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MSA Safety, Inc. (MSA)

Business Update Call

CORPORATE PARTICIPANTS

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OTHER PARTICIPANTS

Stanley S. Elliott

Analyst, Stifel, Nicolaus & Co., Inc.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the MSA Safety Special Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please also note this event is being recorded.

I would now like to turn the conference over to Chris Hepler. Please go ahead.

Christopher Hepler

Executive Director-Corporate Development (M&A) & Investor Relations, MSA Safety, Inc.

Good morning and welcome to today's webcast regarding the divestiture we announced yesterday afternoon. This is Chris Hepler, Executive Director of Corporate Development and Investor Relations. I'm here with Nish Vartanian, Chairman, President and CEO; and Lee McChesney, Senior Vice President and CFO.

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

We have included certain non-GAAP financial measures as part of our discussion this morning, and the non-GAAP reconciliations are included in the Appendix of today's presentation. The presentation and the press release regarding the transaction are available on our Investor Relations website at investors.msasafety.com. In addition, a replay of this conference call will be made available later today. Following our prepared remarks, we will open the call for questions.

At this time, I'll turn the call over to Nish.

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

Thanks, Chris and good morning, everyone. We're here today to discuss the transaction and how it helps position MSA Safety for sustained success in the next stage of our journey. But first, I'd like to thank the MSA team for their unwavering dedication to our mission to keep both our associates and our customers safe. MSA Safety is the leading global safety technology company.

For over 100 years, we've designed and manufactured safety products and solutions and, today, MSA is an enterprise with 4,800 employees and approximately \$1.5 billion in sales. Since our founding in 1914, we've grown into a company with leading positions across firefighter safety, gas detection, and industrial personal protective equipment sold around the world in a broad range of markets. These diversified markets are characterized by steady demand and resilient organic growth.

Safety is a growing sector and is far less cyclical than broad industrial spending, giving the many mission-critical applications. We augment that foundation of stable demand and organic growth through focused reinvestment in innovation that is complemented by disciplined inorganic growth to strengthen our customer value proposition. In the last few years, we've worked to build on our foundational strengths to accelerate our value creation engine. We invest more than \$60 million in R&D each year, and that is translated to an industry-leading product vitality of approximately 35%.

We complemented our organic growth by investing approximately \$400 million in recent acquisitions to acquire Bacharach and Bristol Uniforms, both of which build on our core platforms of gas detection and firefighter safety. I'm encouraged by our rich history and recent progress. I believe that this transaction is another step toward creating value for all of our stakeholders.

I'll now turn the call over to Lee, who will talk about the transaction in more detail.

Lee Breet McChesney

Senior Vice President & Chief Financial Officer, MSA Safety, Inc.

Thanks, Nish. On slide 5, we have an overview of the transaction. As we announced yesterday, we sold the wholly-owned subsidiary holding legacy product liability claims related to coal dust, asbestos, silica and other exposures to a joint venture between R&Q Insurance Holdings and Obra Capital. R&Q is an insurance company with a proven track record of managing legacy liability matters and Obra is an investment firm with a history of focusing on insurance special situations. Together, they have directly applicable capabilities.

The R&Q and Obra joint venture acquired 100% of the equity interest of the divested subsidiary. At the time of the transaction, the subsidiary held legacy product liabilities along with related insurance and deferred tax assets. At closing, the divested subsidiary was capitalized with \$376 million in cash and cash equivalents. We contributed \$341 million in cash and cash equivalents, while R&Q and Obra contributed an additional \$35 million. We financed the transaction through available cash and cash equivalents and \$315 million of incremental borrowings, inclusive of a new \$250 million term loan facility. The term loan was arranged with our existing bank group and the terms are similar to our existing credit facility.

The completion of the transaction, which closed yesterday, will result in MSA's pro forma net debt/adjusted EBITDA rising to 2.4 times. We anticipate that excess free cash flow in the next 12 to 18 months will be used for deleveraging. Importantly, all current operations have been retained and there's no impact to our revenue as a result of the transaction. The benefits of this transaction align well with MSA's value-creation strategy. The divestiture reduces MSA Safety's risk profile, as these legacy product liability claims were subject to inherent risks and uncertainties.

Further, as a result of the transaction, our balance sheet will be meaningfully simplified through the elimination of associated claims reserve and related insurance and tax assets. The elimination of the costs associated with defending and settling claims results in improved certainty and clarity around future free cash flow to reinvest in our business. And lastly, the management team can enhance its focus on executing our growth strategy to drive long-term value creation.

Now, moving on to slide 6, gaining the benefits of a clearer and more predictable forward cash flow profile does require an investment. As mentioned, funding the divestment will temporarily increase MSA's net leverage to 2.4 times based on the incremental borrowing. We will prioritize deleveraging and anticipate returning to our historical leverage range within 12 to 18 months. We have a long history of flexing our balance sheet to complete important transactions followed by disciplined deleveraging, and we see this transaction following that same historical pattern.

We expect continued strong operating cash flow performance, and our investment in inventories during 2022 will serve as an additional cash flow opportunity in the year ahead as supply chains normalize. However, it is worth noting the accounting for this transaction is expected to result in a GAAP loss in Q1 of 2023. We remain deeply committed to our decades-long track record of paying a dividend, and after our initial debt pay down, believe that our capital allocation flexibility will be augmented by our more predictable cash flow profile.

And with that, I will hand the call back to Nish.

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

So, moving to slide 7, as Lee discussed, today's transaction supports greater cash flow predictability, further strengthening continued investment in each aspect of our growth engine. We drive steady and profitable organic growth through our market-leading portfolio, which we enhance with strategic acquisitions. We combine that with a commitment to operational excellence, and our resilient balance sheet and strong cash generation from these investments. It's a disciplined strategy, as we remain focused on providing industry-leading safety technologies.

Now, moving to slide 8, I'm inspired by the future prospects for MSA. We're committed to driving superior results for our shareholders as we deliver on our mission of safety. As we've discussed throughout this presentation, the benefits of reduced risk, balance sheet simplification, and greater cash flow predictability provided by this transaction are highly supportive of our strategy. This transaction's another step in our journey to make our company, our associates, and our customers fit for the future. We appreciate you joining us today.

We'll now open up the call for any questions you may have.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] And the first question will be from Stanley Elliott with Stifel. Please go ahead.

Stanley S. Elliott

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey, good morning, everyone. Thank you guys for taking the call.

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

A

Good morning, Stanley. Thanks for calling in.

Stanley S. Elliott

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey. I guess, starting off, was there any reason why you guys decided to do this now? You've had kind of the liabilities out there for some time. Was there anything you were seeing in trends with your claims picking up or anything along those lines, just curious how you came to the decision?

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

A

Stanley, we continuously evaluate strategies for managing these liabilities held by our subsidiary. We observed the growing market interest for legacy liability transactions and, ultimately, decided to run a process, and with the help of some professional advisors, obviously. That process that we ran, which was a thorough process, resulted in a transaction that we announced yesterday. And we're very pleased with the conclusion of this process and believe that R&Q and Obra are well-qualified to manage the assets and liabilities held by the divested subsidiary.

Stanley S. Elliott

Analyst, Stifel, Nicolaus & Co., Inc.

Q

In the release, you all mentioned [ph] you had leveraged and paying that (00:11:09) down and then organic and then inorganic investments. Should we think this M&A part of the strategy right now will take a bit of a pause, so you'll make some projects on the leverage? I mean, it's totally manageable, but just curious how you're thinking about balancing all of these moving parts?

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

A

Correct, Stanley. The leverage is very manageable for us. We think that we can pay that down in 12 to 18 months. And I think it's safe to say that for any major acquisitions, we're out of that for over a period of time. And so, we're just going to focus on paying that debt down and, hopefully, in a short period of time, be back in the game for another significant acquisition, like we made with Bacharach or some other. But we're going to focus on paying down this debt, and we're going to continue to work that pipeline when it comes to acquisitions. There's a pipeline we have out there and we'll continue to work that.

Lee Breet McChesney

Senior Vice President & Chief Financial Officer, MSA Safety, Inc.

I think I would also add, Stanley. Okay, go ahead, go ahead, Stanley.

A

Stanley S. Elliott

Analyst, Stifel, Nicolaus & Co., Inc.

Yeah. So, I was going to say – go ahead. I have one more follow-up.

Q

Lee Breet McChesney

Senior Vice President & Chief Financial Officer, MSA Safety, Inc.

I was just going to add to Nish's point that, for this year, the threshold to do a deal is pretty high anyway. So, this is also another reason why the timing is good timing to do this as well. But we're going to still be very actively involved in the market and we'll be ready to go. And, again, we're very confident that, yeah, we'll be able to deleverage here, like we have in the past.

A

Stanley S. Elliott

Analyst, Stifel, Nicolaus & Co., Inc.

And lastly, you mentioned better predictability of the cash flow. The cash flows appear quite strong. Is there anything else in terms of the P&L impact, like was there expense in the SG&A line, anything like that sort of roll off? Just trying to kind of fine-tune the estimates

Q

Lee Breet McChesney

Senior Vice President & Chief Financial Officer, MSA Safety, Inc.

Yeah. I mean, a couple of things. Obviously, we'll be taking out this incremental debt. So, probably, the first thing to think about is just the interest related to that. So, there will be about \$20 million of interest in 2023 related to the incremental debt. And, obviously, the faster we work it down, that number could come down. I'd also note, Stanley, that is directly linked to this transaction. Just with the higher interest rates, we're also going to see about \$10 million just on our existing debt before. So, you're going to see about a \$50 million interest charge in 2023. But, obviously, as we'll talk about in another month, we'll talk to you about how it all balances out with what we think we can do in growth and margin expansion and things like that. There is some benefit potentially that comes, but – from the transaction, but it's pretty neutral for 2023 is kind of my perspective. Yeah.

A

Stanley S. Elliott

Analyst, Stifel, Nicolaus & Co., Inc.

Yeah. Thanks, guys. Appreciate the time and congratulations.

Q

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

Thank you, Stanley.

A

Operator: [Operator Instructions] The next question will be from Rob Mason from Baird. Please go ahead.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Yes. Good morning and thanks for hosting the call on this. Just a couple of detailed questions. I think you covered a lot of ground already. There was mention during last year of a structured settlement also related to the liabilities, and I think that the amount talked about was around \$26 million. Does this agreement supersede that or did that settlement also take place?

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

A

So, Rob, I think the answer to your question on that is, if I'm taking it in the way you're asking it, that goes along with the transaction. So, that moves over. Yes.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Okay. So that cash did not get paid out in other words in 2022?

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

A

Yeah. That's correct.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Okay, okay. Also, in your filings, you've referenced – I'm assuming the entity – the subsidiary that sold here is MSA LLC. And also, there was mention of Globe LLC in past filings as well. Does anything tied to Globe LLC also go with this transaction?

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

A

No, this is all MSA LLC, which was housed in the Jacksonville facility.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Okay.

Lee Breet McChesney

Senior Vice President & Chief Financial Officer, MSA Safety, Inc.

A

The way I think about it is anything with legacy product lines is part of what's in the Q and K references, anything we still do business with as we go forward, single point, product liability, things like that, that's part of our business on a go-forward basis.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Understood. Okay. And just maybe last question is, I think I can tease out some of the value – the balance sheet values on the asset/liability side, reserve side. What's the amount of deferred tax assets that are going with the transaction?

Lee Breet McChesney

Senior Vice President & Chief Financial Officer, MSA Safety, Inc.

Yeah. We just filed the full document, too. It's about \$75 million, Rob.

A

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Okay.

Q

Lee Breet McChesney

Senior Vice President & Chief Financial Officer, MSA Safety, Inc.

So, you're going to see approximately about a \$200 million GAAP loss in Q1 from this transaction.

A

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Very good. Okay. Very good. And maybe, I'll take a shot at this in a public forum. Nish, just any comment on business trends as you exited the year?

Q

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

Yeah. We're in a quiet period right now as you know. So, we're looking forward to February when we can announce the Q4 results and looking forward to visiting with you on that call.

A

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Very good. I'll join in it. Thank you.

Q

Nishan J. Vartanian

Chairman, President & Chief Executive Officer, MSA Safety, Inc.

You bet. Thanks for calling in, Rob.

A

Operator: Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to Chris Hepler for any closing remarks.

Christopher Hepler

Executive Director-Corporate Development (M&A) & Investor Relations, MSA Safety, Inc.

Thank you for joining us this morning. If you missed the portion of the conference call, a replay will be available on our Investor Relations website for the next 90 days. We look forward to speaking with you again soon. Thanks for joining.

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

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