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MSA - Q3 2018 MSA Safety Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the MSA Third Quarter Earnings Call. (Operator Instructions) It is now my pleasure to introduce today's host, Elyse Lorenzato, Director of Investor Relations. Please begin.

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

Thank you, Kelly. Good morning, everyone, and welcome to MSA's Third Quarter Earnings Call for 2018. With me here today are Nish Vartanian, President and CEO; and Ken Krause, Senior Vice President, CFO and Treasurer.

Our third quarter press release was issued last night and is available on the MSA website at www.msasafety.com.

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 our most recent Form 10-K filed in February 2018. MSA 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. Reconciliations to the most directly comparable GAAP measures are available on our Investor Relations website at investors.msasafety.com.

With that, I'd like to turn the call over to our President and CEO, Nish Vartanian.

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

Thank you, Elyse, and good morning, everyone. I want to begin by saying thank you for joining us this morning and for your continued interest in MSA.

As you saw in our press release that was issued last night, third quarter revenue increased by 12% on a reported basis or 14% on a constant currency basis. We continued to see good operating leverage in the quarter, with 27% adjusted earnings growth.

If you recall, at the end of the second quarter, our backlog was trending substantially higher than historical levels on improved demand across our core products. I'm pleased to report that we saw continued strength in incoming orders throughout the third quarter. As a result, our backlog remains at a healthy level heading into the final months of 2018.

We've seen some exciting wins in the quarter, which I'll talk about in a moment. But first, I'll provide you with some insight into key trends and platforms that are driving our growth. And then I'll talk about a couple of our innovative new products that are on the horizon. After that, I'll turn it over to Ken for a financial review. And then we'll conclude the call with our question-and-answer session.

In the third quarter, we continued to invest in programs that support our growth in focus initiative, which is centered on investing to achieve market leadership in our core products and markets while improving profitability. We're highly focused on executing this strategy. And as you can see in our R&D run rate, we continue to invest in new product development projects that will position us for continued market share growth.

Of course, we're also focused on investing in other enabling programs such as digital marketing and enhancing our go-to-market strategy via channels optimization. Collectively, these customer-facing programs and our new product development investments as well as productivity improvements are fueling MSA's profitable growth and value creation in 2018.

Regarding our core product portfolio, we saw solid performance as core product revenue in the quarter increased 14% in constant currency. It was good to see another quarter of strong growth across firefighter safety, gas detection and our industrial core PPE business, which includes hard hats and fall protection. On the SCBA side, we continue to see good traction in the replacement cycle in the U.S. We were recently awarded contracts with several large fire departments, including Memphis Fire Department and Prince William County fire department for a total of over $11 million. Each of these customers opted to purchase our Integrated Thermal Imaging Camera or iTIC technology. In fact, the iTIC technology was a key differentiator for each department as they evaluated our G1 SCBA platform.

We continue to raise the bar to protect firefighters with technology that has the potential to save lives, and the MSA iTIC reflects a cost-effective way to put life-saving thermal imaging capabilities into the hands of every firefighter.

While the G1 SCBA is the market leader in North America, we have a broad range of SCBA products that address global fire service market preferences, standards and price points. And at the end of the quarter, we achieved an exciting milestone in further developing that SCBA offering by unveiling our new M1 SCBA at the French Firefighters Congress. As you may have seen in our press release, the M1 SCBA is designed for European and international markets.

Among its many features and benefits, the M1 SCBA can be customized and configured to meet a broad range of firefighter needs and brigade budgets. Utilizing the winning design platform, that's the foundation of the G1 success, the M1 was likewise designed with countless hours of voice-of-customer research. And as a result, the M1 SCBA represents the most advanced and ergonomic SCBA we've ever launched for our international markets.

For instance, this new platform has a number of differentiating features that help to enhance hygiene, improve wearer comfort and balance and reduce total cost of ownership for our customers. It's also compatible with our G1 SCBA facepiece, allowing us to offer international customers market-leading technology while gaining scale with this facepiece on a global basis.

Our international sales teams are receiving very positive feedback from the market. In fact, we already won our first significant contract with the fire brigade in the Netherlands, and we expect to begin production on the M1 by the end of this year at our manufacturing facility in Berlin.

Switching gears to the industrial side of the business. We saw solid growth in head protection, gas detection and fall protection in the quarter throughout the world. Our V-Gard hard hat continues to support our market-leading position, and we're leveraging that strong brand to capture market share in another area of personal protective equipment, fall protection. We introduced our V-Series line of fall protection products earlier this year, which represented another year of rapid innovation and product launches in fall protection, which remains the largest and fastest growing area of the sophisticated safety products market.

In the third quarter, we expanded this focus and launched the V-FLEX full body harness. The V-FLEX is a racing-style harness that delivers exceptional comfort and fit for long days on the job, so workers can focus on the task at hand. It's significantly lighter than competitive offerings and has innovative features like breathable shoulder padding and horizontal leg straps. At MSA, we're committed to driving safety and productivity for our customers. When fall protection harnesses are more comfortable and easier to use, customers are more likely to wear them. Very simply, comfort drives compliance in many cases, and the design of our V-FLEX and V-Series products keeps workers comfortable all day, every day.

Innovation is the lifeblood of MSA, and it's the core competency that underpins our Growth in Focus program. In the quarter, more than 35% of our total revenue was from products developed and launched over the past 5 years, notably the G1 SCBA, ALTAIR portable gas detection line and X5000 and S5000 fixed gas monitors were significant contributors to our vitality metric in the quarter. As I mentioned at the beginning of my commentary, we continue to invest in R&D and demand creation programs to bring our innovative products to the marketplace and get them into our customers' hands.

Before I turn the call over to Ken for his financial review, I wanted to briefly comment on the performance in our geographic reporting segments. If you've been following the MSA story, you know that improving profitability in our International segment is a key priority for 2018 and beyond. Our leadership team continues to focus on executing a number of initiatives to streamline our operations and reduce complexity across the segment.

In the quarter, our International segment had revenue growth of 11% as reported or 14% in constant currency. Bob Leenen's team also achieved operating margin expansion of 150 basis points, continuing the solid improvements we saw in the first half of this year. We continue to make progress in our go-to-market strategy, which we've discussed as our channel optimization program. In the quarter, our international team signed contracts with several new channel partners and continued to focus on improving the effectiveness of our sales organization across the segment. While we're still in the early stages of these go-to-market improvements, we're making good progress and moving in the right direction.

Lastly, before I turn the call over to Ken, I'd like to recognize our associates and leadership team at our plant in Jacksonville, North Carolina. You saw the destruction that Hurricane Florence had on the region. While all our associates are safe, their homes suffered varying degrees of damage. Our facility had minimal damage, and we were back up and running within 2 weeks, thanks in large part to the dedication of our team in Jacksonville. Because the team was able to restore operations quickly, the storm did not have material impact on our quarterly financial performance. Our Jacksonville associates' response represents the commitment and customer focus mindset, that I believe truly defines the MSA spirit and culture that exists throughout the world. And that as much as anything is a driver to our results as well.

With that, I'll turn the call over to Ken for a financial review. Ken?

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

Thanks, Nish, and good morning, everyone. Before I begin the P&L review, I'd like to start with a few financial highlights.

Revenue growth was 14% in the quarter with organic revenue growth of 13%, driven by strong growth across the portfolio. Operating margin of 17.2% increased 120 basis points from a year ago, with improvements in both of our reporting segments.

We continue to make good progress in improving the efficiency of our business with another quarter of gross profit expansion and SG&A leverage while continuing to invest in R&D. Incremental operating margins have been approaching 30% over the last 12 months and continued at that level in the quarter. Those incremental margins are inclusive of booking an additional $4 million in variable incentive compensation in the quarter to account for our strong financial performance, and increasing R&D expense by 8%. The profitability profile of our business has certainly changed, but we continue to invest in the new products, technology and talent that drive our results. Despite those investments, we are realizing strong leverage as we bring on revenue volume.

Free cash flow generation was strong at $111 million in the quarter. Free cash flow conversion continues to exceed 100% of net income despite seeing such strong organic growth in the business.

Now I'd like to take some time to walk you through our quarterly financial results. Total revenue increased 14% in the quarter in constant currency, with growth in nearly all core products. We had a 2% foreign currency headwind on revenue in the quarter, mostly related to the weaker Brazilian real compared to this time last year. We continue to see solid results in head production, portable gas detection and fall protection in the quarter, which all posted double-digit revenue increases from strong performance across our global footprint.

In the past, we've discussed how these shorter cycle businesses respond more quickly to improving business conditions, while fixed gas and flame detection orders typically lag the cycle and are more tied to projects and capital investments. That trend is materializing as expected. We've seen a good pickup in FGFD orders and shipments in the quarter, notably in North America and China. In the fire service area of our business, we had good performance in SCBA this quarter, and we continue to see ongoing benefits from the replacement cycle with competitive conversions and retention of large customers as Nish mentioned.

Revenue from turnout gear from Globe was also strong in the quarter, and we continue to make good inroads with channel synergies as we progress with the integration of that asset.

Gross profit of 44.8% was up 20 basis points in the quarter, which includes 60 basis points of dilution from Globe. It is good to see the underlying improvement in margins despite seeing inflationary pressures.

SG&A expense was $78 million in the quarter or 23.6% of sales compared to $73 million or 24.6% of sales a year ago. Approximately half of the increase in SG&A this quarter is related to higher levels of variable incentive compensation associated with our strong financial performance. Our teams around the world are executing and driving profitable growth and improving cash flow. As a leadership team, we're glad to reward those efforts and encourage continued progress with our incentive compensation programs.

The remainder of the increase is primarily in revenue-generating investments and is helping drive the organic revenue growth and capture market share. While we remain committed to investing in customer-facing areas and R&D to capture market share against this strong backdrop, we continue to evaluate additional cost reduction and productivity improvement programs for our business in light of the inflationary environment that we expect to continue into Q4 and 2019.

GAAP operating income was $40 million or 12.1% of sales in the quarter, which includes $15 million of other operating expense related to cumulative trauma product liability. During the quarter, we learned more information about certain asserted claims through our defense efforts, which led to an increase in our asserted claims product liability reserve. Excluding foreign currency, restructuring strategic transaction cost and product liability expense, adjusted operating margin was 17.2%, improving 120 basis points from a year ago. For the year-to-date period, adjusted operating margin is 17%, which is up 180 basis points.

It is encouraging to see the improvement in margins and notably in the Americas where sequential margins are up 150 basis points to 24.6%. It was good to see the recovery in margins on a sequential basis in the Americas, despite absorbing higher variable compensation expense on the improved operating performance.

On a trailing 12-month basis, adjusted EBITDA is $271 million or 20% of sales, increasing 27% from a year ago on a 17% increase in revenue. Our GAAP effective tax rate was 11% for the quarter, which includes favorable adjustments related to the U.S. tax reform as well as a benefit from product liability expense we recorded in the quarter. On an adjusted normalized basis, our ETR was 19.2% in the quarter and is trending at 23% year-to-date. We continue to plan for our full year effective tax rate to be between 23% and 24%, in line with what we previously communicated to you.

In addition to driving the lower ETR, U.S. tax reform has also provided us with the ability to repatriate foreign cash. Year-to-date, we have brought back nearly $60 million and we're on track to reach our cash repatriation goal of $75 million to $100 million by the end of the year. GAAP net income was $34 million in the quarter compared to $32 million a year ago. Quarterly adjusted earnings were $45 million or $1.16 per share compared to $0.92 per share a year ago. The earnings growth of 27% is just about double the pace of revenue growth, driven by a good gross margin performance in our core business, our ongoing focus on productivity, accretive acquisitions and the benefits of the U.S. tax reform.

Free cash flow was $111 million in the quarter compared to $37 million a year ago. The current quarter includes $58 million of net inflows from insurance receivables compared to prior year that reflected net outflows of $5 million. With and without the benefits of those insurance collections, free cash flow conversion was over 100% in the quarter on strong working capital management despite the accelerated organic revenue growth. The strong cash flow enabled us to pay down $38 million of debt in the quarter and fund $15 million in dividend to our shareholders. While cash repatriation allows us to tap into offshore cash more efficiently, it is the strong underlying improvements in operating cash flow that has allowed us to delever, fund an increasing dividend and remain well positioned to execute on growth investments.

Debt to EBITDA is 1.4x at the end of the third quarter compared to 2x at year-end. It has been just over a year since the Globe acquisition, and our current leverage is relatively consistent with our pre-acquisition leverage in the second quarter of 2017, which was 1.3x. We also refinanced our credit facility during the quarter. The new credit facility we put in place in the quarter provides us with the flexibility to continue investing in profitable growth programs. I'm pleased with the double-digit revenue growth in the third quarter, the sustained improvement in incremental operating margins and the free cash flow conversion of more than 100%.

Looking forward, if you recall, we had a record-breaking fourth quarter in 2017 in terms of revenue and earnings. While I expect that strong comparable period to put some pressures on the Q4 growth rate, we are well positioned heading into the fourth quarter.

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

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

Thank you, Ken. I'm pleased with the strong performance in the quarter. We had double-digit organic revenue growth, solid expense leverage and adjusted earnings growth of 27%. The sustained levels of demand that we're seeing in the industrial and energy markets as well as the fire service are encouraging as we prepare to close out 2018. The momentum in the order book, our healthy backlog, streamlined cost structure and benefits we're seeing from tax reform, all provide confidence that we're well positioned to continue driving profitable growth and value creation for our shareholders.

Thank you for your attention this morning. At this time, Steve Blanco, President of the Americas segment, has joined us in the room, and we'll be happy to take any questions you may have.

Please remember that MSA does not give guidance, and that precludes most discussion related to our expectations for future sales and earnings.

Having said that, we will now open up the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Stanley Elliott from Stifel.

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

On the European -- or the international business rather, you just talked about the X1 (sic) [M1] just coming online, but the breathing apparatus in International was up, looked like 23%. Is that success that you're having with the G1 internationally and so that we should think about the new products being on top of that? Or can you help us with the moving pieces there?

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

That's the M1 breathing apparatus that we're launching and will begin to ship here in the fourth quarter a bit later this year. What you're seeing is some business that we announced that we won earlier this year. It was a $10 million order out of Australia. And we shipped about half of that order in the third quarter and the balance should go in the fourth quarter. So we have a product that competes nicely in the marketplace and around the world and we do quite well. But the M1 will take things to another level for us.

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

Can you talk a little bit about the M&A environment? What you're seeing out there? You guys have typically done a very nice job of finding kind of right bolt-on acquisitions that fit well within the portfolio. With leverage approaching where it is now, can you help us kind of frame out the opportunities, if you could?

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

So as you know, we continue to entertain lots of opportunities. Ken and I spend a lot of time on the M&A side, but we're fairly selective in that area. The targets we're looking at, they have to have a good fit from a product standpoint, geographical standpoint, certainly within a market that we understand. We have pretty tight criteria around the revenue growth profile and what we can bring to that acquisition or that target, the EBITDA margin. We have some pretty tight parameters around what we look for, for acquisitions and have been very successful, obviously, with Globe and the last acquisition was a really nice fit in the market, that we know quite well and fit product-wise where we wanted to expand our coverage of the firefighter. So we continue to look for those opportunities, Stanley, and have several in the pipeline. It's just a matter of timing and getting people to sell their business obviously. The valuations are fairly high at this point, but we do see some nice opportunities and targets in the marketplace. As you know, Ken heads up our corporate development. And Ken, if you want to add anything to that, you are free to.

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

Yes. The only thing I would add, Nish, is that we're positioned very well. As you mentioned, Stanley, our leverage ratios are certainly at a level that will allow us to continue to execute in the M&A environment. But with that said, we will continue to be disciplined. We've been disciplined in the past, and we'll continue to maintain that discipline as we execute on this strategy going forward.

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

Perfect. And then I know you guys don't give forward guidance. But certainly a lot of volatility at least in the stock market right now, I think concerns about slowing economy. It didn't sound like that, that's anything that you all are seeing in and I don't put words in your mouth, but not seeing in your book of business or necessarily any concerns that you would have thinking about into 2019?

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

Stanley, we see solid fundamentals throughout our businesses, and the investments we're making really give us confidence about the future. So we aren't seeing any slowdown and we expect business to purr along nicely.

Operator

And our next question we have is from Richard Eastman from Baird.

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

Yes. Could I ask you if you could just parse through a little bit your backlog comments. And again, the backlog here generally pertains to some of your maybe a little longer cycle businesses around the fixed gas and flame, for instance. And it looks to me when I look at this -- when I look at your numbers that your short-terms businesses have good momentum. And the backlog here, as it relates to the longer -- maybe longer cycle businesses, maybe you could just kind of parse through that a little bit. Is that kind of the right way to think about this when you talk about backlog and order growth? Or how are you feeling about the short-cycle businesses just relative to the longer -- maybe the longer cycle?

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

Yes, you're absolutely thinking of it the right way. The way to think about the backlog is that we had a very large backlog of breathing apparatus coming into 2018. What we've seen is a very healthy rotation of that backlog. We shipped a lot of those breathing apparatus throughout the year. We mentioned the Australian order, which we've talked about in the past, and a couple of other big orders that we saw here in the third quarter that will ship between the third and fourth quarter. So we have seen some nice rotation of that backlog at these very healthy levels moving into more fixed gas and flame detection products. And we talked about in the past, as these economic expansion cycles in the energy markets continue at a healthy pace, that project type business starts to kick in and we start to see the fixed gas and flame detection part of the business pick up for us. And that's exactly what we've seen. What's also interesting is where you do see some significant growth of around 15% in fall protection and 13% in portable gas detection, 11% in head protection, those areas are also seeing backlog pick up just a bit. Fall protection, for instance, our backlog, which isn't significant like it would be in some other areas, actually doubled. So that business is very healthy. While we had a strong third quarter from an invoicing standpoint in fall protection, that backlog picked up significantly. And we typically -- for hard hats, we like to deliver logo hard hats in typically 3 or 4 days, and that actually peaked at about 6 days, and we were able to get back down to 5 days and which is -- within the 3- to 5-day range that we look for. So we're seeing strength in all of the areas with our backlog and a nice rotation. I do expect to see some strength here with breathing apparatus and hoping that we go into the first quarter with a nice backlog of breathing apparatus, because the Assistance to Firefighters Grant were released and we are seeing a pickup in that business once again.

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

I see. Okay, excellent. And could you -- circling back for a second to the M1 that was just recently introduced, sounds very exciting. Is that -- can you talk a little bit about what that market looks like? Say, as we address Europe, the channel to the fire service departments, if you will, within these various countries, I assume it doesn't look like what we have in the U.S. We have a really defined distribution base. So your introduction of the M1 into the European market and international market, is that more of a direct sale then? Or is there other provincial channels within countries that you can tap into and make a bigger impact earlier?

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

Yes, based on the part of the world, it really varies. So in the European markets, we do have very some good channels of distribution into fire service. And in various countries throughout Latin America, we have very well-developed channels of distribution. And in fact China, we have some good channels. There are some other areas, some of those emerging markets where we do take some orders on a direct basis. But because of our market position, we do quite well internationally with breathing apparatus. And of course, the Cairns or the Gallet firefighting helmet, the F1XF helmet is a leading product around the world, and that's sold through our fire service distribution network. So we have a very well-developed network of distribution throughout the world.

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

Okay. Is the -- are the financials and the margin profile of the M1 similar enough to the G1 here domestically that we should not expect any sort of mix issue there from a profit standpoint?

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

Yes. The margin profile is very much in line with what we have in the U.S. in our current product offering, it's slight -- probably be slightly better than our current product offering in the international market. But from a pure volume standpoint, the price per unit is significantly different. The NFPA-compliant SCBA has much more from a standpoint of electronics and other features built into that device. So when you're selling an NFPA-compliant breathing apparatus, that may sell 3x from a revenue standpoint more per unit than an M1 type unit.

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

I see, okay. But similar margin. Okay. Perfect. And then just 2 last questions. Could you just possibly break out Europe's just sales growth from international in local currency and report it? In other words, I'm trying to get at the currency impact, but also just kind of local currency demand there. Any change in demand there?

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

Ken, do you have that number in front of you?

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

The only thing I would say is I don't see a major change in demand. European sales were up about 8% in the quarter. So we continue to see pretty good robust level of demand coming in from our European operating segment.

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

Okay. And Ken, that's an LC, local currency?

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

That's right.

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

Yes. And then just last question, promise you. Nish, when you look at the coverage ratios and you addressed this a little bit kind of in the acquisition kind of pipeline commentary, but again, we're down to literally about 1x -- our coverage ratio is down to about 1x our net debt. I'm curious, is there any other thoughts there around returning capital to shareholders, either a bigger dividend, a dividend increase, some buyback activity? I'm just curious, because the leverage ratio obviously has gotten low again.

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

We're really not changing our thoughts around that area. We think that we do a nice job in investing in the business from an R&D standpoint, where organically we can grow this business at a healthy rate. We continue to think that if there are some opportunities for acquisition, and then of course, a piece we have for our dividend rate that we have increased that dividend on an annual basis for, I would imagine, 50 years or so, I think, is our track record. So really we don't see that changing much. And of course, we have a stock buyback program that's in place that we've used periodically to offset some of the dilution that we have in the stock, of course. Ken, feel free to add.

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

The only thing I would add is the payout as a percentage of free cash flow is around 25% to 30% in the quarter. And then year-to-date, it's around 35% to 40%. So I think it's at a pretty sustainable level. We'll certainly continue to look at the dividend and be responsible just as we have over the past, as Nish indicated, 50-or-so years. But we'll certainly continue to look at that and certainly share with our shareholders.

Operator

And our next question we have is from Edward Marshall from Sidoti.

Edward James Marshall - *Sidoti & Company, LLC - Research Analyst*

I just -- I wanted to ask about the organic fire down 16% on a consolidated. First, I'm assuming that SCBA runs through breathing apparatus, which makes sense. But what's going on specifically in the fire that we talk about from just driving that organic revenue lower?

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

What we're seeing there, Ed, is a matter of large opportunities, large tender bids. A year ago, we had several large tender bids, especially in international, that really boosted our business. This year, we haven't seen those. And in fact, I think the first one we've seen was recently in Brazil. We had a reason -- we're in the Brazilian market. But we just haven't seen the large bids. So we haven't had those to win nor have we lost any. That's the flip side. But we do see some of those come through. We just signed off on a big quote here recently for a customer in a European market. So we just see that as the cycle in the marketplace with those large tenders.

Edward James Marshall - *Sidoti & Company, LLC - Research Analyst*

Got it. So you're just saying it's tougher comps. Is there anything that we should be concerned about with not seeing a number of orders being quoted? Or is that a periodic thing that kind of -- becomes -- tends to be a little bit lumpy?

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

That's a periodic thing, and it does tend to be lumpy. It's not an area of concern for us. Also coupled into that, and I should add that our Jacksonville plant does manufacturer the Cairns helmet, and we did see a little impact of some business that's pushed into the fourth quarter, not overly significant, but probably in the $1 million range.

Edward James Marshall - *Sidoti & Company, LLC - Research Analyst*

Got it. Okay. And then on the energy business, looks, like you had some pretty decent growth there. And I'm curious, we've heard from several service companies that the fourth quarter looks a little bit choppy as takeaway capacity, as they call it, or budget exhaustions kind of pushed up. Have you seen any kind of indication that there might be softness in energy coming into the fourth quarter? I don't want to get too close to guidance, but I'm just kind of curious what you're seeing.

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

None whatsoever. Yes, we're not seeing any slowdown at all.

Edward James Marshall - *Sidoti & Company, LLC - Research Analyst*

Got it. And then the $14.6 million other expense, Ken, what was included in that $4.6 million?

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

It's Ken. The bulk of that is associated with what I had called out as the change in our estimated reserve for asserted claims. We went through our defense efforts in the quarter and we continued to learn more about the claims that were asserted against MSA. And so we increased our asserted claims liability and the bulk of that $15 million associated with that. The residual was just related to defense efforts, so defense efforts of around $2 million to $3 million.

Edward James Marshall - *Sidoti & Company, LLC - Research Analyst*

Litigation, okay. Okay. Perfect.

Operator

And our question we have is from Brian Rafn from Morgan Dempsey.

Brian Gary Rafn - *Morgan Dempsey Capital Management, LLC - Principal, Director of Research, and Lead Portfolio Manager*

Give me a sense, you talked a little bit, Nish, on 3x with the M1. Is that a little more of an analogue design, less electronic? And what is the ability of that SCBA to accessorize like you do the G1 here in the U.S.?

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

Good question. So the M1 stands for modular. So modular design -- it's a modular design unit. So we're able -- think of building blocks on a self-contained breathing apparatus. So we're able to get in and win some bids on a base setup, base unit. It has very little from an electronic standpoint and heads-up display and some of the features that you see on the unit that we sell in the North American market. But that M1 has capabilities to build off that platform. So once we get into departments, the idea is, is to go in and up-sell those customers in later years where we can add some additional features to improve protection for firefighters. So that's the entire idea behind the design of the unit. But the initial bids, as you go into wind departments, those are fairly streamlined units and we -- they are featured up as you see here. What's kind of interesting is I mentioned Brazil on fire helmets earlier. We received our first large order in Brazil, the São Paulo Fire Department. In the past, they had used the international type self-contained breathing apparatus, the EN-approved product. A few years back, we were pretty aggressive in going into that market and showing them the G1 capabilities. And in Chile, the Chilean fire department has used the NFPA-compliant unit, and we received our first order for G1 self-contained breathing apparatus out of São Paulo. It was about $900,000 order. So we are beginning to show the NFPA-compliant unit around the world and the capabilities of the unit. But the reality is this is standards and some of the budgets, they're not quite ready for that. But we do try to sell up, because the reality is those products do provide better protection for firefighters having that integrated thermal imaging capability and in some of the electronics on the breathing apparatus. So as we visit customers, we do try to show some of those additional features.

Brian Gary Rafn - *Morgan Dempsey Capital Management, LLC - Principal, Director of Research, and Lead Portfolio Manager*

Like you guys really have to educate the international on the technology then, more so than in the U.S.?

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

That's correct.

Brian Gary Rafn - *Morgan Dempsey Capital Management, LLC - Principal, Director of Research, and Lead Portfolio Manager*

Yes, okay. If you look at Globe acquisition on the turnout here, now that Globe is under the MSA umbrella, have you been able to leverage sales at all, packaging, bundling, cross-selling? Or has the sales growth been really similar to maybe a pre-acquisition legacy rate at Globe?

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

I think the latter. It's really been more preacquisition, the legacy growth rate of Globe. What's really helped us is we have had some Globe distributors pick up the MSA self-contained breathing apparatus and fire helmets. And so that's helped us a bit on that side of the business. And there are some MSA distributors who carry competitive turnout gear who are looking to pick up Globe. But at this point, the synergy sales, so to speak, that's probably been in that $4 million to $5 million range for us at this point. We do expect that to pick up here in the next couple of years. On the MSA side of the business for breathing apparatus and of course fire helmets and then of course some Globe product going through MSA distribution.

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

The only thing I would add, Nish, is when you look at the multiple that we paid for Globe, we paid 9 to 10x. And a year after acquisition, our adjusted multiple is around 7x. So we've seen some synergies come through on the cost side in addition to what Nish alluded to on the revenue in the channel side.

Brian Gary Rafn - *Morgan Dempsey Capital Management, LLC - Principal, Director of Research, and Lead Portfolio Manager*

Yes, I appreciate the color around that. Getting back to the G1. As we've gotten through the period, where the pent-up demand has been satiated. As you look right now on kind of the run rate, are you seeing a normalized bid quote activity, normalized patterns of order? Is there any differentiation between world volunteer fire departments versus more of the urban salaried forces? What are you seeing on the G1?

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

The business is pretty consistent. The pipeline is fairly full. We have pretty good line of sights, evaluations that are ongoing. I can tell you, I'll leave this call and go downstairs and visit 2 large city fire departments that here as part of their evaluation for a tour, that's in the pipeline. We're pretty confident about those 2 departments. So the pipeline remains pretty full, and the replacement activity continues at a real good pace for us.

Brian Gary Rafn - *Morgan Dempsey Capital Management, LLC - Principal, Director of Research, and Lead Portfolio Manager*

Excellent. And then Ken, you talked about the repatriation, you said $75 million or $80 million, is that earmarked for CapEx? Is it earmarked for dividend? Is there anything that you're looking to allocate?

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

Brian, we target between $75 million and $100 million for the year, and we've remained committed to a very balanced approach to capital allocation. That's consistent with what we've done for a number of years and it is inclusive of our investments for growth and continuing to fund our R&D as well as some of our M&A efforts combined with our continued discipline with respect to the dividend and debt service.

Brian Gary Rafn - *Morgan Dempsey Capital Management, LLC - Principal, Director of Research, and Lead Portfolio Manager*

Okay. And I missed your opening comments. Anything on the inflation front, materials, SG&A, payroll? Anything you're seeing, Ken, that's an outlier?

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

I wouldn't say anything as an outlier. This is -- every other industrial and other companies are facing inflationary pressures are certainly there. But what we've said and consistently said to our investors is that we continue to aggressively price our products. And we've been very successful to date and expect to continue to be successful at passing along inflation through the form of higher prices. In the quarter, we saw good gross margin performance, up about 20 basis points and up about 80 basis points when you exclude the impact of the lower-margin Globe products. So we continue to see another quarter of good margin performance, and we continue to plan for that going forward.

Operator

(Operator Instructions) And it looks like we have no further questions, and I will turn it back to you, Elyse Lorenzato, for final comments.

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

Thank you, Kelly. Seeing that we have no more questions, that will conclude today's call. If you missed a portion of the call, an audio replay and transcript will be available on our Investor Relations website for the next 90 days. On behalf of our entire team here, I want to thank you again for joining us this morning, and we look forward to talking with you again soon.