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MSA Safety, Inc. (MSA)

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

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Amit Mehrotra

Analyst, UBS Securities LLC

MANAGEMENT DISCUSSION SECTION

Amit Mehrotra

Analyst, UBS Securities LLC

Hi, everybody. Welcome to the webcast here. Really, really happy to have MSA Safety, Lee McChesney, Senior Vice President, CFO. We've got Larry De Maria, Executive Director-Investor Relations here in the audience as well. I think – my name is Amit Mehrotra, I'm the electrical equipment multi-industry analyst here at UBS. It's been my pleasure to kind of learn about MSA Safety for the last couple of weeks. Really a company with a lot of history, over a 100 years of history with great technology, great product. And it's just been a pleasure to kind of get to know this company over the last couple of weeks and really happy to dig into kind of some of the investment points here.

We've got a few minutes or maybe 10 minutes of prepared remarks going through a presentation, and then we'll dive into Q&A. Lots to talk about with this company. So Lee, thanks for joining and I'll hand it over you.

Lee Breet McChesney

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

Thank you. Thank you. All right. So again, so number one, appreciate, Amit, the invitation. A couple times now we've been to this conference and I'd like to take just a few minutes to walk us through MSA, a little bit of our mission. And why we think it's such a good investment opportunity from a long-term perspective.

So before I do that, just obviously we're required to talk about our forward-looking – cautionary statements on forward-looking statements and our non-GAAP measures. And then finally, this session is being webcast, and it will be posted to our website after this today. So if you want to digest that, we'd encourage you to do that as well.

So let's talk about MSA for just a couple of minutes here. And it starts, first of all, with our mission. And our mission goes back to 1910. And when the company was founded, and that mission is simply this, that men and women go to work. They work in safety. They their families in the communities, really – they live in health throughout the world. And that was created in the company's foundation. And it's still what we rally around today a 110 years later. We service that mission really through a leadership position in industrial safety, and that is driven by innovation.

That is one of the key differentiations for us in the marketplace today. Now, again, fast forward, we just celebrate a 110-year anniversary. We wanted to share – this year we shared what we've really done in terms of how we keep people safe around the world. So we communicated 40 million workers annually are protected by MSA Safety. And certainly, go back to the origins of when that mission was created quite a build from that from those original origins in keeping people safe in a mine.

So a little bit of recap on the company. So if you go backwards on a 12-month basis, about \$1.8 billion in sales, we make significant investments in R&D at over 4.5%, almost \$80 million a year going into R&D. And that drives a very strong product vitality, certainly for an industrial business of 37%.

Amit Mehrotra

Analyst, UBS Securities LLC

And that's measured by percentage of sales that are new introduction over what period of time?

Lee Breet McChesney

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

Over a five year basis.

Amit Mehrotra

Analyst, UBS Securities LLC

Got it. Okay. Got it.

Lee Breet McChesney

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

Yeah. So and that focus on innovation I've talked about and then also our business system which really focuses on driving productivity, really brings together these really strong gross margin, operating margins certainly. Some really good values here from an industrial perspective. And [ph] one thing (00:03:46) we'll talk about throughout our session today, is also just a consistency in the resiliency of that performance as well based on just how the business is made up.

So that's the kind of the P&L side of things, certainly really strong balance sheet, really good cash flow perspective today. Net leverage is below one. And we do that obviously with even digesting several acquisitions over the last decade as well. So we're very, very disciplined from a capital allocation perspective. Certainly, if you look at our history, good performance organically through acquisitions and then certainly what we do in terms of returning dollars to our shareholders. So quite disciplined, really, about a third of it goes into innovation and organic growth. Another third goes into acquisitions and then the third into really a very strong dividend history. And then we certainly do buyback shares to offset any type of dilution and things like that.

So that's the business in a snapshot now. Again, very, very diverse. So you see on the slide there, about 70% of that's in the Americas, but that also includes Latin America. So about 53% is in the US, 47% really – rest around the world there. Our product categories, we have been very focused in these areas the last three – last 10 years. And it's led by fire service, which is almost 40% of our sales. Detection, which is about 36%. And then Industrial PPE is 25%. And again, these are three product categories. We're really focused on the last 10 years, has really been a differentiator in terms of how the company has performed over this past.

QUESTION AND ANSWER SECTION

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And I assume Detection is growing faster with higher margins. Fire safety is kind of stable. What's the margin differential, not to interrupt your prepared remarks but [indiscernible] (00:05:34)

Lee Breet McChesney

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

A

Yeah. No, no, it's okay. It's interesting. Detection has all the attributes to grow at a faster rates of just the TAM itself in terms of what's going on there. Certainly it's a good margin category for us. It's our highest.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

But quite frankly, our focus in all three of these are high margin categories is how you end up with the 48% gross margin. But certainly Detection leads the way. But Fire has been a growth catalyst for us, and it's also benefited from some really good acquisitions as well. So probably if you asked this five years ago, we might have said Detection was going to be the largest segment and then some really good things happened in Fire Services organically and through acquisitions.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

When I look at like Honeywell or 3M, well, I was doing this a couple of days ago and like looking at some of their PPE business, they saw a lot of the same stuff you guys do. But I think the differentiator here is, is that maybe they're a little bit more higher volume, lower tech, and you guys are kind of deeper on the technology side. Can you talk a little bit about that?

Lee Breet McChesney

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

A

Sure. Sure. I mean, just overall, I mean, innovation really is the driver for everything we do. So you're right. In these three product categories, we certainly lead with innovation. And as a result, really in the product lines that we focus on, we have a strong kind of leading position, number one, number two...

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

...in many cases. And you're right, that's a great description of – we focus on the end user, what do they need, what's the solution and bring that to marketplace. And that's really what we're known for. That's why people turn to us oftentimes in many cases, that they need a – to solve a problem, addressing a safety issue. And we're seeing this many cases having really some of the best solutions out there.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And on the Detection side, can you break down fixed versus wearables? How that's growing and some of that.

Lee Breet McChesney

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

A

Yeah. Sure. Yeah.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Again, sorry...

Lee Breet McChesney

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

A

No. It's good. It's actually...

Amit Mehrotra

Analyst, UBS Securities LLC

Q

...if you want to complete your prepared remarks, please [indiscernible] (00:07:24)

Lee Breet McChesney

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

A

You probably has seen the slides a little bit as well. So this is actually perfect. So let me give you a little bit of background there. So again, really three product categories that I just mentioned here. So Detection is, certainly a growing category, as you just talked about, really benefits from some really strong organic growth and acquisition growth over the past decade.

And really two orientations to that. So, number one, you think about Detection is connected to a worker. That's what we call portable solutions. And then think about Detection, that's really about critical infrastructure attaching to facilities and things like that. That's what we call our fixed business. That fixed business is about two-thirds of Detection today and the portable is about a third. And the portable also includes our connected worker platform. What we go through the MSA plus today is really a nice high growth category, so I'm sure you'll ask about it in a second. So It's certainly been a nice driving category there.

Fire Service, as we just talked about, still our leading category today, head to toe solutions for firefighter. That's certainly been a benefit again from good organic growth, but also through acquisition.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Because a lot of that rely on some funding and can you talk about kind of the outlook for the funding piece?

Lee Breet McChesney

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

A

Yeah. So in the Fire Service category, certainly we sell to large departments and then municipal departments all over the world.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Sure.

Lee Breet McChesney

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

A

And certainly funding from a federal level, local level is important. We, historically has been and has been very consistent. So really around the world, no matter which way the leaning administration is, a lot of support for firefighters. I mean, I think the way we've seen it is, if there is a good environment, people want to fund, first responders, certainly firefighters. And then if there's even a bit of a challenged economic cycle, it's a good place to invest in, it's a good place to put dollars. And so as we look forward, we think that we'll still continue really no matter what happens with administration, because there's just broadly a lot of support here.

And for us, what's nice about that is it adds to the stability, this diversity of the business. So I'll show in a chart in the second here, if you look back in time, this business is quite steady, and it's a nice foundation for the business, it's a good cash business, enables us to really stay on mission with safety. We're not having to deal with as big as swings as you can get in some other industrial companies and things like that.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Got it.

Lee Breet McChesney

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

A

And then finally, Industrial PPE. So certainly the largest two pieces that start with our iconic head – industrial head protection.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

I have a hard hat, by the way, made by MSA, [indiscernible] (00:10:06) technology, which is one of the best hard hat that I've ever had.

Lee Breet McChesney

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

A

Well, that's perfect because a good amount, what we do there is also branded for end users because, it's obviously part of their safety protocols to do that.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

So leading position there, iconic V-Gard you look on at a construction site, really anywhere except for residential, you're probably likely to see a V-Gard hat today if you take a look. We've also focused on really – again, following our end users, fall protection is still one of the – is the top issue on the job site. So we really brought our innovation mindset there as well. And we think it's a big growing category, which today you have the one business we are in a leading position, but we are seeing almost near double-digit growth there consistently over the last five years as we really double down on our fall protection business. So, that's a nice growing category as well here.

So if we pivot just a little bit, I just want to give a quick update on 2024, so no change in our outlook. Back in September or in October, we released our 3Q results. We gave a bit of an update and I really look at 2024 and as example there really this stable makeup of the business. Obviously, it's been a dynamic environment. You've had lots of conversations. We still have really persevered quite well. Here in the fourth quarter, we're looking at mid-single digit growth. The orders that we saw early in the quarter is still playing out that way.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And the full year low-single digit got a little bit misleading because, I mean, I always look at this company interesting, like a GDP plus, plus, plus business. But then you obviously have that big Air Force contract that's kind of messing up the comps a little bit. Can you talk a little bit about that?

Lee Breet McChesney

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

A

Yeah. So I mean, I think actually the fourth quarter is a perfect example, right? So we're looking at mid-single digit growth and we're going to comp and top of mid-teen from last year. So we really – you think about the whole year, we have low-single digit growth on top of almost mid-teens growth from last year. So we're actually quite, quite happy with that. And you're right, we've had some large wins over the last several years that have been helpful and great. And then, to your point, you can get some lumps here and there, but as I'll show you in a second, that is part of the business. In the end, it's really the diversity of all these end markets and all these different places we serve, they give us this nice stability.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Got it.

Lee Breet McChesney

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

A

And so, yeah, I think the last thing I'll just say on here for 2024, again, no change in outlook and beyond that growth. Still looking at really strong incrementals, kind of the high-end of 30% to 40% for the full year and cash flow still being in that kind of 90% to 100% zone for the year.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And so the growth algorithm outside of maybe this comp issue, is it mid-single – a little bit mid-plus-single digit, obviously you're converting at 30%, but so there's GDP, there's pricing, there's maybe some market share gains to kind of dissect that for us.

Lee Breet McChesney

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

A

Yeah. So the investment thesis for us is definitely about mid-single digit growth and that's from the Detection category has the opportunity is to grow a little bit faster than that, certainly Fire overall depends on the large wins [ph] and things like that, so (00:13:22) that's going to be in the middle. And then you can get some swings in Industrial PPE. You look at a year like this where you got a little bit more slower, broader growth, you could have a little bit of lower growth there. And then you get into more of a boom cycle, lower interest rates and things like that. Industrial PPE could be actually a nice positive, but on average about mid-single digit growth. We talked about incrementals between 30% to 40% and then, very strong cash flow, very consistently delivering 90% to 100%.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Is there an opportunity for the incrementals, to me, I mean, international margins are obviously lagging here. Domestic margins talk about kind of the opportunity there. And then I know in Europe, you maybe went from like a model where you're everything to – everybody to more focused. What type of opportunity, are we through, the benefits of that or what's the opportunity prospectively there?

Lee Breet McChesney

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

A

Yeah. So yeah, I'll mention this in a second, but just I mean broadly a lot of progress in margin over the last decade, certainly the last five years. So what we show, almost a 1,000 basis points of operating margin improvement. And what's great about that is certainly the Americas team has done a wonderful job, [indiscernible] (00:14:35) margins, in many cases up to the high-20s or low-30s. But the international business, like I think a lot of industrials has challenges just based on things that happened in Europe and the infrastructure you need in different countries and things like that. We've made a lot of progress. Our industrial international business has moved from single-digit operating margin to the mid-teens.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

So, probably one of the most popular questions asked is, can the international get to the Americas level? And I think it has certainly equal levels of improvement. But I think there will be always some difference just because of the nature of the international business versus the US, particularly the dynamics of what happens in Europe. But overall, as we look forward, we really see some consistent, 30 to 50 basis points of operating margin opportunity that's going to come from the business system, I mentioned earlier, certainly we've done a nice job of managing inflation and price. And then, we have innovation and innovation that's helping fuel the businesses. Obviously, that's a nice help for margins. And also, there's been an orientation towards the Detection, and Detection is our highest margin category. So we consistently, just by strategy, have a nice positive mix element that comes out as well.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And I was intrigued by that product vitality. I think it was almost 40% or something like that. And that is such a key. Just in my experience, companies that constantly invest in R&D and have an innovation funnel, obviously that translates directly to growth. Is that a high number for you guys or is that more normal? And as you look over the next couple of years, do you think that the innovation pipeline is more robust where you can actually grow that number? What's the view there?

Lee Breet McChesney

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

A

Yeah. Well, I think, number one, if you look at us, we are a pure safety company. That's 100% of what we do, that's all we think about it all day. So I think one of our biggest advantages over the last decade is no matter what's happened, economic cycles, COVID...

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

...we've continued to invest in innovation. And so, as I said today, we're going to spend over \$80 million this year. We spent very similar amount during COVID year as opposed to like trying to pull back as we're trying to avenge some type of massive swing. We still had a pretty stable growth environment in that year, which enables us to continue to focus on innovation. So I think the trick for us is the consistency. We drive that vitality rate and we bring products to market and these products become 5-, 10-, 15-year products for us. So certainly where you're putting more dollars into certain categories, that's certainly a process we've gone through. This is a consistent review of the portfolio. So Detection certainly gets a higher ratio than that 4% today. We spend a lot of money, for example, on the connected worker, which is really helped drive growth in both industrial. And we're seeing some really nice opportunities in firefighters over time as well. So I think it's the consistency and the discipline, but again, it's how we service that mission is we are known for having in many cases the best solutions out there and you only do that by consistently investing.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And then, there's also like – you think about innovation in products, but there's also, I think innovation in kind of how you guys go to market. And one of the things that I was struck by, I was talking to Larry earlier on was really the subscription model in Detection and kind of the SaaS approach. Can you just dig into that a little bit...

Lee Breet McChesney

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

A

Sure.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

...like what the margin profile of having a more recurring stream of business and what that actually means for you guys?

Lee Breet McChesney

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

A

Yeah. No, absolutely. I'm actually going to pivot here. Just have this as a backdrop for you so that highlight there is a key part of what we just – back in May we did Investor Day. And we identified obviously we want to still stay in these secular trends and leading with industrial safety. And we picked these product categories. They've served us well over the last 10 years. But we've also identified these really nice growth catalysts. And certainly the connected worker is one of them. And so what we've been doing for the last now, probably almost seven years, is investing in this connected worker strategy.

And we see opportunities that can play out really in all three of the product categories I highlighted. Certainly, in Firefighter today, every SCBA, we sell is connected. So that data is being captured. We can turn that into productivity. In the analytical solutions, we can help them do tracking of their items and really just overall inventory control. So those are features that are out there today. Even in the fall protection space. We've had work with large distribution clients really working on, how do I make sure people use that safety gear? Because one of the challenge of the safety gear is make it comfortable, but also make sure they're using it. So, imagine your fall protection devices connected and tells people whether they're using it. If they're not using it, a piece of equipment won't work or something like that.

So all that's been going on over the last five-plus years. But probably the fastest adoption has been in industrial. So, today we have a product, for example, called io 4, and that is a portable detection device that's attached to the worker. And we have the actual detection unit and now it's also connected to our grid software platform. So you imagine a facility an EH&S manager trying to oversee a 1,000 employees and making sure that they are safe. They're now on that, on scene. And instead of that unit before that used to just be attached to them, they kind of would wear it for the day. And it was kind of really up to the employee to follow the directions. It's all connected. So I can see if I'm in a certain area of the facility I'm picking up maybe trace amounts of some type of contaminant, maybe not enough, and it's a safety issue that you stop doing that. But imagine now I have the power of all those employees going all over the site. So I have a great solution, but now it's fully connected and I can start building out these additional insights to help them from not only a safety perspective, but really from a productivity perspective.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Sounds like a ways for Detection.

Lee Breet McChesney

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

A

Well, and it really again solve the safety solution.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

Compliance is really important. Record keeping of compliance is really important safety. But also, it's a productivity savings. In the old days someone would get a device, they'd have to check it in. Today you can tap into your badge. I mean this, so we're seeing really a rapid acceleration and adoption for us. We're just a little bit

over two years into this and we're seeing really a strong adoption rate and what we're doing is they're also selling it on a subscription basis, so you can buy the unit and then turn on these features over time. Or you can come to us and sign up for a three or four year model. We guarantee performance. If there's any issue, you just get a replacement. And we're seeing today really a lot of interest in signing up for that type of model. And we're seeing some really good incremental business because we've seen new customers coming to us that we didn't necessarily have before just in our traditional units.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Can we talk about the short cycle piece of the business a little bit, on Industrial PPE side, obviously you have great market position in hard hats and fall protection, maybe another growing area where you're taking market share. But I assume like a lot of your customers, when they need it, they need it. And so that creates a little bit of challenges from a stocking perspective...

Lee Breet McChesney

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

A

Yeah.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

...especially in an industrial environment that's a little bit weaker. So one, can you talk about, have you seen any trends? I mean, we're a global industrial conference here. You guys are a little bit different because you're so critical to every company. Safety is the number one priority because the cost of being unsafe is just still significant. So it's a little bit of an isolated kind of dynamic. But anything on the short cycle side that you think is notable and how do you guys manage kind of the ability to kind of deliver on big orders that come very quickly on the Industrial PPE?

Lee Breet McChesney

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

A

Yeah. No, let me answer your question directly first. So for us today, about 25% of the business is what I call more shorter cycle. And that number used to be like 40% plus. But what's really happened is these other parts of the business have grown faster.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Sure.

Lee Breet McChesney

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

A

This business is still continue to grow. But it's just become a smaller percentage. But what we're seeing across the globe and to your question, there is surprising resiliency. Again, think over the last 20 years that, you and I can imagine you kind of see the cycle where it is today and you'd expect a bit more a fall off.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

We've seen it hold. Now, keep in mind, we are obviously are selling safety products. Again, this is the nice thing about the resiliency of the business, doesn't really matter what the economy is, people need to be kept safe. Maybe people even think about protecting the workers even more after COVID than they did before. But we are seeing, just to give you some insights around the world, certainly in the US, where the unemployment levels are still quite low. We're seeing maybe what would have been something that would have been a bit more negative. It's kind of more flattish. And then certainly you go into Latin America, your combination of – it's mixed, but we're doing a nice job ourselves just in terms of winning share. So we're seeing actually some nice positive numbers there. And then I move over to the international market. Certainly, we saw the slowdown in China that a lot of people did see. But we've now, I would say lapped kind of what was this year long period of decline and is now a bit more stable. I still think Europe is challenged. We're doing some good things to drive share, but certainly when you look at the core market, it's a bit negative on those more short cycle times today.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

With all this, obviously one of the big topics for us in industrials in the US, is this kind of reshoring of industrial manufacturing capacity in North America. I don't know if it's US, but it's North America. Maybe it's more US now prospectively. Is that a huge like I mean, is that – we haven't necessarily seen the output of that because the construction capacity is actually being put in place as we speak. But is that, as you guys think about kind of your longer term opportunity, is that something that is really top of mind for you or is that something that, yeah, if it comes, great, but it's not necessarily something that we're necessarily to hang our head on in terms of prospective growth?

Lee Breet McChesney

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

A

Yeah. I think a couple of things. I mean, you bring up that's generally as a positive, right. So if you go around the world, there's certainly different levels of dollars put in to safety. Certainly, more Western markets spend probably more per worker.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

So I would say that equation is changing over time. You see that number growing really across the globe universally. I think to your point, whether it's onshoring, whether it's infrastructure spending, those are positive things for us as maybe also part of why we see some of those short cycle things not seeing the same pressure maybe we would have seen in the past. And as we look forward, I think, trends like that, I would just say broadly, safety is just a secular trend as well. So you mix that combination together. I think it's been a positive for us and as we look forward, we think it's actually one of the nice positives for us as well.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Okay. So the long-term algorithm, mid-single digit kind of organic growth, pricing market share plus GDP, you've got 30% to 40%, high 30% incremental margin. So that's maybe high-single low-double digit EPS growth. So that's a great organic algorithm. But let's talk about the \$1.5 billion you have with respect to firepower.

Lee Breet McChesney

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

Yeah.

A

Amit Mehrotra

Analyst, UBS Securities LLC

So that's kind of fun in terms of the opportunity to drive inorganic growth. Can you talk about – I'm not super familiar with the company, but can you just talk about your history of – it seems like a company that's not overly focused on buying products that don't have great market positions already. You want to stick with quality and kind of focus on that. But just talk about the M&A history and where...

Q

Lee Breet McChesney

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

Yeah.

A

Amit Mehrotra

Analyst, UBS Securities LLC

...you're – I assume you're going to be focused on Detection going forward. But talk about if that's not right.

Q

Lee Breet McChesney

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

I love the question. I got a couple of good slides for that. [indiscernible] (00:26:55)

A

Amit Mehrotra

Analyst, UBS Securities LLC

Okay. Good. Yeah. Yeah. So I kind of hijacked your prepared remarks. So sorry about that.

Q

Lee Breet McChesney

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

No, it's okay, let me go back here for a sec. So this is a slide that – you know, obviously, this is all public information. This is the last 10 years of performance. This really was the basis for something we showed back in May. So we speak about the resiliency of the business. So this shows you the last 10 years of MSA Safety.

A

Amit Mehrotra

Analyst, UBS Securities LLC

Yeah.

Q

Lee Breet McChesney

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

And certainly, I think the numbers speak for themselves.

A

Amit Mehrotra

Analyst, UBS Securities LLC

Q

By the way, the CAGR is pretty consistent. There's only a couple of years where it's down, actually. So that's pretty much...

Lee Breet McChesney

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

A

Again, very steady business model, right.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

We talked about the Fire Services, in Detection, in fixed Detection, once you install that devices, there's a lot of replacement work [indiscernible] (00:27:39).

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Right.

Lee Breet McChesney

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

A

So over 60% of the business is very stable really no matter what happens with the economy. But we've certainly focused on bringing the businesses into life. We talked about innovation before. You see, the operating margins expanding almost a 1,000 basis point. But the numbers are impressive. But also, it's the consistency. So this was the backdrop. And think about what happened in the last 10 years, right. Two recessions, COVID, supply chain changes, you name it. And this is certainly – this speaks to really the makeup of the business and where we are today. So with that backdrop and again, we touched on really the strategy as you look forward here, we did put out in May goals for 2028. So, going back to your perspective here. So yes, on the growth perspective, you're really resilient business as we just showed there. And that's certainly the mindset. We haven't put out targets ever in history. So Steve and I just felt, the rest of the leadership team felt this is the appropriate time to do that based on this momentum we've been building as an organization. And these are the organic growth goals which would push us into the \$2 billion plus range. Certainly the focus on innovation, the business system really driving that margin acceleration we talked about. And then just frankly, volume leverage puts us an opportunity to really have an operating margins approach 25% and then ultimately, an EPS that gets into the \$10-plus range. And then to your point, that's all organic.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

And certainly, again, you look at those targets, looking 10 years back, acquisitions were really important. There's probably five acquisitions to help support those financial returns as well. So, part of our message is, M&A has been important. We have been very disciplined in what we do bring in. We're very focused on what they do. They lead with innovation. What are their financials? Where do you think the financials can go? And that's why it's been very complementary. Haven't had to really step backwards with this M&A. And with all that said, yeah, there's a \$1.5 billion of capital that can be deployed here. This is after doing dividends and share buybacks. I think...

Lee Breet McChesney

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

A

And so keeping the leverage, obviously very reasonable. Yeah.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah. And we said, we probably think the leverage over time is probably more between 1.5 and 2.5 times. But again, we're going to be disciplined. We do have a tremendous amount of optionality, which is really a strategic advantage. Again, we've got this really core strong organic business and then we can continue to add through acquisitions. And we're certainly in the marketplace participating. But we're looking for things that, again, complement what we do today. We certainly are disciplined investors looking for EPS accretive pretty soon after ownership. Our cost of capital is pretty low. It's about [indiscernible] (00:30:34). So we certainly want to cross that. I'll say in the first five or six years and that's why you see us today with the confidence organically, we can do this. And then certainly we have this cash flow to enhance that with acquisitions.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And is that \$1.5 billion kind of specifically, I assume, obviously, Detection is growing above that mid-single digit? Is that where you want to be? And talk about like...

Lee Breet McChesney

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

A

Yeah.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

...I assume you have a lot of skews and there's places where maybe you're underrepresented relative to that growth.

Lee Breet McChesney

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

A

Yeah.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

What does that – how does that inform kind of where you want to deploy that capital?

Lee Breet McChesney

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

A

Yeah. So – yeah, it's interesting. Clearly, if you look at the business today, Detection has been a key focus area and that business almost doubled in size.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah.

Lee Breet McChesney

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

A

So certainly that will remain a key focus area. And I think it's Detection, it's adjacencies that we're already in today would be natural enhancements to that and where you get into instrumentation and monitoring and things like that, which again is an outtake from what we do in the safety space. But Fire is still interesting to us. So yes, we have a strong position. But there's also a lot of global opportunities out there and there's other things in the firefighter space that would be interesting. And then I think in the Industrial PPE probably fall protection is probably the focus area as I mentioned earlier, that's a still the number one solution that needs to be solved for in workplace. We think there's a lot of inherent growth really around the world for us and we'd like to get our share even stronger. We've moved that share from single digits to low teens, but we're still number three in that space today.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And in terms of the – when I think about the pipeline of opportunities, you obviously have some very large competitors. But how – just give us a sense of how fragmented it is and how you think about the funnel of opportunities from an M&A perspective?

Lee Breet McChesney

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

A

Yeah. So, clearly if we step back, there's – we have a good funnel. We've been focused on even probably growing our funnel over the last couple of years as the market's been a little bit softer and just creating those relationships. But certainly, I think fragmentation wise it's probably more opportunities in Detection. So it'll be a natural bolt-on type things out there. If you look at what we've done, the most recent acquisition was Bacharach and here's a business that just – was just a bit under a \$100 million. It was squarely in the Detection space. We did some in that space, but we were certainly the leaders in that was owned by private equity. We've also done a lot of private as well. Those are probably the likely scenarios for us to do on a [indiscernible] (00:33:23) basis.

Certainly there's a larger things out there. They just would have a higher level of, I'll say, financial discipline to make sure they check all the boxes or something like that. But certainly we participate in those as well. I mean, if you look at our history over the last 10 years and kind of where we are today, we certainly have the capacity to do even more in terms of quantity, but also just size.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

So that that [ph] 10%, 50% (00:33:47) 2028 target, what does that imply from like a compound and organic growth perspective from your starting point? And then I guess the, the M&A piece is accretive to that, right.

Lee Breet McChesney

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

A

Yeah. So what we have out here for growth is we have 3% to 5% organic growth. And in here from an organic perspective, the EPS growth here is just kind of high-single digit, is about 8%. And again, if you put that in perspective that we just showed in the 10-year basis...

Amit Mehrotra

Analyst, UBS Securities LLC

Q

12% or whatever, yeah .

Lee Breet McChesney

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

A

Yeah. Obviously, M&A becomes an option to take those numbers to a higher level, which is what you saw over the last.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

And that 3% to 5% is probably maybe on the conservative side a little bit relative to the history and obviously the opportunity.

Lee Breet McChesney

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

A

Yeah. Well, that – to your point, that is solely just linked to this special 2024 we're having...

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah. Right.

Lee Breet McChesney

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

A

...where we offset this Air Force business which is again, \$75 million of business. But it won't be there next year. So it just becomes a little bit part of the math.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Yeah. Yeah. It makes sense. Makes sense. Okay. Cool. I think we're going to – do you have any final remarks or maybe I can finish it, but what don't you talk about...

Lee Breet McChesney

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

A

Yeah. Yeah. I'll just add a final thought here. So again, I'll start where I did as well just the focus on the mission we serve that mission, we wake up each and every day focused on safety, that's what the organization has rallied around. Certainly we have leading positions in these areas around the world, in these three product categories, innovation, combination with the business system has really put us in a really good place from a financial

perspective. And we're focused on really leveraging that to drive organic growth and then to complement it with smart M&A. And that's why we put out those objectives for 2028 and we're on track to those.

Amit Mehrotra

Analyst, UBS Securities LLC

Yeah. It's great. I mean, it's like a great mission. 40 million people made safer combined with good financial performance. So it's kind of a win-win. So thanks Lee for taking the time. Really appreciate it. And hope you have a great day.

Lee Breet McChesney

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

Thanks, Amit.

Amit Mehrotra

Analyst, UBS Securities LLC

Thank you.

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