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MSA.N - Q3 2024 MSA Safety Inc Earnings Call

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OVERVIEW:

Company Summary

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Rob Mason Baird - Analyst

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PRESENTATION

Operator

Thanks, Good day. Welcome to the MSA Safety Third Quarter 2024 earnings conference call. All participants will be in a listen only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question. You may press star then one on your touch-tone phone. To withdraw your question, please press star then two. Please note, this event is being recorded. I would now like to turn the conference over to Larry De Maria, Executive Director of Investor Relations. Please go ahead.

Lawrence T. De Maria - MSA Safety Inc - Executive Director, Investor Relations

Thank you. Good morning and welcome to MSA Safety's third quarter 2024 earnings conference call. This is Larry De Maria, Executive Director of Investor Relations. I'm joined by Steve Blanco, President and CEO, Lee McChesney, Senior Vice President and CFO and Stephanie Sciallo, President of our Americas Segment. During today's call, we will discuss MSA's third quarter financial results and provide an update on our full year 2024 outlook.

On slide two, 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 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.

Turning to slide three, we've included certain non-GAAP financial measures as part of our discussion this morning and non-GAAP reconciliations are available in the appendix of today's presentation. Presentation and press release are available on our Investor Relations website at investors.msasafety.com. I'd now like to turn the call over to Steve Blanco, Steve?

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

Thanks, Larry, and good morning, everyone. I'm on slide four. Thanks to our team's dedication and hard work. Our ability to serve our customers and advance our mission has never been stronger. We continue to be guided by the strategy we outlined earlier this year at our Investor Day to drive profitable growth while judiciously deploying our capital as we work towards our 2028 financial goals. We remain focused on bringing industry-leading safety solutions to our customers around the world.

I'll touch on some of our mission driven innovation accomplishments in a few minutes, but let's first look at some of the third quarter highlights. Overall, we once again demonstrated operational resilience with our quarterly results. For the third quarter, net sales decreased 3% year over year

on both a reported and organic constant currency basis and adjusted earnings increased 3%. As we noted in our press release, the decline in sales was largely due to the previously mentioned delivery timing with Fire Service, and some specific customer delays.

With that said, we continue to see positive order momentum and our backlog grew sequentially during the quarter. Orders increased year over year by high single digits, excluding the impact of the U.S. Air Force order in each period. During our earnings call in July, we discuss some aspects of order and delivery timing that could impact the cadence of the second half, including the Assistance to Firefighter Grants or AFG funding. This was released later this year than in 2023 and specifically around the U.S. Air Force SCBA order delivery timing. In final form, the U.S. Air Force schedule has shifted towards the end of the year, but we still expect to deliver most of that order in 2024. While our top line sales number came in below what we planned.

The team performed exceptionally well from an operational standpoint, as evidenced by our overall earnings growth and margin performance. The overall demand environment remains healthy, albeit with some choppiness, and we continue to see a strong business pipeline. Moving to our product categories. Sales in Fire Service were down high single digits in the quarter, primarily due to the U.S. Air Force shipping delay and also a decline in breathing apparatus sales versus a strong prior year comp that included several large departments, such as LA County. As you know, Fire Service SCBA order timing can be lumpy. While orders were up year-over-year, some customer orders have been delayed. At the same time, we retain a solid pipeline in North America.

We continue to have excellent international momentum with our M1 SCBA and in the third quarter experienced continued momentum in fire helmets with growth of our new Cairns 1836 and our F1XF, as well as turnout gear. Sales in Detection were up mid-single-digits. Fixed Gas and Flame Detection had a solid quarter moderately declining compared to last year's robust third quarter growth, with good contribution from our FL5000 Flame Detector. Portable Detection sales continued to perform strongly in both traditional and connected devices. We also continue to see solid margin improvement in our Detection business. Industrial PPE sales were down mid-single digits year over year as international markets slowed. Head Protection was up modestly, while Fall Protection declined mid-single digits. And we saw continued customer delays in ballistic helmets.

Turning to slide five, I'd like to share some innovation highlights from the third quarter. First, I'm proud to note that the Product Development and Management Association named MSA a 2024 Outstanding Corporate Innovator, making us one of only two companies to achieve this distinction twice in the 37 year history of the award. It recognizes companies consistently generating long-term value through exceptional product and service innovation. We were honored, in part, for our transformation from a safety equipment manufacturer to the global leader in developing and manufacturing advanced safety technologies and solutions.

Second, I'd like to briefly highlight our Portable Detection business. We continue to grow across our diverse Detection product category through innovation. Portable sales have grown by nearly 40% over the last two years. While we continue to see strong growth in traditional portable devices, our fastest growing category is connected portables, now including a complete solution set sold through MSA+ subscriptions. We're signing up new customers and are converting our existing installed base of customers to connected solutions, with most customers selecting durable multi-year contracts.

In addition, there are opportunities for service contract add-ons and backend contract renewals. We expect to see strong profitability from this business that will scale even more over time. Most of these contracts are incremental, with many new customers. We'll discuss connected portables more in the future, but we wanted to highlight the success and strength we've had so far, we're in the early innings of this journey, led by our [Altair] io 4 device, which is the heart of our industrial technology strategy.

Finally, MSA is proud of our products and solutions protecting more than 40 million workers annually, demonstrating our team's impact in safety. In the third quarter, we were made aware of two specific cases where MSA's end users were saved from significant injury or death. One case was related to our io 4 Gas Detector and the other was related to our LUNAR device in the Fire Service. These remind us each and every day of our purpose and the importance of our mission that the entire team at MSA is committed to.

I want to thank our team for working hard with these customers and our more than 5,000 associates around the world for their dedication to delivering innovative products and solutions that enable us to continue advancing the MSA mission of helping men and women working safely throughout the world. With that, I'll turn the call over to Lee, who will discuss our financial results for the third quarter, Lee?

Lee Mcchesney - MSA Safety Inc - Senior Vice President, Chief Financial Officer

Thank you, Steve, and good day, everyone. We appreciate you joining the call. Let's now review our third quarter performance and provide an update on our full year outlook. Let's get started on slide six with the quarterly results. Sales were \$433 million, down 3% year over year on an organic constant currency and reported basis. With lower volumes offsetting positive price contributions. Currency translation was relatively neutral in the quarter across our product categories. Mid-single-digit growth in Detection was offset by contractions in Fire Service and Industrial PPE. Though growth was challenged by a strong year over year comparable period and the shipment timing change Steve mentioned, double digit sales growth on a two-year stack reflects the health of our underlying business.

Overall, orders in the quarter were robust and have been high single digits over the past six months, with growth in all of our markets. Our commercial pipeline remains encouraging across our product categories and in most of our regions. We have seen a nice continuation of activity so far in October. In the third quarter, our book-to-bill ratio was above 1.1 times and exceeds one times on a year-to-date basis. As a result, our backlog increased sequentially due to these favorable trends, and the normal third quarter seasonality but remains below the unusually elevated levels of the past couple of years.

Our margin performance continues to be resilient. The team's commitment to the MSA Business System's processes and behaviors are evident in our results. Gross profit margins were 47.9% in the quarter, 110 basis points below the strong levels of the prior year. Operating margin on a GAAP basis was 21.1% in the quarter, including the benefits of lower SG&A. Adjusted operating margin was 22.6%, down 10 basis points over the prior year. And decremental operating margin was 24%, within our target range of 20% to 30%. Operating margin performance was largely driven by mix, productivity, cost/price management and lower SG&A levels.

GAAP net income in the quarter was \$67 million or \$1.69 per diluted share. On an adjusted basis, diluted earnings per share were \$1.83, up 3% over the prior year. The increase was a combination of positive mix, productivity, lower SG&A, lower interest expense and a lower year over year adjusted tax rate. Now moving on to our segment performance. In our Americas Segment, sales decreased 5% on a reported basis year-over-year with mid-single-digit growth in Detection, offset by a shipment impacted decline in Fire Service and a slight contraction in Industrial PPE.

Currency was a 2% headwind in the quarter. The adjusted operating margin was 30.7%, up 80 basis points compared to the prior year. Margin expansion was driven by positive mix, productivity, cost/price actions and a lower SG&A. In our International Segment, sales increased 1% on a reported basis year over year. Healthy growth in Fire Service and Detection was mostly offset by a decline in Industrial PPE. On a geographic basis, growth in APAC was partially offset by a decline in EMEA. Currency translation was a 2% tailwind in the quarter.

Adjusted operating margin was 13.6%, a decrease of 340 basis points year-over-year, and profitability was challenged by lower volumes, a robust comparison period and partially offset by productivity and price. Now turning to slide seven. Free cash flow of the quarter was \$70 million, representing a conversion rate of 97% of adjusted earnings. Third quarter cash flow reflected healthy earnings and solid working capital execution. Consistent with the capital allocation strategy outlined at our Investor Day, capital deployment in the third quarter was balanced.

Capital expenditures were \$14 million, up modestly compared to the prior year. We returned \$20 million in dividends to our shareholders, and we repurchased \$10 million in common stock. Debt payments totaled \$38 million. Our net debt at in the quarter was \$400 million with a cash balance of \$154 million. Our net leverage ratio at quarter end was 0.9 times, consistent with the second quarter levels. Adjusted EBITDA for the trailing 12 months ended September 30 was \$464 million or 25.7% of net sales.

Now, let's move on to our full-year outlook on slide eight. Although the operating environment in the second half of the year has been incrementally more dynamic, our broad diversification across products, geographic regions and markets, as well as the attractive underlying market trends in the safety industry continue to position us to deliver resilient results.

As we look ahead to the fourth quarter, we expect to finish the year favorably with mid-single digit revenue growth in the quarter, implying low single-digit growth for the full year 2024. The expected mid-single-digit growth in the fourth quarter is supported by our orders and backlog, including the U.S. Air Force business and compounds on top of that 12% reported growth we delivered in the fourth quarter of last year. Compared to our July sales outlook, we have adjusted our view in line with the order and shipment dynamics that we're seeing with specific customers.

Looking forward, we're also well positioned to deliver at or above the high end of our 30% to 40% incremental margin objectives and we remain on track to deliver a healthy cash flow conversion. Finally, I want to extend my thanks to our associates worldwide, who are so focused on passionately supporting our customers each and every day and supporting the mission Steve highlighted earlier. Now I'll turn the call back to Steve for concluding remarks.

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

Thank you, Lee. As we look forward, I want to reiterate the resiliency of our business driven by strong underlying industry fundamentals, our proven innovation process and leading positions across our markets. I believe we have the best team in the industry, and with our mindset around continuous improvement and commitment to the MSA Business System, we're well positioned to create value over the long term for our stakeholders. With that, I'll turn the call back to the operator for questions.

QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session. To ask a question, you may press star then one on your touch-tone phone. If you're using a speakerphone, please pickup your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster. And our first question today comes from Rob Mason with Baird. Please go ahead.

Rob Mason - Baird - Analyst

Good morning. I just wanted to start with, you noted you were able to deliver the decrements within your guided range and it looked like SG&A was a lever within that dynamic. Can you just speak to -- we don't -- we saw a sequential decline there, perhaps some seasonality around that, but just how should we be thinking about SG&A as we go into the fourth quarter and your ability to manage that number specifically?

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

Yes. Certainly, Rob, I'll give it to Lee to take that.

Lee Mcchesney - MSA Safety Inc - Senior Vice President, Chief Financial Officer

Sure, good morning, Rob, the decremental certainly in the range we've talked about in the past. Certainly, gross margin was a continued nice resilient level. And to your point, SG&A is in a good place. Certainly, we are focused on prioritization of SG&A and we certainly flex when we need to. There's a benefit in the third quarter from just a bit lower volume that comes through as well. But as we go forward, mean, versus from what you've seen the past, you're going to see continued momentum. It won't be quite what it was in the third quarter -- it will certainly go up dollar-wise just because of the higher volume, but you'll still see a pretty healthy ratio there. But again, we're focused on driving incrementals, not decrements, but good to see that when it happens.

Rob Mason - Baird - Analyst

Okay. I wanted to see again some of the customer timing. It's not a complete surprise there, but I am curious, as you're thinking about your fourth quarter levels, sounds like Air Force you are counting on shipping some of that. But just can you parse through some of the other specific customer delays? Are you expecting those to abate in the fourth quarter? Do those carry through year end? And where would we see those, if it's AFG related? You mentioned ballistic helmets, also, but just provide a little more color around where you're seeing those delays.

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

Yes, sure. Rob, if you think about the Air Force, first to answer that question, we expect pretty much, I'd say 90%-plus of that to ship in the fourth quarter. So that will ship. And again, that's based on customer timing and what they would do, what they want to accept at what time. So that's really how that pushed. So, we are prepared and expecting to do that. So, I'd say most of that ships in the fourth quarter. And then the other things, you talked about ballistics, this happened in Q2 actually, but in Q3, the European government customer pushed this back to 2025.

So, that, obviously, comes out of the 2024 story from a revenue perspective. We've got that business. We have the contract here, but it's a push from them on timing to take that order. So that's what we see. And we've seen a couple of others like that. For those that are going to affect the fourth quarter, we've got one in the Americas. In Latin America, a large government order, the same thing.

Again, we have the business, we are the incumbent and they've told us we have the business, they just pushed it back because of the election change they had with their government.

So, everything's intact there. You know, in the Fire Service, it's not inconsistent, as you know, our story pretty well. So, we've seen this lumpiness before. The pipelines really good, business is resilient. The AFG funding is now released, which is good, but the order timing can be lumpy as we've seen in past years. And that's what we've seen this time. They haven't gone to competitive accounts, but they're slower to close than we expected. So, that's really where we're at on why we called out some of these orders taking a little bit more time than we hoped.

Rob Mason - Baird - Analyst

Just one last follow up. Could you go through, you called out Portable Gas strength in the quarter, both on the traditional in the connected side, just the kind of the underlying market drivers there, do you think this is some strength or do you think that there is some share gain mixed into that? What kind of underpins the double-digit growth there?

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

I think it's both. I think you're correct on your thesis on share gain, we're certainly seeing that occur. We're also seeing expansion of wallet share, right? As we're providing more value through these connected solutions to our customer base. And, really, we're expanding the customer base overall itself. So, if you think about the portable portfolio, we really got a diverse set of options for the markets, right? So, our customers can choose whether they want that traditional platform, or they want to have this connected platform, which we go to market through MSA+.

And it's a tremendous combination for that customers to choose from. So, the growth was both. So, we saw some mid to upper single digit, depending on the market, for the traditional. But really, by and large, the high acceleration of growth is the connected platforms we're seeing. So, that's what we expect to kind of continue to see. It fits really well with what we talked about earlier this year as we walk through the strategy at Investor Day. And that's playing out really nicely.

Operator

Again, if you have a question, please press star then one. And our next question today comes from Ross Sparenblek with William Blair. Please go ahead.

Ross Sparenblek - *William Blair - Analyst*

Hey, good morning, guys. Maybe just starting with broader end market demand. Backlog is difficult to track, can you just give us a sense of the high single-digit growth in the quarter? Is that seasonal or maybe more just the push out of the orders in the third quarter, and what expectations are for broader demand? I mean, would it appear you guys are taking share across most of these segments?

Steven Blanco - *MSA Safety Inc - President, Chief Executive Officer*

Thanks, Ross. So, if we think demand, it was healthy, to your point, with orders up high single digits. And I'll turn it over to Lee to talk a little bit more about what it does on the backlog story and a bit on the book to bill. But when we look at the markets, I would kind of think of it this way. We do feel like we're in a really good position from a share perspective. Detection, we just talked a little bit about as I answered, Rob's question on Portables. We've seen some nice performance in Fixed as well. Last year was a tough comp because we had such great growth. But really solid performance.

Industrial is still mixed. We see some really good market performance in some categories and some we don't, some that are a little softer. Europe's a little softer than most right now. But overall, it's been consistent throughout the year. We haven't seen an uptick as we've come into the second half of the year, but we haven't seen much degradation either, and we can expect it to remain fairly constant through the rest of the year.

And in Fire Service, as you know, we're really doing well with international growth in the Fire Service, the team is taking a ton of share, which we're really pleased with. They're performing well. They're competing extremely well with customers across the international markets, which is a real strength for us. And then we expect the Fire Service in North America, as we said, we've got the pipeline. It's just a matter of getting some of those orders to close. But overall, we feel like, in totality, our position in the markets are really strong, probably as strong as they've ever been. But maybe, Lee, you can parse out a little bit about the backlog.

Lee Mcchesney - *MSA Safety Inc - Senior Vice President, Chief Financial Officer*

Sure. So good morning, Ross. As we noted on the call, and I remind everyone, never overreact to one quarter, but certainly a nice quarter year-over-year, but we also gave you the full year year-to-date number as well, which is slightly above one. And that really speaks to where Steve was going. We're still seeing generally good markets. It can be lumpy from quarter to quarter. We're talking about, for orders, a nice high single-digit number here in the third quarter with a similar performance in the second quarter. So, I think that does speak to everything Steve was walking through there as you look forward as well.

Just giving some insight, too, across the markets, we say orders were high single-digit was very consistent, frankly, across all three categories of our business. Good performance around the globe as well. There are spots in the world that are not as healthy, but overall, it's a good place. And I clarify as well, that in the third quarter, the orders we saw did not include Air Force. We booked Air Force in the second quarter. So this just speaks the order dynamics.

Ross Sparenblek - *William Blair - Analyst*

That's very helpful. Maybe just follow-up on Rob's question. I mean, can you maybe help us size that third quarter impact? And I know, I'm not trying to pin you guys down on 2025, but it would be good to get a sense of the comp impact we should expect as we think about the \$23 million Air Force order and also the backlog conversion in the first half of the year.

Lee Mcchesney - MSA Safety Inc - Senior Vice President, Chief Financial Officer

So, Ross, let me clarify, too, because we had Air Force orders in the first half of the year for the first tranche. And, obviously, that went through the business and a good portion of Air Force also fell into 3Q, which is really what you're going to see here predominantly in 4Q as we talked to earlier. Just wanted to clarify that for you. So beyond that, I know you'll have healthy growth in the categories I mentioned.

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

Yes. I would say, Ross, you're right. We're going to be comping two straight years of Air Force, right? For 2025, to your point,, but we'll plan to talk more about 2025 as we wrap 2024. What I would suggest is that you think about, and what we stay centered on and we're very comfortable with, is we're fully committed to our 2028 targets we identified during Investor Day. And as we noted, the 2025 comp challenges are there with Air Force. But we're fully committed to what we laid out there for the Investor Day – the margin expansion, certainly the growth and the compounding on EPS.

Ross Sparenblek - William Blair - Analyst

Yes. Okay. And then maybe just for International Fire, do you get the sense that competitors have become more price rational there? Or should we think about that more as volume in the quarter?

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

That's a really interesting question. It's really different by market. China and Asia Pacific are a bit different. So, we've introduced a different product category for SCBAs in the Asian market this year. That's doing really well, but it's matching the needs of the customer base in that area. So, it's a little lower price point, but the M1 is competing really well. A lot of what we're seeing, there's still some of this price-based customer needs, I guess I'd call it, out there, and certainly we understand that. But a lot of the customers really looking to functionality, fit and performance. And when they do an evaluation, it's really nice to see them weigh that a lot more than they do price. So they're looking at total value, which I think we compete very well with.

Ross Sparenblek - William Blair - Analyst

Perfect. And then just one more on Portables. Third quarter is a seasonal low, historically, and double-digit growth, that's obviously showing some signs of acceleration. By our math, there is 5,000-6,000 incremental units, so is the expectation that we're kind of ramping to, maybe, a 20,000 unit run rate?

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

You mean on Portable instruments? Is that what your question is?

Ross Sparenblek - William Blair - Analyst

Yes, Portable Gas Detection.

Steven Blanco - MSA Safety Inc - President, Chief Executive Officer

Okay. So yes, so if you look at Fixed Gas Detection, I think the unit run rate continues to be pretty consistent. Portable gas detection, I think on orders, you may be closer on the order count, but on unit count, it's a magnitude higher than that. What's really nice is what we're seeing on this traditional business, the customer continues to really look at our value prop. So, we talk about accuracy of sensors, durability of the product,

reliability across our portfolio and certainly our service. So, we're winning there and converting business. It's probably a higher rate than we expected on the traditional.

And then, what's happening on the connected portable side is playing out how we thought it would. You think of the growth there more like you would think of a software platform and that's the kind of growth we're actually seeing there. So, we do expect that to continue. Now it is on a low base. It's still under 10% of our overall Portables revenue. And I think that's important to note, which is why we keep these combined, and we'll continue to track that and keep you updated on the progress.

Ross Sparenblek - *William Blair - Analyst*

That is great, thank you guys.

Steven Blanco - *MSA Safety Inc - President, Chief Executive Officer*

Thank you.

Operator

This concludes our question and answer session. I would like to turn the conference back over to Larry De Maria for any closing remarks.

Lawrence T. De Maria - *MSA Safety Inc - Executive Director, Investor Relations*

Thank you. We appreciate you joining the call this morning and for your continued interest in MSA Safety. If you missed a portion of today's call, an audio replay will be made available later today on our Investor Relations website and will be available for the next 90 days. We look forward to updating you on our continued progress again next quarter. The conference has now concluded. Thank you for attending today's presentation.

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