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MSA - Q1 2013 Mine Safety Appliances Earnings Conference Call

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PRESENTATION

Operator

Welcome to the MSA first-quarter earnings conference call. My name is Christine and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session. Please note that this conference is being recorded.

I will now turn the call over to Mark Deasy. You may begin.

Mark Deasy - *MSA - Corporate Communications Director*

Thank you, Christine. Good morning, everybody. I too would like to welcome you to our first quarter earnings conference call for 2013. As Christine said, I am Corporate Communications Director and with me this morning are Bill Lambert, President and Chief Executive Officer; Dennis Zeitler, Senior Vice President and Chief Financial Officer; Joe Bigler, President of MSA North America; Ron Herring, President of MSA International who is responsible for our business in Europe, Russia, the Middle East, India and North Africa; and lastly Kerry Bove, President of MSA International responsible for Latin America, Asia, Australia and sub-Saharan Africa.

Our first quarter press release was issued this morning at 8.30 and we hope everyone has had an opportunity to review it. The release is available on the homepage of our Web site at www.msasafety.com. This morning Bill Lambert will provide his commentary on our quarter, Dennis will review our financials and then Bill will conclude with formal remarks with a few closing comments. After that, we will open up the call for your questions.

Before we begin, I want to remind everybody that the matters discussed on this call, excluding historical information, are forward looking statements within the meaning of Private Securities Litigation Reform Act of 1995. Forward looking statements, including without limitation, are projections and anticipated levels of future performance, involve risks, uncertainties and other factors that may cause our actual results to differ materially from those discussed here. These risks, uncertainties and other factors are detailed from time to time in our filings with the SEC, including our most recent Form 10-K which was filed on February 20 of this year. You are strongly urged to review all such filings for a more detailed discussion of such risks. Our SEC filings can be easily obtained at no charge at www.sec.gov, our own Web site and many other commercial sites.

That concludes our forward looking statements. At this point, I'll turn the call over to Bill Lambert for his comments. Bill?

Bill Lambert - *MSA - CEO and President*

Thank you, Mark. Good morning, everyone. Let me begin by saying thank you for joining us today on this conference call and for your continued interest in MSA. Presumably all of you have seen our first quarter press release and have our financial figures with all comparisons corresponding to the equivalent period in 2012.

As we discussed in our last call in February, I told you we were seeing uneven economic and business conditions in the early weeks of 2013. Order activity was choppy in January and to some extent into February. This was due to seasonal slowdowns associated with the Chinese new year, holidays and vacation in the southern hemisphere and the uncertainty surrounding the sequestration issued in the US. I was pleased to see our order pace show an improving trend during the second half of the first quarter. And that has remained so into the first few weeks of the second quarter. While this does give us a little encouragement as we head into the second quarter, uncertainty in the global economy seems ever present. Therefore, we remain diligent on managing and controlling operating costs to assure improved performance going forward.

Additionally, our management team remains committed to executing our corporate strategy with a strong focus on -- one, growing MSAs core business in both developed and emerging growth markets around the world; two, developing innovative new products that help keep our customers safe in the workplace and; three, diligent management of manufacturing and operating costs by executing efficiency initiatives like Europe 2.0. Which, as I've described before, is the next step we have taken in our European transformation. This initiative is focused on the integration and alignment of our SAP IT systems throughout Europe. It is focused on transitioning Europe from a [SOB] optimized affiliate based organization to one that is pan-European, working under common processes and data and enabled by a common IT platform. Our goal is to improve our customer service while decreasing the complexity and cost of our business in generating more robust financial performance out of MSA Europe.

Of particular note, I am pleased with the progress that we are making on the previously mentioned Europe 2.0 program. Over the Easter weekend, we had our first go live event with the new system in Germany, our largest and most complex organization in Europe, with no disruptions in our business. In fact, we are already beginning to see the operational business process improvement efficiencies that we had expected leading longer-term to reduce costs, and improve customer service. It is important to note that we will have close to 70% of our Western European revenues under the Europe 2.0 system by the beginning of 2014.

As you saw in our press release, our consolidated sales for the quarter were $283 million. On an as reported basis, sales were down $10 million from a year ago. However, the first quarter of 2012 included $5 million of ballistic helmet sales in our North American segment. This non-core business was divested in the second quarter of 2012. Additionally, weakening foreign currencies decreased as reported first quarter 2013 sales by $5 million. Therefore, excluding the currency effect and the divested business impacts, our sales were relatively flat when compared to the first quarter of 2012. Dennis will provide more of the financial performance details and a breakout by region and by market in his comments.

In my comments, I want to discuss and provide context to you regarding our strategy to grow this business and to expand our operating margins. Driving demand for core MSA product lines remains a key element of our long-term strategy. As you probably recall, these lines include fixed gas and flame detection instrument systems, portable gas detection instruments, industrial head protection products, supplied air respirators, and fall protection products. Sales from these five core product lines comprised almost 70% of our total first-quarter sales. And showed local currency revenue growth of 3% when compared to the first quarter of 2012.

When analyzing year-over-year core product sales growth, I think it is important to consider the significant amount of large orders we delivered in the first quarter of last year, which is a tough comparison because it was a record first quarter or MSA. Looking back at the first quarter of 2012, we delivered $5 million of non-recurring large fixed gas and flame detection instrument orders associated with large projects in the Middle East and in the Gulf of Mexico. As you might remember, Q1 of 2012 was a record quarter for General Monitors. Excluding those non-repeating large FG FD project related orders from the year-over-year comparison, MSA core product sales growth was 6% in the quarter, led by growth of 14% in breathing apparatus and 9% in portable gas detection products. In spite of the ongoing spending and restrictions that we see in the fire service market, the results we are achieving in increasing breathing apparatus shipments are very encouraging. The fire service remains a key market segment for MSA.

I have talked in the past about how we are positioning ourselves with new products for what we anticipate will be strong years late in 2013 and into 2014 and 2015 within the fire service. In these years, life cycle issues associated with older SCBA purchased 10 plus years ago with assistance to firefighter grant monies, we believe will be evaluated for replacement. In just a few days, one of MSA's largest fire service shows, the fire department instructors conference, or FDIC, will get underway in Indianapolis. We will be displaying two new products at the show. A new SCBA called the MSA M7XT air mask and a new thermal imaging camera called the MSA Evolution 6000. While we are currently in the final stages of obtaining the required NIOSH and NFPA approvals for these products, these new products provide me with a solid sense of optimism. We have until August to continue to sell our current version SCBA after that, all SCBA sales will be of the new M7XT version which will meet the latest NFPA performance standards.

We are focussed on executing key initiatives and programs throughout the fire service, the construction, oil and gas, mining and other key industrial markets that drive profitable growth of core products and improved levels of customer satisfaction and loyalty. We continue to see strong results from these efforts throughout developed and emerging markets like Mexico, where during Q1 a key distributor named MSA Mexico their supplier of the year.

As we have noted in the past, we remain committed to developing innovative new core products that enhance the MSA brand and advance the level of worker safety in the industries we serve. During the quarter, we showed solid progress in this area, introducing innovative new products like the mining version of our very successful ALTAIR 4X Portable Gas Detection product platform. This new version is specifically approved for the mining markets in North and South America. The incredible ruggedness, durability and low cost of ownership advantages that the ALTAIR 4X possesses resonates with mining market customers in both developed and emerging markets.

During the quarter, our team also developed and introduced a combination carbon monoxide H2S sensor which is the first combination sensor of its type in the world that is resistant to hydrogen. Carbon monoxide sensors that have been available to date are often cross sensitive to hydrogen, which can limit their application in steel mills and other applications. The new combination design addresses that problem and brings all of the performance benefits that our customers have come to expect from MSA's innovative line of XCell Sensors.

Staying in the portable instrument category, we launched major enhancements to the capability of our industry-leading MSA GX2 instrument calibration and data management systems. These enhancements, including new software named MSA Link Pro, allows users to manage the vast amounts of data from their large fleet of portable instruments on-site and without the need or expense of a third-party subscription service. Our voice of the customer market research efforts indicated customers wanted this. What we have developed and launched is the right data management package at an attractive price point that many customers in the marketplace are embracing as they look to lower their total cost of ownership.

The results we see from our R&D team continue to be encouraging and reinforced my belief that innovation and the continuous flow of new product introductions are critical to success in the advanced safety markets that we serve. The progress we're making in managing manufacturing costs and improving gross profits has part of our operational excellence initiatives is also encouraging. Our efforts to optimize our manufacturing footprint and improve our supply chain processes globally continue to yield solid results. Overall, these and other initiatives continue to favorably impact gross profit margin in the quarter which increased 80 basis points over Q1 a year ago.

In light of the ongoing economic uncertainty, we continue to implement and monitor contingency plans that require close management of operating costs. These contingency plans have us focused on controlling costs without sacrificing ongoing development of talent or the required investments in new products and new technologies.

Now I'd like to turn the call over to our CFO, Dennis Zeitler, who will provide greater insight into our first quarter financial performance. I will be back after the CFO's report to provide some closing comments. Dennis?

Dennis Zeitler - *MSA - CFO and SVP*

Thank you, Bill. Good morning. Let me give you my insight into our first-quarter performance and also comment on a balance sheet and cash flow statements. Additional information will be available later today when we file our Form 10-Q with the Securities and Exchange Commission.

As Bill mentioned, sales in the first quarter of 2013 were $283 million, down $10 million from the first quarter of last year. However, the first quarter of last year had $5 million of US ballistic helmet sales and a strength of the US dollar compared to last year further reduced our reported sales by another $5 million. So on a local currency basis, and excluding divested businesses, our sales this quarter were flat when compared to the record sales we had in the first quarter of last year.

By markets, our global fire service sales were up 5%. Our military business was down 39% and represented just 3% of total sales. Our industrial businesses, representing 70% of sales, was down 1% compared to last year. By product, our five core product groups were nearly 70% of sales and were up 3%. SCBA sales were up 14%, portable instruments were up 9%, and fall protection was up 3%. Head protection was down 2% and fixed gas and flame detection, which we abbreviate to FG and FD, was down 6% compared to an exceptionally strong first quarter last year. The remaining 30% of sales were down 6% with decreases in most product categories as we execute the first element of our corporate strategy to focus on our core, most profitable and growing product lines.

In North America, sales in the first quarter were down 1% due to the divested ballistic helmets business. Otherwise, sales were up 3%. Our sales to the fire service were 10% higher this quarter than last year, while our sales to the US military were down 74% and were less than $2 million. The remaining 71% of our North American sales was up 1%. By product group, our five core product groups represent 80% of sales in North America and were up 6% in total. North American SCBA sales were up 21%. Portable instruments were up 6% and fall protection was up 10%. However, head protection sales and FG and FD were each down 1%. As noted earlier, fixed gas and flame detection was exceptionally strong in the first quarter of last year. All other non-core product groups were down a total of 8%.

Our international segment reported sales were down 9%. However, 6% of this decrease is due to currency devaluation, especially the South African rand and the Brazilian real. Fire service sales were down 1% on lower sales of fire helmets and TIC cameras. Military business was only $1 million and the remaining 80% of our sales in the international segment were down 3%. This unusual decrease in our international sales happened in the region of the world where mining is our largest market and the recent weakness in commodity prices impacted our sales. Those are the Andean countries of South America, Southern Africa, and Australia, with our sales in these regions decreasing 11%. In the regions where mining is not as significant for us such as China, southeast Asia and Brazil, our sales were up 14%. In our overall international segment, sales of core products were up 1% for the quarter and represented 53% of total sales. SCBA sales were up 10% and portable instruments were up 7%. However, head protection was down 2% and both FG and FD and fall protection were down 10%. All other product groups were down 7%.

The second element of our corporate strategy is to grow our sales in emerging markets and sometimes investors tend to think of our international segment sales as synonymous with emerging markets. But, our reported North American sales include the emerging market of Mexico and our European sales include the emerging markets in Eastern Europe and Russia, while our international sales include the developed economies of Australia and Japan. So our actual emerging market sales were 29% of our total sales in the first quarter and they increased by 2% over last year. This is not the growth rate that we have historically enjoyed and we expect to report better numbers regarding this element of our corporate strategy in the future.

In Europe, our reported sales were down 2% but down 1% in local currency terms. European fire service sales were flat. Military sales were down 5% and the industrial business, representing 56% of total European sales, was down 2%. Core product sales were flat this quarter and comprised 66% of total sales. SCBA sales were up 8% and portable instruments were up 15%. However, head protection was down 6%. FG and FD was down 15% and fall protection sales were not material. All other product groups were down 4%. Again, this is an especially difficult comparison for our European sales which were up 17% in the first quarter of last year. Our gross profit rate for this quarter was 44.1%, an improvement of 80 basis points over last year, with gross profit dollars just $2 million less than last year even though sales are $10 million less.

The third element of our corporate strategy is to reduce costs. Our global efforts to reduce manufacturing costs, the increased percentage of our sales coming from the higher margin core products and more effective pricing, all contributed to this gross profit improvement. It is our expectation that we will continue to improve our gross profit margin by increasing volumes, cost discipline, product mix and value-based pricing. We are pleased to be reporting to our investors that these efforts continue to bear meaningful results. Administrative costs were up almost $5 million this quarter compared to last year. $2.3 million of this $5 million was due to changes in how we must account for executive stock based compensation. Of this $2.3 million, half is a one-time charge. The other half relates to certain senior executives who are now eligible to retire, although they are far too young to seriously consider that possibility.

We did not increase stock-based compensation. We only accelerated the recognition of the expense into the first half of this year versus the second half. Therefore, stock-based compensation over the remaining three quarters of this year will be $2 million less than last year. Another $1 million of the $5 million increase in administrative expense relates to salary inflation around the world, $1 million is one-time business development costs that we incurred and $1 million is a decrease in recorded pension income compared to last year. Except for merit increases that were granted over the past year, there was no ongoing increase in actual administrative spending compared to the first quarter of last year. Selling and marketing costs are up 4%, or a little less than $2 million, due to both merit salary increases and head count additions that are focused on driving sales of our core products.

Our investment in new product development this quarter was $10.6 million, up $1.4 million over last year as we are investing in a significant pipeline of new products to be introduced over the next 24 months. I do not expect this expense to increase significantly as the year progresses. There was a $1 million foreign currency loss this quarter and there were no restructuring charges. The resulting operating income, excluding those foreign currency expenses, was $31 million compared to $41 million last year. As a percent of sales, that is 11% this year versus 14% last year. About half of this $10 million decrease in last year is accounted for by the stock compensation accounting that I mentioned earlier, one-time business development expenses, and a decrease in pension income.

Contrary to last year, the first quarter is typically our lowest quarter. Given the numerous non-recurring expenses we saw this quarter, and the recent improvement in our customer orders, we do remain confident that we can accomplish our operating margin goal for the full year.

Our consolidated tax rate this quarter was 27%, down 300 basis points from last year due to our accounting this quarter for all of last year's research and development tax credit which was retroactively approved by Congress in early January and a pro rata portion of the credit for this year. I would expect the tax rate to be closer to 30% for the remainder of 2013. Bottom line, first quarter net income of $19 million, or $0.52 per basic share, compared to $0.65 last year. Adjusting only for the foreign-currency loss, pro forma EPS would be $0.54. Our cash position of $77 million is down $6 million in three months and is composed almost entirely of cash outside of the United States. Our total debt at the end of the quarter was $286 million. As you know, it is our plan over the next several years to significantly reduce our outstanding debt. We did see a significant increase in accounts receivable at the end of the quarter as March was a strong invoicing month. We invested $7 million in capitalized items and we paid over $10 million in dividends.

In summary, we are confident in our ability to grow sales and improve our financial performance. On a pro forma basis, our sales for the first quarter were a record by a slight margin and our operating earnings for the first quarter were second only to the unusually strong first quarter of last year.

I would now return the microphone to Bill.

Bill Lambert - *MSA - CEO and President*

Thank you, Dennis. As I look back at the quarter just finished, I see plenty of opportunity for encouragement and optimism as we saw successes on many fronts. However, there were some disappointments and unfavorable surprises in non-operating costs that detracted from our overall performance. We must do better in these areas in coming quarters and we will.

As we move forward in 2013, our plan is to continue to execute the same strategies that have transformed MSA into a company that has proven itself capable of delivering profitable growth throughout the economic cycle. Our focus remains on driving demand of core products throughout our markets and geographies, driving down manufacturing and operating costs while investing in new and innovative core products. We believe our strategy positions us to create value and gain profitable growth, even in uncertainty. Our market presence and product portfolio is stronger than ever but we are carefully monitoring economic condition and its impact on demand for our products and technologies. Attention to detail and agility in an uncertain environment will be key. I assure you that we remain focused on those areas of our business where we are seeing stability and we have good opportunity for growth. Agility will enable us to profitably grow, increase market share, and ensure the Company's long-term success.

At this time, Joe Bigler, Kerry Bove, Ron Herring, Dennis Zeitler, Stacy McMahan and I will be more than glad to take your questions. Please remember that MSA does not give what is referred to as guidance and that precludes most discussion related to our expectations for future sales and future earnings. Having said that, we will now open the call to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Edward Marshall, Sidoti & Company

Edward Marshall - *Sidoti & Company - Analyst*

Good morning, guys.

Bill Lambert - *MSA - CEO and President*

Good morning, Ed.

Edward Marshall - *Sidoti & Company - Analyst*

So if I can understand appropriately the SG&A expense and the selling expense. I think, Dennis, you said $2.3 million in change in stock based compensation based on the year-over-year comparison?

Dennis Zeitler - *MSA - CFO and SVP*

Correct.

Edward Marshall - *Sidoti & Company - Analyst*

I think you said $1 million or so of that is non-recurring?

Dennis Zeitler - *MSA - CFO and SVP*

Right.

Edward Marshall - *Sidoti & Company - Analyst*

What are you doing? Are you accelerating the option expense there due to timing of retirement? Is that what is going on?

Dennis Zeitler - *MSA - CFO and SVP*

There are two things going on, Ed. I will try to make it relatively clear. The non-recurring piece has to do with performance shares and how you have to account for them. If you have performance shares that are based upon an internal metric, you have to account for them on a market-based value. So it's not like -- if you have a performance share that is based on a market like a total shareholder return, that gets accounted for at the time that they are issued at the value of the stock when they are issued and that never changes. Doesn't go up, doesn't go down. Right? When we issue a performance share unit that is based on an internal metric, if the share price goes up, we have to account for the incremental cost and incremental value of that or if it goes down. We had to account for the increase in our stock price. Now, we changed it, so we no longer have performance share units based on internal metrics. They are all based on total shareholder return. So this is the last year that we are going to have this catch up on the value of the stock.

Edward Marshall - *Sidoti & Company - Analyst*

So the change in the principal so to speak?

Dennis Zeitler - *MSA - CFO and SVP*

Basically, yes. It was tricky win that we had not caught before. Did not realize that the accounts thought there was two different ways to account for something like that. The other half is strictly based on a group of our executives getting close to age 55. And Bill's birthday is actually April 1. He turned 55 so we had to account for it, not only in the first quarter but we have to account for some of it in the second quarter. And then Kerry and Ron and we have a significant group that are 53, 54 as they get close to the age, we have to accelerate that recognition.

Edward Marshall - *Sidoti & Company - Analyst*

Okay.

Dennis Zeitler - *MSA - CFO and SVP*

We did not increase it. The total this year will be no more than it was last year. Actually because of some of these catch ups, in future years the expense will actually go down.

Edward Marshall - *Sidoti & Company - Analyst*

That make sense. So if I could ask, you are running at 83.6 in Q1. You are saying about $1 million per se? What is the full balance that would be considered non-recurring?

Dennis Zeitler - *MSA - CFO and SVP*

$1 million. $1 million was non-recurring. But if you are looking at quarter over quarter, so you go to the second quarter, stock compensation will still be about $1 million over quarter two 2013 over quarter two 2012.

Edward Marshall - *Sidoti & Company - Analyst*

If I throw a number out, say 82.5, that is roughly where you will run on a quarter basis for the year, the balance of the year on a run rate? That is about right.

Dennis Zeitler - *MSA - CFO and SVP*

Good try, Ed.

Edward Marshall - *Sidoti & Company - Analyst*

This is the second quarter in a row where we saw the SG&A expense higher than normal and I'm trying to parse together as to the expectations that we should be thinking about because my understanding was that, that would fall down -- would bounce back under 80 and it did not. Trying to understand why it did not and the different mechanics and pieces moved in there. I understand there is higher -- lower pension income, as well as some other changes including these SG&A expense now. But trying to understand --

Dennis Zeitler - *MSA - CFO and SVP*

If you look at sequential quarters, the first quarter had a total stock compensation of $5.2 million. The second quarter would probably be about $2.8 million.

Edward Marshall - *Sidoti & Company - Analyst*

Okay. So that would be the adjustment there. That $2.8 million, is there additional for the balance of the year?

Dennis Zeitler - *MSA - CFO and SVP*

It continues to go down. Maybe $1 million a quarter after that.

Edward Marshall - *Sidoti & Company - Analyst*

From the SG&A expense, it will be sliding down and to the right as we move throughout the year?

Dennis Zeitler - *MSA - CFO and SVP*

That piece of it, correct.

Bill Lambert - *MSA - CEO and President*

Additionally, we had the business development expense in there that would not -- we would not anticipate having in Q2.

Edward Marshall - *Sidoti & Company - Analyst*

What was the business development expense again?

Dennis Zeitler - *MSA - CFO and SVP*

That was an acquisition that we were looking at.

Edward Marshall - *Sidoti & Company - Analyst*

What was the total?

Dennis Zeitler - *MSA - CFO and SVP*

$700,000.

Edward Marshall - *Sidoti & Company - Analyst*

Okay. Onto the R&D expense, it ran 10.6. I know you have a lot of stuff in the pipeline. Is that about, is that about where we should be running the rest of the year so to speak, $10 million plus?

Dennis Zeitler - *MSA - CFO and SVP*

That's what I'm told that it probably will not change much quarter to quarter the rest of the year.

Edward Marshall - *Sidoti & Company - Analyst*

The cadence of the quarter that you mentioned in the press release saying that March was stronger than say January and February. Is there anything in particular, I know you mentioned the core products, but is there anything in particular from a market perspective, the markets that you serve that you saw strength, maybe that you had not seen strength in before, a weakness maybe where you have not seen weakness before, i.e, I think the oil and gas looked like it was softer in this particular quarter? Did that pick up in March or did that continue to say soft?

Bill Lambert - *MSA - CEO and President*

I do not think that I would characterize oil and gas as being soft. It is not as strong this year as it was in the early part of last year. I think we talked about that in our conference call back in February. We came out of the gates in early 2012 very strong on the oil and gas side. That is not repeatable, there were a lot of orders in the latter part of 2011 and into the early part of 2012 that were non-repeatable for 2013. The one area that we did also talk about in our last conference call where I think we are seeing some strength, we mentioned it both in my comments and in Dennis' comments, is really the North American fire service market. We are seeing fairly strong, just as we said we thought we might, we are seeing fairly strong SCBA sales to the North American fire service market; both fire service municipal fire departments as well as industrial accounts.

Edward Marshall - *Sidoti & Company - Analyst*

Anything on the construction side notable to discuss?

Bill Lambert - *MSA - CEO and President*

I do not think so. There is not much noteworthy there. We, I think in Dennis' comments, provided some texture around industrial head protection sales being down maybe a percentage point or so. We are just not seeing a whole lot going on in construction. Not yet anyway.

Edward Marshall - *Sidoti & Company - Analyst*

Okay. Fair enough. Thanks, guys.

Dennis Zeitler - *MSA - CFO and SVP*

You are welcome, Ed.

Operator

(Operator Instructions)

Richard Eastman, Robert W Baird.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

It is a follow-up for a second, Bill, on your comments about the US fire service. And maybe, again, I will direct this at you or Bill or -- Can you talk maybe for a minute or two about how you are seeing -- is the SCBA demand, is that, for the fire service, is that up due to the pre-buy or is the market healthier for the product overall?

Bill Lambert - *MSA - CEO and President*

Yes, Rick, it is very difficult to separate those two areas to really have a good solid handle on how much of it is pre-buy and how much of it is the condition we've talked about in the past, which is just essentially a lifecycle issue on all of the breathing apparatuses that were brought 10 years ago or so under the AFG funds that were provided by the US government. We have talked about in the past about positioning ourselves for what we think is going to be a fairly strong uptick in demand as we approach the useful life of some of the SCBA that were purchased back in 2012 and 2013 and 2014. Those were extraordinarily strong years for SCBA purchases in the US fire service because they were fueled but the monies provided by the assistance to firefighter grant program.

Now this year, we also have the NFPA 1981 standard which becomes effective -- which is effective now and manufacturers need to sell only that type of approved product by August of this year. So some fire departments who are familiar with our current version of SCBA are pre-buying. We do see a little bit of that happening. But we also see that other fire departments are very interested in the new standard and very interested in new product that we'll be introducing at the FDIC show in Indianapolis. You have a combination of effects. I would not say that we are seeing an overall improvement in municipal fire department funding. We are not seeing any kind of great improvement on that front. I will stop there and I'll look to Joe Bigler and ask Joe if he has any comments or would like to add more color?

Joe Bigler - *MSA - President MSA North America*

I think you pretty much characterized it, Bill. I think the replacement SCBA market is growing because the SCBA is getting old, so I think the number of SCBA that will be replaced is somewhat on the rise. As Bill said, the municipal fire service market, the funding isn't getting any better but there are some municipalities that the funding they do have, they are shifting to SCBA to do the pre-buy before the new NFPA standard comes. The industrial side of SCBA was relatively strong. As you take a look at some of the energy companies, even some of the federal government agencies, there was some strong purchases by these industrial counts in SCBA that helps SCBA sales that goes into the fire brigades. There's certainly an uptick in the number of SCBAs being replaced, primarily because of the age of the SCBA out there.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Is the municipal marketplace, fire service market in the US, is it your feeling, Joe, that the markets kind of weaned off this federal AFG money? And that what we are going to replace is going to be at a cadence that is more in keeping with the municipal budgets?

Joe Bigler - *MSA - President MSA North America*

Yes. As you know, the 2012 AFG funding, about 60% of that funding has been released. There are still some -- probably 35% to 40% of that funding that still has to be released. They are just starting to take requests for the 2013 AFG funding which we are told will probably be somewhere around 5% to 8% below the funding level of 2012. The AFG funding still is a factor but it is becoming less and less of a factor and it's really going to rely more and more on the municipal budgets.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Bill, if we could just talk for a minute or two to Europe. Europe was off 1% core LC growth. Can you maybe give us a flavor for what Eastern Europe did versus Western Europe? I will jump the answer and just ask if the Eastern Europe growth is more distribution, expansion of distribution or if there's actually end market demand in Eastern Europe?

Bill Lambert - *MSA - CEO and President*

Okay let me try to break that down. We do not provide that level of clarity in our public numbers, but I will try to give you a bit of flavor in that regard. When we look at Western Europe for the quarter, versus last year, sales were actually just about flat from where they were a year earlier, maybe a point higher, a percentage point higher. We actually see that in the other parts of Europe, outside of Western Europe, when we kind of group Eastern Europe, Russia, the former CIS countries and Middle East countries together, that is where we saw a little bit of slowdown compared to last year a quarter ago, a year ago quarter because I talked about some of that fixed gas and flame detection large orders that went into the middle east. I do not see though this as a trend. What we are actually seeing and feeling is good incoming order growth coming out of those parts of the world -- the Eastern European, Russia former CIS and we see a lot of opportunity in the Middle East for a strong order book. Does that help, Rick?

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Yes, that is good. Just from a gross margin perspective, can you just add a little bit of color as to what the geographic mix did to your gross margin? I know it is kind of a tough answer. But again, it strikes me that some of your mining related end markets were weaker geographically. It strikes me that those are lower gross margin kind of geographies. Is that -- can you look at your gross margin and say -- mix was actually favorable by geography? Or is that too granular?

Bill Lambert - *MSA - CEO and President*

That is too granular for me. I'll look to Dennis.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Well okay.

Bill Lambert - *MSA - CEO and President*

Dennis can you provide any color on that?

Dennis Zeitler - *MSA - CFO and SVP*

I can give you some really rough stuff here. North America is definitely our most profitable business. Strong core product sales but I do not see -- I do not see -- most of the improvement we saw in gross margin came in North America. I do not see a significant improvement in the international segment. And I do not see -- there was some improvement -- let me get to the right one here. There was some improvement in Europe in total. Significant improvement in the US and about flat in international.

Richard Eastman - *Robert W. Baird & Company, Inc. - Analyst*

Okay. That is helpful. I think that more or less answers my question. Okay. Thank you.

Bill Lambert - *MSA - CEO and President*

Okay, Rick.

Operator

Dick Ryan, Dougherty & Company.

Dick Ryan - *Dougherty & Company - Analyst*

Dennis, you didn't have any restructuring charges in Q1, do you anticipate such charges during the rest of 2013?

Dennis Zeitler - *MSA - CFO and SVP*

We do, Dick, but I do not have a good idea of what the number is. It will be a small number in a low single-digit $1 millions maybe as we go through Europe 2.0. I do not have an estimate of what quarter that is going to be.

Dick Ryan - *Dougherty & Company - Analyst*

Okay. What would your CapEx expectations be for this year, total year?

Dennis Zeitler - *MSA - CFO and SVP*

In total it should be somewhere in the low 30s.

Dick Ryan - *Dougherty & Company - Analyst*

Okay. Now when you look at Q2, are there any -- was there any ballistic sales in the year ago quarter or any large orders that you are going to kind of look at again when you report this year and say -- well if on a pro forma, is anything in there that was similar to Q1 of a year ago?

Dennis Zeitler - *MSA - CFO and SVP*

I think what we have done with the ballistic helmet sale comparisons when we get into the second quarter.

Dick Ryan - *Dougherty & Company - Analyst*

Okay. And then on the gas detection side, were there large deliveries a year ago similar to Q1?

Bill Lambert - *MSA - CEO and President*

Dick, I'm going by memory here, I know that the first half of last year did have some extraordinarily large FG, FD type orders. We talked about the $5 million difference in Q1. I do not remember what it is for Q2. I hesitate to say what it will be for this Q2 versus last year. But there were strong shipments in Q2 a year ago in fixed gas and flame detection. I just do not remember how big they were and how that will compare to this year. I cannot provide you that kind of color.

Dick Ryan - *Dougherty & Company - Analyst*

Okay. And, Dennis, you mentioned you are still on track for your operating goals for this year so I'm not going to ask you what they are but can you give us some context of directionally where that might go from last year?

Dennis Zeitler - *MSA - CFO and SVP*

We have talked publicly about increasing operating margins 100 basis points a year, up to 15% in 2015.

Bill Lambert - *MSA - CEO and President*

We did 12% last year.

Dick Ryan - *Dougherty & Company - Analyst*

Okay great. That is it for me. Thanks.

Dennis Zeitler - *MSA - CFO and SVP*

Thank you, Dick.

Operator

We have no further questions. I will now turn the call back over to Mark Deasy.

Mark Deasy - *MSA - Corporate Communications Director*

Thank you, Christine. Since we have no more questions, that will conclude today's call. I want to thank everybody again for joining us. If you missed a portion of this morning's conference, an audio replay will be available on our Web site for the next 30 days, as will a transcript of the call. So once again, on behalf of Bill, Dennis, Joe, Ron and Kerry, we look forward to talking with you again and hope everybody has a great day. Thank you. Goodbye.

Operator

Thank you, ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.