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MSA - Q1 2012 Mine Safety Appliances Earnings Conference Call

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PRESENTATION

Operator

(Operator Instructions). Welcome to the MSA first quarter earnings conference call. (Operator Instructions). Please note that this conference is being recorded. I will now turn the call over to Mr. Mark Deasy. Mr. Deasy, you may begin.

Mark Deasy - Mine Safety Appliances Co - Corporate Communications Director

Thank you, John. Good morning, everybody. As John said, I would like to welcome everybody to our first quarter earnings conference call for 2012. As John said, I'm Mark Deasy, Corporate Communications Director. Joining us on our call this morning are Bill Lambert, President and Chief Executive Officer, Dennis Zeitler, our Senior Vice President and Chief Financial Officer, Joe Bigler, President of MSA North America, Ron Herring, President of MSA International, responsible for Europe, Northern Africa, Russia, the Middle East and India, and Kerry Bove, President of MSA International, responsible for Asia, Australia, Sub-Saharan Africa and Latin America.

Our first quarter press release was issued this morning at 8.30 AM and we hope everyone has had an opportunity to review it. The release is posted on the home page of MSA's website at www.msasafety.com. This morning, Bill Lambert will provide his commentary on our first quarter performance and then Dennis will review our financials in more detail. After Dennis' comments, we will open up the call for your questions.

Before we begin, I want to remind everybody that the matters discussed on this call, with the exception of historical information, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 as amended, and Section 21E of the Securities Exchange Act of 1934 as amended. Forward-looking statements, including without limitation all 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 Securities and Exchange Commission. Including our most recent Form 10-K, which was filed on February 22, 2012. You are strongly urged to review all such findings for a more detailed discussion of such risks and uncertainties. Our SEC filings can be easily obtained, at no charge, at www.SEC.gov, our own website and a number of other commercial sites. That concludes our forward-looking statements. At this point, I would like to turn the call over to Bill Lambert for his comments. Bill?



William Lambert - *Mine Safety Appliances Co - CEO, President*

Thanks, Mark and 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 earnings release and have our financial figures with all comparisons corresponding to the equivalent period in 2011. To begin, I want to say at the outset, that we are pleased to report today's quarterly results, which demonstrate another quarter of solid performance by the MSA team.

Above all, these results reflect continued demand and preference for the MSA brand around the globe and the focus that our team is placing on successfully executing our corporate strategy aimed at, one, growing MSA's core business in both developed and emerging markets throughout the world. Two, focusing on developing innovative new products that help keep our customers safe in the workplace. And three, diligent management of our operating costs and business efficiency under initiatives like Project Magellan and our European transformation efforts.

As you saw in our press release, our consolidated sales in the quarter were \$293 million. An increase of \$17 million or 6%, compared to the same period a year ago. Our comparative earnings per share were \$0.65 versus \$0.36 per share, for the same period in 2011. An increase of 80%. When analyzing our EPS, I think it is worthwhile to note, that during the quarter we recognized pretax non cash foreign currency losses of \$2.4 million, or roughly \$0.05 per basic share after tax. So excluding these charges, our earnings per share was \$0.70 per basic share in the quarter.

The increase in sales volume across most of our product lines, combined with our efforts to improve margins and expand MSA's presence in emerging markets, continued to positively impact our results. Our record first quarter was driven by the focus our team is placing on driving demand for our core product lines, which are fixed gas and flame detection systems, industrial head protection products, Supplied-Air Respirators, portable gas detection instruments and fall protection products. These five product areas, which comprise 63% of total sales in the quarter, had revenue growth of 16% when compared to the first quarter of 2011.

What I think is especially encouraging, is that sales across these same product groups in emerging markets grew 21%. As we have stated previously, driving demand for core product groups is a critical element of our long-term corporate strategy and we remain focused on executing this initiative in both developed and the emerging markets. Another critical element of our strategy that contributed to our strong quarter, was the continued progress we are making in managing manufacturing costs and improving gross profits as a part of our overall operational excellence initiatives. Our multi-year efforts to optimize our manufacturing footprint and to improve our supply chain processes globally, are yielding some solid results.

The focus on these initiatives helped contribute to the 340 basis point improvement in gross profit margins during the quarter. Our ability to control selling, general and administrative expenses resulted in an operating margin of 13.8% for the quarter, an improvement of 410 basis points over the same period a year ago. As always, Dennis will provide more detail about this progress in his comments. I want you to know that we remain committed to developing innovative new core products that enhance the MSA brand and advance the level of worker safety in the industries that we serve.

Quarterly R&D expense was \$9.3 million, down about \$1 million from the same period a year ago, but I want you to know this is not a trend. It is more reflective of heavy spending on particular projects in the R&D pipeline during the first quarter of last year. I want to assure you that we continue to invest in developing innovative, new core products, like the portable and fixed gas and flame detection instruments, that I have mentioned to you in earlier calls.

To give you a sense of the impact these investments and product introductions are having, portable gas detection instrument sales are up 14%, and fixed gas and flame detection instrument sales are up 32% from a year ago. Looked at another way, for the quarter, 37% of our portable gas detection sales and 26% of our fixed gas and flame detection sales were related to new products developed and introduced in just the last three years. You will see our commitment to R&D continue over the coming quarters, as we think we have a pretty exciting pipeline of new core products that emphasize innovation, durability and improved profitability.

Cash flow, which is an area of focus at MSA, was strong in the quarter. Quarterly operating cash flow increased to \$33 million, compared to \$11 million in the first quarter of 2011. We used this cash to continue to invest in CapEx, fund our dividend, and to pay down \$21 million of debt. Dennis, again, will provide more details on cash flow in his commentary.

Now, I would like to turn your attention to the results in each of our geographic segments, and let me start with MSA North America. Sales grew 18% over the same quarter a year ago, in the North American industrial market. And it is equally encouraging to see strong growth in multiple core MSA product lines. More specifically, sales of gas detection products increased \$11 million. Accompanying the solid growth in core product groups, profitability in North America also improved, with gross profit margins increasing almost 620 basis points, due to the combined effects of strategic pricing and lower costs of recently introduced products.

In the North American military market, we saw a \$2 million decrease in shipments of Advanced Combat Helmets during the quarter. As we've indicated in previous calls, we are nearing the completion of this contract with the US Army, and as we announced earlier during the first quarter, we have signed a nonbinding letter of intent to sell the North American ballistic helmet business. That is the North American ballistic helmet business, only, that we are selling. We expect the transaction to divest of this non core business to close sometime in the second quarter of 2012.

In the North American fire service market, municipalities continue to deal with lower AFG funding levels and municipal budget pressures. For the quarter, sales in the North American fire service business were down 12% from a year ago. We don't believe that's an indication that the North American fire service market is getting worse. We believe that this market has leveled off, as we have indicated to you in earlier investor calls, and the decrease in the first quarter is more related to a difficult comp to the first quarter of last year, which had strong shipments of SCBA into Canada.

Looking at Europe, while ongoing economic uncertainty and austerity measures continue to provide headwinds for us there, especially in our government related business, I was encouraged by the 12% increase in sales that we saw during the quarter. Gross profit margins increased 440 basis points in Europe, with solid improvements coming from the European industrial market. For the quarter, sales grew 23% in the European industrial market, 28% if we exclude the impact of weakening currencies.

Our growing industrial sales are reflective of our strategic efforts to transition our focus from government spending, to industrial channels of distribution in Europe. Industrial sales now represent 57% of total sales in our European segment, and we think that has plenty of room to grow. The industrial channels better align with our core product line strategy and is more profitable than government-related sectors.

Although the current quarter European results provide me with a sense of optimism, it merits repeating, that business and economic conditions remain very challenging across much of Europe. As I have indicated on past calls, we are committed to executing our strategic initiatives across our Pan-European business. These strategic initiatives, which are focused on increasing revenues while targeting new channels of industrial distribution all the while lowering our cost of operations, are yielding solid results. But as I have said before, the transformation of MSA Europe involves long term initiatives.

I'm certainly encouraged by the accomplishments our team is making and the improved performance that we are seeing from our European segment, but we still have much to accomplish. In a highly uncertain environment with a forecasted, and perhaps, even optimistic flat GDP growth rate for much of Western Europe in 2012, a key focus of ours continues to be lowering our overall costs of doing business in this segment.

Shifting attention now to our international segment. I'm pleased to report solid profitability improvements in the international segment, which includes the geographies of Asia, Sub-Sahara Africa, Australia and Latin America. Our focus on emerging markets and the efforts we are putting forth in this segment, are very much reflected in the positive results we are seeing. Growing our business in international emerging markets, as I have noted earlier, is another key element of our corporate strategy.

We continue to grow our business in areas like Brazil, where local currency core product group revenues increased 32% during the quarter. It is clear from this performance that our team remains highly committed to advancing our strategy and the results in industrial markets within emerging international regions, are gaining traction and are certainly very encouraging to see. The revenue earnings and cash flow improvements we have reported over the past several quarters, demonstrates success in how our global team is effectively executing our corporate strategy. While we continue to closely monitor uncertain economic conditions, especially in Europe, I assure you that we remain focused on those areas of our business that will help us to accelerate growth, increase market share and ensure the Company's long term success.

While we are seeing strength in the US industrial market and continued strength in emerging markets around the world, we expect uncertain economic conditions to remain in much of Central and Western Europe for the remainder of 2012. Overall, however, I remain optimistic and I believe



our business and our position in the marketplace for life saving personal protective equipment and instruments, affords us many opportunities for profitable growth. I continue to feel our strategy is appropriate and provides us with sustainable competitive advantage for the future. Now, I would like to turn the conference call over to Dennis Zeitler, our CFO, who will provide you with more insights into our financial results. Dennis?

Dennis Zeitler - Mine Safety Appliances Co - SVP, CFO

Thanks, Bill. Good morning. I would like to give you some further insight into our first quarter performance and comment on the 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 2012 were a record \$293 million. An increase of 6% over the first quarter of 2011 and our highest first quarter sales ever. Compared to last year, European sales were up 12%, North American sales were up 5%, and international sales were up 3%.

By markets, the fire service was down 4% and military was down 22%. But our industrial business, which has grown to 70% of our total sales, was up 13% over last year. In local currency terms, our industrial sales were actually up 16%, with strength in each of our geographic areas. Our North American segment sales in the first quarter were up 5% compared to 2011, comprised of a 12% decrease in the fire service, and a 33% decrease in military sales. Both of which were more than offset by an 18% increase in industrial sales, which were 70% of our total North American sales.

In our industrial business, head protection was up 15%, portable gas detection up 15%, and fixed gas and flame detection was up 31%, with a strong contribution from General Monitors. Our sales of gas masks and ballistic body armor decreased this quarter in North America, compared to 2011.

Our international segment sales were up 3% this quarter in US dollars, but were up 7% in local currency terms. Fire service was up 16%, military was down 35% on a very small base, and industrial sales, which were 81% of our international sales, were up 2% in US dollar terms, but actually up 7% in local currencies.

In Europe, our reported sales were up 12% in US dollars and up 17% in local currency terms. European fire service sales decreased 1% and military was up 5%. But industrial sales, comprising 57% of our total European sales, were up 23% in US dollars and up 28% in local currency terms. Our ongoing efforts to expand our industrial sales in Europe, plus the addition of General Monitors, has shown real benefits for us in the face of uncertain economic times in Europe.

The other view of our sales performance is to separate the two portions of our business that historically have been the most volatile, the US Fire Service and the US Military, from everything else. Our US Fire Service sales of \$30 million, was a decrease of 8% and our US Military sales of \$7 million, was a decrease of 33%. Then when we look at all of our other globally diversified sales, which has risen to 87% of our total sales this quarter, these sales were up 10% in US dollars, and up 13% in local currencies. Our gross profit rate for this quarter was 43.3%, up 340 basis points from 39.9% last year.

Our global efforts to reduce manufacturing costs, the increased production volume in our factories 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 higher volumes, cost discipline, product mix and value based pricing. We are pleased to be reporting to our investors that these efforts are bearing very real and meaningful results.

Selling and marketing costs in this quarter were up \$4 million, primarily due to the higher level of sales. Administrative costs were up only slightly on a comparable basis, as we strive to control and to reduce the numerous aspects of administrative expense. I am most pleased to report that there were no restructuring charges in this quarter, and I do not anticipate any such expense for the remainder of this year. We did record a non-cash foreign currency loss, due to intercompany transactions, of \$2.4 million pretax.

Our investment in new product development this quarter was \$9 million, down from an unusually high number in the first quarter of last year, of \$10.5 million. I do expect this expense to increase as the year progresses, as we are able to attract the additional engineering talent we are looking for around the world. We continue to invest in exciting new products that will be coming to market in 2012, such as our all new Galaxy GX2

Instrument Management System, more of our V-Gard branded hard hat accessories, more of our best in class XCell Sensors and cross branded MSA and General Monitors fixed gas and flame detection products.

The resulting operating income, excluding those foreign currency expenses, is \$41 million. An increase of 52% over the first quarter of 2011. That is just under 14% of sales this quarter, and an increase of 400 basis points over our comparable performance in the first quarter of 2011. This quarter is obviously a very good start to the year, and we have real optimism that we will exceed the 12% target for our operating margin for the full year, that we communicated at our last investor call.

Our consolidated tax rate this quarter was 31%, down 300 basis points from last year, due to the increase in the proportion of our profits earned outside the United States. Even though the R&D tax credit has yet to be extended, which would reduce our effective tax rate by roughly another 1%. The bottom line is record first quarter net income of \$24 million or \$0.65 per basic share, compared to \$0.36 last year. An increase of 81%. On a pro forma basis, excluding the non cash currency expense, our net income will be \$26 million, which is \$0.70 per share and 43% over the comparable 2011 calculation.

As for the cash flow statement, we had a good quarter and we plan to carry our successes forward into the remainder of 2012. You will be glad to see that we have now begun to include a cash flow statement in our quarterly earnings press release. Our cash position is down \$3 million and is composed almost entirely of cash outside the United States. Our total debt at the end of the quarter was \$321 million, down \$21 million in three months, and down nearly \$70 million in 12 months. As you know, it is our plan over the next several years to continue to significantly reduce our outstanding debt.

Although our working capital did increase by \$1 million in the first quarter, our cash from operations was \$33 million. We invested \$8 million in capital equipment, paid dividends of \$9 million and still had \$21 million to reduce our debt. Those are my comments. At this point, Bill, Joe Bigler, Ron Herring, Kerry Bove and I, will be more than glad to answer whatever questions you may have. Please remember that MSA does not give what is referred to as guidance, and that precludes most discussions related to our expectations for future sales and earnings. Having said that, we will now open the call to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question comes from Edward Marshall from Sidoti & Company. Please go ahead.

Edward Marshall - *Sidoti & Company - Analyst*

Good morning.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Hi. Good morning, Ed.

Edward Marshall - *Sidoti & Company - Analyst*

What is the encore?



Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Second quarter.

Edward Marshall - *Sidoti & Company - Analyst*

That's promising. I thought you guys didn't give guidance. I'm kidding. Anything unusual in the gross margin that I should be aware of? It was exceptionally strong in the quarter. Any one-time items or any discrete items?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

The first quarter was reasonably clean, Ed. Actually, we had only negative things in the first quarter actually. There is about \$2 million of bad things that happened that we didn't plan on, but there is always bad things that happen.

Edward Marshall - *Sidoti & Company - Analyst*

Sure.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

But there was no particular good thing that happened that improved gross profits, other than everything we've talked about.

Edward Marshall - *Sidoti & Company - Analyst*

You look like you have hit another level for this year as we go forward. I'm assuming this is somewhat, and I know you are not going to give guidance, but you would be surprised if this is not sustainable or at least that is your goal I'm assuming.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

You're right. We are not going to give that guidance, Ed.

Edward Marshall - *Sidoti & Company - Analyst*

Okay.

William Lambert - *Mine Safety Appliances Co - CEO, President*

It was a very good quarter, Ed. There's no question about it and I think we hit on a lot of cylinders that we have been talking about in this earnings call and in other investor meetings, for quite a few years. You are starting to see some of the fruits of that effort. I think that there is still some uncertainty out there. Europe had a very good quarter, and whether or not we are able to really continue that kind of performance in Europe, I think is --that is probably where I have the lowest confidence. But the things that are happening within the North American market, the General Monitor's acquisition, the introduction of some exciting new products, it is all helping us in a very strong way.



Edward Marshall - *Sidoti & Company - Analyst*

Let's talk about Europe, if we can, for a second. You say it is the lowest confidence market, but I think there is a few things going on there, with distribution markets and point of contact with the customer, et cetera and then, of course, the gas products that you are selling into. Is that really -- are those the two key points as to why that performance was so much better, I think, than what we would have expected given the GDP growth there?

William Lambert - *Mine Safety Appliances Co - CEO, President*

That is exactly right. At the top line those are the key reasons. With the expansion of our industrial distribution as we change our focus, over the last few years, we've really tried to transition that organization more towards industrial commercial accounts and less on government spending and that's bearing fruit. The oil and gas market in that particular region, in that segment, as we report, is doing very well. Then the only other area to improve upon in the profitability on the bottom line for Europe, has to do with reflection of the cost reduction efforts and restructuring efforts that we have had going on there in 2010 and 2011.

Edward Marshall - *Sidoti & Company - Analyst*

And just remind me, as you switch to a distribution model in Europe, there is movements on the gross margin, the operating margin, how does that play out? I mean is there a little bit of more compression as you give a little bit on price, on the gross margin and you get it back as your selling expense goes down? How do I think about that?

William Lambert - *Mine Safety Appliances Co - CEO, President*

There is a little bit of that. But again, we went through that in North America about a little more than a decade ago, as we used to have a strong commitment to direct selling. Then, as I said, a little more than a decade ago, we transitioned from direct selling to 100% indirect selling through distribution channels. So there is a little bit that you give up on margin in doing that. But when we are really comparing ourselves to selling principally to government agencies, government-related entities in Europe, there was highly competitive in the pricing in those situations was always tight, you know? There wasn't -- the margins there were relatively tight.

We actually feel, and based on some of the results we are seeing, we actually think that we can pick up a few margin points as we shift from government related spending to commercial industrial. Even though we will be going through industrial distribution. We don't see that as a hit the way it was here in North America, but we reacted and responded in North America. Over time, you have lower selling expenses as a result of that, lower commission expenses as a result of that, and so there is increased profitability. I think we have -- we lived through some tough times in North America, but we have made that transition fully, and I think some of the strong performance that you see out of our MSA North American operation is because of that.

Edward Marshall - *Sidoti & Company - Analyst*

In North America, any traction in nonresidential construction at all? You know, we are hearing hints of that through this earnings season so far from other competitors there or other players there. Are you seeing that yet?

William Lambert - *Mine Safety Appliances Co - CEO, President*

I will ask Joe to address that. Joe Bigler.



Joseph Bigler - *Mine Safety Appliances Co - VP and President, MSA North America*

The real spark in the first quarter has really come from general manufacturing, and obviously, the energy sector. But we are seeing, especially with some of our major distributors, such as Grainger, that the commercial construction sector is starting to show some signs of life, as well as, government spending in some areas. Although it is not strong, it does seem to be somewhat on the uptick, both of those segments, which have really been a drag on the economy over the last 12 months.

Edward Marshall - *Sidoti & Company - Analyst*

And both of those businesses are legacy businesses for you, so I'm assuming that the cost bleed has really been bled out of that system and so any incremental improvement there should be a benefit to margin. Is that the right way to think about those businesses?

Joseph Bigler - *Mine Safety Appliances Co - VP and President, MSA North America*

Yes.

Edward Marshall - *Sidoti & Company - Analyst*

Any chance you can give -- given the quarter and the performance and your -- that you look at that 15% goal that you have in 2015 and like to hike it up a little bit, or maybe bring it forward a year or so, or should I just leave that alone?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Why don't we think about that when we get this year over with.

Edward Marshall - *Sidoti & Company - Analyst*

I'm taking a guess, ballistic helmet business went for about \$10 million or so? Is that --?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

That is a pretty fair guess.

Edward Marshall - *Sidoti & Company - Analyst*

Thanks again. Great quarter.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Thanks, Ed.

Operator

Our next question comes from Walt Liptak from Barrington Research. Please go ahead.



Walter Liptak - *Barrington Research Associates, Inc. - Analyst*

Hi, thanks. Good morning, guys and great quarter, too.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Thanks, Walt.

Walter Liptak - *Barrington Research Associates, Inc. - Analyst*

So I wanted to ask a few more about the industrial sales up 28% and the channel strategy. How long has the change to the channel strategy been going on and I don't want to be sour grapes or ask questions like that, but what about channel sales? Is part of it that your inventory is going up at distributors?

William Lambert - *Mine Safety Appliances Co - CEO, President*

Well, let me, are you talking specifically about Europe and our industrial channels strategy in Europe, Walt?

Walter Liptak - *Barrington Research Associates, Inc. - Analyst*

Exactly.

William Lambert - *Mine Safety Appliances Co - CEO, President*

That effort has been going on for at least the last two years. 2010 -- 2008 is when we developed the corporate strategy, as we have talked to our investors many times in the past. 2009 was a difficult year for everybody and 2010. But we remain true to our strategy, in implementing that strategy, and began making the shift back in 2010.

2011 had a lot of change management activities going on within our organization in Europe, and we didn't see a lot of the traction that we had hoped to see in 2011. But we continued to make progress. And now in -- at the end of 2011 and into 2012, we are seeing more traction. We are seeing additional channels of distribution being added in Europe. So this also, as a part of our European transformation effort, is a multi year effort. So now we are just pleased to be able to report that some of that effort, whether it be the cost reduction efforts and restructuring efforts, or the increase in channels of distribution to grow our core product areas in that segment, that they are starting to bear fruit.

Walter Liptak - *Barrington Research Associates, Inc. - Analyst*

Okay. So in the quarter, there were new distributors that were added, and presumably there would be initial sales that distributors would build up inventory. Is that part of what is going on with that 28% organic growth?

William Lambert - *Mine Safety Appliances Co - CEO, President*

I'm sure that is a piece of it. I don't have the details on how that might break down. But also, we added distributors and channels of distribution throughout 2011, as well. But that continues, that effort continues. We pare out the non-performers and further emphasize those channel partners, who are really able to penetrate markets, and bring MSA products to those markets where previously, we didn't have a strong presence.



Walter Liptak - *Barrington Research Associates, Inc. - Analyst*

Okay. I appreciate the comments. You know, it is just such a big number, and when you compare it to the backdrop that we read in the paper every day about what is going on in Europe, it almost doesn't make sense. It is good to hear comments on it.

William Lambert - *Mine Safety Appliances Co - CEO, President*

The other piece that we really haven't talked about, and it is difficult for us to really quantify, but we can very much qualify or with qualitative data point to evidence, and that is, that we are gaining market share through some of those channels of distribution in Western and Central Europe and as we look even more are broadly into Eastern Europe. There is the market share opportunities that we see and just the industrial channel, our presence, MSA's presence in the industrial market within Europe, is not what we would like it to be and we think there is great opportunity, and like I said, I'm pleased that we are making progress on that front.

Walter Liptak - *Barrington Research Associates, Inc. - Analyst*

Okay. Okay. And the other question I wanted to ask was related to the gross margin. I wonder if it is possible to look at, maybe different components, the price increase and that is related to new products, volume leverage and cost out, just to get an idea of how sustainable the gross margin is?

William Lambert - *Mine Safety Appliances Co - CEO, President*

Dennis.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

We don't have the detail on what the components of the increase in gross margin are. However, I think it is a reasonable statement that we think our current gross margin rate is sustainable. As we mentioned in one of the other questions, there is nothing unusual in the first quarter gross margin that would make it an exception going forward.

Walter Liptak - *Barrington Research Associates, Inc. - Analyst*

Okay. Can you, maybe, walk me through the price increases so far this year? Have you done a global price increase or has it been North America only?

William Lambert - *Mine Safety Appliances Co - CEO, President*

We do them regionally and maybe we can ask Joe and Ken and Ron, or Kerry and Ron, to answer that.

Joseph Bigler - *Mine Safety Appliances Co - VP and President, MSA North America*

North America we had a selective price increase that went into effect January 1, and on a selective basis. It wasn't across-the-board on all products. It averaged somewhere around 2.5%.

William Lambert - *Mine Safety Appliances Co - CEO, President*

And what about last year, Joe, we had --



Joseph Bigler - *Mine Safety Appliances Co - VP and President, MSA North America*

Last year we actually had two price increases. We had one on January 1, 2011 and another one in July.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Kerry, why don't you comment on the international areas what you saw in the way of price increases?

Kerry Bove - *Mine Safety Appliances Co - President, MSA International (APZ and ALZ Zones)*

Our price increases were not done universally across. Our price increases were not done universally across the regions, but we are in the process of continuing to refine that. We have put some in and we'll continue to put more in.

William Lambert - *Mine Safety Appliances Co - CEO, President*

And Ron, what about in Europe?

Ronald Herring - *Mine Safety Appliances Co - President, MSA International (WEZ and MEZ Zones)*

Across Europe, we had price increases that were pretty much targeted for each particular region, but the effective price increase was in the 2% to 3% of price increase and it was spread out. The implementation of it really started in December and the last one, I think, was in February.

Walter Liptak - *Barrington Research Associates, Inc. - Analyst*

Okay, great. Okay. Thanks very much and great quarter and have a great day.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Thanks, Walt.

Operator

Our next question comes from Holden Lewis from BB&T. Please go ahead.

Holden Lewis - *BB&T Capital Markets - Analyst*

Thank you. Good morning.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Hi, good morning, Holden.



Holden Lewis - *BB&T Capital Markets - Analyst*

I just wanted to make sure I had some of the numbers, correct. Did you say that -- how much in revenue did you do in US fire safety in total?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

US Fire Service total is just under \$30 million.

Holden Lewis - *BB&T Capital Markets - Analyst*

Okay. Didn't you say, at some point, that US fire safety was down 12%? That would be quite a bit higher than last year, wasn't it?

William Lambert - *Mine Safety Appliances Co - CEO, President*

That was overall North America. I said overall North America, Holden, was down 12%.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

We had a big order to Halifax, in the first quarter last year, for the fire service. So North America, which is Canada and Mexico with the US, was down 12%, but US only was down 8%.

Holden Lewis - *BB&T Capital Markets - Analyst*

Was down --?

William Lambert - *Mine Safety Appliances Co - CEO, President*

8%.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

A little over \$32 million, down to a little under \$30 million.

Holden Lewis - *BB&T Capital Markets - Analyst*

A little under -- so in Q1 the US fire safety was a little under \$30 million?

William Lambert - *Mine Safety Appliances Co - CEO, President*

Correct.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Yes.



Holden Lewis - *BB&T Capital Markets - Analyst*

Okay. And the US military was how much?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

\$7.4 million.

Holden Lewis - *BB&T Capital Markets - Analyst*

\$7.4 million. Then there was no acquired revenues in here, correct?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Correct.

Holden Lewis - *BB&T Capital Markets - Analyst*

And the foreign exchange bit was about a negative \$5 million for the quarter?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

The negative foreign for what line?

Holden Lewis - *BB&T Capital Markets - Analyst*

Foreign exchange impact for the quarter was about a negative \$5 million?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

On the P&L or on the balance sheet. The P&L expense is \$2.4 million.

Holden Lewis - *BB&T Capital Markets - Analyst*

Minus \$2.4 million okay.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Pretax.

Holden Lewis - *BB&T Capital Markets - Analyst*

I guess what I'm kind of curious about is in every respect Q1 was better than Q4. Whether it be related to the margins, whether it be related to the growth rate once you strip out the US fire safety and military bits, and feels like such a light switch event. Last year you were decelerating from end

of the year and all of a sudden accelerate in Q1. Could you give some insight as to why the beginning of 2012 looks and feels so much different from the end of 2011? Maybe give some insight -- when you gave a 12% margin expectation for the year, I'm guessing you didn't envision that starting with a 14%. Can you give a sense of where the beeps are coming from or where you have been surprised?

William Lambert - *Mine Safety Appliances Co - CEO, President*

Well, I think we have talked a lot about where the strength is coming from and what the efforts have been to get us there. I don't think there is a light switch event, to use your words, Holden. We are seeing some strength in some of our more profitable areas of the business. As I indicated in my comments, our portable instruments and the new products we brought to market there, with increased gross margin performance and our fixed gas and flame detection instruments. That is among our highest profitability segments.

Total fixed gas and flame detection up 32% quarter to quarter. Now, that is first quarter last year versus first quarter this year. I don't have it at my finger tips what it would be in consecutive quarters, but we have just got -- I think that the fruits of the efforts and where we are putting our focus, have been in the right areas. There isn't really anything that would -- other than the efforts we have already talked about, that would indicate that there is some light switch event that has gone on to improve our gross profit by -- what did Dennis say? 300 to 400 basis points improvement.

I guess in looking back at the second quarter, yes, you are still looking -- excuse me, looking back at the fourth quarter of last year, and it is still a 300 or 400 basis point improvement in gross margins. There is no one-off big items that are doing that, other than strength in the core areas where we are providing a lot of focus. We did have, as I said, just some really strong performance out of our fixed gas and flame detection instruments area, portable instruments area and those are two of our most profitable product lines.

Holden Lewis - *BB&T Capital Markets - Analyst*

You talk about how your five focus areas is about 63% of revenues. In aggregate, what is the profitability of those five areas? Are those also your more profitable areas, so that as they grow relative to the mix that you just get the mix kicker?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Absolutely.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Sure, absolutely correct. That is exactly right.

Holden Lewis - *BB&T Capital Markets - Analyst*

Okay. And can you comment on the role of sort of this new product offering and strategic pricing component? Did that -- are you really starting to see traction coming from the hires you made and maybe new products becoming a bigger part of the mix? Is that part of it or is that still sort of on the come?

William Lambert - *Mine Safety Appliances Co - CEO, President*

I think it is still on the come, because the strategic pricing initiative, value based pricing as we refer to it here, that is an initiative that really started to get traction in early 2011. We began it in 2010, really started to get traction in 2011. We are now starting to see some of the full effect of that, but we have got a lot of new products in the pipeline that will come out that will also have this value based pricing attached to it. I think that there

is -- we believe there is more upside there from a pricing perspective than an increased improved margins, due to the product mix and due to the value based pricing initiatives that we have got going forward.

Holden Lewis - *BB&T Capital Markets - Analyst*

You, sort of, did call out the strategic pricing as one of the pieces pushing the gross margin up. Are you doing the strategic pricing outside of new products, at this point? Are you repricing existing products in the market or is the goal really still to introduce the strategic price as you put out new products and refresh the line?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

We are doing that. But it is not a matter of changing the price of existing products. It is more a matter of controlling the discounts that we give on existing products. We've established a matrix of who at what level and at what time, who is allowed to give an incremental discount on a specific order.

Holden Lewis - *BB&T Capital Markets - Analyst*

Okay. And then the last thing, I know you don't like to give forecasts and projections, but last call you did, in fact, project kind of a 12% operating margin for the year. And again, I'm assuming that you didn't envision the year starting with a 14% in front of it. Do you have any sense of -- should we assume that 14% operating margin is, kind of the 13.5%, 14% is kind of the right level for the year now, or is there some seasonality we should be considering or anything of that sort?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

I can't give you a lot of help there, Holden. I would say we have a lot more confidence in our 12% number now than I did three months ago.

Holden Lewis - *BB&T Capital Markets - Analyst*

Okay.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

The only other comment I want to make, we came into this year very cautiously. Cost-wise, we told everybody to hold back on spending money. We had a lot of cost controls in place and they are still in place. So that is part of -- it is not just the volume of sales and everything there. We did a pretty good job in controlling costs so far. Hopefully we can keep that up.

Holden Lewis - *BB&T Capital Markets - Analyst*

Okay. And we would expect sort of normal seasonality to play out this year is kind of the way to think about that?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

At this point, yes.



Holden Lewis - *BB&T Capital Markets - Analyst*

All right. Thanks, guys.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Thanks, Holden.

Operator

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

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

Good morning.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Hi. Good morning, Rick.

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

If you wouldn't mind, Bill, would it be possible -- you talk about these five core product lines that 63% and obviously, the impact that it had on the gross margin. Could you just give us, in local currency, the growth rate of those five product categories?

William Lambert - *Mine Safety Appliances Co - CEO, President*

Well, how about if I ask Dennis? I think Dennis has some of that data handy, okay?

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

Okay. That's fine.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Okay. For the quarter --

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

Just industrial head, fall protection --

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Yes. Make sure I get these numbers right here.



Current year, prior -- okay. So we go by our product group numbers. The first one I've got here is breathing apparatus was up 1%. Are you looking for gross margins or just --?

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

I can kind of relate that to the gross margin impact. But given that, you know, these products --

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Right.

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

Are such a big percent and the focus area, just LC growth rate would be great.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Head protection was up 17%. Portable instruments are up 14%. Fixed gas and flame detection was up 31%.

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

Okay.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

And fall protection was up 12%. Average all those together, it comes out to 16%.

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

Okay. All right. Great. That's helpful. And then again, I just -- I'm not going to look for any more color on the gross margin, but the incremental there was virtually 100%. So all the incremental revenue growth turned into profit growth, and again, I guess that is the higher margin products growing so dramatically here and then I guess it was a decline in fire service. Is that -- was there an LC decline in fire service overall?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

I don't have -- yes, I do. Hold on here a second. Fire service on a consolidated basis, local currency was down 3%.

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

Okay. And what was military and LC?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Minus 21%.



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

Minus 21%, okay. Okay. Okay. Can I ask a question, just double back to Europe for a second. If I think about Europe industrial for the products that you have in the marketplace there, what would you guess was maybe the market growth rate? I mean you guys delivered 28% growth in local currency. There is no way the market grew at anywhere near that level, not with the PMI numbers we have been seeing and --

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Right, right.

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

So you had share gain, you had expansion of distribution. I mean, do you think the market growth was a positive number?

William Lambert - *Mine Safety Appliances Co - CEO, President*

Well, I think that you need to keep in mind, Rick, that as we report Europe, and some of that 28% growth that you see in Europe is not what we are reading about in the paper, it is not just Western and Central Europe. But Europe from a, say segment reporting basis, also includes the Middle East and Russia and Eastern Europe. So it is this much larger area. The oil and gas segment, in particular, has provided a lot of that growth. We have had some terrific performance in our fixed gas and flame detection systems and sales into that area.

So -- and I don't have the breakout of that, but I would say -- well, I won't even guess. But it was a significant improvement, that 32% that Dennis talked about, overall consolidated fixed gas and flame detection sales. I'm willing to bet that a nice piece of that is coming from that part of the world. Eastern Europe, Russia, and Middle East and India, and some of those projects. So getting back to your question, what do we think the market may have grown, did it grow during the first quarter? I mean, the numbers that we put on it are low single digits. I think that based on what I'm reading more recently, I think that might even be on the optimistic side.

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

Because I recall coming out of the fourth quarter you had some real caution around Europe. In fact, you went so far as to suggest low single digits. If we don't grow at least at that pace, we might have to take some more costs out of Europe and that is why I'm starting out with a growth rate of 28% is, you know, polar opposite of maybe the caution that you were tossing out, you know, back in early February.

William Lambert - *Mine Safety Appliances Co - CEO, President*

The 28% is industrial sales same currency, right. The actual reported increase in our international European segment sales was 12%.

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

I understand.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Okay.



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

I understand, but industrial is the driver there.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Yes. You're right.

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

Okay. So we just got off to a really fast start, though, is that fair enough?

William Lambert - *Mine Safety Appliances Co - CEO, President*

Yes and I really, as I said in my comments early on in this call, I am really still very hesitant and very concerned about Europe. I think that is a very uncertain environment for us. So our focus there continues to be on cost control, cost management, and while finding those opportunities to grow and we think there are opportunities to grow, and we are actually seeing good success in growing our channels of distribution on the industrial side. But that doesn't give me a lot of room for celebration. We are watching it -- continue to watch it very, very closely.

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

Okay, and did you guys -- when I look at the net income out of Europe, you paid taxes there, right? There was a tax rate?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Yes.

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

Okay. So I got to give you kudos to the growth, at least the improvement in profit in Europe. Since I seem to bang you on that every quarter. At least that's better. And then just the last thing. When I think of MSA's business for the full year, and just leaving military aside here with the puts and takes going on there, is it still reasonable to assume that fire service has a growth rate, say mid single digit, but industrial then would double that up? You know, being high single digit or maybe low doubles. I mean, is that still a reasonable way to think about how the segments play out for the year?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

We wouldn't give that specific kind of guidance. I think the last time we talked about global fire service for this year, we thought it would be about flat for the year.

William Lambert - *Mine Safety Appliances Co - CEO, President*

That's right. I think that is a better way to look at the global fire services, is that we would continue to think that it is flat. Even though we feel like we had a down quarter in the first quarter in North America for the fire service, we really believe that is because of a difficult comp versus last year. But overall, I don't see great improvement in the fire service, but I don't see it degrading at all and we think it is going to be about flat.



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

Okay. And then last thing, Paraclete sales in the first quarter of 2011, \$3 million-ish or something?

Joseph Bigler - *Mine Safety Appliances Co - VP and President, MSA North America*

\$2.4 million.

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

Okay. Alright, thanks, Joe. All right, thank you.

William Lambert - *Mine Safety Appliances Co - CEO, President*

You're welcome.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Thanks, Rick.

Operator

Our next question comes from Dick Ryan from Dougherty. Please go ahead.

Dick Ryan - *Dougherty & Company - Analyst*

Thank you. Dennis, on the closing of the sale of the helmet business, assuming it does happen, will there be charges in Q2?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

No, there will be a slight income in Q2.

Dick Ryan - *Dougherty & Company - Analyst*

Okay. Okay. Bill, on the fixed gas and portable side, are you seeing any cross selling coming in as both the product lines have come together?

William Lambert - *Mine Safety Appliances Co - CEO, President*

You mean from -- oh, okay, between the portable instrument line and the fixed gas? Not a lot, Dick. Those tend to be different channels of distribution. Fixed gas and flame is going through ECPs and large project managers, that sort of thing. Whereas, portable instruments, is more through our industrial channels of distribution, the Graingers, the Airgases. Those that are very tightly connected to the turn arounds in a refinery, onshore, that sort of thing. There is not a lot.



We've tried it over many years to look for and to build some synergies between our portable instrument sales and our fixed gas and flame. We had some success, but it is not all that great. They are really two distinct markets, if you will. Not markets, but rather sales channels, and they have their individual successes.

Dick Ryan - *Dougherty & Company - Analyst*

Okay. On the new safety standards, fire service standards for SCBAs, is the timing still the end of this year? Is that still what we are looking for?

William Lambert - *Mine Safety Appliances Co - CEO, President*

That's correct.

Dick Ryan - *Dougherty & Company - Analyst*

That should do it. Thank you.

William Lambert - *Mine Safety Appliances Co - CEO, President*

You're welcome, Dick.

Operator

Our next question comes from Edward Marshall from Sidoti & Company. Please go ahead.

Edward Marshall - *Sidoti & Company - Analyst*

Two quick follow-ups. There is a shift right now in rig count, going from gas to oil and knowing General Monitors and the big exposure in the Middle East, et cetera, I mean looking at kind of your fixed gas instrumentation being up 31%. Can you talk about maybe the mix, and I think this question has been asked in prior conference calls, and I don't know that you had it? I'm curious if you have the mix between gas and oil, and the rig count and the exposure that you have to individual markets? And whether maybe some of that conversion from gas to oil is helping drive your results here?

William Lambert - *Mine Safety Appliances Co - CEO, President*

I don't have that data here.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

We tried. We were putting some reports together this week and I tried to get some rig counts split between oil and gas and our guys at General Monitors couldn't come up with it. So we are not sure --

William Lambert - *Mine Safety Appliances Co - CEO, President*

How our instrument sales are affected by that.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

We actually didn't have -- we couldn't find a source to track how many rigs have been converted from gas back to oil or either way. We know how many total rigs there are drilling at any given time, but whatever the sources of that data are, they don't really tell you how many are gas and how many are oil.

Edward Marshall - *Sidoti & Company - Analyst*

What is their exposure, maybe, to Middle East versus Eastern Europe? Can you give a sales breakdown between the two regions?

William Lambert - *Mine Safety Appliances Co - CEO, President*

I don't have that, Dennis.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

We don't have that, we probably wouldn't break out our -- we don't have fix gas and flame by region, because we sell it as a global product, but General Monitors products are very well accepted in the Middle East. Very strong market for them.

Edward Marshall - *Sidoti & Company - Analyst*

And, again, that is a much higher margin business, too, looking back to the results and when that hit and impact it had on your overall performance.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

That's right.

Edward Marshall - *Sidoti & Company - Analyst*

Lastly, the military business and looking at the \$7 million in sales versus what was a run rate of between, say, \$12 million to \$20 million in sales last year. How much of that cost have you bled out of the system as it's preparing for sale anyway? Knowing that it was, what, I think, a 200 basis point drag on operating margins last year anyway, as it was a break even business. As you transition that business to get ready for sale, could that be also results for some of the margin improvement in the quarter?

William Lambert - *Mine Safety Appliances Co - CEO, President*

We didn't do anything in this quarter to impact that.

Edward Marshall - *Sidoti & Company - Analyst*

It was a lower sales line, right? So presumably you have lower head counts, et cetera, and I'm assuming it is a heavily intensive headcount business.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

We certainly had less people in the factories than we had, simply because of low volumes. But the -- I guess the flip side is, in the second quarter we will be able to reduce costs in line with our sales. We will be able to eliminate the costs to go with the sales.

Edward Marshall - *Sidoti & Company - Analyst*

Is there a large fixed cost component for that business?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

The factory, but the factory is going to the seller, so --

William Lambert - *Mine Safety Appliances Co - CEO, President*

The buyer.

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Or the buyer, sorry.

Edward Marshall - *Sidoti & Company - Analyst*

Great. Thanks, guys.

William Lambert - *Mine Safety Appliances Co - CEO, President*

Okay.

Operator

(Operator Instructions). We have a question from Holden Lewis from BB&T. Please go ahead.

Holden Lewis - *BB&T Capital Markets - Analyst*

Just an easy one. In light of what looks to be sustainable improvement in Europe, what should we be thinking about in terms of tax rate? Is that 30.7%, kind of, the best guess for the full year? I'm guessing even going forward, we would expect the tax rate to be lower than what you have had in the past given Europe's disturbance, right?

Dennis Zeitler - *Mine Safety Appliances Co - SVP, CFO*

Given the mix of geographies we had in the first quarter, and the fact that the R&D tax credit is not in there, I guess my best guess for the full year tax rate would be some where around 30%.

Holden Lewis - *BB&T Capital Markets - Analyst*

All right. Excellent, thank you .

Mark Deasy - *Mine Safety Appliances Co - Corporate Communications Director*

John, is that it for the queue?

Operator

We have no questions at this time.

Mark Deasy - *Mine Safety Appliances Co - Corporate Communications Director*

Give than we have no more questions, that will conclude today's call. I want to thank everybody for joining us again today and I want to remind you, if you missed a portion of this morning's conference, an audio replay will be available on the MSA website for the next 30 days. On behalf of Bill, Dennis, Joe, Ron and Kerry, we thank you for your interest. And again, look forwarding to talking with you again soon and hope everybody has a great day. Goodbye.

Operator

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

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