

MINE SAFETY APPLIANCES CO  
Form 10-Q  
July 28, 2008

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarter ended June 30, 2008

Commission File No. 1-15579

# MINE SAFETY APPLIANCES COMPANY

(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

121 Gamma Drive

**25-0668780**  
(IRS Employer  
Identification No.)

15238

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**RIDC Industrial Park**

**O Hara Township**

**Pittsburgh, Pennsylvania**

(Address of principal executive offices)

(Zip Code)

**Registrant's telephone number, including area code: (412) 967-3000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller

Smaller reporting company

reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

On July 25, 2008, there were 35,782,366 shares of common stock outstanding, not including 2,386,889 shares held by the Mine Safety Appliances Company Stock Compensation Trust.

**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****MINE SAFETY APPLIANCES COMPANY****CONDENSED CONSOLIDATED STATEMENT OF INCOME**

(In thousands, except per share amounts)

Unaudited

|                                     | Three Months Ended<br>June 30 |            | Six Months Ended<br>June 30 |            |
|-------------------------------------|-------------------------------|------------|-----------------------------|------------|
|                                     | 2008                          | 2007       | 2008                        | 2007       |
| Net sales                           | \$ 293,162                    | \$ 249,099 | \$ 559,506                  | \$ 475,038 |
| Other income                        | 1,492                         | 1,063      | 2,408                       | 1,464      |
|                                     | 294,654                       | 250,162    | 561,914                     | 476,502    |
| Costs and expenses                  |                               |            |                             |            |
| Cost of products sold               | 181,573                       | 155,303    | 341,565                     | 292,073    |
| Selling, general and administrative | 68,919                        | 58,777     | 135,013                     | 115,349    |
| Research and development            | 9,202                         | 6,787      | 16,554                      | 12,714     |
| Restructuring and other charges     | 1,125                         | 2,261      | 2,231                       | 2,495      |
| Interest                            | 2,281                         | 2,232      | 4,775                       | 4,225      |
| Currency exchange (gains) losses    | (76)                          | (1,469)    | 4,018                       | (1,236)    |
|                                     | 263,024                       | 223,891    | 504,156                     | 425,620    |
| Income before income taxes          | 31,630                        | 26,271     | 57,758                      | 50,882     |
| Provision for income taxes          | 11,676                        | 8,943      | 21,777                      | 17,486     |
| Net income                          | 19,954                        | 17,328     | 35,981                      | 33,396     |
| Basic earnings per common share     | \$ 0.56                       | \$ 0.49    | \$ 1.01                     | \$ 0.93    |
| Diluted earnings per common share   | \$ 0.55                       | \$ 0.48    | \$ 1.00                     | \$ 0.92    |
| Dividends per common share          | \$ 0.24                       | \$ 0.22    | \$ 0.46                     | \$ 0.40    |

See notes to condensed consolidated financial statements.

**MINE SAFETY APPLIANCES COMPANY**  
**CONDENSED CONSOLIDATED BALANCE SHEET**

(In thousands, except share amounts)

Unaudited

|  | June 30<br>2008 | December 31<br>2007 |
|--|-----------------|---------------------|
| <b>Assets</b>  |                 |                     |
| Current assets   |                 |                     |
| Cash and cash equivalents  | \$ 67,009       | \$ 74,981           |
| Trade receivables, less allowance for doubtful accounts of \$6,219 and \$6,558   | 220,800         | 205,737             |
| Inventories  | 183,052         | 155,332             |
| Deferred tax assets  | 23,431          | 21,821              |
| Prepaid expenses and other current assets  | 43,220          | 39,179              |
| Total current assets   | 537,512         | 497,050             |
| Property, less accumulated depreciation of \$290,787 and \$276,583   |                 |                     |
| Property, less accumulated depreciation of \$290,787 and \$276,583   | 140,267         | 130,445             |
| Prepaid pension cost   | 220,309         | 212,304             |
| Deferred tax assets  | 25,959          | 24,125              |
| Goodwill   | 86,868          | 87,011              |
| Other noncurrent assets  | 76,333          | 65,371              |
| Total  | 1,087,248       | 1,016,306           |
| <b>Liabilities and Shareholders Equity</b>   |                 |                     |
| Current liabilities  |                 |                     |
| Notes payable and current portion of long-term debt  | \$ 70,283       | \$ 54,676           |
| Accounts payable   | 55,861          | 50,648              |
| Employees compensation   | 28,919          | 24,920              |
| Insurance and product liability  | 18,214          | 15,192              |
| Taxes on income  | 7,759           | 7,199               |
| Other current liabilities  | 56,285          | 56,554              |
| Total current liabilities  | 237,321         | 209,189             |
| Long-term debt   |                 |                     |
| Long-term debt   | 103,289         | 103,726             |
| Pensions and other employee benefits   | 134,148         | 126,790             |
| Deferred tax liabilities   | 100,899         | 100,934             |
| Other noncurrent liabilities   | 12,339          | 13,129              |
| Total liabilities  | 587,996         | 553,768             |
| Minority interests   |                 |                     |
| Minority interests   | 844             | 1,007               |
| Shareholders equity  |                 |                     |
| Preferred stock, 4 1/2% cumulative authorized 100,000 shares of \$50 par value, issued 71,373 and 71,373 shares, callable at \$52.50 per share     | 3,569           | 3,569               |
| Second cumulative preferred voting stock authorized 1,000,000 shares of \$10 par value; none issued  |                 |                     |
| Common stock authorized 180,000,000 shares of no par value; issued 62,081,391 and 62,081,391 shares (outstanding 35,782,366 and 35,661,776 shares) | 67,453          | 63,303              |
| Stock compensation trust 2,386,889 and 2,530,206 shares  | (12,461)        | (13,208)            |

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|   |           |           |
|---|-----------|-----------|
| Treasury shares, at cost:               |           |           |
| Preferred 52,853 and 52,841 shares      | (1,751)   | (1,750)   |
| Common 23,912,136 and 23,889,409 shares | (255,971) | (255,096) |
| Accumulated other comprehensive income  | 49,564    | 36,233    |
| Retained earnings                       | 648,005   | 628,480   |
| <br>                                    |           |           |
| Total shareholders equity               | 498,408   | 461,531   |
| <br>                                    |           |           |
| Total                                   | 1,087,248 | 1,016,306 |

See notes to condensed consolidated financial statements.

## MINE SAFETY APPLIANCES COMPANY

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(In thousands)

Unaudited

|  | Six Months Ended<br>June 30 |                 |
|--|-----------------------------|-----------------|
|  | 2008                        | 2007            |
| <b>Operating Activities</b>                                  |                             |                 |
| Net income   | \$ 35,981                   | \$ 33,396       |
| Depreciation and amortization                                | 13,857                      | 12,085          |
| Pensions   | (4,475)                     | (2,232)         |
| Net gain on sale of investments and assets                   | (674)                       | (366)           |
| Stock-based compensation                                     | 3,444                       | 3,311           |
| Deferred income taxes  | (1,586)                     | (153)           |
| Other noncurrent assets and liabilities                      | (14,189)                    | (10,616)        |
| Currency exchange losses (gains)                             | 4,018                       | (1,236)         |
| Other, net   | (71)                        | 1,832           |
| <b>Operating cash flow before changes in working capital</b> | <b>36,305</b>               | <b>36,021</b>   |
| Trade receivables  | (10,743)                    | (14,380)        |
| Inventories  | (22,430)                    | (6,681)         |
| Accounts payable and accrued liabilities                     | 8,463                       | 6,960           |
| Prepays and other current assets                             | (3,103)                     | (4,337)         |
| <b>Increase in working capital</b>                           | <b>(27,813)</b>             | <b>(18,438)</b> |
| <b>Cash flow from operating activities</b>                   | <b>8,492</b>                | <b>17,583</b>   |
| <b>Investing Activities</b>                                  |                             |                 |
| Property additions   | (19,582)                    | (13,488)        |
| Property disposals   | 1,230                       | 675             |
| Acquisitions, net of cash acquired and other investing       | (379)                       | (6,771)         |
| <b>Cash flow from investing activities</b>                   | <b>(18,731)</b>             | <b>(19,584)</b> |
| <b>Financing Activities</b>                                  |                             |                 |
| Proceeds from (payments on) short-term debt, net             | 15,022                      | 30,002          |
| Cash dividends   | (16,456)                    | (14,395)        |
| Company stock purchases                                      | (875)                       | (15,591)        |
| Exercise of stock options                                    | 601                         | 858             |
| Excess tax benefit related to stock plans                    | 852                         | 574             |
| <b>Cash flow from financing activities</b>                   | <b>(856)</b>                | <b>1,448</b>    |
| <b>Effect of exchange rate changes on cash</b>               | <b>3,123</b>                | <b>961</b>      |
| <b>(Decrease) increase in cash and cash equivalents</b>      | <b>(7,972)</b>              | <b>408</b>      |
| <b>Beginning cash and cash equivalents</b>                   | <b>74,981</b>               | <b>61,296</b>   |
| <b>Ending cash and cash equivalents</b>                      | <b>67,009</b>               | <b>61,704</b>   |

See notes to condensed consolidated financial statements.

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**MINE SAFETY APPLIANCES COMPANY**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Unaudited

**(1) Basis of Presentation**

We have prepared the condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the rules and regulations for reporting on Form 10-Q. Accordingly, they do not include certain information and disclosures required for comprehensive financial statements.

The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The other information in these financial statements is unaudited; however, we believe that all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of these interim periods have been included. The results for interim periods are not necessarily indicative of the results to be expected for the full year.

The condensed consolidated financial statements include the accounts of the company and all subsidiaries. Intercompany accounts and transactions have been eliminated.

Certain prior year amounts have been reclassified to conform with the current year presentation.

Management's Discussion and Analysis of Financial Condition and Results of Operations that is included elsewhere in this report contains additional information about our results of operations and financial position and should be read in conjunction with these notes.

**(2) Restructuring and Other Charges**

During the three and six month periods ended June 30, 2008, we recorded charges of \$1.1 million (\$0.7 million after tax) and \$2.2 million (\$1.4 million after tax), respectively. These charges for the six months ended June 30, 2008 included \$1.7 million in North America, primarily related to stay bonuses and other costs associated with our Project Magellan initiative to outsource or transfer certain production activities from our Evans City, Pennsylvania plant. International segment charges of \$0.5 million were severance costs related to staff reductions associated with our strategic initiative to improve our business in Japan.

During the three and six month periods ended June 30, 2007, we recorded charges of \$2.3 million (\$1.5 million after tax) and \$2.5 million (\$1.6 million after tax), respectively. The charges for the six months ended June 30, 2007 were primarily related to reorganization activities. In Europe, charges of \$1.0 million related to the reorganization of our management team. North American charges of \$1.0 million were primarily stay bonuses related to moving fire helmet manufacturing from Clifton, New Jersey to Jacksonville, North Carolina and moving our Mexican manufacturing operations to a new factory in Queretaro, Mexico. The Clifton Plant closed during 2007. International charges of \$0.5 million related to severance costs associated with workforce reductions in Brazil and Australia.

**(3) Comprehensive Income**

Components of comprehensive income are as follows:

| (In thousands)   | Three Months Ended<br>June 30 |           | Six Months Ended<br>June 30 |           |
|--|-------------------------------|-----------|-----------------------------|-----------|
|  | 2008                          | 2007      | 2008                        | 2007      |
| Net income   | \$ 19,954                     | \$ 17,328 | \$ 35,981                   | \$ 33,396 |
| Cumulative translation adjustments                     | 2,046                         | 2,364     | 13,331                      | 3,271     |
| Pension and other benefit plan adjustments, net of tax |                               | (96)      |                             | 188       |
| Comprehensive income                                   | 22,000                        | 19,596    | 49,312                      | 36,855    |





Components of accumulated other comprehensive income are as follows:

| (In thousands)                               | June 30<br>2008 | December 31<br>2007 |
|--|-----------------|---------------------|
| Cumulative translation adjustments           | \$ 32,817       | \$ 19,486           |
| Pension and post-retirement plan adjustments | 16,747          | 16,747              |
| Accumulated other comprehensive income       | 49,564          | 36,233              |

#### (4) Earnings per Share

Basic earnings per share is computed on the weighted average number of common shares outstanding during the period. Diluted earnings per share includes the effect of the weighted average stock options outstanding during the period, using the treasury stock method. Antidilutive options are not considered in computing diluted earnings per share.

| (In thousands, except per share amounts) | Three Months Ended<br>June 30 |           | Six Months Ended<br>June 30 |           |
|--|-------------------------------|-----------|-----------------------------|-----------|
|  | 2008                          | 2007      | 2008                        | 2007      |
| Net income                               | \$ 19,954                     | \$ 17,328 | \$ 35,981                   | \$ 33,396 |
| Preferred stock dividends                | 10                            | 10        | 20                          | 20        |
| Income available to common shareholders  | 19,944                        | 17,318    | 35,961                      | 33,376    |
| Basic earnings per common share          | \$ 0.56                       | \$ 0.49   | \$ 1.01                     | \$ 0.93   |
| Diluted earnings per common share        | \$ 0.55                       | \$ 0.48   | \$ 1.00                     | \$ 0.92   |
| Basic shares outstanding                 | 35,594                        | 35,689    | 35,567                      | 35,777    |
| Stock options                            | 393                           | 574       | 437                         | 572       |
| Diluted shares outstanding               | 35,987                        | 36,263    | 36,004                      | 36,349    |
| Antidilutive stock options               | 434                           | 185       | 434                         | 185       |

#### (5) Segment Information

We are organized into three geographic operating segments: North America, Europe, and International. Reportable segment information is presented in the following table:

| (In thousands)                          | North<br>America | Europe     | International | Reconciling<br>Items | Consolidated<br>Totals |
|---|------------------|------------|---------------|----------------------|------------------------|
| <b>Three Months Ended June 30, 2008</b> |                  |            |               |                      |                        |
| Sales to external customers             | \$ 148,682       | \$ 76,853  | \$ 67,627     | \$                   | \$ 293,162             |
| Intercompany sales                      | 14,660           | 29,964     | 4,842         | (49,466)             |                        |
| Net income                              | 11,514           | 4,118      | 4,346         | (24)                 | 19,954                 |
| <b>Six Months Ended June 30, 2008</b>   |                  |            |               |                      |                        |
| Sales to external customers             | \$ 295,324       | \$ 137,258 | \$ 126,924    | \$                   | \$ 559,506             |
| Intercompany sales                      | 27,260           | 56,413     | 6,895         | (90,568)             |                        |
| Net income                              | 25,919           | 4,369      | 8,526         | (2,833)              | 35,981                 |

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**Three Months Ended June 30, 2007**

|                             |            |           |           |          |            |
|-----------------------------|------------|-----------|-----------|----------|------------|
| Sales to external customers | \$ 131,818 | \$ 56,026 | \$ 61,255 | \$       | \$ 249,099 |
| Intercompany sales          | 11,496     | 23,075    | 1,676     | (36,247) |            |
| Net income                  | 10,532     | 1,830     | 4,405     | 561      | 17,328     |

**Six Months Ended June 30, 2007**

|                             |            |            |            |          |            |
|-----------------------------|------------|------------|------------|----------|------------|
| Sales to external customers | \$ 254,719 | \$ 109,113 | \$ 111,206 | \$       | \$ 475,038 |
| Intercompany sales          | 21,644     | 45,714     | 3,236      | (70,594) |            |
| Net income                  | 21,133     | 4,444      | 7,634      | 185      | 33,396     |

Reconciling items consist primarily of intercompany eliminations and items reported at the corporate level.

**(6) Pensions and Other Postretirement Benefits**

Components of net periodic benefit (credit) cost consisted of the following:

| (In thousands)                          | Pension Benefits |          | Other Benefits |        |
|---|------------------|----------|----------------|--------|
|   | 2008             | 2007     | 2008           | 2007   |
| <b>Three months ended June 30</b>       |                  |          |                |        |
| Service cost                            | \$ 2,408         | \$ 2,686 | \$ 179         | \$ 175 |
| Interest cost                           | 4,809            | 4,286    | 534            | 381    |
| Expected return on plan assets          | (9,330)          | (8,333)  |                |        |
| Amortization of transition amounts      | 3                | 11       |                |        |
| Amortization of prior service cost      | 45               | 43       | (90)           | (90)   |
| Recognized net actuarial (gains) losses | (250)            | 237      | 412            | 211    |
| Net periodic benefit (credit) cost      | (2,315)          | (1,070)  | 1,035          | 677    |
| <b>Six months ended June 30</b>         |                  |          |                |        |
| Service cost                            | \$ 4,795         | \$ 5,264 | \$ 347         | \$ 318 |
| Interest cost                           | 9,579            | 8,758    | 928            | 742    |
| Expected return on plan assets          | (18,442)         | (16,886) |                |        |
| Amortization of transition amounts      | 5                | 22       |                |        |
| Amortization of prior service cost      | 92               | 85       | (179)          | (180)  |
| Recognized net actuarial (gains) losses | (504)            | 525      | 607            | 390    |
| Net periodic benefit (credit) cost      | (4,475)          | (2,232)  | 1,703          | 1,270  |

We made net contributions of \$1.2 million to our pension plans during the six months ended June 30, 2008. We expect to make net contributions of approximately \$2.4 million to our pension plans in 2008.

**(7) Goodwill and Intangible Assets**

Changes in goodwill and intangible assets, net of accumulated amortization, during the six months ended June 30, 2008 were as follows:

| (In thousands)                           | Goodwill  | Intangibles |
|--|-----------|-------------|
| Net balances at January 1, 2008          | \$ 87,011 | \$ 15,633   |
| Goodwill and intangible assets acquired  |           | 233         |
| Adjustments to purchase price allocation | (1,289)   | 1,289       |
| Amortization expense                     |           | (1,600)     |
| Currency translation and other           | 1,146     | (118)       |
| Net balances at June 30, 2008            | 86,868    | 15,437      |

At June 30, 2008, goodwill of approximately \$63.5 million, \$19.9 million, and \$3.5 million related to the North American, European, and International operating segments, respectively.

In March 2008, we finalized the allocation of the purchase price related to the March 2007 acquisition of Acceleron Technologies, LLC. The final allocation resulted in a \$1.3 million adjustment between goodwill and intangibles.

**(8) Inventories**

| (In thousands)             | June 30<br>2008 | December 31<br>2007 |
|----------------------------|-----------------|---------------------|
| Finished products          | \$ 76,654       | \$ 64,513           |
| Work in process            | 36,772          | 28,582              |
| Raw materials and supplies | 69,626          | 62,237              |
| Total inventories          | 183,052         | 155,332             |

**(9) Stock Plans**

On May 13, 2008, the shareholders approved the 2008 Management Equity Incentive Plan and the 2008 Non-Employee Directors Equity Incentive Plan. The 2008 Management Equity Incentive Plan provides for various forms of stock-based compensation for eligible key employees through May 2018. The 2008 Non-Employee Directors Equity Incentive Plan provides for grants of stock options and restricted stock awards to non-employee directors through May 2018. These plans replace the 1998 Management Share Incentive Plan and the 1990 Non-Employee Directors Stock Option Plan. Our stock-based compensation includes stock options and restricted stock awards. Stock options are granted at market value option prices and expire after ten years, with limited instances of option prices in excess of market value and expiration after five years. Stock options granted after 2005 are exercisable beginning three years after the grant date. Stock options granted in 2005 and earlier years were fully vested as of December 31, 2005. Restricted stock awards are granted without payment to the company and generally vest three years after the grant date. Certain restricted stock awards for management retention vest in three equal tranches four, five, and six years after the grant date. Unvested restricted stock awards for management retention are forfeited if the grantee's employment with the company terminates for any reason other than death or disability. Restricted stock awards are valued at the market value of the stock on the award date. We issue Stock Compensation Trust shares or new shares for stock option exercises and restricted stock awards.

Stock-based compensation expense was as follows:

| (In thousands)  | Three Months Ended<br>June 30 |        | Six Months Ended<br>June 30 |          |
|---|-------------------------------|--------|-----------------------------|----------|
|   | 2008                          | 2007   | 2008                        | 2007     |
| Restricted stock awards                               | \$ 650                        | \$ 701 | \$ 1,782                    | \$ 1,730 |
| Stock option grants                                   | 576                           | 233    | 1,662                       | 1,581    |
| Total compensation expense before income taxes        | 1,226                         | 934    | 3,444                       | 3,311    |
| Income tax benefit                                    | 432                           | 325    | 1,202                       | 1,159    |
| Total compensation expense, net of income tax benefit | 794                           | 609    | 2,242                       | 2,152    |

A summary of stock option activity for the six months ended June 30, 2008 follows:

|                                | Shares    | Weighted<br>Average<br>Exercise Price |
|--------------------------------|-----------|---------------------------------------|
| Outstanding at January 1, 2008 | 1,562,405 | \$ 23.12                              |
| Granted                        | 224,961   | 44.93                                 |
| Exercised                      | (73,166)  | 8.22                                  |
| Outstanding at June 30, 2008   | 1,714,200 | 26.62                                 |
| Exercisable at June 30, 2008   | 1,237,668 | 20.53                                 |



A summary of restricted stock award activity for the six months ended June 30, 2008 follows:

|                             | Shares   | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-----------------------------|----------|---|
| Unvested at January 1, 2008 | 183,333  | \$ 42.00  |
| Granted                     | 71,900   | 44.68   |
| Vested                      | (53,999) | 43.97   |
| Forfeited                   | (1,080)  | 43.25   |
| Unvested at June 30, 2008   | 200,154  | 42.42   |

#### (10) Derivative Financial Instruments

In 2004, we entered into an eight year interest rate swap agreement. Under the terms of the agreement, we receive a fixed interest rate of 8.39% and pay a floating interest rate based on LIBOR. The notional amount of the swap was initially \$20.0 million and declines \$4.0 million per year beginning in August 2008. The interest rate swap has been designated as a fair value hedge of a portion of our fixed rate 8.39% Senior Notes.

In order to account for these derivatives as hedges, the interest rate swap must be highly effective at offsetting changes in the fair value of the hedged debt. We have assumed that there is no ineffectiveness in the hedge, since all of the critical terms of the hedge match the underlying terms of the hedged debt.

The fair value of the interest rate swap at June 30, 2008 has been recorded as a liability of \$0.1 million, that is included in other noncurrent liabilities, with an offsetting reduction in the carrying value of long-term debt. The fair value of the interest rate swap at December 31, 2007 was recorded as a liability of \$0.2 million, that was included in other noncurrent liabilities, with an offsetting reduction in the carrying value of long-term debt.

As a result of entering into the interest rate swap, we have increased our exposure to interest rate fluctuations. Differences between the fixed rate amounts received and the variable rate amounts paid are recognized in interest expense on an ongoing basis. This rate difference resulted in no change in interest expense during the six months ended June 30, 2008 and an increase in interest expense of \$0.2 million during the six months ended June 30, 2007.

#### (11) Acquisitions

In December 2007, we acquired TecBOS GmbH of Halstenbek, Germany. TecBOS is a leading developer of software solutions for the fire service and other emergency planning organizations. We believe that this acquisition strengthens our presence in the European fire service and emergency responder market by adding complementary software solutions used for on-site management and reporting of major incidents such as fires, traffic accidents, industrial plant emergencies and public events. A purchase price of \$0.7 million was paid in cash to the previous owners.

In March 2007, we acquired Acceleron Technologies, LLC, a San Francisco-based developer of advanced technology suitable for personal locator devices. We believe that the acquisition of this technology significantly expedites the development of reliable systems for first responder and soldier location applications. The purchase price of \$5.7 million included amounts paid to the previous owners and other direct costs associated with the acquisition. The acquisition agreement provides for additional consideration of up to \$4.9 million to be paid to the former owners of Acceleron based on the achievement of specific technology development milestones by September 28, 2008.

In March 2007, we acquired the outstanding shares of MSA (India) Limited that were previously held by our joint venture partner for a purchase price of \$1.1 million. As a wholly-owned subsidiary under MSA management, we believe that we are better positioned to take advantage of opportunities in the large and growing Indian market.

The operating results of all acquisitions have been included in our consolidated financial statements from their respective acquisition dates. Pro forma consolidated results, as if the acquisitions had occurred at the beginning of 2007, would not be materially different from the results reported.

#### **(12) Income Taxes**

At June 30, 2008, we had a gross liability for unrecognized tax benefits of \$5.7 million. We have recognized tax benefits associated with these liabilities of \$2.2 million at June 30, 2008. These balances are unchanged since December 31, 2007. We do not expect that the total amount of the unrecognized tax benefit will significantly increase or decrease within twelve months of the reporting date.

We recognize interest related to unrecognized tax benefits in interest expense and penalties in operating expenses. At June 30, 2008, we had \$0.5 million of accrued interest related to unrecognized tax benefits.

#### **(13) Fair Value Measurements**

On January 1, 2008, we adopted FAS No. 157, Fair Value Measurements, as it relates to financial assets and liabilities that are remeasured and reported at least annually. In February 2008, the FASB issued FASB Staff Position (FSP) 157-2, Effective Date of FASB Statement No. 157, which delayed the effective date of FAS No. 157 for all nonfinancial assets and liabilities that are recognized and disclosed at fair value in the financial statements on a nonrecurring basis until January 1, 2009. Also in February 2008, the FASB issued FSP 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13, which amends FAS No. 157 to exclude FAS No. 13, Accounting for Leases, and its related interpretive accounting pronouncements.

FAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements and are to be applied prospectively with limited exceptions. Our adoption of FAS No. 157, as it relates to financial assets and liabilities that are remeasured and reported at least annually, had no impact on consolidated results of operations or financial condition. We are currently evaluating the potential impact of FAS No. 157, as it relates to nonfinancial assets and liabilities that are recognized and disclosed at fair value in the financial statements on a nonrecurring basis.

FAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This standard is now the single source under generally accepted accounting principles for the definition of fair value, except for the fair value of leased property as defined in FAS No. 13. FAS No. 157 establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy under FAS No. 157 are:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, including quoted prices for similar assets or liabilities in active



markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates); and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs that are both significant to the fair value measurement and unobservable.

In 2008, the valuation methodologies we used to measure financial assets and liabilities within the scope of FAS No. 157 were limited to the derivative financial instrument described in Note 10. We estimate the fair value of this financial instrument, consisting solely of an interest rate swap, based upon a valuation model with inputs that generally can be verified by observable market conditions and do not involve significant management judgment. Accordingly, the fair value of this financial instrument is classified within Level 2 of the fair value hierarchy.

#### **(14) Contingencies**

Various lawsuits and claims arising in the normal course of business are pending against us. These lawsuits are primarily product liability claims. We are presently named as a defendant in approximately 2,600 lawsuits, primarily involving respiratory protection products allegedly manufactured and sold by us. Collectively, these lawsuits represent a total of approximately 16,600 plaintiffs. Approximately 90% of these lawsuits involve plaintiffs alleging they suffer from silicosis, with the remainder alleging they suffer from other or combined injuries, including asbestosis. These lawsuits typically allege that these conditions resulted in part from respirators that were negligently designed or manufactured by us. Consistent with the experience of other companies involved in silica and asbestos-related litigation, in recent years there has been an increase in the number of asserted claims that could potentially involve us. We cannot determine our potential maximum liability for such claims, in part because the defendants in these lawsuits are often numerous, and the claims generally do not specify the amount of damages sought.

With some limited exceptions, we maintain insurance against product liability claims. We also maintain a reserve for uninsured product liability based on expected settlement charges for pending claims and an estimate of unreported claims derived from experience, sales volumes, and other relevant information. We evaluate our exposures on an ongoing basis and make adjustments to the reserve as appropriate. Based on information currently available, we believe that the disposition of matters that are pending will not have a materially adverse effect on our financial condition.

In the normal course of business, we make payments to settle product liability claims and for related legal fees and record receivables for the amounts covered by insurance. Various factors could affect the timing and amount of recovery of insurance receivables, including: the outcome of negotiations with insurers, legal proceedings with respect to product liability insurance coverage, and the extent to which insurers may become insolvent in the future.

We are currently involved in coverage litigation with Century Indemnity Company (Century). Century filed a lawsuit in the Superior Court of New Jersey seeking a declaration of Century's obligations with respect to certain asbestos, silica and other claims under five insurance policies issued to us by Century. The New Jersey Superior Court issued an order granting our motion to dismiss this case on jurisdictional grounds. Century appealed that order and on February 26, 2008, the Appellate Division of the Superior Court of New Jersey affirmed the decision of the trial court dismissing the case. The decision of the appellate court was not appealed and the New Jersey action is concluded. We have sued Century in the Court of Common Pleas of Allegheny County, Pennsylvania, alleging that Century breached the five insurance policies by failing to pay amounts owing to us. The Pennsylvania court has denied a motion by Century to stay or dismiss the Pennsylvania lawsuit in favor of the New Jersey action. The court also denied certain preliminary motions filed by both parties to narrow the issues in dispute. It is expected that additional motions will be filed during discovery. We believe that Century's refusal to indemnify us under the policies is wholly contrary to Pennsylvania law and we are vigorously pursuing the legal actions necessary to collect all amounts.

We regularly evaluate the collectibility of insurance receivables and record the amounts that we conclude are probable of collection based on our analysis of our various policies, pertinent case law interpreting comparable policies and our experience with similar claims. Receivables from insurance carriers totaled \$51.2 million and \$39.1 million at June 30, 2008 and December 31, 2007, respectively. Based upon our evaluation of applicable insurance coverage and the current status of the coverage litigation discussed in the preceding paragraph, we believe that the recorded balance is fully recoverable from carriers.

**(15) Recently Issued Accounting Standards**

In December 2007, the FASB issued FAS No. 141 (revised 2007), Business Combinations, which replaces FAS No. 141, Business Combinations. FAS No. 141(R) changes a number of significant aspects of the application of the acquisition method of accounting for business combinations. Under FAS No. 141(R), acquisition costs will generally be expensed as incurred; noncontrolling interests will be valued at fair value at the acquisition date; in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date will generally affect income tax expense. FAS No. 141(R) is effective on a prospective basis for business combinations with acquisition dates on or after the January 1, 2009, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. Adjustments to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that close prior to the effective date of FAS No. 141(R) would also apply the provisions of FAS No. 141(R). We do not expect that the adoption of this statement, as it relates to past acquisitions, will have a material effect on our consolidated results of operations or financial condition.

In December 2007, the FASB issued FAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51. FAS No. 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. It also amends certain ARB No. 51 consolidation procedures for consistency with the requirements of FAS No. 141(R) and expands disclosure requirements regarding the interests of the parent and its noncontrolling interest. FAS No. 160 is effective January 1, 2009. We do not expect that the adoption of this statement will have a material effect on our consolidated results of operations or financial condition.

In December 2007, the Emerging Issues Task Force issued EITF No. 07-1, Accounting for Collaborative Arrangements. EITF No. 07-1 requires that transactions with third parties (i.e., revenue generated and costs incurred by the partners) be reported in the appropriate line item in each company's financial statement and includes enhanced disclosure requirements regarding the nature and purpose of the arrangement, rights and obligations under the arrangement, accounting policy, amount and income statement classification of collaboration transactions between the parties. EITF No. 07-1 is effective January 1, 2009 and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. We do not expect that the adoption of this statement will have a material effect on our consolidated results of operations or financial condition.

In March 2008, the FASB issued FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. FAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide disclosures about (a) how and why derivative instruments are used, (b) how derivative instruments and related hedged items are accounted for under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its related interpretations, and (c) how derivative instruments and related hedged items affect the entity's financial position, financial performance, and cash flows. FAS No. 161 is effective January 1, 2009. We are currently evaluating the impact of adopting this statement.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis should be read in conjunction with the historical financial statements and other financial information included elsewhere in this report on Form 10-Q. This discussion may contain forward-looking statements that involve risks and uncertainties. The forward-looking statements are not historical facts, but rather are based on current expectations, estimates, assumptions and projections about our industry, business, and future financial results. Our actual results could differ materially from the results contemplated by these forward-looking statements due to a number of factors. These factors include, but are not limited to, spending patterns of government agencies, competitive pressures, product liability claims and our ability to collect related insurance receivables, the success of new product introductions, currency exchange rate fluctuations, the identification and successful integration of acquisitions, and the risks of doing business in foreign countries. For discussion of risk factors affecting our business, see Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007.*

**BUSINESS OVERVIEW**

We are a global leader in the development, manufacture, and supply of sophisticated products that protect people's health and safety. Sophisticated safety products typically integrate any combination of electronics, mechanical systems, and advanced materials to protect users against hazardous or life threatening situations. Our comprehensive lines of safety products are used by workers around the world in the fire service, homeland security, construction, and other industries, as well as the military.

We are committed to providing our customers with service unmatched in the safety industry and, in the process, enhancing our ability to provide a growing line of sophisticated safety solutions for customers in key global markets. Four strategic imperatives drive us toward our goal of building customer loyalty by delivering exceptional levels of protection, quality, and value:

Achieve sustainable growth through product leadership;

Expand market penetration through exceptional customer focus;

Control costs and increase efficiency in asset utilization; and

Build the depth, breadth, and diversity of our global team.

We tailor our product offerings and distribution strategy to satisfy distinct customer preferences that vary across geographic regions. We believe that we best serve these customer preferences by organizing our business into three geographic segments: North America, Europe, and International. Each segment includes a number of operating companies. In 2007, approximately 52%, 24%, and 24% of our net sales were made by our North American, European, and International segments, respectively.

*North America.* Our largest manufacturing and research and development facilities are located in the United States. We serve our North American markets with sales and distribution functions in the U.S., Canada, and Mexico.

*Europe.* Our European segment includes well-established companies in most Western European countries, and more recently established operations in a number of Eastern European locations. Our largest European companies, based in Germany and France, develop, manufacture, and sell a wide variety of products. Operations in other European countries focus primarily on sales and distribution in their respective home country markets. While some of these companies may perform limited production, most of their sales are of products that are manufactured in our plants in Germany, France, and the U.S., or are purchased from third party vendors.

*International.* Our International segment includes operating entities located in Abu Dhabi, Argentina, Australia, Brazil, Chile, China, Hong Kong, India, Indonesia, Japan, Malaysia, Peru, Singapore, South Africa,

Thailand, and Zambia, some of which are in developing regions of the world. Principal manufacturing operations are located in Australia, Brazil, South Africa, and China. These companies develop and manufacture products that are sold primarily in each company's home country and regional markets. The other companies in the International segment focus primarily on sales and distribution in their respective home country markets. While some of these companies may perform limited production, most of their sales are of products that are manufactured in our plants in the U.S., Germany, and France, or are purchased from third party vendors.

## RESULTS OF OPERATIONS

### Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

**Net sales.** Net sales for the three months ended June 30, 2008 were \$293.2 million, an increase of \$44.1 million, or 18%, compared with \$249.1 million for the three months ended June 30, 2007.

| (In millions) | Three Months Ended |          | Dollar Increase | Percent Increase |
|---------------|--------------------|----------|-----------------|------------------|
|               | 2008               | 2007     |                 |                  |
| North America | \$ 148.7           | \$ 131.8 | \$ 16.9         | 13%              |
| Europe        | 76.9               | 56.0     | 20.9            | 37               |
| International | 67.6               | 61.3     | 6.3             | 10               |

Net sales by the North American segment were \$148.7 million for the second quarter of 2008, an increase of \$16.9 million, or 13%, compared to \$131.8 million for the second quarter of 2007. During the second quarter of 2008, our sales of self-contained breathing apparatus (SCBA) improved \$9.6 million. Higher SCBA sales reflect \$12.6 million in shipments of our Firehawk<sup>®</sup> M7 Responder to the U.S. Air Force. Instrument sales were \$3.4 million higher in the current quarter, primarily due to strong shipments of our new Altair<sup>®</sup> multigas detectors to the oil and gas industry. Sales of head protection, primarily to the construction industry, improved \$2.0 million in the current quarter. Higher sales of Advanced Combat Helmets to the U.S. Army and CG634 helmets to the Canadian Forces, up \$3.9 million and \$4.9 million, respectively, in the current quarter, were somewhat offset by a \$2.9 million decrease in shipments of other ballistic protection.

Net sales for the European segment were \$76.9 million for the second quarter of 2008, an increase of \$20.9 million, or 37%, compared to \$56.0 million for the second quarter of 2007. Local currency sales in Europe were \$8.6 million higher than in the same quarter last year. The increase reflects strong sales of SCBAs and air purifying respirators in Eastern Europe and higher shipments of helmets to the fire service and law enforcement agencies in France. Currency translation effects increased European segment sales, when stated in U.S. dollars, by \$12.3 million, reflecting the stronger euro.

Net sales for the International segment were \$67.6 million in the second quarter of 2008, an increase of \$6.3 million, or 10%, compared to \$61.3 million for the second quarter of 2007. The sales increase was primarily in Africa and Latin America, where local currency sales were up \$3.9 million and \$4.1 million, respectively. The improvement in Africa was primarily due to strong growth in sales to the mining industry. These increases were partially offset by lower sales in the Middle East, where second quarter 2007 sales included a \$4.8 million shipment of ballistic vests to the Iraq Joint Contracting Command. Currency translation effects increased International segment sales, when stated in U.S. dollars, by \$3.6 million, primarily related to a strengthening of the Australian dollar and the Brazilian real.

**Cost of products sold.** Cost of products sold was \$181.6 million in the second quarter of 2008, compared to \$155.3 million in the second quarter of 2007. Cost of products sold, selling, general and administrative expenses, and research and development expenses include net periodic pension credits during the second quarters of 2008 and 2007 of \$2.3 million and \$1.1 million, respectively.

**Gross profit.** Gross profit for the second quarter of 2008 was \$111.6 million, which was \$17.8 million, or 19%, higher than gross profit of \$93.8 million in the second quarter of 2007. The ratio of gross profit to net sales

was 38.1% in the second quarter of 2008 compared to 37.7% in the same quarter last year. The higher gross profit ratio in the second quarter of 2008 was primarily related to sales mix and our ongoing efforts to reduce costs.

**Selling, general and administrative expenses.** Selling, general and administrative expenses were \$68.9 million during the second quarter of 2008, an increase of \$10.1 million, or 17%, compared to \$58.8 million in the second quarter of 2007. Selling, general and administrative expenses were 23.5% of net sales in the second quarter of 2008 compared to 23.6% of net sales in the second quarter of 2007. Local currency selling, general and administrative expenses in the European and International segments were up \$3.4 million, reflecting our increased focus on global initiatives and the higher selling and marketing expenses required to sustain sales growth in these markets. North American segment selling, general and administrative expenses were up \$3.3 million quarter-to-quarter, primarily due to the increased selling and marketing expenses required to support higher sales levels. Currency exchange effects increased second quarter 2008 administrative expense, when stated in U.S. dollars, by \$3.7 million, primarily related to a stronger euro, Australian dollar, and Brazilian real.

**Research and development expense.** Research and development expense was \$9.2 million during the second quarter of 2008, an increase of \$2.4 million, or 36%, compared to \$6.8 million during the second quarter of 2007. The increase occurred in the United States and Germany and reflects our continued focus on developing innovative new products.

**Depreciation and amortization expense.** Depreciation and amortization expense, which is reported in cost of sales, selling, general and administrative expenses, and research and development expenses, was \$7.1 million for the second quarter of 2008, an increase of \$1.0 million, or 16%, compared to \$6.1 million for the second quarter of 2007. The increase in depreciation expense was primarily on production and computer equipment in North America.

**Restructuring and other charges.** During the second quarter 2008, we recorded charges of \$1.1 million. These charges were primarily related to stay bonuses and other costs associated with our Project Magellan initiative to outsource or transfer certain production activities from our Evans City, Pennsylvania plant.

During the second quarter of 2007, we recorded charges of \$2.3 million, primarily related to reorganization activities. In Europe, charges of \$1.0 million related to the reorganization of our management team. North American charges of \$0.8 million were primarily stay bonuses related to moving fire helmet manufacturing from Clifton, New Jersey to Jacksonville, North Carolina and moving our Mexican manufacturing operations to a new factory in Queretaro, Mexico. The Clifton plant, which employed about 70 associates, was closed during 2007. International charges of \$0.5 million related to severance costs associated with workforce reductions in Brazil and Australia.

**Currency exchange (gains) losses.** Currency exchange gains were insignificant in the second quarter of 2008. Currency exchange gains of \$1.5 million in the second quarter of 2007 were primarily related to the Canadian dollar and the Australian dollar.

**Income taxes.** The effective tax rate for the second quarter of 2008 was 36.9% compared to 34.0% for the same quarter last year. The higher effective tax rate in the current quarter reflects a less favorable non-U.S. tax profile and the expiration of the research and development tax credit in the U.S.

We file a U.S. federal income tax return and various state and foreign income tax returns. Examinations of our U.S. federal returns have been completed through 2002. The Internal Revenue Service is currently examining our U.S. federal tax returns for the years 2003 through 2006. We also file in various state and foreign jurisdictions that may be subject to tax audits after 2002.

**Net income.** Net income for the three months ended June 30, 2008 was \$20.0 million, an increase of \$2.7 million, or 15%, compared to \$17.3 million for the same quarter last year. Basic earnings per share of common stock was \$0.56 for the second quarter of 2008, compared to \$0.49 for the second quarter of 2007.

North American segment net income for the second quarter of 2008 was \$11.5 million, an increase of \$1.0 million, or 9%, compared to \$10.5 million in the second quarter of 2007. Higher net income in North America was primarily related to the previously-discussed increase in sales.

European segment net income for the second quarter of 2008 was \$4.1 million, an increase of \$2.3 million, or 125%, compared to net income of \$1.8 million during the second quarter of 2007. Current quarter net income for the European segment includes a \$0.5 million after-tax gain on the sale of property in France. Currency translation effects increased European segment net income, when stated in U.S. dollars, by approximately \$0.5 million, reflecting the stronger euro. The remainder of the increase in European segment net income was primarily related to the previously-discussed increase in local currency sales.

International segment net income for the second quarter of 2008 was \$4.3 million, compared to \$4.4 million in the same quarter last year. Currency translation effects were not significant.

### Six Months Ended June 30, 2008 Compared to Six Months Ended June 30, 2007

**Net sales.** Net sales for the six months ended June 30, 2008 were \$559.5 million, an increase of \$84.5 million, or 18%, compared with \$475.0 million in the same period in 2007.

| (In millions) | Six Months Ended |          | Dollar Increase | Percent Increase |
|---------------|------------------|----------|-----------------|------------------|
|               | 2008             | 2007     |                 |                  |
| North America | \$ 295.3         | \$ 254.7 | \$ 40.6         | 16%              |
| Europe        | 137.3            | 109.1    | 28.2            | 26               |
| International | 126.9            | 111.2    | 15.7            | 14               |

Net sales in the North America segment were \$295.3 million for the six months ended June 30, 2008, an increase of \$40.6 million, or 16%, compared to \$254.7 million for the same period in 2007. SCBA sales during the six months ended June 30, 2008 were \$24.4 million higher than in the same period last year. The increase reflects improved availability of fire department funding under the U.S. Assistance to Firefighters Grant program and the release of customer orders that had been delayed during the second half of 2007 as manufacturers and the fire service market made the transition to a new National Fire Protection Association (NFPA) standard for SCBAs. SCBA sales during the first half of 2008 also include \$12.6 million in shipments of our Firehawk<sup>®</sup> M7 Responder to the U.S. Air Force. Fire service market sales of thermal imaging cameras and fire helmets were up \$2.7 million in the first half of 2008. Sales of head protection, primarily to the construction industry, improved \$3.6 million in the current period. Higher sales of Advanced Combat Helmets to the U.S. Army and CG634 helmets to the Canadian Forces, up \$8.3 million and \$9.1 million, respectively, in the current period, were partially offset by a \$2.5 million decrease in shipments of other ballistic protection.

In Europe, net sales for the six months ended June 30, 2008 were \$137.3 million, an increase of \$28.2 million, or 26%, compared to \$109.1 million in the same period in 2007. The increase in European sales, when stated in U.S. dollars, includes favorable currency translation effects of \$23.1 million, primarily due to a stronger euro in the current period. Local currency sales in Europe for the six months ended June 30, 2008 were \$5.1 million higher than in the same period last year. The increase reflects improved sales of SCBAs and air purifying respirators in Eastern Europe and higher shipments of helmets to the fire service and law enforcement agencies in France.

Net sales for the International segment were \$126.9 million for the six months ended June 30, 2008, an increase of \$15.7 million, or 14%, compared to \$111.2 million in the same period in 2007. Local currency sales in the International segment for the six months ended June 30, 2008 were \$7.9 million higher than in the same period last year. The sales increase was primarily in Latin America and Africa where local currency sales were up \$6.3 million and \$6.8 million, respectively. The improvement in Africa was primarily due to strong growth in sales to the mining industry. These increases were partially offset by lower sales in the Middle East, where sales

for the six months ended June 30, 2007 included a \$4.8 million shipment of ballistic vests to the Iraq Joint Contracting Command. The increase in International segment sales, when stated in U.S. dollars, includes favorable currency translation effects of \$7.8 million, primarily due to a stronger Brazilian real and Australian dollar in the current period.

**Cost of products sold.** Cost of products sold was \$341.6 million for the six months ended June 30, 2008 compared to \$292.1 million in the same period in 2007.

Cost of products sold, selling, general and administrative expenses, and research and development expenses include net periodic pension benefit costs and credits. Pension credits, combined with pension costs, resulted in net pension credits during the six month periods ended June 30, 2008 and 2007 of \$4.5 million and \$2.2 million, respectively.

**Gross profit.** Gross profit for the six months ended June 30, 2008 was \$217.9 million, which was \$34.9 million, or 19%, higher than gross profit of \$183.0 million in the same period in 2007. The ratio of gross profit to net sales was 39.0% in the six months ended June 30, 2008 compared to 38.5% in the same period last year. The higher gross profit ratio in the first half of 2008 was primarily related to sales mix and our ongoing efforts to reduce costs.

**Selling, general and administrative expenses.** Selling, general and administrative expenses were \$135.0 million during the six months ended June 30, 2008, an increase of \$19.7 million, or 17%, compared to \$115.3 million in the same period in 2007. Selling, general and administrative expenses were 24.1% of net sales in the six months ended June 30, 2008 compared to 24.3% of net sales in the first half of 2007. Local currency selling, general and administrative expenses in the European and International segments were up \$8.5 million in the six months ended June 30, 2008, reflecting our increased focus on global initiatives and the higher selling and marketing expenses required to sustain our sales growth in these markets. North American segment selling, general and administrative expenses were up \$4.7 million, primarily due to the increased selling and marketing expenses required to support higher sales levels. Currency exchange effects increased selling, general and administrative expenses, when stated in U.S. dollars, by \$7.1 million, primarily due to a stronger euro, Brazilian real, and Australian dollar.

**Research and development expense.** Research and development expense was \$16.6 million during the six months ended June 30, 2008, an increase of \$3.9 million, or 30%, compared to \$12.7 million during the first half of 2007. The increase occurred in the United States and Germany and reflects our continued focus on developing innovative new products.

**Depreciation and amortization expense.** Depreciation and amortization expense, which is reported in cost of sales, selling, general and administrative expenses, and research and development expenses, was \$13.9 million for the six months ended June 30, 2008, an increase of \$1.8 million, or 15%, compared to \$12.1 million for the same period in 2007. The increase in depreciation expense was primarily on production and computer equipment in North America.

**Restructuring and other charges.** During the six months ended June 30, 2008, we recorded charges of \$2.2 million. These charges were primarily related to stay bonuses and other costs associated with our Project Magellan initiative to outsource or transfer certain production activities from our Evans City, Pennsylvania plant.

During the six months ended June 30, 2007, we recorded charges of \$2.5 million, primarily related to reorganization activities. In Europe, charges of \$1.0 million related to the reorganization of our management team. North American charges of \$1.0 million were primarily stay bonuses related to moving fire helmet manufacturing from Clifton, New Jersey to Jacksonville, North Carolina and moving our Mexican manufacturing operations to a new factory in Queretaro, Mexico. The Clifton Plant, which employed about 70 associates, was closed during 2007. International charges of \$0.5 million related to severance costs associated with workforce reductions in Brazil and Australia.

**Interest expense.** Interest expense was \$4.8 million during the six months ended June 30, 2008 compared to \$4.2 million in the same period last year. The increase in interest expense was primarily due to higher short term debt.

**Currency exchange (gains) losses.** Currency exchange losses were \$4.0 million during the six months ended June 30, 2008, compared to currency exchange gains of \$1.2 million during the same period last year. Currency exchange losses during the first half of 2008 were primarily unrealized, and related to the effect of a stronger euro and a weaker South African rand on intercompany balances and losses on Canadian dollar trade receivables. The currency exchange gains during the first half of 2007 were primarily related to the strengthening of the Canadian dollar and Australian dollar.

**Income taxes.** The effective tax rate for the six months ended June 30, 2008 was 37.7% compared to 34.4% for the same period last year. The higher effective tax rate in the current period reflects a less favorable non-U.S. tax profile and the expiration of the research and development tax credit in the U.S. The income tax provision for the six months ended June 30, 2008 also includes a one-time charge of \$0.4 million in Germany, related to a tax law change that imposed a 3% flat tax on previously untaxed subsidies.

We file a U.S. federal income tax return and various state and foreign income tax returns. Examinations of our federal return have been completed through 2002. The Internal Revenue Service is currently examining our U.S. federal income tax returns for the years 2003 through 2006. We also file in various state and foreign jurisdictions that may be subject to tax audits after 2002.

**Net income.** Net income for the six months ended June 30, 2008 was \$36.0 million, an increase of \$2.6 million, or 8%, compared to \$33.4 million for the six months ended June 30, 2007. Basic earnings per share of common stock was \$1.01 for the six months ended June 30, 2008, compared to \$0.93 for the same period last year.

North American segment net income for the six months ended June 30, 2008 was \$25.9 million, an increase of \$4.8 million, or 23%, compared to \$21.1 million in the same period last year. The increase in North American net income was primarily due to the previously-discussed increase in sales.

European segment net income for the six months ended June 30, 2008 was \$4.4 million, unchanged from \$4.4 million for the first half of 2007. As previously noted, the income tax provision for the six months ended June 30, 2008 included a one-time charge of \$0.4 million in Germany, related to a tax law change that imposed a 3% flat tax on previously untaxed subsidies and a \$0.5 million after-tax gain on the sale of property in France. Currency translation effects increased European segment net income, when stated in U.S. dollars, by approximately \$1.0 million, reflecting the stronger euro.

International segment net income for the six months ended June 30, 2008 was \$8.5 million, an increase of \$0.9 million, or 12%, compared to \$7.6 million in the same period last year. Currency translation effects increased International segment net income, when stated in U.S. dollars, by approximately \$0.3 million. The remainder of the increase was primarily due to the previously-discussed increase in local currency sales.

The loss of \$2.8 million for the six months ended June 30, 2008 reported in reconciling items was primarily related to the previously-discussed currency exchange losses.

## LIQUIDITY AND CAPITAL RESOURCES

Our main sources of liquidity are cash generated from operations and borrowing capacity. Our principal liquidity requirements are for working capital, capital expenditures, acquisitions, and principal and interest payments on outstanding indebtedness.

Cash and cash equivalents decreased \$8.0 million during the six months ended June 30, 2008, compared to an increase of \$0.4 million during the six months ended June 30, 2007.

Operating activities provided cash of \$8.5 million during the six months ended June 30, 2008, compared to providing cash of \$17.6 million during the six months ended June 30, 2007. Lower cash flow from operations in the six months ended June 30, 2008 reflected an increase of \$12.1 million in amounts due from insurance



carriers, as well as increases in working capital items, particularly inventory. During the six months ended June 30, 2008, inventories increased \$22.4 million, compared to an increase of \$6.7 million in the same period last year. LIFO inventories were \$183.1 million at June 30, 2008 and \$155.3 million at December 31, 2007. Trade receivables were \$220.8 million at June 30, 2008 and \$205.7 million at December 31, 2007. The increase in inventories occurred primarily in North America and was largely due to a ramp-up in SCBA and Thermal Imaging Camera production to meet an expected increase in fire service market demand. The increase in trade receivables was primarily in North America, and reflects the previously-discussed increase in sales. The increases in trade receivables and inventories, as reported on our balance sheet, include currency exchange effects of \$4.3 million and \$5.3 million, respectively.

Investing activities used cash of \$18.7 million during the six months ended June 30, 2008, compared to using \$19.6 million in the same period last year. During the six months ended June 30, 2008 and 2007, we used cash of \$19.6 million and \$13.5 million, respectively, for property additions. Higher capital spending in the current period includes costs associated with the construction of our new facility in Suzhou, China, as well as major building improvement projects in Brazil and Australia. During the first six months of 2007, we used cash of \$5.7 million to acquire Acceleron Technologies, LLC.

Financing activities used cash of \$0.9 million during the six months ended June 30, 2008, compared to providing cash of \$1.4 million in the first half of 2007. During the first six months of 2008, we paid cash dividends of \$16.5 million compared to paying dividends of \$14.4 million in the first half of 2007. During the six months ended June 30, 2008 and 2007, we used cash of \$0.9 million and \$15.6 million, respectively, to purchase treasury shares. During the six months ended June 30, 2008 and 2007, our short-term borrowings, increased \$15.0 million and \$30.0 million, respectively. Proceeds from short-term borrowings were used primarily to finance property additions and increases in working capital and insurance receivables.

#### **CUMULATIVE TRANSLATION ADJUSTMENTS**

The position of the U.S. dollar relative to international currencies at June 30, 2008 resulted in a translation gain of \$13.3 million being credited to the cumulative translation adjustments shareholders' equity account during the six months ended June 30, 2008, compared to a gain of \$3.3 million during the six months ended June 30, 2007. Translation gains in both periods were primarily due to the strengthening of the euro.

#### **COMMITMENTS AND CONTINGENCIES**

We have purchase commitments for materials, supplies, services, and property, plant and equipment as part of our ordinary conduct of business.

In September 2006, we acquired Paraclete. Under the terms of the asset purchase agreement, we issued a \$10.0 million note payable to the former owners of Paraclete. The note is non-interest bearing and is payable in five annual installments of \$2.0 million beginning September 1, 2007. We recorded the note at a fair value of \$8.5 million at the time of issuance. The discount of \$1.5 million is being recognized as interest expense over the term of the note.

During 2003, we sold our real property in Berlin, Germany for \$25.7 million, resulting in a gain of \$13.6 million. At the same time, we entered into an eight year agreement to lease back the portion of the property that we occupy. Under sale-leaseback accounting, \$12.1 million of the gain was deferred and is being amortized over the term of the lease.

In 2003, we entered into a lease agreement with BASF pertaining to that portion of the Callery Chemical site that is occupied by our Evans City, Pennsylvania manufacturing operations. The initial term of the lease was one year, with a renewal option for five successive one year periods. In September 2007, we exercised our fourth one year renewal option.

Various lawsuits and claims arising in the normal course of business are pending against us. These lawsuits are primarily product liability claims. We are presently named as a defendant in approximately 2,600 lawsuits, primarily involving respiratory protection products allegedly manufactured and sold by us. Collectively, these lawsuits represent a total of approximately 16,600 plaintiffs. Approximately 90% of these lawsuits involve plaintiffs alleging they suffer from silicosis, with the remainder alleging they suffer from other or combined injuries, including asbestosis. These lawsuits typically allege that these conditions resulted in part from respirators that were negligently designed or manufactured by us. Consistent with the experience of other companies involved in silica and asbestos-related litigation, in recent years there has been an increase in the number of asserted claims that could potentially involve us. We cannot determine our potential maximum liability for such claims, in part because the defendants in these lawsuits are often numerous, and the claims generally do not specify the amount of damages sought.

With some limited exceptions, we maintain insurance against product liability claims. We also maintain a reserve for uninsured product liability based on expected settlement charges for pending claims and an estimate of unreported claims derived from experience, sales volumes, and other relevant information. We evaluate our exposures on an ongoing basis and make adjustments to the reserve as appropriate. Based on information currently available, we believe that the disposition of matters that are pending will not have a materially adverse effect on our financial condition.

In the normal course of business, we make payments to settle product liability claims and for related legal fees and record receivables for the amounts covered by insurance. Various factors could affect the timing and amount of recovery of insurance receivables, including: the outcome of negotiations with insurers, legal proceedings with respect to product liability insurance coverage, and the extent to which insurers may become insolvent in the future.

We are currently involved in coverage litigation with Century Indemnity Company (Century). Century filed a lawsuit in the Superior Court of New Jersey seeking a declaration of Century's obligations with respect to certain asbestos, silica and other claims under five insurance policies issued to us by Century. The New Jersey Superior Court issued an order granting our motion to dismiss this case on jurisdictional grounds. Century appealed that order and on February 26, 2008, the Appellate Division of the Superior Court of New Jersey affirmed the decision of the trial court dismissing the case. The decision of the appellate court was not appealed and the New Jersey action is concluded. We have sued Century in the Court of Common Pleas of Allegheny County, Pennsylvania, alleging that Century breached the five insurance policies by failing to pay amounts owing to us. The Pennsylvania court has denied a motion by Century to stay or dismiss the Pennsylvania lawsuit in favor of the New Jersey action. The court also denied certain preliminary motions filed by both parties to narrow the issues in dispute. It is expected that additional motions will be filed during discovery. We believe that Century's refusal to indemnify us under the policies is wholly contrary to Pennsylvania law and we are vigorously pursuing the legal actions necessary to collect all amounts.

We regularly evaluate the collectibility of insurance receivables and record the amounts that we conclude are probable of collection based on our analysis of our various policies, pertinent case law interpreting comparable policies and our experience with similar claims. Receivables from insurance carriers totaled \$51.2 million and \$39.1 million at June 30, 2008 and December 31, 2007, respectively. Based upon our evaluation of applicable insurance coverage and the current status of the coverage litigation discussed in the preceding paragraph, we believe that the recorded balance is fully recoverable from carriers.

#### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosures. We evaluate these estimates and judgments on an on-going basis based on historical

experience and various assumptions that we believe to be reasonable under the circumstances. However, different amounts could be reported if we had used different assumptions and in light of different facts and circumstances. Actual amounts could differ from the estimates and judgments reflected in our financial statements.

The more critical judgments and estimates used in the preparation of our financial statements are discussed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2007.

#### **RECENTLY ISSUED ACCOUNTING STANDARDS**

In December 2007, the FASB issued FAS No. 141 (revised 2007), Business Combinations, which replaces FAS No. 141, Business Combinations. FAS No. 141(R) changes a number of significant aspects of the application of the acquisition method of accounting for business combinations. Under FAS No. 141(R), acquisition costs will generally be expensed as incurred; noncontrolling interests will be valued at fair value at the acquisition date; in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date will generally affect income tax expense. FAS No. 141(R) is effective on a prospective basis for business combinations with acquisition dates on or after the January 1, 2009, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. Adjustments to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that close prior to the effective date of FAS No. 141(R) would also apply the provisions of FAS No. 141(R). We do not expect that the adoption of this statement, as it relates to past acquisitions, will have a material effect on our consolidated results of operations or financial condition.

In December 2007, the FASB issued FAS No. 160, Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51. FAS No. 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. It also amends certain ARB No. 51 consolidation procedures for consistency with the requirements of FAS No. 141(R) and expands disclosure requirements regarding the interests of the parent and its noncontrolling interest. FAS No. 160 is effective January 1, 2009. We do not expect that the adoption of this statement will have a material effect on our consolidated results of operations or financial condition.

In December 2007, the Emerging Issues Task Force issued EITF No. 07-1, Accounting for Collaborative Arrangements. EITF No. 07-1 requires that transactions with third parties (i.e., revenue generated and costs incurred by the partners) be reported in the appropriate line item in each company's financial statement and includes enhanced disclosure requirements regarding the nature and purpose of the arrangement, rights and obligations under the arrangement, accounting policy, amount and income statement classification of collaboration transactions between the parties. EITF No. 07-1 is effective January 1, 2009 and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. We do not expect that the adoption of this statement will have a material effect on our consolidated results of operations or financial condition.

In March 2008, the FASB issued FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. FAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide disclosures about (a) how and why derivative instruments are used, (b) how derivative instruments and related hedged items are accounted for under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its related interpretations, and (c) how derivative instruments and related hedged items affect the entity's financial position, financial performance, and cash flows. FAS No. 161 is effective January 1, 2009. We are currently evaluating the impact of adopting this statement.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk represents the risk of adverse changes in the value of a financial instrument caused by changes in currency exchange rates, interest rates, and equity prices. We are exposed to market risks related to currency exchange rates and interest rates.

**Currency exchange rate sensitivity.** We are subject to the effects of fluctuations in currency exchange rates on various transactions and on the translation of the reported financial position and operating results of our non-U.S. companies from local currencies to U.S. dollars. A hypothetical 10% strengthening or weakening of the U.S. dollar would decrease or increase our reported sales and net income for the six months ended June 30, 2008 by approximately \$26.4 million and \$1.3 million, respectively. When appropriate, we may attempt to limit our transactional exposure to changes in currency exchange rates through contracts or other actions intended to reduce existing exposures by creating offsetting currency exposures. At June 30, 2008, contracts for the purpose of hedging cash flows were not significant.

**Interest rate sensitivity.** We are exposed to changes in interest rates primarily as a result of borrowing and investing activities used to maintain liquidity and fund business operations. Because of the relatively short maturities of temporary investments and the variable rate nature of industrial development debt, these financial instruments are reported at carrying values which approximate fair values.

We hold one interest rate swap agreement, which is used to hedge the fair market value on a portion of our 8.39% fixed rate long-term debt. At June 30, 2008, the swap agreement had a notional amount of \$20.0 million and a fair market value of \$0.1 million in favor of the bank. The swap will expire in 2012. The notional amount of the swap will decline \$4.0 million per year beginning in August 2008. A hypothetical increase of 10% in market interest rates would not have a significant effect on the fair value of the interest rate swap.

We have \$100.0 million of fixed rate debt which matures at various dates through 2021. The incremental increase in the fair value of fixed rate long term debt resulting from a hypothetical 10% decrease in interest rates would be approximately \$1.8 million, excluding the impact of outstanding hedge instruments. However, our sensitivity to interest rate declines and the corresponding increase in the fair value of our debt portfolio would unfavorably affect earnings and cash flows only to the extent that we elected to repurchase or retire all or a portion of our fixed rate debt portfolio at prices above carrying values.

**Item 4. CONTROLS AND PROCEDURES**

- (a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of the end of the period covered by this Form 10-Q, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.
- (b) *Changes in internal control.* There were no changes in the Company's internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION****Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

## (c) Issuer Purchases of Equity Securities

| Period                   | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs |
|--------------------------|----------------------------------|------------------------------|--|--|
| April 1 - April 30, 2008 |                                  |                              |  | 1,310,202  |
| May 1 - May 31, 2008     | 12,473                           | \$ 39.55                     |  | 1,180,898  |
| June 1 - June 30, 2008   |                                  |                              |  | 1,217,810  |

On November 2, 2005, the Board of Directors authorized the purchase of up to \$100 million of common stock from time to time in private transactions and on the open market. The share purchase program has no expiration date. The maximum shares that may yet be purchased is calculated based on the dollars remaining under the program and the respective month-end closing share price.

We do not have any other share repurchase programs.

Shares purchased during May 2008 related to stock compensation transactions.

**Item 4. Submission of Matters to a Vote of Security Holders**

The annual meeting of shareholders was held on May 13, 2008. The following matters were acted upon:

**Election of Directors**

William M. Lambert, Diane M. Pearse, and L. Edward Shaw, Jr. were elected to serve until the annual meeting in 2011 by the following votes:

|                     | Votes For  | Votes Withheld |
|---------------------|------------|----------------|
| William M. Lambert  | 31,975,512 | 4,298,227      |
| Diane M. Pearse     | 36,032,481 | 241,258        |
| L. Edward Shaw, Jr. | 29,500,048 | 6,773,691      |

Thomas H. Witmer was elected to serve until the annual meeting in 2009 by the following votes:

|                  | Votes For  | Votes Withheld |
|------------------|------------|----------------|
| Thomas H. Witmer | 35,858,329 | 415,410        |

Directors whose term of office continued after the meeting are Robert A. Bruggeworth, James A. Cederna, Thomas B. Hotopp, John T. Ryan III, and John C. Unkovic.

**Adoption of the 2008 Management Equity Incentive Plan**

The 2008 Management Equity Incentive Plan was adopted by the following votes:

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| Votes For  | Votes Against | Abstentions/Broker Nonvotes |
|------------|---------------|-----------------------------|
| 30,064,674 | 1,251,485     | 4,957,580                   |

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**Adoption of the 2008 Non-Employee Directors Equity Incentive Plan**

The 2008 Non-Employee Directors Equity Incentive Plan was adopted by the following votes:

| Votes For  | Votes Against | Abstentions/Broker Nonvotes |
|------------|---------------|-----------------------------|
| 28,858,049 | 2,453,622     | 4,962,068                   |

**Selection of Independent Registered Public Accounting Firm**

PricewaterhouseCoopers LLP was selected as the independent registered public accounting firm for the year ending December 31, 2008 by the following votes:

| Votes For  | Votes Against | Abstentions/Broker Nonvotes |
|------------|---------------|-----------------------------|
| 33,372,353 | 368,646       | 2,532,740                   |

**Item 6. EXHIBITS**

(a) Exhibits

- 10.1\* 2008 Management Equity Incentive Plan, filed as Exhibit 10.1 to Form 8-K dated May 13, 2008, is incorporated herein by reference
- 10.2\* 2008 Non-Employee Directors Equity Incentive Plan
- 10.3 Trust Agreement, effective June 1, 1996, as amended through May 13, 2008, between the registrant and PNC Bank, N.A. regarding the Mine Safety Appliances Company Stock Compensation Trust
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. (S)1350

\* The exhibits marked by an asterisk are management contracts or compensatory plans or arrangements.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

July 28, 2008

MINE SAFETY APPLIANCES COMPANY

/s/ Dennis L. Zeitler  
Dennis L. Zeitler  
Senior Vice President Finance;

Duly Authorized Officer and Principal Financial Officer

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