coming back to work. But that has been just really choppy for us. So we have a real lack of sight into what's going to happen here through the second half. There are just a lot of variables, obviously tied to COVID.

Parts of the business have been stable and fairly strong. With fixed gas and flame detection, we pretty much -- results were what we expected. Turnout gear, while the numbers look a little soft, that's a matter of output in our plant, some supply chain issues with getting material and us getting product through the plant. But that business is really stable and in really good shape. And breathing apparatus is pretty much where we expected to be. We had a strong second quarter. And now it just becomes a matter of timing with the AFG funds as is always the case.

So it's really a matter of the economy opening back up and those workers getting back to work and having those PPE products kick back in for us. So, Ken, if you want to add anything to that in case I missed something.

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

The only thing that I would add is that, as we had talked in our public webcast in June, May was a really tough month. June started a little bit slow, but we had a really good finish to June. June was a solid month for us before the virus resurgence here again in July, here in the Gulf Coast and some of those states where we are considerably stronger than others. But generally, we feel like we're well positioned here as we enter the second half. The backlog is very healthy, and our pipeline of restructuring activities is certainly moving forward.

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

And in terms of what's happening at distribution, do you think that they have kind of taken down their inventory as well? I'd be curious to kind of get your view on what level of inventory you think they're carrying just because -- my guess is they're trying to be conservative in how they're approaching things as well given the lack of visibility.

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

That's a real good read, Stanley. But keep in mind, there's an awful lot of our product that's made to order. So whether it's logoed hard hats or breathing apparatus, gas detection, those are assembled to order in a lot of cases. One area is fall protection. Fall protection is an area where distributors will build inventory and cut inventory back. And that's exactly what we saw in the month of May. We saw distributors cut their inventory levels pretty heavily. And obviously, the pipeline was pretty weak. And then it came back a bit in June. July has been spotty. There's some that feel that there's going to be a possible resurgence in the fall of construction jobs, if they can keep a lid on COVID. So some may be thinking that they need to build some inventory.

So it's really spotty. It's a difficult environment. And I'm sure distributors are going to watch their inventories very closely for cash flow purposes. But we don't think destocking was a major factor in our business through the quarter.

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

And lastly for me, very nice work on International year-to-date. Can you help parse out kind of how much of the improvement that we've seen has been more discretionary cost saves versus restructuring versus the pricing improvement that you're seeing in the channel? Just trying to get a flavor for what sort of cadence we're on, on improved mix trajectory here.

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

So I'll answer that first, and then, Ken, maybe you can give a little more color on that. But the team has done a fantastic job. We've talked about this for a couple of years. We showed some improvement. We're a little frustrated with the time it's taken to get to where we are today. But clearly, the team has done a great job. We talked about this at the 2019 Investor Day. And Bob and his entire team have really built a culture of looking at their cost structure, on a monthly basis and looking for opportunities to restructure and drive productivity improvements as an organization so we've done some nice work. And the restructuring, for the cost to come through, it takes a little bit of time in Europe, and we're starting to see that.

And as we talk about our pricing strategy, we were able to execute really well in the Americas going back to 2018 and '19, and that took a little more time to put the processes in place and get the discipline in place around pricing. So we've seen some real strong results around that. And then we have a new operations director for International who's just done a fantastic job from an operational standpoint and driving some improvements. That's been another leg of improvement as an organization. And then, of course, we have a number of restructuring initiatives going into the future. So we're optimistic about the path we're on for International. The team has done a nice job. We certainly feel we'll meet some of those internal goals we set for ourselves, and I think we stated 500 basis points of improvement over a 5 year period. We're well on track for that. So we're really pleased with what we're doing there.

Ken, I don't know if you can parse that out a bit more for Stanley.

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

If I would parse one thing, I would parse the SG&A side of the business. When we look at SG&A notably in the quarter, we talk about a reduction to compensation accruals of about $5 million. The majority of that reduction is actually in the Americas and Corporate segment. And so what you're seeing come out of that International segment is a couple of hundred basis points of improvement associated with SG&A and a couple of hundred basis points of improvement in the gross profit line, which is really, for the most part, all coming from our restructuring activities. I mean we're just seeing some really good returns associated with the dollars we're spending on the restructuring line.

Operator

The next question comes from Richard Eastman of Baird.

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

Yes. Just a couple of things on the product lines. The portable gas business fell maybe more than anticipated. And again, is that a function of -- is there kind of a 2-reason function there? Is part of that distribution? Or is that more of a direct drop off? If you could just throw a little bit of color around the portable gas business.

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

Rick, that's really direct business. It's a direct relation to what's happening in the marketplace. You don't see a lot of portable gas detection in the pipeline. Those are assembled to order for customers. They might buy 2 gas, 3 gas, different variations of the product. So that's budget cuts. That's what we saw there with employment cuts. Projects were pushed out.

So on the portable side, it was probably down a bit more than we anticipated, but not unusual from what we saw from initial downturns in '15, '16, '08, '09. So we expect that to moderate a bit. It's really interesting it's still a very small part of our business, but in Safety io, where we have our subscription service for portable gas detection, we had our best quarter ever. We actually met our internal plan in the second quarter for the number of contracts we signed. We won some significant orders there that pulled through some gas detection business, so we're encouraged by that. Monitoring workers and the path we're taking with Safety io, we feel we're on a good track there, so we're positioned well. But this is typically what we see. And then as things bounce back a bit and work picks up, we'll start to see that business pick up again.

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

Okay. And then just a question, I want to just dig into International a little bit further. Could you maybe clarify and speak a little bit to how Europe did? I'm kind of looking at this 7% decline. I'd say -- I guess a reported decline in revenue for all of International. I guess about 3 points of that was currency. But let me just ask you, how did Europe perform versus rest of world? I would think the rest of world piece -- yes. Maybe just kind of deal with that a little bit. Curious how sales were kind of rest of world versus Europe.

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

Sure. I'll open it up, and then Ken will provide some more detail. At a high level, Rick, our Asia business was actually very good. China is ahead of last year. China business bounced back very nicely in the second quarter. The business, the order pace has been real strong in China. We're up in China year-to-date, and we were up in the second quarter. So the outlook is really good in China. We were kind of hoping that we would see a similar recovery for Europe and the Americas that we saw in China due to their quick recovery from COVID. But that hasn't materialized yet. Then we started to see some good recovery in Europe, and now that's petering out a bit. I think a couple of countries are tightening back up again. But we are seeing growth in our Chinese market.

And Ken, maybe you have some more detail for him on U.S. and other pieces.

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

Yes. The only thing I would add is that it's interesting, our business reflects kind of how COVID spread around the world, unfortunately. You see second quarter, good growth coming out of China, Asia. I think it was -- I talked about in my prepared comments, 9% growth. You saw the Middle East and Africa not doing quite as bad as maybe Europe. Europe was off something like 7% in the quarter. Middle East and Africa was off low single digits. So you kind of saw our business respond the same way that you saw the COVID virus outbreak occur throughout the world throughout the second quarter. But as Nish said, we're pretty happy to see that Chinese business bounce back so quickly.

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

Okay. Understood. And just maybe a quick question around -- when you put the pieces together and we track into the third quarter, I mean, typically, the third quarter for you guys has some seasonality to it, particularly in Europe. But we had this very weak May. And I'm curious, how do you feel sequentially about revenue into the third quarter relative to the second? I mean all puts and takes kind of considered here, should -- do you feel comfortable that at least we should see sequentially some revenue growth across the businesses and across the geographies relative to the second?

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

Rick, the clarity on it is really tough. An awful lot of our business, a large percentage of our business comes in and goes out the door in a 2-week period. So the line of sight to August and September is just really tough today. It's really hard to get your arms around where we're headed with COVID and the recovery and what looms out there. But you're right in that the third quarter is typically a bit soft because of Europe, and they typically go on holiday, which we're seeing that. And then there's a bit of a lull with the breathing apparatus and timing with AFG funds as fire departments are waiting to see what happens with their funding. They do some quick evaluations and make their purchases, and that typically helps late third quarter and into the fourth quarter, obviously, so we look for that pattern to continue.

We hope, obviously, that the low point is the second quarter, but it's just really hard to predict that and be firm with that, with the choppiness of the business and watching the economy open and close and people pull back, particularly in some of those strong markets that we serve in the south. When you get into the Gulf Coast and Texas, Louisiana, Alabama, those are all good markets for us, and they seem to be tightening up a bit. So I would go out at this point.

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

Yes. I've got you. Okay. Okay. And if I can just sneak one more in. In the M&A pipeline, what does the opportunity set look like, Nish? I mean -- maybe handicap the potential for a bolt-on acquisition to drop in by year-end.

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

We continue to have good conversations with a number of targets and opportunities. One of the difficulties today with the lack of travel would be integration. And that's one area that concerns us. As you go down the path and you look at acquisition opportunities, how do you get the integration work done with the lack of travel and COVID. So that plays into it. The international opportunities would be even more difficult. But we continue to cultivate that pipeline. We have a number of active situations where we have good discussions with some targets, and that remains open. We're well positioned, as you know, to act. We've had a lot of success with acquisitions, so it's a key part of our asset allocation and our strategy as we go forward. We'll be very active there as things open up, Rick.

Operator

The next question comes from Dan Moore of CJS Securities.

Brendan Popson - *CJS Securities, Inc., Research Division - Equity Research Analyst*

This is Brendan on for Dan. Just wanted to ask about fire safety. You talked about it's just difficult to get in front of customers right now with social distancing. I was curious if -- now I understand there's some seasonality that -- more in the back half of the year, but is there some kind of backlog building there just with the lack of ability to get work done? Or is it -- or everyone's kind of waiting for the funding?

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

Well, the backlog is really in our opportunity pipeline. When we look at our opportunity pipeline of business for both G1 and M1 SCBA on an annual basis, month-to-month basis, and the pipeline is fantastic right now. We're in a strong position with opportunities. So that's what's building. There are a number of departments who would be doing evaluations today, live evaluations with product. They've pushed those off a bit. So we look for that to continue. I would imagine once they get their funding, they're going to push hard to get those done. And so the activity will begin once again. But the encouraging part is that the pipeline is really strong for both G1 and M1. And it's just a matter of timing of the AFG grants and getting some of those evaluations done where people are looking at competitive conversions. So that's what we're seeing today.

We don't see funding as a big issue. Breathing apparatus is that critical, must-have type item for fire departments. So that's a must-have product and critical in nature where firefighters use those in atmospheres that are immediately dangerous to life and health. So from a funding standpoint, we're really not getting any indications from fire departments that they'll be holding off on purchases when they need to replace their breathing apparatus. So that's so far been pretty encouraging for us. It's just a matter of timing at this point.

Brendan Popson - *CJS Securities, Inc., Research Division - Equity Research Analyst*

Okay. Great. And then with the CARES and Heroes Acts, have you seen any benefit or impact from that yet? Or is that still too early to tell?

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

We have. Through the CARES Act, there was approximately $100 million for fire departments for COVID-related products. And so where we fit in that category is we have an air-purifying respirator adapter that plugs into the M7 and G1 facepiece, and the M1 facepiece for that matter. And that converts that facepiece into an air-purifying respirator that you could put a high-efficiency or an N95-type filter on there for COVID.

A number of departments who hadn't purchased that in the past got some funding and made those purchases, so we did see some of that business come through. I believe last I looked, about $40 million of the $100 million has been allocated to fire departments. So there's still a little bit of money left in that pipeline. There is money in the Heroes Act, quite a bit of funding for fire departments going forward. And I would imagine that there's going to be some level of funding for those firefighters that will come in the next round of funding however that looks. So we're keeping a close eye on that. And certainly, that would be helpful.

Brendan Popson - *CJS Securities, Inc., Research Division - Equity Research Analyst*

Okay. And then changing gears to International segment, your impressive margin performance. Is this level kind of how we should think of looking forward? Obviously, not exactly. It obviously fluctuates. But is this kind of a level that you think International can do from now on, pending an extreme drop in sales or something of that nature?

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

Sure. We've talked about it. I think we have 15% op margin in the area. And so we've talked about that being the target long term. So I think second quarter was on the high side. We probably have some wind to our back on some of the SG&A and some benefit there. But the real encouraging part is the cost takeout that we've really focused on. A lot of those are permanent. And the pricing that we're realizing in the marketplace, the team is doing a much better job and have much better discipline around getting price in the marketplace. And we're starting to see some benefit, too. It will take some time from an operational standpoint and some of the adjustments we're making.

So we're on a good track. Certainly, I don't expect this level through the balance of the year, but we're on a good track here to meet the goals we set for ourselves and hopefully exceed them.

Ken, I don't know if you want to add to that.

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

No. I think you hit all the key points, Nish.

Operator

(Operator Instructions) 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*

Quick -- first, a clarification. I believe you said, but I wanted to clarify, did you say orders were up 16% year-over-year? And second to that is, what's the book-to-bill at the end of the quarter?

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

Yes. The 16% increase is in China. That's the Chinese order pace. And so we saw good order flow there. And as we had said on the call, Larry, in the prepared comments, the backlog remains relatively steady with the end of the first quarter. So orders and book-to-bill is hanging in there at a pretty healthy level.

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

Okay. Thank you for clarification. And secondly, obviously, the nice margin performance, especially International. Were temporary furloughs a big factor like we've seen with other companies and are all workers back now? In other words, that big tailwind, I don't know if it becomes a headwind or just more in line with what it should be. I'm just curious about the temporary furloughs and levels of employment looking into the second half.

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

Yes, Larry. We haven't had temporary furloughs for our workforce. We held off on that, quite frankly. We took a hard look at pay cuts for management and furloughs for some management and other key people. And we've got a fantastic workforce with a great culture. And we have done a nice job from a profitability standpoint and have been able to manage through this thing without cutting 401(k) contributions or pulling the lever on any of those, so we haven't done that. And really, what you saw was the cost savings from T&E and the lack of travel that we've had. And then obviously, the bonus and some of the incentive plans, those are not going to pay out at 100% because revenue is down. And so we unwound some of that. There were some in that area. But we have not done any furloughs of our management team and workforce or any other pay cuts at this point.

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

Okay. That's good to hear. So I guess sort of where I'm going with this is I realize, obviously, we know there's a lot of uncertainty in the second half. But you guys seem fairly optimistic, obviously, APRs, firefighter business, et cetera. And 2Q, obviously, most likely the most affected by the macro and the shutdown, et cetera. So typically, EPS are about first half, 45%; second half, around 55% historically. Is there anything that would suggest that there would be a big discrepancy with that into the second half? Obviously, caveat being COVID could accelerate and all of a sudden, we're shutdown again. But absent something material like that, is that sort of regular seasonality where the second half is at the very least the same as the first half? Is there -- would you push back on that at all?

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

Larry, it's just really hard to get line of sight and to give any outlook with COVID and then also the AFG funding and the timing of the funding. Hopefully, there's not a hurricane. I can tell you that FEMA controls things with AFG funding. And if there's a hurricane, that typically puts things on hold where they get distracted, and that slows the pace down of AFG funds that are released. There's just so many variables as we go into the second half of the year here; it's just really hard to give a statement like that.

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

Okay. I'm just looking historically. And I think once in the last 5 years, it was flat, first half and second half. Every other year seasonally, second half is stronger. And AFG flows, maybe hurricane could push it into next year, but that obviously would be fairly unprecedented, I think. It will be more likely we'll move from 3Q to 4Q. So okay.

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

The only thing I would add to that, Larry, is -- I mean we're very balanced. I mean when we think about where our business is for the remainder of the year, we've got a very healthy backlog. As you know, we're ramping up our respiratory manufacturing capabilities. But we also are dealing with the virus resurgence and the potential for further issues, as you had pointed out. And so that's, I think, part of the reason, I think why you hear Nish and the hesitancy in Nish when you ask that question. I just feel like we're balanced. We just feel like we have a balanced view, and we're trying to focus on the controllables and controlling what we can control and execute the restructuring programs that we can to continue to improve the efficiency of our business. But there's just so many unknowns on the horizon that it's hard for us to commit to what we might do in the second half.

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

Okay. And as it relates to M&A, obviously, you guys are somewhat eager to get back out there, I guess. Talk about bid-ask spreads. Are they getting closer in line? And is -- I know one of the holdups for most companies being able to forecast EBITDA for potential acquisitions. I don't know if that's getting any easier or not. So just talk about the ability to do deals based on bid-ask spreads and forecast and kind of the [blocking] happening that obviously you need to do to get deals done.

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

Well, that's one of the challenges, right, is what is the EBITDA of a company you're looking at today, where some of them are seeing -- in some cases, we've got companies that have had 30% and 40% drop in their top line. And so getting an understanding as to what the EBITDA would be for a company, who's in that position and how quick their business may snap back, that becomes an unknown from a timing standpoint. So that's become one of the challenges. And hopefully, by year-end, we'll see some clarity and be able to get a better understanding and pull the lever on something.

Ken, if you want to add something to that, feel free.

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

Yes. Just from a bid-ask spread perspective, Larry, I think they're certainly coming back into a more normal expectation level from where they were maybe latter part of last year. But with that said, you hear the hesitancy that we have around the visibility we have in our own business, and it makes it very difficult for us to go out and try to establish what an EBITDA stream might look like for somebody else's business at this point.

So with that said, we're looking for good brands. We're looking for good businesses. And we think we have a really nice pipeline of healthy relationships that hopefully we'll be able to action in the coming quarters and years, just as we have with Latchways as we rebounded from the industrial recession of 2015; General Monitors when we were rebounding from the Great Recession. So we feel like we're positioned well to do that. And hopefully, we'll get an opportunity here in the future to do that.

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

Okay. Yes. Because that's what I was trying to understand. I know you guys want to be sort of countercyclical and buy things when they're a little bit out of favor, but it seems like it's not super imminent, I guess. And then last question. Price, you noted, was positive in Europe. Was it positive in North America and Europe? And can you just give some color on magnitude of positive price?

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

It was positive.

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

Yes. We had positive pricing. We measure our pricing and price increase, and track those metrics on a monthly basis. So both the Americas and International did quite well in that area. We were really encouraged, and we talked about the fact that Europe has really kicked in. Europe and the Middle East, those are two areas that have just taken a lot of work to build discipline and they're starting to come through nicely on the pricing.

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

The only thing I would add is that if you look at gross profit, Larry. We had talked about in the prepared comments, being down 110 basis points, and we identified $3 million of costs that we incurred in the quarter. If you exclude those costs, you can see that we actually had some improvement in the gross profit line, which was reflective of the pricing initiatives that Nish had indicated because we certainly weren't getting it from mix with portable gas and some of those products that are our most profitable products coming down. So greatly, we did not have a favorable mix, but we did see some pricing improvements.

Operator

The next question comes from Garo Norian of Palisade Capital Management.

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

On the APR capacity expansion, do you guys have any more certainty regarding costs and timing of when you'll get to where you want to be? And can you share that?

THOMSON REUTERS

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

Sure. The costs are pretty much in line with what we anticipated. We were probably on the upper end of that $10 million to $13 million range. So that's coming together nicely. We're pacing well there. We're doing a nice job in execution of the program. It's not as fast as we would like it to be. We'll probably be completed -- October time frame is now what we're projecting to have completion. Would like to have seen it in the third quarter and earlier in the third quarter, but with COVID, that slowed us down a bit pace-wise. We're a little bit behind where we expected to be. But that's understandable, dealing with some of the issues we don't control. So we're pacing well there. And we're really encouraged with where we'll be from a productivity standpoint in Jacksonville. Really happy with how we've ramped up there. Obviously, this is a very difficult environment to add a lot of employees and new employees and build the safety precautions in that we have to make sure we're protecting those employees.

So the team has done a really nice job in Jacksonville. And in fact, we've had a number of industrial engineers and other key individuals from Pittsburgh who volunteered to go down there and help with that. So that's coming together nicely, and we're encouraged about where we are and completing that come October.

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

Good to hear. And just can you help me understand why is that business not as significant internationally? It seems like it's very Americas-focused business.

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

Yes. The volume of that business has always been much larger for MSA. As we've talked about, the majority of that business has come from existing customers, existing customers who've really amped up their air-purifying respiratory protection programs. And the existing customer base throughout International is not as large and strong as we have here in the Americas. But we do, do business that's fairly significant. And in Europe, we manufacture in Berlin. And then also in Brazil, where we've expanded production in that area. So that business, there's some opportunity there for some good growth. As we go forward, there'll be some good opportunities for us.

Operator

And we have a follow-up from Richard Eastman of Baird.

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

So just on the same APR business, Nish. Maybe could you just kind of speak to us a little bit? I'm trying to kind of parse through your comments in the press release. And clearly, we have a backlog there of product, we're scaling up the capacity to fulfill the backlog. But how do you feel about the longer-term growth in APR? Does that become structurally a growth business for you? Or are we basically kind of taking advantage of the backlog here and fulfilling that? So how do you look at the growth there post backlog flush, if you will?

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

Yes. Really, Rick, we're really putting some marketing effort into that. So we see it as a possible growth opportunity for us, and we're investing in some marketing activity to try to position elastomeric respirators as an alternative or supplemental option for the medical community along with N95 respirators. And it just depends on our success in that area. And so that remains to be seen. There are some in the medical industry who have documented -- there was that article I mentioned in the New York Times. And there have been some other publications that have talked about the opportunity to use elastomeric respirators as a backup when these major pandemics hit. And that's not, at this point, widely accepted. So it just becomes a matter of how widely that becomes accepted here in the U.S. and other parts of the world. And could provide a nice opportunity for us going forward. So we continue to stay after that. And so it remains to be seen.

But as we mentioned, the investments we're making, we're really confident on the payback due to the level of business we're seeing today, the backlog that we have. We've done a nice job in supporting the customers, those long-term customers that we've had. So we think we're pretty well positioned for that business as we go forward.

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

Okay. Got you. And then just secondly, for Ken. Just a question around OpEx. Kind of moving forward, I think you made the comment that OpEx stays tightly managed through Q3. But it's a little bit -- maybe a little difficult to sift out. There's lower traveling here, some things around access and -- but how does the OpEx kind of flex here as we move forward? So should we expect Q3's OpEx to be flattish sequentially? Is that the degree of management you're putting into that? And then we'll see some inflation around Q4 or...

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

Yes. That's a good question. When we look at SG&A, let me try to help you out there a bit. And so we have about $69 million in SG&A in the quarter. There was a $5 million adjustment to our compensation accruals in the quarter. So most likely, that won't occur again in the third quarter. You'll certainly have some true-ups as you go forward, probably not to that same magnitude. So that probably needs to be considered.

And then out of the additional $6-or-so million of additional savings that we have in the line, roughly half of that is savings associated with restructuring activities that we've executed on. And so you could see $5 million is the compensation accruals. And the $3 million is roughly related to the -- no travel and things like that, that we're doing because of the pandemic. And so that might give you a better sense as to how the breakout of SG&A is.

Operator

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

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

Thank you. I believe at the end of the day, it comes down to this. We have a mission and a passion for protecting lives of people who work in dangerous environments, and that mission has never been more important than it is today. Built on our mission, we have a strong corporate culture and very healthy balance sheet that puts us on firm ground to ride through this challenging macroeconomic environment. Around the world, the MSA brand is known for durability and reliability. We excel at delivering sophisticated safety solutions our customers rely on to work in the most challenging work environments known demand.

As you've heard today, despite the difficult macro challenges we face, with the diversification of our products and markets, good investment in organic growth opportunities, disciplined cost control for today and an eye for the future, solid cash flow, our strong balance sheet and the support of a good backlog of orders, we're well positioned to continue to fulfill our mission and continue to create shareholder value.

Thank you for taking your time and your interest today in MSA. I appreciate that. Have a good day.

Operator

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