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PRESENTATION

Operator

Good day and welcome to the MSA Third Quarter Earnings Conference Call. (Operator Instructions) It is now my pleasure to introduce your host, Ken Krause, Vice President of Strategic Finance and Treasurer. Please go ahead.

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Thank you, Joe. Good morning, everyone, and welcome to our third quarter earnings conference call for 2015. I'm Ken Krause, Vice President of Strategic Finance and Treasurer for MSA. Joining me on the call this morning are Bill Lambert, Chairman, President, and Chief Executive Officer; Kerry Bove, Senior Vice President, Chief Strategy Officer, and Interim CFO; Nish Vartanian, Senior Vice President and President, MSA Americas; Ron Herring, Senior Vice President and President, MSA International. As you might have noticed, Kerry, Nish, and Ron have new titles since the last time we spoke, and Bill will provide more detail on those changes during his commentary.

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

Before I begin, I need 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 Securities and Exchange Commission, including our most recent Form 10-K, which was filed on February 25, 2015. You are strongly urged to review all such filings for a more detailed discussion of such risks. Our SEC filings can be obtained at no charge at www.sec.gov and on our Investor Relations website.

MSA undertakes no duty to publicly update any forward-looking statements made on this call except as required by law. In addition, we have included certain non-GAAP financial measures as part of our discussion today. These non-GAAP financial measures should not be considered replacements for GAAP results. Reconciliations to the most directly comparable GAAP measures are available on our Investor Relations website at investors.msasafety.com within the Quarterly Results section under the Financial Information header.

And with that, let me introduce MSA's Chairman, President, and Chief Executive Officer, Bill Lambert.



William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Thank you, Ken, and good morning, everyone. As always, I want to begin by saying thank you for joining us this morning and for your continued interest in MSA. Overall, when I look at our third quarter results, I see a few key themes emerging. First, MSA, like so many other global industrials, is fighting the strong headwind produced by a strong U.S. dollar. Second, the energy-related markets continued to contract due to the low price of oil, and employment levels in this space showed deceleration year-over-year. And lastly, we continue to feel the effects of a persistent recession in Brazil and slowing growth in China. However, offsetting these headwinds, we saw the results of our past investments in R&D paying off and in executing our strategy of advancing the core of MSA.

The innovative G1 SCBA is producing exceptional results. Additionally, just yesterday, we closed on the Latchways acquisition, which will double our fall protection sales, and we've made substantial progress on our Europe 2.0 initiative. To offset the economic challenges that I mentioned early on, we've begun executing a restructuring plan aimed at reducing our cost structure by more than \$10 million. Today, I will share more detail with you regarding each of these areas, highlighting the most strategic points of the quarter, and then I'll turn the call over to Kerry Bove and Ken Krause for a more detailed financial review.

Clearly, a positive headline for us in the third quarter was continued strong performance for our new innovative SCBA platform, the G1. Overall, I'm pleased to report that our strategic and organic investments over the past five years in developing the G1 SCBA is yielding strong returns. For the quarter, our sales of breathing apparatus were up 83% in local currency terms driven by an increase of more than 160% in SCBA sales in North America. These results certainly speak for themselves and demonstrate how well the G1 SCBA is being received in the market.

Additionally, I'd like to give you a quick update on where we stand relative to our G1 manufacturing ramp-up activities and our backlog pipeline. During the quarter, we were able to reduce our global SCBA backlog from \$77 million to \$68 million, and we did this with incoming orders that were up 20% on a sequential basis from Q2.

We feel we've really hit our stride in producing G1 SCBAs. As you might conclude from these numbers, we are running three shifts 24/7, and I'm exceptionally pleased to see such great commitment and performance from our operations team, particularly all those working at our Murrysville, Pennsylvania facility. Because of their efforts, we have reached our production goals and are meaningfully working down our backlog while keeping up with a strong incoming order pace.

September was our highest month ever in terms of G1 production, topping June's level by more than 35%. We are steadily working through the sizable backlog and we continue to successfully convert competitive accounts and gain market share with the G1.

While sales to the fire service have been a significant source of strength for MSA throughout the year, we've seen considerable headwinds created by a strong dollar. We've seen weakness in the energy market and weakness in key emerging markets of Brazil and China. Given that these challenges will likely persist for the foreseeable future, we have taken decisive measures to reduce our global cost structure to improve profitability in the face of such headwinds. Within the past month, we completed the first wave of restructuring to reduce headcount and operating costs to better position us to achieve our financial goals.

Restructuring decisions are never easy, but with the macro conditions we are facing and the slower growth we see across emerging market geographies, we're taking decisive action now to create value for our shareholders over the long term. Ken Krause will talk in a moment about the restructuring investments we're making and the SG&A reduction we can expect to realize from this program in 2016.

Shifting gears, I want to give you an update on another important action that will help build MSA's value for shareholders. Of course, I'm talking about our recent acquisition of UK-based Latchways. As you saw in our press release yesterday, we have now closed on the acquisition and we fully expect that the combination of our customer relationships, engineering capabilities, marketing expertise, and global distribution reach will provide great new opportunities for our newly combined organization. This acquisition represents a key step in the execution of our corporate strategy by investing in one of the largest and fastest-growing product segments of the global safety market, estimated to be between \$1.5 billion and \$2 billion and expected to grow in the mid to high single-digits over the next several years.



Latchways, which had sales of about \$50 million for the fiscal year ended March 31, is highly complementary to MSA from a product, market, and geographic standpoint. They are a leader in what is referred to as highly engineered permanent fall arrest systems. In a complementary way, MSA has greater strength in the soft goods space. And by soft goods, I'm referring to textile products such as lanyards, harnesses, and personal fall limiters. We're excited about this deal because Latchways has very strong positions in the utilities, telecommunications, and aircraft maintenance segments, while MSA's fall protection is strong and primarily sold into the construction markets, the oil and gas, and general industrial applications. Lastly, from a geographic standpoint, Latchways has strong market positions in the U.K. and in northern Europe, while MSA's sales of fall protection are weighted towards North and South America. So there are many great synergies we intend to realize from this transaction including the fact that our two companies also represent a great cultural fit.

So from a strategic perspective, we believe this acquisition is down the center of the fairway. From a financial perspective, we expect the transaction to be accretive to earnings in the first full year of ownership, and we also expect to return in excess of our cost of capital by year three. Again, Ken Krause will provide further insight into these expected returns during his review in just a bit.

Overall, the key message I want to leave everyone with this morning is that the Latchways acquisition provides MSA with a very solid foundation for future growth in the highly attractive fall protection market. It makes MSA a stronger competitor in the geographies and the markets that we serve. And needless to say, we look forward to welcoming Latchways to the MSA family and leveraging their strengths to continue building innovative fall protection solutions for our customers.

Moving on to another key value driver, I'd like to give everyone a quick update on our Europe 2.0 program. As many of you know, this initiative was designed to transform the way we conduct business throughout our European region by moving away from a fragmented structure of individually managed affiliates to one featuring a truly pan-European organization enabled by a single IT platform. Additionally, this program included implementation of our principal operating company model, or POC, in order to drive optimal performance by aligning certain strategic planning and decision-making functions into one location based in Switzerland. Structuring the region in this way allows us to derive maximum value from our investment and reinforces the standardized business processes designed throughout Europe 2.0.

Since we last spoke, our team in Europe has continued to make great progress in making this vision a reality. Earlier this year, we spoke about bringing four more European affiliates into our principal operating company model by October. I'm pleased to tell you today, we have accomplished exactly that as Austria, the U.K., Switzerland, and Sweden are now part of the POC model. These go-live events went smoothly with no business disruptions. By January 2016, four more affiliates will come into the POC model.

In past calls, we also told you that our warehouse consolidation efforts were expected to progress throughout the second half of 2015 and conclude by January 2016, and we are on track to accomplish that goal as well.

When we started this project, we had 10 warehouses throughout Western Europe. At Investor Day last year, Ron Herring gave you an update that we had reduced from 10 warehouses to eight at that time, well, as of this month, we are now down to five warehouses with four more closures scheduled in early 2016. So, clearly, we are on track to reach our goal of operating out of a single third-party logistics provider. And we are consolidating to one warehouse, which will reduce overall inventory held throughout Europe and reduce the related management costs. But most importantly, it will enable us to better serve our customers with improved on-time delivery.

While we have more to do, including leveraging SAP modules to drive operational excellence and exploring how we might further implement shared services, the key activities are on schedule to be completed by January 2016, just as we have discussed with you in past calls. All of the programs I've discussed today, advancing the core with organic and inorganic investments, and driving operational excellence with programs like the Europe 2.0 initiative, are the result of focus on our corporate strategy, and executing the key pillars of that strategy, which have proven successful in creating value in the past.

With the headwinds we are seeing throughout much of our business right now, remaining on track with our strategy has never been more important, and that was precisely the thinking behind the realignment of our executive structure, which we recently embarked upon and are working to implement. Overall, this executive realignment will ensure that we are structured appropriately to reach all of our strategic goals.

Allow me to explain. The realignment will involve three specific actions: one, the promotion of Kerry Bove to the newly created position of Senior Vice President and Chief Strategy Officer; two, the promotion of Ron Herring to the newly created position of Senior Vice President and President, MSA International; and three, the promotion of Nish Vartanian to the newly created position of Senior Vice President and President, MSA Americas. Kerry, Ron, and Nish are currently transitioning into their new roles and should be operating full time in these positions by the beginning of 2016.

First and foremost, this new structure allows us to create a dedicated team, under Kerry Bove's leadership, focused exclusively on executing the important deliverables of our MSA corporate strategy. We've never had that position before. But very clearly, as we seek to drive growth throughout our global business. That type of focus is more important than ever. Changing our geographic leadership structure allows Ron Herring and Nish Vartanian, two very experienced and capable business leaders, to focus exclusively on achieving our long-range plans while also developing next-generation executive leadership. Ultimately, and through our ongoing restructuring initiatives, I see this structure fostering more efficient management and more efficient communication throughout our business regions. I'm confident that this new structure will align our resources with our strategic vision and our priorities. And in doing that, our executive leadership team and supporting management will be able to place a keener focus on those areas critical to our success while positioning us for the future as we write that next chapter in MSA's 100-year history.

At this point, I now would like to turn the call over to Kerry Bove, who, in addition to his primary role as Chief Strategy Officer, is temporarily serving quite capably as MSA's interim CFO. After he has finished, I'll provide some closing comments and then we'll open up the call for your questions. Kerry?

Kerry Bove - *MSA Safety Incorporated - SVP, Chief Strategy Officer and Interim CFO*

Thanks, Bill, and good morning, everyone. As you just heard, I am currently transitioning into the newly created role of Chief Strategy Officer, and I'm looking forward to leading our team as we continue to execute around our strategic pillars and to drive value for all our stakeholders.

Bill and the Board of Directors are conducting a robust search for the next CFO of MSA. And during this transitional period, I am serving as the interim CFO. While I will oversee the finance organization and provide the necessary leadership for the team over the next several months, I'm relying on the experienced leaders that we already have in place throughout the finance group to continue guiding the financial health of the organization and to ensure we continue to provide fair and accurate financial reporting.

In that spirit, I will look to Ken Krause, whom you are all most likely familiar with, to take you through the financial results this morning. Ken?

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Thanks, Kerry. As Kerry indicated, I would like to walk you through our third quarter financial results and to provide more insight into the drivers of financial performance. Additional information will be available when we file our Form 10-Q with the Securities and Exchange Commission later today.

Sales from continuing operations in the third quarter were \$274 million, down \$1 million or 1% from the prior year on an as-reported basis, and up 8% on a local currency basis. The headwinds that we saw in the quarter related to the weaker foreign currencies were 9% on revenue.

Earlier this year, we indicated to you that FX headwinds on revenue would be about 5% to 6% for the full year. Since that time, we have seen significant weakening in many of our key currencies, including the Brazilian real, Australian dollar, and Mexican peso. Just in this past quarter, we saw the real depreciate by 22% versus the dollar, the Australian dollar weakened by 9%, and the peso dropped 7%. We now estimate that the FX headwind on revenue for the full year will be closer to 7% to 8%, on some of the more recent weakness we are seeing in emerging markets. This recent weakness will present a challenge to our as-reported results comparison in the fourth quarter.

In the quarter, core product sales increased by 13% on a local currency basis. Results continue to be driven by strong sales into fire service markets. SCBA sales were up 83% and fire helmet sales were up 32%, growth driven by investments we have made and continue to make in R&D. These

improvements were partially offset by portable gas detection, down 13%; and industrial head protection, down 8%, as lower employment levels in the energy market continued to impact demand for these products, particularly in North America.

Looking at FGFD, if you remember, on the last call, we indicated that we faced a challenging comparison in this area for the second half as this same period in 2014 was exceptionally strong, growing over 20% on large order activity. Given this tough comparison and the overall market conditions, we saw a 9% decline in quarterly FGFD sales. Additionally, fall protection revenues were down 2% in the quarter.

Let me take a moment to provide an update on the trends we are seeing and our outlook in these areas moving forward. As we have discussed on past calls, a significant portion of our portable gas detection and industrial head protection sales are tied to employment levels in the oil and gas industry. As we've communicated in past presentations, we estimate the total exposure levels within these products reflect between 10% to 15% of consolidated revenue. During the quarter, we saw continued pressured results in these products. Oil prices remain depressed in the quarter, and we certainly do not see any uptick in energy-related employment levels.

Continuing to look at energy exposure, another 5% to 10% of our consolidated revenue, primarily in the FGFD product line, is more susceptible to a pullback in capital equipment spending. Although FGFD was growing in the high single-digits through the first half, we saw it weakened in the third quarter with a 9% decline on a very challenging prior-year comparison.

While orders have been somewhat choppy in the quarter, we're still seeing healthy interest overseas, notably in the Middle East where the cost of extraction is favorable. Overall, backlog in FGFD is relatively healthy and has increased from the end of the second quarter. However, it is important to note that we had an unusually high volume of large project shipments in the fourth quarter a year ago.

Let's look at emerging markets. Our business in these areas grew at 3% and has grown at 5% for the first nine months of 2015, all on a local currency basis. While we have seen good growth year-to-date, we certainly saw a slower growth environment emerge in the third quarter. As you know, recessionary conditions and economic slowdowns are impacting several key emerging markets. Looking closer at Brazil and China, which now reflect about 3% and 5% of our global business, respectively, both areas were down 7% in the quarter on a local currency basis. While certain emerging market geographies like Mexico are still growing at a healthy clip, we expect overall weakness in emerging markets to persist into 2016.

In light of the weakness we are seeing in emerging markets and across the energy space, we have begun to execute on a significant restructuring program. I'll give you more detail on that in a moment, but first, let's jump back into the quarterly results.

Our gross profit rate for the quarter was 43.8%, a decline of 120 basis points from last year. Sixty basis points of this decrease is related to a less favorable mix. Additionally, we saw a 90-basis-point increase in variances and other indirect charges. Excluding these, we actually saw underlying margins improve across a number of our core product groups as we continue to launch new products, manufacture them efficiently, and price them effectively.

SG&A costs were \$73 million in the quarter, down \$5 million from a year ago. In local currency terms, cost grew 3% on the 8% increase in revenue, providing good operating leverage. The local currency increase in SG&A is primarily associated with higher noncash expense in our defined benefit pension plan as we continue to closely manage headcount and discretionary spending levels.

Our investment in R&D this quarter was just below \$13 million or 4.6% of sales as we continue to innovate around the G1 platform and other areas of the core. Our core sales vitality results, that is the percentage of core sales derived from products developed and launched within the past five years, continues to gain momentum, finishing at over 40% in the quarter, driven by investments we have made in SCBA, portable gas detection, and industrial head protection.

Operating margin in the quarter was 12.6% of sales, up 60 basis points from a year ago on higher sales volume and improved leverage of operating expenses. Below the operating income line, we invested just under \$4 million in restructuring and other charges in the quarter, primarily associated with headcount reductions and activities related to our European restructuring program.

As Bill indicated during his comments, we are operating in a slower growth environment that affects much of our portfolio. To mitigate the challenges from softer end markets and emerging markets, and continue to drive toward our financial targets, we have begun executing on a cost reduction program initially focused on reducing headcount. You're seeing some of this restructuring spend come through in the third quarter, and we expect to invest \$4 million to \$6 million in restructuring in the fourth quarter in connection with these activities. This program is estimated to result in about \$10 million of SG&A cost savings in 2016, and we are focused on identifying further steps we can take in terms of headcount reduction and geographic footprint rationalization to expand on these cost savings and position ourselves to effectively navigate through the challenging end market conditions.

Our effective tax rate this quarter was 37.1%, up from 32.1% a year ago, primarily due to nondeductible losses in certain jurisdictions, coupled with nondeductible acquisition costs incurred for the Latchways transaction. Given these factors, we expect our full year rate to be in the range of 33% to 34%, excluding European exit taxes. With that said, and as you know, our effective tax rate is, and will continue to be, heavily dependent upon the overall geographic mix of profitability.

Net income from continuing operations was \$16 million in the third quarter or \$0.41 per diluted share, down 16% from a year ago. Adjusted earnings were \$22 million or \$0.59 per diluted share, increasing just under 4% from a year ago on an as-reported basis.

Quarterly operating cash flow was \$2 million compared to \$35 million a year ago on weaker results in working capital. We used cash flow and inventory as we continue to plan for increased demand for the G1 SCBA. Additionally, we paid \$17 million in connection with the product liability settlement that we discussed with you on the February call. If you remember, the settlement totaled \$72 million and was substantially all-insured, and we indicated that we would pay it over four quarters beginning in this quarter and ending in the second quarter of 2016.

Our debt balance was just below \$400 million while cash balances approximated \$190 million at the end of the quarter, both elevated to meet the funds certain requirements of the Latchways acquisition. On a net debt basis, our net debt was just over \$200 million, resulting in net debt to adjusted EBITDA of approximately 1.1x and 2.1x on an absolute basis. We expect debt to adjusted EBITDA to approximate 2.5x at year-end, up about 1 turn from the second quarter of this year when we started to execute on this strategic acquisition.

In addition to the compelling rationale, strategic rationale that Bill shared with you, the Latchways acquisition is also attractive from a financial standpoint, with earnings accretion expected in year one and returns in excess of cost of capital by year three. As you'd expect, we are anticipating dilution in 2015 due to the Q4 closing date. We have forecasted about \$6 million to \$7 million of transaction, integration and other acquisition-related costs for 2015, and we have incurred approximately \$1 million of these costs through the end of the third quarter. While we are in the process of finalizing our purchase accounting assumptions for the acquisition, we currently estimate EPS accretion in the range of \$0.05 to \$0.10 per diluted share on a GAAP basis in 2016, the first full year of ownership.

In summary, the quarterly results were driven by higher sales of SCBA as we really hit our stride in ramping up manufacturing of the G1 in the quarter. The order pace and our pipeline of new business in this area remains strong while our backlog is still very healthy, all providing a sense of optimism to close out 2015 and to start 2016. While the fire service market provides strength and is expected to be a source of strength going forward, the stronger U.S. dollar, weaker energy market, and softer conditions in emerging markets like Brazil and China are providing headwinds. We expect these challenges to persist in the near term and are planning for a slower growth environment to extend into 2016.

As a result, we are closely monitoring additional investments and have begun executing on a restructuring program to reduce our cost structure. These programs will help us navigate through the challenging end market conditions while helping us recognize improvements in profitability and operating margins. And while we take actions to manage our cost structure in light of the challenging business conditions, we continue to invest in developing new products and to deploy capital in this low-rate environment while making strategic acquisitions, both of which will help drive long-term value creation for our shareholders.

Bill, back to you.



William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Thank you, Ken. While the G1 backlog remains strong and I'm pleased with our exceptional performance in the fire service market, we are undoubtedly up against a slower growth environment that affects a significant portion of our portfolio. As we continue to plan for 2016 and face the headwinds, including lower commodity prices, strong dollar and weak emerging markets in Brazil and China, we are taking the decisive action to restructure our business and reduce our cost structure while positioning MSA for profitable growth for the future as we continue to make organic investments in new product development and use our strong capital structure for inorganic growth to execute on acquisitions like Latchways.

Thank you for your attention and interest in MSA this morning. At this time, Nish Vartanian and Ron Herring have joined us, and we'll be happy to take any questions that you may have. Please remember that MSA does not give guidance, and that precludes most discussions related to our expectations for future sales and earnings. Having said that, we will now open the call to your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. The floor is now open for questions. [Operator Instructions] Our first question comes from Edward Marshall of Sidoti & Company.

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

Hey, guys. Good morning. So I just wanted to kind of talk about the cost takeout, the \$4 million to \$6 million. You mentioned headcount, you mentioned structural. How much is, how much of that is going to headcount? How much of that is going to structural? And I guess maybe if you can put it in the context of the \$10 million you expect, this \$10 million savings that you expect.

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Ken, I'll look to you. Maybe you can provide some context around that. And Ed, maybe you can better define structural. What do you mean by structural?

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

Well, you're taking out -- you're closing facilities, closing warehouses. How do I look at that number, if you could kind of break that down?

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

So, yes, Bill had spoke about in his comments about the European program with closing warehouses and so forth. This additional restructuring program that we're talking about now with an estimated cost savings of \$10 million in 2016 is predominantly related to optimizing our headcount. We are also looking at our geographic footprint, but a significant part of the savings that we're targeting is headcount and discretionary spending levels.

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

Got it. Okay, so pretty much all headcount then. And nothing in Europe? I mean this is emerging markets. I mean I understand a lot of the energy assets are in Europe. Are you planning on cutting there? I mean I know it's kind of hard to take the cost out, so.



William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Yes. The cost reduction programs that we've talked about here in this call is globally, across all entities within MSA. So not just in the Americas, but also in Europe, and then in the international emerging markets as well. So we are looking at all of those areas and removing the costs where we don't see a strengthening future here, but protecting those assets, people and otherwise, that are a part of our future and our strategic growth plan going forward. But it's all areas, Ed. It's not just one particular or two particular areas.

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

Okay. So if I look at the 9% headwind in currency, and I know that's the impact to sales, I'm wondering if you could kind of help us quantify from the, for a maybe an EPS or earnings perspective, what currency did to the model. And secondly, I'm wondering if you're facing increased competition from the dollar or is this more of just the translation effects that's running through the P&L.

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Ken, I'll let you answer that.

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

So the currency headwind is certainly presenting us challenges throughout our P&L. We do have natural hedges in place as we've talked about from time to time where we manufacture in Europe and we manufacture in Brazil. We manufacture in many of these locations, but we certainly are seeing some cross currency exposure with some sourcing that we do across the footprint. So it's hard to quickly identify the total amount of headwind that we are seeing, but we are certainly seeing -- we're seeing considerable headwind on the FX line throughout the entire P&L, Ed.

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

Okay. Can you quantify an EPS or an earnings impact from (Multiple Speakers)

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

I'd be reluctant at this point to quantify that earnings impact for you, Ed. I could tell you, like we said, we said a number of times, we do have a strategy in place, a manufacturing strategy that helps mitigate the exposure, but we also are realistic in knowing that there is some cross currency exposure there, and we do see it from time to time.

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

Okay. And of the \$0.05 to \$0.10 on a GAAP basis that you expect to see from Latchways, I'm curious, when you say GAAP, I'm assuming you're talking about the inventory write-ups and such?

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Yes, that's right. On a GAAP basis, when we look at our -- and include a lot of the things we have to do from an accounting perspective, that's right.

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

Are there additional due diligence expense or legal expenses with this acquisition? Or does that all hit during 3Q and maybe a trickle in 4Q?

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

I think what we said in my comments, Ed, was that we expect something like \$5 million to \$6 million of acquisition-related costs in the fourth quarter. And so we certainly did see some due diligence cost in the third quarter and some legal-related costs. We still expect integration-related and acquisition-related cost of somewhere between \$5 million and \$6 million in the fourth quarter.

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

Did you break out those due diligence expense in the reconciliation table?

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Yes. In the adjusted earnings reconciliation, we broke out what we incurred in the quarter. We did do that, Ed.

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

Okay. And you'll continue -- Oh I see it here, \$707 thousand. And you'll continue do that on a go-forward basis, I assume?

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Yes, that's right, Ed. That's our plan.

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

Perfect. Thanks, guys.

Operator

Our next question is coming from Walter Liptak of Seaport Global.

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

All right. Good morning. So a nice quarter. I wanted to ask first a follow-on to the first question. Just in China and Brazil, I wonder if -- especially in China, we're hearing a lot of mixed things, mostly mix negative. What you saw sequentially maybe on a monthly basis or from last quarter, and I don't typically think of your products as being real capital goods-oriented, and that seems where most of the slowing in China is happening. Hopefully, you can give some color there.

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Sure. I mean I can provide some color if I understand your question appropriately, Walt. Year-to-date, local currency growth in China has been low single digits. But during the third quarter I think, as Ken mentioned, our sales were off 7%, I believe it was. Is that right, Ken?

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Yes, that's right.

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

And I think that we and other industrials expect slower growth environment, the slower growth environment in China to persist into 2016. Our incoming order pace has been a little bit choppy there. But I think that the published growth rates for China's economy still exceeds that of most economies. But our outlook, based on what we saw in the third quarter, based on what we're seeing currently, is a little cautious for China. And so, we are very carefully monitoring the additional investments we're making there, the discretionary spending, and we have part of our cost reduction and headcount reduction program is in China.

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

Okay, I understand. Thank you. So the question I have is on the run rate for SCBA. It sounds like you ramped it and it's a nice production line that's hopefully getting more efficient. But I wonder if we can get a little bit more detail about the units per day that are getting produced now versus what they were maybe last quarter or maybe a metric like on lead times. How long is it taking at this point from an order to a shipment, and has that improved?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Well, I won't give you the specifics on what our output is on a per day basis, Walt. But I will tell you that our order lead time has come down, has not extended out at all. And in fact, orders placed today would be shipped likely by the end of the year. So we're meaningfully cutting into that backlog with the production rates that we have achieved. And our incoming order pace is strong, and I would expect that -- we would expect that the G1 will, for the coming quarters, continue to be a source of strength for MSA.

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

Okay. How are you thinking about the profitability? Are you at kind of corporate margins yet with the SCBA line, the new G1? Or is there still cost takeout that you have to do efficiencies to get on the line?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Well, I think that as we've talked about in the past calls, the SCBA line, out of our six core product areas, the SCBA line is at the lower end of some of those gross margins that we look to. The G1 has had certain production efficiency issues as we have ramped up production, but we see ourselves working our way through that, and we see the gross margins returning to that more normalized corporate average. And so I don't have any grave concern there. But year-to-date, certainly as we have ramped up and we needed to add overtime and we needed to take certain measures and steps to work down that backlog and meet demand, it's a little bit on the low side of our gross margin profitability but I have no concerns going forward.

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

All right. Sounds good. And then switching to the Latchways acquisition, I wonder about the growth. You mentioned what the market was expected to grow. I wonder if we can get the data points on the last six months. And are you experiencing that high-single-digit growth that you're expecting the market to grow in?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Well, we certainly are expecting that high single digit growth in the market. In fact, we expect a bit more than that as we think there's opportunity for us to take share on a global basis. And as far as the details of how they performed over the last six months, we just closed on the acquisition

yesterday. So I think it's a little bit early for us to be disclosing that. But over time, we'll certainly be releasing that information of how they've performed, what we see happening from the Latchways acquisition and how we do for the full year this year.

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

Okay. Well, you gave us a revenue number on Latchways, and obviously there's public documents out there. But what kind of EBITDA are you expecting for 2016?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

What kind of EBITDA? Are you referring --

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

Oh I mean, you know, I wonder if you could --

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

from Latchways?

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

Yes. The question is what EBITDA are you forecasting for Latchways over the next 12 months or in 2016?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Yes, well, Walt, I appreciate your attempt here at guidance, but we're pretty good about not doing that, not providing that. Let me just say this to you. You're right. The Latchways financial data is public information, and you can track its performance over the past few years.

The past couple of years have been a tough time for Latchways. We believe they're in a trough. We believe we fully understand why they entered a trough, and we also believe based on everything that we had seen through our due diligence that they were coming out of that trough. And their performance was going to be strong, stronger than it was last fiscal year. That's all good. But during that trough, their operating margins were running around 14% to 14.5%. So even with the headwinds that they experienced and even with them being in a trough, their operating margins would have been accretive to MSA's operating margins. If you look at where Latchways was during their peak, they had 24% roughly operating margins. So it's a highly profitable segment within fall protection. We're excited to have it as part of our family, and we think it will certainly be accretive to our margins going forward.

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

Okay. Okay, sounds good. I've got a few more questions regarding Latchways but we can take those offline. I guess the last question I've got is on -- the foreign currency gain was a little bit larger than we expected at the \$4.3 million. And I wonder if there was something transactional, like there was a -- if there was a transactional event that occurred during the quarter and what we should expect from foreign currency, that line item in your income statement in the fourth quarter.

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Yes. So Ed -- or I'm sorry, Walt, the FX loss, you're right, is about \$4 million. There are a couple of components there that drove that. One was related to some inter -- they're all intercompany, predominantly noncash expenses, first and foremost. Secondly, the noncash expense that was driven in the quarter was related to intercompany activity in Brazil, where the currency weakened so considerably, some intercompany activity in emerging parts of Europe and then also a little bit of exposure as we were managing and optimizing the capital structure for the Latchways acquisition. We would hope, though, obviously that, that would come down going into the future. We have done a pretty good job over the last one to two years at managing that down. It's just in the quarter we had such a considerable weakening in certain geographies that drove that to a higher number.

Walter Liptak - *Seaport Global Securities, LLC - Analyst*

Okay. Okay, thank you very much.

Operator

Our next question is from Richard Eastman of Robert W. Baird. Please go ahead.

Richard Eastman - *Robert W. Baird & Co. - Analyst*

Yes, good morning. Can I ask on the energy side of the business. Bill, you kind of gave some color there on expectations. But I'm curious, the head protection and portable gas -- in this quarter, head protection was down 8% in LC, and portable gas, down 13%. But, again, the understanding there is that only half of those businesses in terms of revenue is actually energy-related. So I'm curious, is the order of magnitude here 2x what you're reflecting on the energy side? The other half of those two businesses that goes to more general industrial, were they up in the quarter? Or are you seeing softness there as well? (Multiple Speakers)

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Rick, I'm not sure I fully understood your question, but let me try to answer it the way I heard it. In the energy sector, the turnaround activity in plants and in the Gulf Coast region and the rig count here in North America, we understand and can clearly see how employment levels have dropped quite considerably there. And that affects, those turnarounds, the fact that there aren't the turnarounds happening, with refineries having low feedstock, they're running their refineries all out; probably the lowest number of turnarounds in the last seven to eight years this fall, which is dramatic, which has been dramatic. And so with those employment levels off, we see that directly impacting then how many hardhats we sell and how many portable instruments we sell into that market segment.

Quite honestly, the employment levels have gone down there much further than what our sales have decreased. And where have we made up in sales is in other industries like utilities that -- and commercial construction that have offset some of that steep, steep decline in the energy sector. So we're seeing some benefits in some areas. But to say, has general industry really picked up or been strong? Our channel partners that rely on general industry would say, no, it hasn't, that it's still a pretty tough environment out there from an employment perspective, and general industry, energy sector being hurt the most.

Richard Eastman - *Robert W. Baird & Co. - Analyst*

We tend to look at the Graingers, MSC Industrial, to a lesser extent, Fastenal, kind of those short-term distributors, and they've obviously seen their growth rates slow. So I would presume that the other half of head protection and the portable gas protection business, the industrial side of that is up, but again, maybe slowing as well. Is that a fair representation maybe?



William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Well, I think it's a fair representation. I mean we're obviously very close to those distributors and channel partners that you mentioned, and they react very, very quickly on items like hardhats and portable instruments to pull back their inventories and to slow down their orders as they keep pace with what they see happening to end markets.

Richard Eastman - *Robert W. Baird & Co. - Analyst*

I see, okay. All right, that's good color. And then the fixed gas and flame piece of energy, I understand the tough comp here in the third quarter. You have an equally tough comp in the fourth quarter, but it sounds like the backlog is flattening out or maybe the revenue line is flattening out, but how do you perceive that business trending towards the end of the year and into '16, because obviously we'll have tough comps in the first half of '16 then? But is it your general sense that, that fixed gas and flame business, as it's more midstream and downstream, is more flattening out? Or is there some downside in the revenue contribution from that business as we go forward over the next four quarters?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Well, I certainly think there's some risk there that needs to be considered. But just as we characterized it, we've been surprised, to a certain extent, on the strength in the FGFD, especially in the international markets. The FGFD business internationally, not looking at North America, but rather looking at it outside of North America, has actually been a bit stronger this year than what we had expected it to be. So we're running just about where we were last year.

What we have seen, which gives us a little bit of caution, is some of those orders that are in the pipeline, some of that backlog that Ken referred to in his comments, the shipment of the backlog is being pushed out into 2016. Projects are slowing down a bit and so the release of the FGFD instruments that we have are getting pushed out into 2016. The comp in Q3 was difficult and the comp in Q4 will be difficult as well. Last year fourth quarter, as you know, it was a record quarter for MSA, and we had very, very strong sales in the fourth quarter last year and a lot of that was driven by FGFD shipments. We're not seeing that same ability in this fourth quarter for this year.

Richard Eastman - *Robert W. Baird & Co. - Analyst*

Okay, all right. And then I want to just switch over to the G1 here and the SCBA business. Again, nice order quarter, it sounds like, sequentially. So that's being maintained. There's two, maybe two dynamics that I just want to explore for a second. First of all, when we see the growth rate here and we see the success you've had to date with the G1 in North America, is it your sense -- and can you tightly or closely track how much is share gain versus kind of replace -- replacing your own installed base there? Do you have some color on that?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

We do, Rick. Now that color is a little bit lagged in the sense of the official statistics because the International Safety Equipment Association, of which we are a member and our competitors are members of, they report what their sales are. Now we'll see that a quarter after a quarter closes, but we could clearly see that we had gained share in the second quarter with SCBA. And then we have our own statistics that we track, competitive conversions, internally. And we believe that, in fact, we are converting and gaining market share with the G1.

So we feel pretty confident about that. The statistics that we would cite or quote are going to be lagged somewhat because of -- we rely on the ISEA data, but there's every indication that we've got a good handle on what we're getting and how we're converting and what our conversion rates are.

Richard Eastman - *Robert W. Baird & Co. - Analyst*

And would you expect, as we push into the late fourth quarter and into the first quarter, I think back to when we got EU approval for the G1, and I know there's a different situation there. There's no replacement cycle going on, but would you expect to see a bump in the business, a noticeable bump in the business? And are you taking any orders now for the EU?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Ron, I'll look to you on that answer and the G1. I mean it's part of the product line now, and I know we've got certain orders going into the Middle East, right? Maybe you can provide some more color on the G1 and what we've done since introducing it at Interschutz.

Ronald Herring - *MSA Safety Incorporated - SVP and President, MSA International*

Sure. Yes, the price points in the EU tend to be a little bit different than in the U.S., but there surely is a higher-end opportunity here with the G1 and that's where we're targeting it. So, we'll see -- it gives us another line in the product here for our supplied air respirators into the fire service.

We've had some success in the Middle East with some large conversions there. And there are other areas that respect an NFPA-compliant device that we can actually sell this product to in other areas of the international organization and sell through the manufacturing that we have in Europe.

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

So it's still a little bit early in Europe and in international markets. Primarily the G1 activity that we're seeing is really being driven by the U.S. market, North American market. But we have had success in Chile and selling the unit now down and winning accounts down in Chile.

Richard Eastman - *Robert W. Baird & Co. - Analyst*

Okay, all right. And then just two quick questions, sorry. First, so I guess from Ken's comments, we got a fourth quarter charge in the \$4 million to \$6 million range for the restructuring. We got another \$5 million to \$6 million from Latchways and costs associated with that, and I presume that's like purchase accounting cost? But all of that will basically be adjusted out in the EPS number, correct, or at least be shown?

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Yes, that's right, Rick. We'll certainly put that into our reconciliation of earnings.

Richard Eastman - *Robert W. Baird & Co. - Analyst*

Yes. And then just the final question here. When I look at this legal settlement, and I know we agreed to all that back at the end of December of last year, but I just have a question around the strategy there. I mean we know that's a -- or we've been assured, I guess, that, that's covered by insurance. But the insurance receivable, I think, is -- at the end of the second quarter was up to about \$220 million. And I'm curious what conversations have you had in the insurance companies that we can start to see some reimbursement at a better rate? And that's one thing to settle them, and I understand why, but isn't there anything we can do here to accelerate the cash flow on the insurance receivable if everybody is in agreement here that we should be settling these?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Well, I think you just said the magic words. Not everybody is in agreement. So it's a pretty complex matter but fully disclosed in our K and our Q. As we discussed, the litigation, the ongoing litigation activities between our insurance carriers and MSA, we feel, and our auditors agree with us,



that, that receivable is fully collectible. But the insurance companies are being quite resistant in paying that. And we are -- we continue to litigate with them. We've got a trial date set for early next year, but it's a fight. So, Rick, there's nothing I would like more than to see some of that \$220 million being recovered and flowing back into MSA. But --

Richard Eastman - *Robert W. Baird & Co. - Analyst*

No, I understand. I just thought that it's a little bit curious in terms of the strategy that there's -- obviously, it's perceived internally at MSA that settling these and accelerating the settlements and reducing the number of claims is preferred over the insurance company managing the cash flow and settling them themselves, but I guess that's more of a point. Okay. And congrats to Kerry, Nish, and to Ron.

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Thanks, Rick.

Operator

Our next question is coming from Rudy Hokanson of Barrington Research.

Rudolf Hokanson - *Barrington Research - Analyst*

Thank you, A couple of questions. One, could you give a little more color on what you're seeing in terms of European activity? I know that you're giving a pretty clear outline of what's happening with Europe 2.0 in terms of the warehouses, et cetera. But what about the actual sales or demand on products right now that you're seeing?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Yes, let me provide some color there and then I'll turn it over to Ron to add anything to that. During the quarter, we saw sales volumes decline and that was primarily related to lower shipments of ballistic helmets against that contract that we have for the French military. We have talked about that before. And as that contract begins to wind down, we're seeing less shipments of ballistic helmets, which, as you know, is a noncore product line for us. Secondly, the strong dollar created unfavorable variances on the products that Europe imports from the U.S. So we saw that in the gross profit line causing a significant swing in margins from a year ago for Europe. And lastly, we also saw some higher levels of SG&A related to pension expense on the German plan. Ken talked about that in his call, in his comments, but we also saw some increased payroll costs compared to a year ago related to the Swiss operating model and increased project spending as we readied for the October SAP implementations under Europe 2.0.

So all told, a number of factors tended to collide to cause that net loss in the quarter. But our sales in Europe remain healthy and at expectations. And I don't see a great concern developing in Western Europe for us especially in our core areas of the business.

Ronald Herring - *MSA Safety Incorporated - SVP and President, MSA International*

Yes, the only thing I'd add there, too, Bill, is -- and if you look at the nine months' period, Rudy, our core business, excluding some of the noncore ballistic helmet business, is in that low single-digit, 3% local currency growth. So that's about what we've talked about in the past, and as we all know, Europe's economies are just not growing as fast as we'd like. And so a low single-digit growth is pretty good growth for us coming out of Europe.



Rudolf Hokanson - *Barrington Research - Analyst*

And again, under Europe, what regions are included in that?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Under Europe, you mean the as-reported earnings of Europe?

Rudolf Hokanson - *Barrington Research - Analyst*

I'm just saying geographically. Yes, geographically, when you look at Europe, outside of Western Europe, Eastern Europe, I'm trying to remember if there are any parts of the Middle East or not under there.

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

There is. We do include the Middle East and India and Russia in our definition as-reported earnings for Europe.

Rudolf Hokanson - *Barrington Research - Analyst*

Okay, thank you. And then the other question going back to the energy side and again realizing what you were saying or recognizing what you're saying earlier, Bill, about refining turnarounds and that while they're not dependent upon drilling activity, they also have been soft in terms of employment numbers, et cetera. But as you look at energy as a whole historically, are there any thoughts as to the strategic either placement of those products or what to consider in terms of the future growth of what has been called energy? I mean I'm being rather general here, but I'm thinking you've got a lot invested in the energy sector. And depending on your outlook for that sector, even in the short term, the question is how do you position that? I mean how do you look at that going forward? Could you maybe talk a little bit more about that right now?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Sure. Well, I think that we take a long view in the energy sector and the energy market, and so we have positioned ourselves for that longer view. Certainly, the energy sector and certainly the oil and gas market has gone through cycles in the past, where there are peaks and there are valleys, employment rises rapidly and employment decreases rapidly based on the price of oil. But over time, consumption of oil continues to go up on a global basis, which means production of oil needs to go up, and we believe in that. And while this is a short-term and short may be one to two years, but it's a short-term downturn, we believe longer term in the energy sector, and we believe that safety awareness and improved safety on those offshore rigs or on those onshore rigs and within the refining downstream activities, that safety awareness and concern will only increase and we're positioning ourselves for that future growth.

Rudolf Hokanson - *Barrington Research - Analyst*

Is there anything you'd be doing geographically right now, given what's been happening in North America and what apparently is being planned in the Middle East in terms of growth?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Well, we are investing in the Middle East. The Middle East does not have the same outlook currently that the U.S. does, that North America does as far as activity and employment levels go. And so we are investing in our sales and marketing resources within the Middle East to strengthen our position further in oil and gas there. But in other markets of the world, Brazil, for instance, with all that we've read about regarding Petrobras and some of the concerns that have been aired there this year, we're slowing down our investment or we're actually pulling back a little bit there

because that seems like it's going to be on a longer trajectory before it really gets to where it needs to get to. So it's very dependent -- our investments and our restructuring activities are very dependent on what we're seeing happening in those particular markets.

Rudolf Hokanson - *Barrington Research - Analyst*

Okay. Those are my questions for now. Thank you.

Operator

Our last question is coming from Stanley Elliott of Stifel.

Stanley Elliott - *Stifel, Nicolaus & Company - Analyst*

Hey, guys, good morning. Thank you for fitting me in. A quick question on the Europe business and the margins. You talked about kind of the one-time sort of items or issues in the quarter. Is it still realistic to think that, that business can hit a double-digit EBIT sometime into next year, given kind of the exposure to the Middle East and things of that nature?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Yes. I think that, that certainly is a little bit more challenging. I'm not sure on what we have said in the past in that regard on what our targets are for Europe, in particular. The Middle East is not really the issue, Stanley. It's really the other parts, the slower growth elements of Europe that would probably, might cause us to pause for thought and as the rest of the world slows down, as China slows down, and how that impacts those exporting countries within the European market. It's not really the Middle East. The Middle East, we continue to have a very favorable outlook for and see great growth potential.

Stanley Elliott - *Stifel, Nicolaus & Company - Analyst*

And then when we think about kind of moving to the single warehouse, could you help us what that does from an inventory level, cash flows, days of inventory, however you guys want to think about it as we try to model out for next year?

William Lambert - *MSA Safety Incorporated - Chairman, CEO, and President*

Well, it certainly improves in each of those areas. Ken, I'll look to you for any specifics you might be able to provide.

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

Yes, I don't think that we're going to provide specifics on the European segment necessarily and their improvement in terms of working capital. What I would like to do is maybe step back and look at MSA overall. If you look at MSA in the quarter and for the first nine months, we certainly have had a challenging environment as we've seen a significant part of our business grow at a very rapid pace. But as we think about the next two, three, four quarters, we certainly think that we will continue to see improvements in cash flow, just as we have over the long term. And over the long term, with our free cash flow conversion being well over 80%, 70%-80%, we certainly expect to continue to cash flow and continue to drive improvements in cash flow, helping us maintain this very balanced approach to capital allocation.



Stanley Elliott - *Stifel, Nicolaus & Company - Analyst*

That was my point. My expectations would be that cash flow would actually accelerate for you guys, given the behind-the-scene changes that you're making. So that's all I had, so thank you very much.

Operator

There are no further questions in the queue at this time.

Ken Krause - *MSA Safety Incorporated - VP, Strategic Finance and Treasurer*

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

Operator

Ladies and gentlemen, on behalf of MSA, we'd like to thank you for your participation. You may now disconnect, and have a wonderful day.

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