

MINE SAFETY APPLIANCES CO  
Form 10-Q  
October 27, 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 September 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

Smaller reporting company

(Do not check if a smaller

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 October 24, 2008, there were 35,786,621 shares of common stock outstanding, not including 2,378,462 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

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net sales	\$ 285,941	\$ 247,675	\$ 845,447	\$ 722,713
Other income	1,426	11,249	3,834	12,713
	287,367	258,924	849,281	735,426
Costs and expenses				
Cost of products sold	177,203	157,407	518,768	449,480
Selling, general and administrative	67,921	62,362	202,934	177,711
Research and development	9,485	7,560	26,039	20,274
Restructuring and other charges	1,045	707	3,276	3,202
Interest	2,307	2,653	7,082	6,878
Currency exchange (gains) losses	(879)	(23)	3,139	(1,259)
	257,082	230,666	761,238	656,286
Income before income taxes	30,285	28,258	88,043	79,140
Provision for income taxes	12,342	11,523	34,119	29,009
Net income	17,943	16,735	53,924	50,131
Basic earnings per common share	\$ 0.50	\$ 0.47	\$ 1.51	\$ 1.40
Diluted earnings per common share	\$ 0.50	\$ 0.46	\$ 1.50	\$ 1.38
Dividends per common share	\$ 0.24	\$ 0.22	\$ 0.70	\$ 0.62

See notes to condensed consolidated financial statements.

## MINE SAFETY APPLIANCES COMPANY

## CONDENSED CONSOLIDATED BALANCE SHEET

(In thousands, except share amounts)

Unaudited

	September 30 2008	December 31 2007
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 49,877	\$ 74,981
Trade receivables, less allowance for doubtful accounts of \$6,085 and \$6,558	206,088	205,737
Inventories	177,778	155,332
Deferred tax assets	23,153	21,821
Prepaid expenses and other current assets	55,494	39,179
Total current assets	512,390	497,050
Property, less accumulated depreciation of \$282,209 and \$276,583	137,907	130,445
Prepaid pension cost	224,419	212,304
Deferred tax assets	25,253	24,125
Goodwill	84,327	87,011
Other noncurrent assets	77,934	65,371
Total	1,062,230	1,016,306
<b>Liabilities and Shareholders Equity</b>		
Current liabilities		
Notes payable and current portion of long-term debt	\$ 74,580	\$ 54,676
Accounts payable	54,587	50,648
Employees compensation	28,492	24,920
Insurance and product liability	24,917	15,192
Taxes on income	7,395	7,199
Other current liabilities	54,909	56,554
Total current liabilities	244,880	209,189
Long-term debt	93,448	103,726
Pensions and other employee benefits	126,234	126,790
Deferred tax liabilities	100,686	100,934
Other noncurrent liabilities	11,247	13,129
Total liabilities	576,495	553,768
Minority interests	909	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 35,786,942 and 35,661,776 shares)	68,603	63,303
Stock compensation trust 2,378,462 and 2,530,206 shares	(12,417)	(13,208)

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Treasury shares, at cost:			
Preferred	52,878 and 52,841 shares	(1,752)	(1,750)
Common	23,915,987 and 23,889,409 shares	(256,065)	(255,096)
Accumulated other comprehensive income		25,539	36,233
Retained earnings		657,349	628,480
Total shareholders' equity		484,826	461,531
Total		1,062,230	1,016,306

See notes to condensed consolidated financial statements.

## MINE SAFETY APPLIANCES COMPANY

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(In thousands)

Unaudited

	Nine Months Ended September 30	
	2008	2007
<b>Operating Activities</b>		
Net income	\$ 53,924	\$ 50,131
Depreciation and amortization	21,108	17,613
Pensions	(6,768)	(3,507)
Net gain on sale of investments and assets	(628)	(11,001)
Stock-based compensation	4,444	4,047
Deferred income taxes	(2,795)	1,257
Other noncurrent assets and liabilities	(16,135)	(19,810)
Currency exchange losses (gains)	3,139	(1,259)
Other, net	(1,812)	2,738
<b>Operating cash flow before changes in working capital</b>	<b>54,477</b>	<b>40,209</b>
Trade receivables	(6,756)	(13,944)
Inventories	(30,097)	(8,658)
Accounts payable and accrued liabilities	20,686	21,968
Prepays and other current assets	(17,056)	(5,115)
<b>Increase in working capital</b>	<b>(33,223)</b>	<b>(5,749)</b>
<b>Cash flow from operating activities</b>	<b>21,254</b>	<b>34,460</b>
<b>Investing Activities</b>		
Property additions	(30,931)	(22,469)
Property disposals	1,845	14,596
Acquisitions, net of cash acquired and other investing	(2,247)	(6,953)
<b>Cash flow from investing activities</b>	<b>(31,333)</b>	<b>(14,826)</b>
<b>Financing Activities</b>		
Proceeds from (payments on) short-term debt, net	19,820	46,659
Payments on long-term debt	(10,000)	(2,000)
Cash dividends	(25,055)	(22,285)
Company stock purchases	(970)	(25,561)
Exercise of stock options	754	1,947
Excess tax benefit related to stock plans	894	1,334
<b>Cash flow from financing activities</b>	<b>(14,557)</b>	<b>94</b>
<b>Effect of exchange rate changes on cash</b>	<b>(468)</b>	<b>2,851</b>
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(25,104)</b>	<b>22,579</b>
<b>Beginning cash and cash equivalents</b>	<b>74,981</b>	<b>61,296</b>

**Ending cash and cash equivalents**

49,877

83,875

See notes to condensed consolidated financial statements.

## 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 nine month periods ended September 30, 2008, we recorded charges of \$1.0 million (\$0.7 million after tax) and \$3.3 million (\$2.1 million after tax), respectively. For the nine months ended September 30, 2008, these charges included \$2.8 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 for the nine months ended September 30, 2008 were severance costs related to workforce reductions associated with our strategic initiative to improve our business in Japan.

During the three and nine month periods ended September 30, 2007, we recorded charges of \$0.7 million (\$0.4 million after tax) and \$3.2 million (\$2.0 million after tax), respectively. These charges for the nine months ended September 30, 2007 were primarily related to reorganization activities. North American charges of \$1.7 million were primarily stay bonuses and severance costs associated with our Project Magellan initiative to move fire helmet manufacturing from Clifton, New Jersey to Jacksonville, North Carolina and to move our Mexican manufacturing operations to a new factory in Queretaro, Mexico. European charges of \$1.0 million related to severance costs associated with the reorganization of our management team. International charges of \$0.5 million related to severance costs associated with the workforce reductions in Brazil and Australia.

**(3) Comprehensive Income**

Components of comprehensive income are as follows:

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30 2008	September 30 2007	September 30 2008	September 30 2007
Net income	\$ 17,943	\$ 16,735	\$ 53,924	\$ 50,131
Cumulative translation adjustments	(24,025)	7,404	(10,694)	10,675
Pension and other benefit plan adjustments, net of tax		(667)		(479)
Comprehensive income	(6,082)	23,472	43,230	60,327





Components of accumulated other comprehensive income are as follows:

(In thousands)	September 30 2008	December 31 2007
Cumulative translation adjustments	\$ 8,792	\$ 19,486
Pension and post-retirement plan adjustments	16,747	16,747
Accumulated other comprehensive income	25,539	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 September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Net income	\$ 17,943	\$ 16,735	\$ 53,924	\$ 50,131
Preferred stock dividends	10	10	30	30
Income available to common shareholders	17,933	16,725	53,894	50,101
Basic earnings per common share	\$ 0.50	\$ 0.47	\$ 1.51	\$ 1.40
Diluted earnings per common share	\$ 0.50	\$ 0.46	\$ 1.50	\$ 1.38
Basic shares outstanding	35,617	35,559	35,584	35,713
Stock options	344	600	406	581
Diluted shares outstanding	35,961	36,159	35,990	36,294
Antidilutive stock options	756	2	756	2

#### (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 America	Europe	International	Reconciling Items	Consolidated Totals
<b>Three Months Ended September 30, 2008</b>					
Sales to external customers	\$ 140,819	\$ 72,796	\$ 72,326	\$	\$ 285,941
Intercompany sales	16,556	29,965	3,761	(50,282)	
Net income	10,914	1,672	4,170	1,187	17,943
<b>Nine Months Ended September 30, 2008</b>					
Sales to external customers	\$ 436,143	\$ 210,054	\$ 199,250	\$	\$ 845,447
Intercompany sales	43,816	86,378	10,656	(140,850)	
Net income	36,833	6,041	12,696	(1,646)	53,924
<b>Three Months Ended September 30, 2007</b>					

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Sales to external customers	\$ 129,737	\$ 58,800	\$ 59,138	\$	\$ 247,675
Intercompany sales	10,942	20,577	1,950	(33,469)	
Net income	13,797	(379)	3,878	(561)	16,735

**Nine Months Ended September 30, 2007**

Sales to external customers	\$ 384,456	\$ 167,913	\$ 170,344	\$	\$ 722,713
Intercompany sales	32,586	66,291	5,186	(104,063)	
Net income	34,930	4,065	11,512	(376)	50,131

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 September 30</b>				
Service cost	\$ 2,585	\$ 2,371	\$ 173	\$ 159
Interest cost	4,797	4,455	463	371
Expected return on plan assets	(9,267)	(8,467)		
Amortization of transition amounts	7	10		
Amortization of prior service cost	46	43	(89)	(87)
Recognized net actuarial (gains) losses	(461)	313	304	192
Net periodic benefit (credit) cost	(2,293)	(1,275)	851	635
<b>Nine months ended September 30</b>				
Service cost	\$ 7,380	\$ 7,635	\$ 520	\$ 477
Interest cost	14,376	13,213	1,391	1,113
Expected return on plan assets	(27,709)	(25,353)		
Amortization of transition amounts	12	32		
Amortization of prior service cost	138	128	(268)	(267)
Recognized net actuarial (gains) losses	(965)	838	911	582
Net periodic benefit (credit) cost	(6,768)	(3,507)	2,554	1,905

We made contributions of \$1.8 million to our pension plans during the nine months ended September 30, 2008.

**(7) Goodwill and Intangible Assets**

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

(In thousands)	Goodwill	Intangibles
Net balances at January 1, 2008	\$ 87,011	\$ 15,633
Goodwill and intangible assets acquired		2,158
Adjustments to purchase price allocation	(1,289)	1,289
Amortization expense		(2,542)
Currency translation and other	(1,395)	(246)
Net balances at September 30, 2008	84,327	16,292

At September 30, 2008, goodwill of approximately \$63.5 million, \$17.5 million, and \$3.3 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.

Intangible assets acquired include additional consideration of \$1.9 million payable to the former owners of Acceleron based on the achievement of specific technology milestones by September 28, 2008.



**(8) Inventories**

(In thousands)	September 30 2008	December 31 2007
Finished products	\$ 73,077	\$ 64,513
Work in process	32,790	28,582
Raw materials and supplies	71,911	62,237
Total inventories	177,778	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 September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Restricted stock awards	\$ 499	\$ 477	\$ 2,281	\$ 2,207
Stock option grants	501	259	2,163	1,840
Total compensation expense before income taxes	1,000	736	4,444	4,047
Income tax benefit	344	295	1,546	1,454
Total compensation expense, net of income tax benefit	656	441	2,898	2,593

A summary of stock option activity for the nine months ended September 30, 2008 follows:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2008	1,562,405	\$ 23.12
Granted	224,961	44.93
Exercised	(80,927)	9.32
Outstanding at September 30, 2008	1,706,439	26.65
Exercisable at September 30, 2008	1,229,907	19.07



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

	Shares	Weighted Average Grant Date Fair Value
Unvested at January 1, 2008	183,333	\$ 42.00
Granted	71,900	44.68
Vested	(62,788)	43.35
Forfeited	(2,341)	41.74
Unvested at September 30, 2008	190,104	42.57

#### (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. The notional amount of the swap was \$16.0 million as of September 30, 2008. The notional amount of the swap declines \$4.0 million each August through August 2012. 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 September 30, 2008 was insignificant. 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 nine months ended September 30, 2008 and an increase in interest expense of \$0.3 million during the nine months ended September 30, 2007.

As part of our currency exchange rate risk management strategy, we enter into certain derivative foreign currency forward contracts that do not meet the criteria for hedge accounting under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities. At September 30, 2008, we maintained foreign currency forward contracts with a total notional amount of \$27.4 million that do not qualify as hedges, but which have the impact of partially offsetting certain foreign currency exposures. We account for these forward contracts on a full mark-to-market basis through current earnings. Net unrealized losses related to these contracts totaled \$0.7 million at September 30, 2008. These losses are reported in currency exchange gains and losses, with a corresponding liability reported in other current liabilities. These contracts are scheduled to mature prior to December 31, 2008.

#### (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 initial purchase price of \$5.7 million included amounts paid to the previous owners and other direct costs associated with the acquisition. In accordance with the terms of the acquisition agreement, additional cash consideration of \$1.9 million, which was charged to intangible assets, was payable to the former owners of Acceleron based on the achievement of specific technology development milestones by September 28, 2008. Under the terms of the acquisition agreement, we have no further obligations to the former owners of Acceleron.

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 September 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 September 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 September 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 instruments described in Note 10. We estimate the fair value of these financial instruments, consisting of an interest rate swap and foreign currency forward contracts, based upon valuation models with inputs that generally can be verified by observable market conditions and do not involve significant management judgment. Accordingly, the fair values of these financial instruments are 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 2,700 lawsuits, primarily involving respiratory protection products allegedly manufactured and sold by us. Collectively, these lawsuits represent a total of approximately 13,000 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. We filed a motion to compel discovery, which was granted by the court in October 2008, and Century has begun to comply with that order. 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 \$64.2 million and \$39.1 million at September 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 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 products that protect people's health and safety. Our 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 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 September 30, 2008 Compared to Three Months Ended September 30, 2007

**Net sales.** Net sales for the three months ended September 30, 2008 were \$285.9 million, an increase of \$38.2 million, or 15%, compared with \$247.7 million for the three months ended September 30, 2007.

(In millions)	Three Months Ended September 30		Dollar Increase	Percent Increase
	2008	2007		
North America	\$ 140.8	\$ 129.7	\$ 11.1	9%
Europe	72.8	58.8	14.0	24
International	72.3	59.1	13.2	22

Net sales by the North American segment were \$140.8 million for the third quarter of 2008, an increase of \$11.1 million, or 9%, compared to \$129.7 million for the third quarter of 2007. During the third quarter of 2008, our sales of self-contained breathing apparatus (SCBA) improved \$15.3 million. SCBA sales for the third quarter of 2008 include \$13.2 million in shipments of our Firehawk<sup>®</sup>M7 Responder to the U.S. Air Force. Sales of Advanced Combat Helmets to the U.S. Army and CG634 helmets to the Canadian Forces were up \$2.3 million and \$2.1 million, respectively, in the current quarter. Shipments of gas masks and communication devices were down \$4.1 million and \$2.5 million, respectively, reflecting the completion of certain military orders.

Net sales for the European segment were \$72.8 million for the third quarter of 2008, an increase of \$14.0 million, or 24%, compared to \$58.8 million for the third quarter of 2007. Local currency sales in Europe were \$8.2 million higher than in the same quarter last year. The increase was primarily due to strong sales of SCBAs to the government in Germany and ballistic vests to the military in France. Currency translation effects increased European segment sales, when stated in U.S. dollars, by \$5.8 million, reflecting the stronger euro.

Net sales for the International segment were \$72.3 million in the third quarter of 2008, an increase of \$13.2 million, or 22%, compared to \$59.1 million for the third quarter of 2007. The sales increase was primarily in South Africa and Latin America, where local currency sales were up \$4.8 million and \$4.1 million, respectively. The improvement in South Africa was primarily due to strong growth in sales to the mining industry. Currency translation effects increased International segment sales, when stated in U.S. dollars, by \$2.0 million.

**Cost of products sold.** Cost of products sold was \$177.2 million in the third quarter of 2008, compared to \$157.4 million in the third quarter of 2007. Cost of products sold, selling, general and administrative expenses, and research and development expenses include net periodic pension credits during the third quarters of 2008 and 2007 of \$2.3 million and \$1.3 million, respectively.

**Gross profit.** Gross profit for the third quarter of 2008 was \$108.7 million, which was \$18.4 million, or 20%, higher than gross profit of \$90.3 million in the third quarter of 2007. The ratio of gross profit to net sales was 38.0% in the third quarter of 2008 compared to 36.4% in the same quarter last year. The higher gross profit ratio in the third 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 \$67.9 million during the third quarter of 2008, an increase of \$5.5 million, or 9%, compared to \$62.4 million in the third

quarter of 2007. Selling, general and administrative expenses were 23.8% of net sales in the third quarter of 2008 compared to 25.2% of net sales in the third quarter of 2007. Local currency selling, general and administrative expenses in the European and International segments were up \$5.5 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 \$2.4 million lower quarter-to-quarter, primarily due to ongoing cost control efforts. Currency exchange effects increased third quarter 2008 administrative expense, when stated in U.S. dollars, by \$2.4 million, primarily related to a stronger euro and Brazilian real.

**Research and development expense.** Research and development expense was \$9.5 million during the third quarter of 2008, an increase of \$1.9 million, or 25%, compared to \$7.6 million during the third 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 \$7.3 million for the third quarter of 2008, an increase of \$1.8 million, or 31%, compared to \$5.5 million for the third quarter of 2007. The increase was primarily related to depreciation on production and computer equipment and amortization of intangible assets in North America.

**Restructuring and other charges.** During the third quarter 2008, we recorded charges of \$1.0 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 third quarter of 2007, we recorded charges of \$0.7 million, primarily severance costs and moving expenses associated with our North American segment Project Magellan move of fire helmet manufacturing from Clifton, New Jersey to our Jacksonville, North Carolina plant and the move of our Mexican manufacturing operations to a new factory in Queretaro, Mexico.

**Interest expense.** Interest expense was \$2.3 million during the third quarter of 2008, a decrease of \$0.4 million, or 13%, compared to \$2.7 million in the third quarter of 2007. The decrease in interest expense was primarily due to reductions in long-term debt and lower interest rates on short-term debt.

**Currency exchange (gains) losses.** Currency exchange gains of \$0.9 million in the third quarter of 2008 were primarily related to the effect of a weaker euro on inter-company balances. Currency exchange gains were insignificant in the third quarter of 2007.

**Other income.** Other income was \$1.4 million for the third quarter of 2008 compared to \$11.2 million in the third quarter of 2007. During the third quarter of 2007, we sold 83 acres of property in our Cranberry Woods office park to Wells Real Estate Investment Trust II - Cranberry Woods Development, Inc. for \$14.6 million. This sale resulted in a pretax gain of \$10.6 million (\$6.5 million after-tax).

**Income taxes.** The effective tax rate was 40.8% in both the third quarter of 2008 and the third quarter of 2007. The third quarter 2008 provision for income taxes includes a one-time charge of \$0.5 million related to the settlement of a tax audit in Germany.

The third quarter 2007 provision for income taxes included a one-time charge of \$1.6 million to adjust our net deferred tax assets in Germany as a result of a reduction in the German statutory income tax rate of approximately 9% that was enacted during that quarter. The lower rate became effective January 1, 2008.

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 September 30, 2008 was \$17.9 million, an increase of \$1.2 million, or 7%, compared to \$16.7 million for the same quarter last year. Net income for the third quarter of 2007 included an after-tax gain of \$6.5 million on the sale of Cranberry Woods property. Excluding this gain, net income increased \$7.7 million, or 75%. Basic earnings per share of common stock were \$0.50 for the third quarter of 2008, compared to \$0.47 for the third quarter of 2007.

North American segment net income for the third quarter of 2008 was \$10.9 million, a decrease of \$2.9 million, or 21%, compared to \$13.8 million in the third quarter of 2007. As previously noted, North American segment net income for the three months ended September 30, 2007 included an after-tax gain of \$6.5 million on the sale of Cranberry Woods property. Excluding this gain, net income for the North American segment increased \$3.6 million, or 50%, primarily due to the previously-discussed increase in sales and reductions in operating costs.

European segment net income for the third quarter of 2008 was \$1.7 million, an increase of \$2.1 million compared to a net loss of \$0.4 million during the third quarter of 2007. As previously noted, European segment net income for the third quarter of 2008 and 2007 include one-time income tax charges of \$0.5 million and \$1.6 million, respectively. Excluding these charges, European segment net income improved \$1.0 million the current quarter, reflecting the previously-discussed increase in local currency sales.

International segment net income for the third quarter of 2008 was \$4.2 million, an increase of \$0.3 million, or 8%, compared to \$3.9 million in the same quarter last year.

Income of \$1.2 million reported in reconciling items for the third quarter of 2008 was primarily related to the previously-discussed currency exchange gains.

#### **Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007**

**Net sales.** Net sales for the nine months ended September 30, 2008 were \$845.4 million, an increase of \$122.7 million, or 17%, compared with \$722.7 million for the same period in 2007.

(In millions)	Nine Months Ended		Dollar Increase	Percent Increase
	September 30 2008	September 30 2007		
North America	\$ 436.1	\$ 384.5	\$ 51.6	13%
Europe	210.1	167.9	42.2	25
International	199.3	170.3	29.0	17

Net sales in the North America segment were \$436.1 million for the nine months ended September 30, 2008, an increase of \$51.6 million, or 13%, compared to \$384.5 million for the same period in 2007. SCBA sales during the nine months ended September 30, 2008 were \$39.7 million higher than in the same period last year. SCBA sales during the nine months ended 2008 include \$25.8 million in shipments of our Firehawk<sup>®</sup>M7 Responder to the U.S. Air Force. The remainder of the increase in SCBA sales reflects higher first quarter 2008 shipments on 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. Sales of head protection, primarily to the construction industry, improved \$5.5 million in the current period. Higher sales of Advanced Combat Helmets to the U.S. Army and CG634 helmets to the Canadian Forces, up \$10.7 million and \$11.2 million, respectively, in the current period, were partially offset by a \$3.8 million decrease in shipments of other ballistic protection. Shipments of gas masks and communication devices were down \$5.6 million and \$3.8 million, respectively, reflecting the completion of certain military orders.

Net sales in Europe were \$210.1 million for the nine months ended September 30, 2008, an increase of \$42.2 million, or 25%, compared to \$167.9 million for the same period in 2007. The increase in European sales, when



stated in U.S. dollars, includes favorable currency translation effects of \$28.9 million, primarily due to a stronger euro in the current period. Local currency sales in Europe for the nine months ended September 30, 2008 were \$13.3 million higher than in the same period last year. The increase reflects improved sales of helmets and ballistic vests to the fire service, law enforcement agencies and the military in France, strong shipments of SCBAs to the government in Germany, and higher sales of SCBAs and air purifying respirators in Eastern Europe.

Net sales for the International segment were \$199.3 million for the nine months ended September 30, 2008, an increase of \$29.0 million, or 17%, compared to \$170.3 million for the same period in 2007. Local currency sales in the International segment for the nine months ended September 30, 2008 were \$19.2 million higher than in the same period last year. The sales increase was primarily in South Africa and Latin America where local currency sales were up \$12.8 million and \$10.4 million, respectively. The improvement in South Africa was primarily due to strong growth in sales to the mining industry. The increase in International segment sales, when stated in U.S. dollars, includes favorable currency translation effects of \$9.8 million, primarily due to a stronger Brazilian real and Australian dollar in the current period.

**Cost of products sold.** Cost of products sold was \$518.8 million for the nine months ended September 30, 2008 compared to \$449.5 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 credits during the nine month periods ended September 30, 2008 and 2007 of \$6.8 million and \$3.5 million, respectively.

**Gross profit.** Gross profit for the nine months ended September 30, 2008 was \$326.7 million, which was \$53.5 million, or 20%, higher than gross profit of \$273.2 million in the same period in 2007. The ratio of gross profit to net sales was 38.6% in the nine months ended September 30, 2008 compared to 37.8% in the same period last year. The higher gross profit ratio during the nine months ended 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 \$202.9 million during the nine months ended September 30, 2008, an increase of \$25.2 million, or 14%, compared to \$177.7 million for the same period in 2007. Selling, general and administrative expenses were 24.0% of net sales in the nine months ended September 30, 2008 compared to 24.6% of net sales in the same period last year. Local currency selling, general and administrative expenses in the European and International segments were up \$14.1 million in the nine months ended September 30, 2008, reflecting our increased focus on global initiatives and the higher selling and marketing expenses required to sustain our growth in these markets. North American segment selling, general and administrative expenses were up \$2.3 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 \$9.4 million, primarily due to a stronger euro, Brazilian real, and Australian dollar.

**Research and development expense.** Research and development expense was \$26.0 million for the nine months ended September 30, 2008, an increase of \$5.7 million, or 28%, compared to \$20.3 million during the same period last year. 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 \$21.1 million for the nine months ended September 30, 2008, an increase of \$3.5 million, or 20%, compared to \$17.6 million for the same period in 2007. The increase was primarily related to depreciation on production and computer equipment and amortization of intangible assets in North America.

**Restructuring and other charges.** During the nine months ended September 30, 2008, we recorded charges of \$3.3 million. These charges were primarily in the North American segment, and related to costs associated with our Project Magellan initiative to outsource or transfer certain production activities from our Evans City, Pennsylvania plant.

During the nine months ended September 30, 2007, we recorded charges of \$3.2 million, primarily related to reorganization activities. North American charges of \$1.7 million were primarily severance costs and moving expenses associated with our Project Magellan initiative to move fire helmet manufacturing from Clifton, New Jersey to Jacksonville, North Carolina and to move our Mexican manufacturing operations to a new factory in Queretaro, Mexico. The remainder of the charges were for severance costs associated with the reorganization of our management team and workforce reductions in the European and International segments.

**Currency exchange (gains) losses.** Currency exchange losses were \$3.1 million during the nine months ended September 30, 2008, compared to currency exchange gains of \$1.3 million during the same period last year. Currency exchange losses during the first nine months of 2008 were primarily unrealized, and related mainly to the effects of a stronger euro and a weaker South African rand on inter-company balances and losses on Canadian dollar trade receivables. The currency exchange gains during the first nine months of 2007 were primarily related to the strengthening of the Canadian dollar and Australian dollar.

**Other income.** Other income was \$3.8 million for the nine months ended September 30, 2008 compared to \$12.7 million in the same period last year. During the nine months ended September 30, 2007, we sold 83 acres of property in our Cranberry Woods office park to Wells Real Estate Investment Trust II - Cranberry Woods Development, Inc. for \$14.6 million. This sale resulted in a pretax gain of \$10.6 million (\$6.5 million after-tax).

**Income taxes.** The effective tax rate for the nine months ended September 30, 2008 was 38.8% compared to 36.7% for the same period last year. The provision for income taxes for the nine months ended September 30, 2008 includes one-time charges in Germany totaling \$0.9 million related to a tax law change that imposed a 3% flat tax on previously untaxed subsidies and the settlement of a tax audit.

The provision for income taxes for the nine months ended September 30, 2007 included a one-time charge of \$1.6 million to adjust our net deferred tax assets in Germany as a result of a reduction in the German statutory income tax rate of approximately 9% that was enacted during the third quarter of that year. The lower rate was effective January 1, 2008.

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 nine months ended September 30, 2008 was \$53.9 million, an increase of \$3.8 million, or 8%, compared to \$50.1 million for the nine months ended September 30, 2007. Net income for the nine months ended September 30, 2007 included an after-tax gain of \$6.5 million on the sale of Cranberry Woods property. Excluding this gain, net income increased \$10.3 million, or 24%. Basic earnings per share of common stock was \$1.51 for the nine months ended September 30, 2008, compared to \$1.40 for the same period last year.

North American segment net income for the nine months ended September 30, 2008 was \$36.8 million, an increase of \$1.9 million, or 5%, compared to \$34.9 million in the same period last year. As previously-noted, net income for the nine months ended September 30, 2007 included an after-tax gain of \$6.5 million on the sale of Cranberry Woods property. Excluding this gain, net income for the North American segment increased \$8.4 million, or 30%, primarily due to the previously-discussed increase in sales and reduction in operating costs.

European segment net income for the nine months ended September 30, 2008 was \$6.0 million, an increase of \$1.9 million, or 49%, from \$4.1 million for the same period last year. As previously noted, European segment net income for the nine months ended September 30, 2008 and 2007 included one-time income tax charges of \$0.9 million and \$1.6 million, respectively. Excluding these charges, European segment net income improved \$1.2 million in the current period, reflecting the previously-discussed increase in sales.

International segment net income for the nine months ended September 30, 2008 was \$12.7 million, an increase of \$1.2 million, or 10%, compared to \$11.5 million in the same period last year. The increase was primarily due to the previously-discussed increase in local currency sales.

The loss of \$1.6 million reported in reconciling items for the nine months ended September 30, 2008 was primarily related to the previously-discussed unrealized 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 \$25.1 million during the nine months ended September 30, 2008, compared to an increase of \$22.6 million during the nine months ended September 30, 2007.

Operating activities provided cash of \$21.3 million during the nine months ended September 30, 2008, compared to providing cash of \$34.5 million during the nine months ended September 30, 2007. Lower cash flow from operations in the nine months ended September 30, 2008 reflected higher use of cash for working capital items, particularly inventory. During the nine months ended September 30, 2008, local currency inventories increased \$30.1 million, compared to an increase of \$8.7 million in the same period last year. LIFO inventories were \$177.8 million at September 30, 2008 and \$155.3 million at December 31, 2007. Trade receivables were \$206.1 million at September 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 production related to the previously-mentioned U.S. Air Force contract. Currency exchange effects reduced trade receivables and inventories, when stated in U.S. dollars, by \$6.4 million and \$7.7 million, respectively.

Investing activities used cash of \$31.3 million during the nine months ended September 30, 2008, compared to using cash of \$14.8 million in the same period last year. During the nine months ended September 30, 2008 and 2007, we used cash of \$30.9 million and \$22.5 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 nine months ended September 30, 2007, we received net cash of \$13.9 million related to our sale of Cranberry Woods property and used cash of \$5.7 million to acquire Acceleron Technologies, LLC.

Financing activities used cash of \$14.6 million during the nine months ended September 30, 2008, compared to providing cash of \$0.1 million in the same period last year. Our short-term borrowings, increased \$19.8 million and \$46.7 million, respectively, during the nine months ended September 30, 2008 and 2007. Proceeds from short-term borrowings were used primarily to finance property additions and increases in working capital and insurance receivables. During the nine months ended September 30, 2008 and 2007, we paid cash dividends of \$25.1 million and \$22.3 million, respectively, and made treasury share purchases of \$1.0 million and \$25.6 million, respectively.

## **CUMULATIVE TRANSLATION ADJUSTMENTS**

The position of the U.S. dollar relative to international currencies at September 30, 2008 resulted in a translation loss of \$10.7 million being charged to the cumulative translation adjustments shareholders' equity account during the nine months ended September 30, 2008, compared to a gain of \$10.7 million being credited to the cumulative translation adjustments shareholders' equity account during the nine months ended September 30, 2007. The translation loss during the nine months ended September 30, 2008 was primarily due to a weakening of the euro, the Brazilian real and the Australian dollar. The translation gain during the nine months ended September 30, 2007 was primarily due to the strengthening of the euro and the Brazilian real.

## 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 Armor and Equipment, Inc. 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.

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 2,700 lawsuits, primarily involving respiratory protection products allegedly manufactured and sold by us. Collectively, these lawsuits represent a total of approximately 13,000 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. We filed a motion to compel discovery, which was granted by the court in October 2008,

and Century has begun to comply with that order. 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 \$64.2 million and \$39.1 million at September 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 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 nine months ended September 30, 2008 by approximately \$40.9 million and \$1.9 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 September 30, 2008, we maintained foreign currency forward contracts with a total notional amount of \$27.4 million that do not meet the criteria for hedge accounting under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities, but which have the impact of partially offsetting certain foreign currency exposures. We account for these forward contracts on a full mark-to-market basis through current earnings. Net unrealized losses related to these contracts totaled \$0.7 million at September 30, 2008. These contracts are scheduled to mature prior to December 31, 2008.

**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 September 30, 2008, the swap agreement had a notional amount of \$16.0 million. The fair market value of the interest rate swap was insignificant at September 30, 2008. The swap will expire in 2012. The notional amount of the swap declines \$4.0 million each August. 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 \$92.0 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
July 1 July 31, 2008				1,473,978
August 1 August 31, 2008	2,590	\$ 36.33		1,340,496
September 1 September 30, 2008				1,277,550

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 August 2008 related to stock compensation transactions.

**Item 6. EXHIBITS**

## (a) Exhibits

- 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



**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.

October 27, 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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