



MTS Systems Corporation
Annual Report to Shareholders 1999

The background of the lower half of the cover is an abstract, curved graphic. It features several concentric, overlapping bands of color that create a sense of motion and depth. The colors transition from dark brown and black at the top to bright yellow and orange in the middle, and finally to a deep red at the bottom. The overall effect is reminiscent of a stylized globe or a dynamic, curved surface.

*driving
innovation*

Our Mission

We are a technology-based, market-driven company providing hardware, software, and engineering services to researchers, designers and manufacturers.

Our mission is to help our customers design, develop, and produce their products faster, with higher quality, and at a lower cost.

Notice to Shareholders:

Beginning the first quarter of our fiscal year 2000, we no longer will mail out quarterly financial reports. Quarterly financial information will continue to be available on our web site at www.mts.com/financial.

Financial Highlights

Net Revenue \$ Million



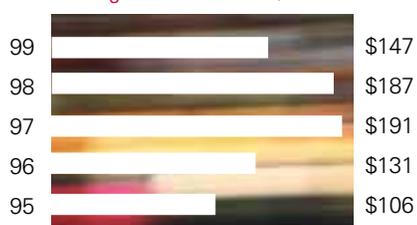
Net Income \$ Million



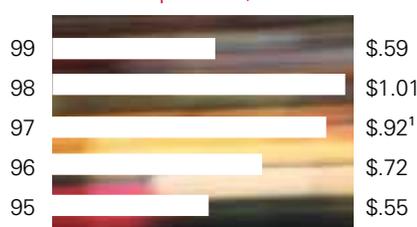
Return on Beginning Shareholders' Investment per Share



Backlog of Orders \$ Million



Net Income per Share, Diluted



¹Excludes an after-tax gain of \$2,654,000 from the sale of land in May 1997, which is equal to \$.13 per share

	1999	1998	Change
<i>(expressed in thousands except per share data)</i>			
Net revenue	\$ 390,542	\$362,163	7.8%
Net income	\$ 12,445	\$ 21,539	(42.2%)
Net income per share, diluted	\$.59	\$ 1.01	(41.6%)
Return on sales	3.2%	5.9%	
Return on beginning shareholders' investment per share	8.0%	15.4%	
Return on average net assets	10.7%	20.9%	
Dividends per share	\$.24	\$.24	
Shareholders' investment per share	\$ 7.80	\$ 7.39	5.5%
Long-term capitalization ratio	27.0%	22.9%	
Weighted average shares outstanding, diluted (000's)	21,184	21,330	
New orders	\$ 350,190	\$352,282	(.6%)
Backlog of orders at year end	\$ 146,833	\$187,185	(21.6%)

Forward-Looking Statements

Throughout this report there exist forward-looking statements, made pursuant to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, which reflect management's current expectations or beliefs. We caution our shareholders and other readers of this report that actual future results could differ materially from those in the forward-looking statements, depending on many factors, some beyond our control, including factors related to company competitive performance, industry conditions, and international economic trends.

1999 Order Distribution

- 56% North America
- 30% Europe/Africa/Middle East/Russia
- 13% Asia Pacific and Japan
- 1% Latin America



Principal Operating Locations

To Our Shareholders

We finished 1999 with a very disappointing fourth quarter and thus a full-year financial return that missed our expectations. While we grew a modest 7.8 percent on the top line (based on the restatement of fiscal 1998 due to the 1999 merger with DSP Technology, Inc.), our net income dropped by 41.6 percent to \$.59 per share. This drop reflects slower than anticipated growth in virtually all our markets, operational difficulties in our entertainment and mechanical testing products businesses, and restructuring costs to cover acquisition integration and to reduce our business capacity.

I reported to you last year that we had set in place a long-range goal to grow revenue by 12 to 15 percent and earnings per share by 14 to 18 percent over the coming three years. It is now clear that these goals were too optimistic for the near term.

Despite the fact that we continue to hold the technology leadership position in many of our businesses, the transition into more specialized engineered software, consulting, and modeling to enhance our traditional physical testing strengths is proving more costly, with longer selling cycles than we anticipated. Yet the very positive response from customers worldwide to these initiatives tells us it's the right strategy.

Additionally, efforts in building a new market by supplying large, complex motion-based equipment to major theme parks hit a snag as we encountered design and execution issues which seriously deteriorated profitability. For the moment we are taking a much more cautious position toward new business opportunities in the entertainment field.

These factors, when combined with the worldwide sluggishness in the material testing market, suggest slow growth in the immediate future.

Coming into 1999, our factory automation group, after a series of acquisitions in 1998 was positioned for strong double-digit top

and bottom line growth. Unfortunately the North American market deteriorated and as a result revenue grew only 3 percent. Income from operations, up 19 percent, improved substantially but was below our expectations.

Geographically our bookings distribution remained similar to 1998. Orders from Japan, which we had been forecasting to be stronger the second half of the year were delayed partly due to the uncertain value of the yen. With orders essentially flat with last year, backlog declined by \$40.4 million or 21.6 percent.

Perhaps the most significant issue was our internal operating performance. After 18 months of preparation, we went live on the full suite of enterprise software in January 1999. We were clearly unprepared for the ensuing lack of timely and correct management information, a situation that—while dramatically improved from those first few weeks of turmoil—still existed at year-end. The implementation of this business software highlighted the need for process re-engineering, particularly in our Minneapolis-based Mechanical Testing and Simulation Sector. This re-engineering process is under way. I expect this activity to continue through the next two years.

With the acquisition of DSP Technology we enhanced the market position of our powertrain unit. Not only did we gain a first-rate management team, but we also have become the leading developer of engine testing equipment. This is essential for providing new growth possibilities.

We strengthened our strategic alliance with Mechanical Dynamics, Inc., together positioning ourselves as the technology leader in the powerful combination of virtual and physical testing. Customer interest in this capability is very strong. Additionally, we captured over \$11 million of new business in the rapidly expanding noise and vibration analysis field—up from zero last year.

AeroMet, our venture into aircraft quality

parts manufacturing, via laser deposition of titanium, made steady progress.

During the year, three long-term contributors to MTS's success retired. Marshall Carpenter, Chief Financial Officer (27 years of service); Howell Owens, Vice President, Manufacturing (32 years of service); and Bruce Hebeisen, Human Resources Manager (31 years of service), were all critical to creating and building the company and well deserved the respect and many accolades they received at their departures.

In summary, despite the disappointing financial performance, we did create lasting value for our customers, built a solid platform for financial recovery, and grew market share in most of our businesses.

You will see in the pages that follow that the excitement, innovation, and technologi-

cal expertise of our people remain unequalled anywhere in the world. That base only grew stronger in 1999. I remain confident that we have the skills, the dedication, and the absolute commitment of the finest people in the industry.

I look forward to a much more positive report next year on our results and prospects for an exciting, challenging and profitably growing MTS.



Sidney W. Emery, Jr.

Chairman and Chief Executive Officer

Seated, left to right:

David E. Hoffman

Vice President and Chief Financial Officer

Keith D. Zell

Executive Vice President

Sidney W. Emery, Jr.

Chairman and Chief Executive Officer

William G. Beduhn

Vice President
Advanced Engineering Systems Division

Standing, left to right:

Hal J. Galvin

Vice President
Corporate Business Development

Mauro Togneri

Vice President
Sensors Division

James M. Egerdal

Vice President
Services and Support Division

William G. Anderson

Vice President
Automation Division

Nancy L. Quist

Vice President
Material Testing Division

Steven M. Cohoon

Vice President
Vehicle Dynamics Division

Laura B. Hamilton

Director, Process Re-Engineering

Marshall L. Carpenter

Vice President
Chief Financial Officer (Ret.)





Process Re-Engineering and Information Systems

In fiscal 1999 a significant portion of our financial shortfall was due to operational inefficiencies that compromised our ability to effectively deliver products. The situation was particularly brought to light during our enterprise-wide information system implementation in January 1999. At that time we went "live" with a new information management system from SAP America, Inc., a leading provider of information system solutions. The implementation affected our Eden Prairie, Minnesota, and Berlin, Germany, facilities.

Unanticipated costs associated with the upgrade, and our underestimation of the widespread impact it would have on our business, resulted in internal inefficiencies. This helped focus management's attention on the larger issues of re-evaluating our internal activities.

We now have a good understanding of the factors that contributed to our results. In response, we have launched a focused business process re-engineering effort to drive significant operational improvement over the next few years.

We have identified the performance issues, prioritized our objectives, and established a clear plan of action.

Our re-engineering efforts are focused on delivering three key results:

1. Reliable, predictable, product manufacturing processes that allow us to accept customers' orders confidently, knowing we can deliver on time;

2. Project operating processes that allow us to deliver

custom-engineered solutions that meet customers' expectations on time and on budget; and

3. Processes that ensure timely delivery of business information to management.

To meet the first objective in the standard product processes area, we will be improving our forecasting, planning, product management, and master scheduling processes.

To meet the second objective of improving project-related processes, we are focusing on understanding our customers' requirements for flawless execution. Custom projects, by their nature, include a high degree of uncertainty as to their requirements, the solution, and project execution. Our re-engineering focus is on the requirements definition, design, procurement, assembly, checkout, and installation processes required in the custom projects market.

Finally, to effectively manage a multinational, multiproduct business, we must ensure timely access to management information. Our investment in enterprise software is only the first step in achieving this goal. We have cross-functional teams in place and plans to simplify procedures.

Taking longer than we previously expected, we have established a two-year schedule to re-engineer our processes and optimize use of our new software tools. We are confident that our investment in process re-engineering and our information system will return improved financial performance as we leverage the benefits of these important efforts.

driving innovation

MECHANICAL TESTING AND SIMULATION SECTOR

Financial Comparison

	1999	1998	1997
Orders	\$277,370	\$ 273,750	\$ 317,634
Net revenue	\$313,685	\$ 287,761	\$ 260,650
Income from operations	\$ 15,388	\$ 25,011	\$ 25,219
Percent of net revenue	4.9%	8.7%	9.7%

Modeling and Analysis

Our mechanical testing and simulation business has always been focused on helping customers get their products to market faster, at lower cost, and with higher quality. Traditionally, our products helped customers do this by helping them test physical prototypes.

Modeling prototypes in software—before time or materials are committed to physical prototyping—lets customers evaluate more design options earlier in the development process. Our expertise in physical testing puts us in a unique position to help customers take advantage of software modeling—bringing realism to “virtual” testing.

Having earlier acquired the I-DEAS noise and vibration test software and services businesses, in 1999 we successfully integrated these software capabilities into our analysis products, initiated an extensive R&D program for the noise and vibration software, and entered into a joint development and distribution agreement with the French company STRACO for advanced vibro-acoustic modeling and simulation software. We also launched an intensive marketing campaign to position MTS firmly in this new thrust.

To integrate physical test equipment and simulation software, we strengthened our strategic alliance with Mechanical Dynamics, Inc., of Ann Arbor, Michigan. The resulting integrated testing solution will aim at dramatically reducing product development time and cost.

Through this alliance we received engineering consulting orders from a North American motorcycle manufacturer and a Japanese auto manufacturer to evaluate and recommend enhancements to their respective product design processes. These activities provide the customer with an engineering and process framework that leverages our strengths in physical testing, software engineering, virtual modeling, and engineering consultancy.

ADAPT-CAS Combustion Analysis System

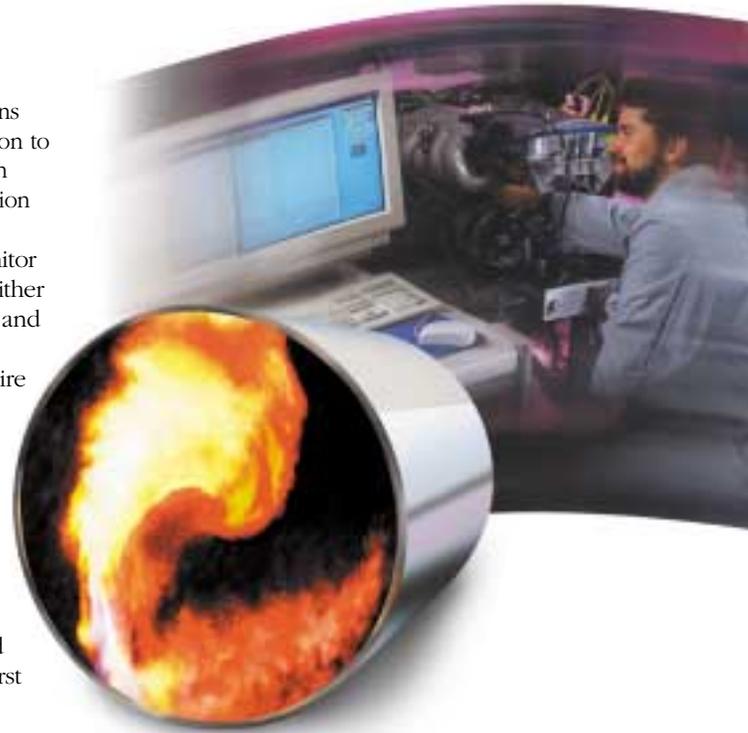
burning with answers

Efficient engine performance depends on efficient fuel combustion. But studying fuel combustion inside the cylinders of a running internal combustion engine poses some technical challenges. These challenges can be met in part through specially designed transducers and instrumentation. But acquiring data from these instruments and turning it into information that automotive engineers can use is a different challenge.

To meet the challenge, DSP Technology, Inc., now the DSP Technology Division of MTS, developed the ADAPT®-Combustion Analysis System, or ADAPT-CAS. Released in 1999 under the trade name RedLine®, this hardware and software system uses high-performance computer technology and powerful application software to provide information about engine knock, spark timing, misfires, fuel injector operation, and other combustion characteristics.

Engineers and technicians can apply this information to modifying engine design and improving combustion efficiency.

ADAPT-CAS can monitor multiple cylinders in either two- or four-cycle gas and diesel engines. It was designed to both acquire and analyze combustion data. Combined with other DSP products, ADAPT-CAS enables us to offer complete solutions for powertrain testing. More than 50 ADAPT-CAS systems were sold during the product's first year on the market.



MECHANICAL TESTING AND SIMULATION SECTOR

Powertrain Testing

Our merger with DSP Technology, Inc., completed in May, created a powerful combination in the powertrain testing market. By year-end we completed the integration of the former MTS PowerTek division into the new DSP Technology Division, headquartered in Ann Arbor, Michigan. While we experienced more costs than anticipated to complete this integration, the combined controls, system integration, data acquisition, and combustion analysis products are the strongest in North America for powertrain testing.

Gas and diesel engines used in the automotive industry are all thoroughly tested, simulated, and analyzed during

their design and development. For the most part, this intensive testing and development work is driven by two factors:

- Manufacturers seeking a competitive edge
 - Increasingly stringent governmental emissions standards.
- The latter factor is driving worldwide growth in the powertrain testing market. As stricter regulations come into effect, the requirements for engine/powertrain manufacturers to comply with emissions standards by using reliable and repeatable testing methods become essential. Our data acquisition, test control, and combustion analysis products address these requirements directly by providing tools to acquire accurate and repeatable engine and powertrain data, analyze the data, and improve emissions and performance.

One of our product development goals is to simplify testing for our customers. We want to make it easy for test-system users to achieve more useful results faster. Remote Parameter Control™ (RPC®) Pro software is a breakthrough in meeting this objective. It simplifies testing while increasing the user's control over the test and the test data. The RPC Pro package is the newest generation of our successful RPC software product family, fully redesigned for flexibility and ease of use.

RPC software allows engineers to collect and edit performance data from vehicles running on roads or test tracks. The edited files are then used to control road simulation systems. In this way, MTS simulators are used to accelerate wear on test specimens, providing data that engineers use to optimize vehicle designs.

RPC Pro software enhances the productivity of road simulation tests by managing test information automatically for the user, providing intelligent diagnostics that flag potential problems early, reducing test setup times, and providing compatibility with third-party software packages for easy customization.

Introduced late in 1999, RPC Pro software is under evaluation at most of the major automakers worldwide and has quickly gained market acceptance.

RPC Pro Software

easy does it



MECHANICAL TESTING AND SIMULATION SECTOR

Vehicle Dynamics

Our vehicle testing business is driven by the demand for shorter model development cycles across the entire range of ground vehicles—from passenger cars to motorcycles to construction equipment. This demand translated into specific opportunities for MTS this year:

- The safety testing market demonstrated particularly strong growth, especially for our free motion headform test system, which is used for compliance testing to meet US and European safety requirements. Our differentiator is greater test accuracy relative to our competitors, which allows our customers to best meet the increasing demand of consumers for safer vehicles.
- Our customers are increasing their emphasis on computer modeling early in their development programs. This has increased the use of test systems and test data to validate such computer models. This trend is evident in growing sales of both component testing systems, such as our elastomer and shock absorber testing systems, as well as complete vehicle characterization systems. We believe that use of our testing systems to validate computer models is a long-term trend that will significantly support our future growth.
- The need for more sophisticated lab testing to replace road testing has created a demand for several new products. In 1999 we introduced and delivered to customers – The 329 six-degree-of-freedom (6-DoF) Road Simulator, which provides engineers with more complete performance data than was previously available, and

329 Six-Degree-of-Freedom Road Simulator

count on it

When it comes to describing the dynamics of an automobile, engineers are concerned with the basic concept of “degrees of freedom” (DoF). The term refers to the number of ways in which a physical body can move. A vehicle, for example, can react in any one or a combination of six degrees of freedom in response to physical forces.

Road simulators that are used to test vehicle fatigue and durability typically provide control of three or four degrees of freedom. These are forces and movements up and down, side to side, front and back, and sometimes brake rotation, which pitches the vehicle nose down. But vehicles driven in the real world are subjected to additional forces and motions. To control these additional degrees of freedom and capture the corresponding data we developed the Model 329 6-DoF road simulator.

Because it provides control of all six degrees of freedom—the four described above, along with wheel camber and steer moment—the 6-DoF road simulator



provides a more complete picture of vehicle dynamics to the automotive engineer.

The first 6-DoF system was delivered to Mazda in Hiroshima, Japan, near the end of the fiscal year (shown in photo). Mazda engineers are using the system to

evaluate properties of a broad range of vehicles under development. We now have orders for 6-DoF systems from other automakers, and we expect this innovative product to become the global standard in road simulator systems.

MECHANICAL TESTING AND SIMULATION SECTOR

- Advanced drivetrain systems that incorporate hostile environments to evaluate noise and vibration issues.

We are achieving high returns on our recent investments through growing sales of our TestLine™ standard testing systems, the SWIFT™ wheel force transducer, and Component RPC III testing software. Key new products that were introduced this year included an extension of our SWIFT product line from passenger vehicle applications to light truck testing and the next generation of our flagship RPC test control software, marketed under the name RPC Pro.

Our investments in 1999 were focused not only on broadening and enhancing our product lines, but also on improving our operating efficiency. Improvements were accomplished in part by organizing our staff around our

two business styles—standard and custom solutions—and clearly separating the two as distinct value propositions for our customers.

In the short term, our primary competitive challenge is maintaining and expanding our value-added relationships across the spectrum of OEMs and subsystem suppliers. We believe we are strongly positioned to meet this challenge with a continuing stream of technically superior products and an ongoing focus on improving our internal operating efficiency.

We expect escalating competition among our automotive customers to continue to drive product development spending at a rate significantly greater than that of vehicle production spending, benefiting our vehicle dynamics business.



MTS Invention Honored

In September, our Spinning Wheel Integrated Force Transducer (SWIFT) was honored by *R&D* magazine as one of 1999's 100 most significant technological achievements. The R&D 100 Awards are given annually to recognize the top technology breakthroughs of the year.

Used for vehicle suspension testing, the SWIFT transducer provides high-quality force and moment data directly at the vehicle spindle. It provides more accurate data than the traditional method of instrumenting a vehicle with strain gages.

Installing a SWIFT transducer requires just hours instead of the six weeks or more that the traditional strain gage method requires. By the end of the fiscal year, we had delivered more than 70 units to 7 customers in 11 locations—making SWIFT the most successful product launch in MTS history.

This is the third time we have earned this recognition from *R&D*. The company's Flat-Trac® Roadway system was honored in 1993. The MTS Artificial Mouth, jointly developed by the company and professors at the University of Minnesota School of Dentistry, won the award in 1983.

From left, SWIFT development team members Al Kempainen, Rick Meyer, and Jodi Sommerfeld

MECHANICAL TESTING AND SIMULATION SECTOR

Aerospace

Fiscal 1999 was a very challenging year for our aerospace business due to industry consolidation in North America and slow aircraft sales in Asia. European orders, on the other hand, grew due to strong sales to rotorcraft manufacturers. Overall market conditions produced a flat year for this business in terms of both orders and revenues.

Among the more significant orders for our Aero-90™ test control systems were those from the Italian aircraft firm Agusta for testing of tilt-rotor craft and from British Aerospace in the United Kingdom.

Strong activity in the regional jet and space systems markets is expected to provide growth stimulus for the future. Our aerospace business depends on aircraft and propulsion systems development programs, and new programs will drive us.

Good progress was made on a number of significant product development initiatives related to our flagship aerospace structural test control platform, the Aero-90 system. We anticipate significant product enhancements in 2000 in the areas of data acquisition and structural test control software and hardware.

Alliance RT Material Testing Systems

second to none

The Alliance™ RT series of material testing systems brings advanced technology to diverse customers while reducing production costs in our electromechanical test system business. These testing systems address the need for easy-to-use tools capable of running the most common tests used in research and development in industries ranging from plastics to consumer goods to medical devices.

Announced in the second quarter of fiscal 1999, the Alliance RT systems include simplified electronics that improve reliability, an enhanced handset that gives users more control and monitoring options, and integrated load-cell connections that improve safety and convenience.

The systems also represent a consolidation of three previous product lines, reducing the number of manufacturing form factors that we produce and the number of parts that we inventory. This product line consolidation will pay

off in improved earnings in the future.

To support sales, we rolled out an aggressive promotional campaign for our material testing business that prominently features the Alliance RT systems. This new campaign uses a combination of sports imagery and challenges to familiar phrases to communicate our message of competitive efficiency. The campaign aims at broader name recognition and consistent brand management for our material testing business.

By the end of the fiscal year, some 50-plus locations were scheduled to receive new Alliance RT systems.



MECHANICAL TESTING AND SIMULATION SECTOR

Material Testing

Our material testing business produced mixed results in 1999. Bright spots included solid order growth in Asia and Europe, while North America remained flat. Our international performance was a welcome sign after several disappointing years in this highly competitive market.

Growth in orders for our Nanoindentation products, a product line acquired in 1998, exceeded our expectations. This fast growing technology allows researchers to probe the mechanical properties of thin films and coatings. We received significant orders for these products from major technical institutes and telecommunications and electronics companies.

Looking ahead, we see slow market growth, requiring us to rationalize our manufacturing capacity around the world. We began this process in 1999.

Despite the year's mixed performance, it was an exciting time for new product introductions. In January we announced the Alliance RT testing systems, our new line of electromechanical test systems. We also introduced the Mini Bionix® II system, a tabletop system for the biomaterials and biomechanics market. In addition to new products, the materials group delivered several key engineered systems, ranging from test systems for tiny electronic leads used in the medical device industry to large metal-forging systems. We consider the ability to provide engineered solutions a core competency that gives us a unique ability to meet this market's special needs.

National Advanced Driving Simulator *going for a spin*

Subjecting highway drivers to adverse situations to test their reactions is not the kind of test anyone would conduct in real traffic. But if the traffic situations could be brought into the safety—and control—of the laboratory, then new options would open up. Providing just this opportunity is the objective of the National Advanced Driving Simulator (NADS), being installed at the University of Iowa. The simulator uses advanced motion and control systems from MTS, along with computer graphics and an audio system, to give the driver a realistic highway experience. The project is funded by the U.S. Department of Transportation.

All of the simulator's motion and motion-control systems were engineered at our Eden Prairie, Minnesota, facility. We applied our expertise in metal belt and hydrostatic bearing technologies, developed from our Flat Trac road simulators, to create a precisely controllable motion system capable of accelerating a 3500-pound car anywhere within a 64-



foot-by-64-foot area. The responsive control of motions that our technology makes possible is at the heart of the NADS system, the largest and most realistic driving simulator in the world.

Shipment of the system to the University of Iowa began in July, after extensive inhouse testing and verification. The complete NADS system is expected to be operational in late 2000.

MECHANICAL TESTING AND SIMULATION SECTOR

Advanced Engineering

Our advanced engineering systems business shipped nine major systems during the year to customers around the world, maintaining 1999 revenue similar to that of 1998. However, our order volume was down. Thus backlog, the key financial indicator of revenue in this generally long-lead custom project business, is nearly one-third down from last year going into the year 2000. This is not an unusual situation in a business niche which focuses only on large projects.

Our strategy here is to engineer solutions to new prob-

lems identified by customers and use those solutions to grow the business in new market niches. This year's successful projects provide us with a number of new and interesting market niche opportunities. Because of our successes in 1999, we are now ready to expand our market penetration in three areas in particular: advanced motion platforms, systems for wind tunnel testing, and advanced manufacturing methods.

The new technologies we developed for the U.S. Department of Transportation's National Advanced Driving Simulator (NADS), and for a high-performance motion control project for the US Army's Tank Automotive Research and Development Command, have generated a new level

Flat-Trac Rolling Road Simulator

the race is on

In the high-stakes world of professional auto racing, fractions of a second can mean the difference between a loss and a win. To squeeze every performance advantage out of a car design, racing teams must look closely at ground effects—the aerodynamics of the space between the ground and a car's underside. Ground effects can significantly influence a car's performance by affecting down force, the vertical force of the car on the ground. Racers depend on a strong down force to improve their traction and cornering speed.

Wind tunnels are used throughout the motorsports world to study down force and other aerodynamic effects. But these studies typically are conducted on small-scale models and at relatively low speeds, limiting their accuracy. To help race car designers perform more accurate tests, we adapted our Flat Trac road simulator technology for use in wind tunnel testing.

By integrating our expertise in high-speed steel-belts and force-measure-

ment and restraint technologies, we are able to create systems for full-scale testing at high speeds that record precise down-force data under each wheel. These systems install directly into a wind tunnel to provide a moving ground plane. Three of the systems were sold to motorsports companies by the end of the fiscal year. To meet the needs of passenger car developers, we are modifying this technology for greater test flexibility. Two of the modified systems already have been ordered for use in designing more fuel-efficient passenger cars.



MECHANICAL TESTING AND SIMULATION SECTOR

of interest in our capabilities in the worldwide motion platform market. These have led to significant new orders.

In September 1999 we shipped our first high-speed Rolling Road system for wind tunnel installation. This system will be used by engineers to develop new designs to improve the performance of high-speed vehicles.

We also designed and delivered advanced welding systems for new production applications. One system uses linear friction welding (LFW) technology to weld critical aerospace parts for a major engine supplier. The LFW technology welds parts together by accurately controlling a vibrating force between the parts. A second application uses advanced sensor technology to program and control

a laser beam for laser welding. A third system uses friction stir welding, a clean, convenient alternative to conventional welding. We expect these technologies, having been demonstrated, will be attractive for a wide array of both research and production activities.

In late 1999 we consolidated our entertainment business initiative, comprising theme park mechanical structures and controls, into the Advanced Engineering Systems Division to correct a series of operational difficulties. While we expect to continue to grow in this niche market, we have shifted in the short term from a growth focus to one of ensuring customer satisfaction and profitable completion of our current contracts.

Our automation business acquired a patented linear motor technology from Airex Corporation in the second quarter. This technology enhances our competitive edge in the factory automation industry. The advanced linear motor technology is a natural extension of our rotary servomotor product lines. By bundling this new linear motor technology with our advanced drive technology, we can now offer a high-performance package to meet and exceed our customers' most demanding applications.

Our MaxPlus® linear motors are built from patented copper windings and slide into a magnetic track lined with high-temperature rare-earth magnets. The track attaches to the customer's bearing system and can be customized to any length to address applications across many industries.

The semiconductor industry is among the markets that the new linear motors open up to us. This industry uses very precise multi-step automated systems in

its high-volume production of wafer boards. The new linear motors also have the potential to replace hydraulic components used in low-force, low-frequency automation systems. We now can offer customers the latest technology for a complete servo solution, regardless of their automation system configuration requirements.

During 1999 we established a manufacturing capability for these new motors in our New Ulm, Minnesota, location, while completing the design and tooling for the full family of offerings. The product was released late in the year with many companies accepting prototypes for early configuration evaluations.



MaxPlus Linear Motors

get it straight

FACTORY AUTOMATION SECTOR

Financial Comparison

	1999	1998	1997
Orders	\$ 72,820	\$ 78,532	\$ 63,236
Net revenue	\$ 76,857	\$ 74,402	\$ 62,774
Income from operations	\$ 10,187	\$ 8,556	\$ 6,044
Percent of net revenue	13.3%	11.5%	9.6%

Automation

This was a year of both expansion and consolidation for our automation business. We successfully acquired licensing agreements for two new product technologies, one for linear motors and the other for a line of digital servo amplifiers. The use of linear motors in automation applications has become one of the fastest growth areas in our factory-automation markets.

In September 1999 we acquired the exclusive license for the PowerBlok product line and trade name from SemiPower Inc., of San Jose, California. PowerBlok amplifiers can interface with any motor type and size. The PowerBlok line is a natural extension to our family of digital power amplifiers and gives design engineers a plug-and-play flexibility to create automated systems.

Orders for this business were slower in 1999 by some 7 percent. In response, we took steps to consolidate our resources. For our North American operations, we implemented one operating system that now links all operations. We expect this to streamline our manufacturing processes and enhance overall customer satisfaction. Additionally, we consolidated our electronics research and development efforts into our Horsham, Pennsylvania, facility. This allowed us to maximize our talent base and reduce costs while assembling a focused global team.

In addition to our motor and servo products, the automation business has developed a line of proprietary, custom-engineered, high-powered amplifiers that work to meet the ever-changing needs of the medical magnetic resonance imaging (MRI) market. These gradient amplifiers are allowing medical manufacturers to design systems that not only increase the diagnostic capabilities they can offer, but also reduce the time required to perform each scan. These capabilities enhance overall patient care, throughput, and comfort. To help meet future medical needs, we are in the process of developing a line of high-performance amplifier products that will help medical researchers reach their ultimate goal of "real time imaging."

Temposonics Auto-SE Sensors

pump up the volume

Magnetostrictive sensor technology makes possible the precise measurements that are critical in many factory automation systems, particularly those used in discrete-part manufacturing. Temposonics®, our line of noncontacting position sensors, is the world's most widely recognized name in magnetostrictive sensor technology. The accuracy, durability, and long life of our Temposonics sensors make them suitable for applications and environments in which competitive products are not rugged enough to perform effectively, providing us with opportunities for potential new markets.

These market opportunities include a number of high-volume (hundreds of thousands of parts annually) applications. To address these opportunities, in 1999 we completed the installation of a fully automated high-volume sensor production system at our facility in Lüdenscheid, Germany. The low-cost Temposonics Auto-SE (Automated

Sensor Element) sensors produced at this facility already have been designed into the active suspension systems of new cars designed by several automakers.

In July the Auto-SE sensor and our assembly and test processes in Lüdenscheid passed a Process Sign Off audit conducted by a customer, Leopold Kostal, GmbH, and attended by representatives from DaimlerChrysler. Passing this milestone brings us one step closer to our goal of providing sensors in large volumes to the on-board automotive market.



FACTORY AUTOMATION SECTOR

Sensors

Our sensors business solidified its position as world leader in magnetostrictive sensing this year. We saw substantial volume growth in Japan and Europe, while experiencing a decline in North American orders. Overall, orders were flat with 1998.

Growth in Germany, Italy, and in Europe generally was supported by favorable currency exchange rates, which created an excellent export environment for both our European customers and for our Lüdenscheid, Germany, manufacturing operation. In addition, European and Japanese businesses have demonstrated an eagerness to incorporate the highest available level of sensor performance into their machine designs. This combination of factors produced a considerable volume increase for our Temposonics III sensors, our latest generation of magnetostrictive sensors.

In the United States the situation was reversed. The migration of machine business to Europe has slowed growth in our traditional US markets and dampened customer interest in adopting higher-performance sensing. After re-evaluating our traditional business in the United States, we've retooled our selling

channel to increase penetration into markets adjacent to our customary markets and into new markets. Altogether, our US growth markets tend to be smaller niches, frequently requiring some custom design content. We've restructured our internal response teams to more quickly address these requirements. These operational changes position us to rekindle the steady growth in domestic markets that traditionally has characterized our sensors business.

Despite less than expected growth, the sensor business produced solid earnings through aggressive cost control, including worldwide component sourcing rationalization. We also reduced costs by benchmarking our US operations against other similar successful businesses, including our German production facility, and eliminating activities at our US site that do not add value. We added new automated processes to reduce costs, ensure consistent quality, and increase yield.

Finally, we have identified several high-volume markets, including the automotive industry, that require tooling and other investments but hold the promise of substantial growth in the coming years, well above the single-digit industry norms.

Six Year Financial Summary

(September 30)

	1999	1998	1997	1996	1995	1994
<i>(expressed in thousands, except per share data and numbers of shareholders and employees)</i>						
Operations⁵						
Net revenue	\$390,542	\$362,163	\$323,424	\$278,170	\$247,793	\$212,215
United States revenue	200,556	200,490	156,877	140,249	136,862	111,312
International revenue	189,986	161,673	166,547	137,921	110,931	100,903
Gross profit	151,171	142,227	132,073	116,047	99,923	86,684
Income before income taxes	18,770	33,448	29,986 ¹	21,813	15,244	13,804
Net income	12,445	21,539	19,237 ¹	15,170	11,105	9,394
Net income per share, diluted basis	.59	1.01	.92 ¹	.72	.55	.45
Research and development expense	26,966	24,348	19,798	19,776	15,471	13,873
Net interest expense	4,597	1,948	1,125	1,123	2,424	1,860
Depreciation and amortization	14,424	10,880	9,608	8,673	7,912	6,745
Financial Position⁵						
Current assets	\$223,651	\$204,311	\$162,814	\$137,584	\$138,159	\$129,042
Current liabilities	104,713	110,223	83,413	63,465	69,312	68,692
Current ratio	2.1:1	1.9:1	2.0:1	2.2:1	2.0:1	1.9:1
Net working capital	118,938	94,088	79,401	74,119	68,847	60,350
Property and equipment, net	73,633	69,942	51,790	49,476	49,465	48,241
Total assets	333,347	313,022	229,075	197,679	198,320	183,767
Interest bearing debt	71,637	74,682	12,865	11,836	22,965	23,851
Shareholders' investment	162,859	152,689	133,524	120,578	113,311	105,886
Shareholders' investment per share	7.80	7.39	6.56	5.90	5.54	5.20
Other Statistics and Ratios⁵						
Diluted shares outstanding ²	21,184	21,330	20,945	21,184	20,258	20,750
Number of common shareholders of record	2,055	1,760	1,575	1,523	1,395	1,394
Number of employees	2,436	2,424	2,125	1,866	1,729	1,654
New orders	\$350,190	\$352,282	\$380,870	\$302,824	\$261,487	\$209,405
Backlog of orders	\$146,833	\$187,185	\$190,784	\$130,621	\$105,967	\$ 89,896
Gross profit percent	38.7%	39.3%	40.8%	41.7%	40.3%	40.8%
Research and development costs as a percent of net revenue	6.9%	6.7%	6.1%	7.1%	6.2%	6.5%
Net income as a percent of net revenue	3.2%	5.9%	5.9% ¹	5.5%	4.5%	4.4%
Effective tax rate	34%	36%	36%	31%	27%	32%
Interest bearing debt to shareholders' investment percent	44%	49%	10%	10%	20%	23%
Return on average net assets ⁴	10.7%	20.9%	22.7%	17.6%	13.2%	12.0%
Return on beginning shareholders' investment per share	8.0%	15.4%	15.6% ¹	13.0%	10.6%	9.3%
Cash dividends paid per share	\$.24	\$.24	\$.20	\$.16	\$.14	\$.14

¹ Excludes an after-tax gain of \$2,654,000 from the sale of land in May 1997, which is equal to \$.13 per share

² Presented on a weighted average basis of common shares assuming conversion of potential common shares during each year after retroactive adjustments for issued shares, for stock splits and for reduction of shares from treasury stock purchases (in thousands of shares).

³ On December 1, 1999, there were 2,055 common shareholders of record, with another estimated 2,200 beneficial shareholders whose stock is held by nominees or broker dealers.

⁴ (Income before income taxes plus net interest expense) divided by (average quarterly assets minus non-interest bearing liabilities).

⁵ All amounts have been restated to reflect the acquisition of DSP Technology, Inc., accounted for under pooling-of-interests.

Management's Discussion and Analysis of Financial Condition and Results of Operations

All amounts have been restated to reflect the acquisition of DSP Technology, Inc., accounted for under pooling-of-interests.

Backlog/New Orders

	1999	1998	1997
	<i>(expressed in thousands)</i>		
New Orders:			
North America*	\$196,367	\$195,206	\$202,241
International	153,823	157,076	178,629
Total	\$350,190	\$352,282	\$380,870
Backlog	\$146,833	\$187,185	\$190,784

*Includes U.S. and Canada

1999 new orders of \$350.2 million were down .6% from 1998 and 1998 new orders were down 8% from 1997. 1997 new orders represented a 26% increase over 1996. 1997 orders included a \$18.5 million contract for a large crash simulation system. There were no orders over \$10 million in 1999 or 1998.

In 1999, the Mechanical Testing and Simulation segment (MT&S) new orders of \$277.4 million increased \$3.6 million over 1998 but represented a 13% decrease from 1997. Orders from the ground vehicle industry and for civil engineering applications were particularly strong in 1997 but declined in both 1999 and 1998 due to the Asian situation and the lingering Japan recession. Europe, in both 1999 and 1998, was a growth area for Vehicle Testing Systems but did not offset the decline in business in Asia and Japan.

The Factory Automation segment (FA) new orders in 1999 of \$72.8 million decreased \$5.7 million from the prior year but represented a 15% increase over 1997. The European and Japanese markets for FA products reflected solid growth in 1999. Orders for industrial automation applications (servo motors, amplifiers, and motion controllers) and industrial sensors were affected, in both 1999 and 1998, by a soft North American market.

Total North American orders for the Company in 1999 were up slightly from 1998 but remained below the record order level achieved in 1997. International orders decreased \$3.3 million from 1998 reflecting continued softness from Asia. See Geographic Analysis of New Orders (below) for the percentage breakdown by geographic area. See Foreign Currencies Effects (page 19) for the impact on orders due to changing foreign currency rates.

The backlog of undelivered orders at September 30, 1999 amounted to \$146.8 million, down \$40.4 million from the prior year. The order backlog of \$190.8 million at the end of 1997 had increased 46% from 1996 as a result of the record new orders received in 1997 which included the large crash simulation system mentioned above and a strong Asia order rate. Approximately 5% of the orders in the 1999 backlog have delivery dates beyond fiscal 2000.

Net Revenue

	1999	1998	1997
	<i>(expressed in thousands)</i>		
United States	\$200,556	\$200,490	\$156,877
International	189,986	161,673	166,547
Total	\$390,542	\$362,163	\$323,424

Record 1999 net revenue of \$390.5 million was up 8% from the prior year and represented a 21% increase over 1997 revenue. For 1999, MT&S revenue of \$313.7 million increased 9% from 1998 and represented a 20% increase over 1997 revenue. FA revenue in 1999 of \$76.8 million increased \$2.4 million from the previous year and represented a 22.4% increase over 1997 revenue (the PCI acquisition in 1998 represented 74% of the 1998 growth). For industry segment and geographic information, see Note 2 of "Notes to Consolidated Financial Statements." See Foreign Currencies Effects (page 19) for impact on revenues due to changing foreign currency rates.

Net revenue in the United States was flat with the prior year but was 28% higher than 1997. International revenue increased 18% in 1999 but decreased \$4.9 million in 1998 from 1997. International revenue grew at a faster rate in 1997 reflecting improved economic conditions which began late in 1995. In 1998, the Asian economies and Japan were in a deep recession which caused the decline in revenues between years. Europe continued to reflect growth in all three years.

The MT&S segment year over year revenue increases reflected positive worldwide demand from our ground vehicle customers, solid growth in our entertainment projects niche from orders booked in 1998, and a strong market for aftermarket sales of accessories and services. Our civil engineering structural test business which was strong in 1997 declined in 1998 and 1999 due to the Asian situation.

The FA sector revenue was up \$2.4 million or 3.3% from 1998 reflecting a continuing strong European demand. Both 1999 and 1998 were solid growth years in Europe reflecting strong demand from European original equipment manufacturers for our sensor products. The North American demand for our servo motor, amplifier, and motion control products declined in 1999.

Selective price changes were implemented in all three years. However, the overall impact of pricing changes did not have a material effect on reported revenue volume.

Geographic Analysis of New Orders

	1999	1998	1997
North America	56%	55%	53%
Europe/Africa/Middle East	30	29	27
Asia Pacific/Japan	13	14	18
Latin America/Rest of the World	1	2	2

Management's Discussion and Analysis of Financial Condition and Results of Operations

Gross Profit

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Gross Profit	\$151,171	\$142,227	\$132,073
% of Net Revenue	38.7%	39.3%	40.8%

The gross profit percentage for 1999 decreased to 38.7% from 39.3% in 1998. This decline in the gross profit percentage was caused by higher than expected costs to complete certain custom entertainment projects, an inventory charge for realigning certain products, and lost productivity early in the year related to the implementation of our new enterprise-wide software system.

The decrease in the gross profit percentage in 1998 compared to 1997 was principally caused by a higher revenue content of "specialty" projects that are sold at a lower gross margin than in our core automotive and material test business, and a high unfavorable overhead manufacturing variance caused by increased expenses and lost direct labor due to training associated with our new enterprise-wide financial and operating software system.

Selling, General, and Administrative Expenses

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Selling Expense	\$61,490	\$56,479	\$54,610
General & Administrative Expense	30,038	27,833	26,402
Total	\$91,528	\$84,312	\$81,012
% of Net Revenue	23.4%	23.3%	25.1%

Selling, General and Administrative (SG&A) expenses for 1999 as a percentage of net revenue was .1 percentage point higher than 1998 but 1.7 percentage points lower than 1997. Full year spending for 1999 totaled \$91.5 million, which represented a \$7.2 million (8.5%) increase over 1998 and a \$10.5 million (13%) increase over 1997.

All three years were similar in that cost control and alignment of existing resources with markets having the greatest potential were heavily emphasized. New investments were made based on evaluations as to how to serve our markets better or to support long-term business strategies. Specific expenses in the selling category are variable, such as commissions, which increased significantly in 1997 due to record new orders. SG&A expenses of newly acquired companies, including goodwill amortization, represented \$2.7 million of the expense increase in 1999 and \$1.5 million of the increase in 1998.

Research and Development Expense

	1999	1998	1997
	<i>(expressed in thousands)</i>		
R & D Expense	\$26,966	\$24,348	\$19,798
% of Net Revenue	6.9%	6.7%	6.1%

The Company provides funds for product, system and application developments (R&D) in both the MT&S and FA segments. The majority of the R&D expenditures in all three years were for new systems and system components such as software, controls and mechanical products; new measurement products; servo motors and amplifiers; and accessories. 1999 product introductions included road and virtual engine simulation systems, wheel force transducer, wheel fatigue testing system, material test systems and several new intelligent sensors.

The R&D as a percentage of net revenue reflected above are representative of the ratio range the Company normally commits to in its annual planning process. Accelerated development programs in both the MT&S and FA segments and a shift from customer funded development caused the higher percentage in 1998 as compared to 1997. The Company also undertakes "first of kind" system level development efforts as part of its custom projects sold to customers. The cost of these efforts is reported as cost of revenue. The combination of internally funded R&D and these customer funded system innovations typically approximates about 10% of net revenue.

Income

	1999	1998	1997
	<i>(expressed in thousands except per share data)</i>		
Income Before Income Taxes	\$18,770	\$33,448	\$34,318
% of Net Revenue	4.8%	9.2%	10.6%
Net Income	\$12,445	\$21,539	\$21,891
% of Net Revenue	3.2%	5.9%	6.8%
Effective Tax Rate	33.7%	35.6%	36.2%
Return On Beginning Shareholder's Investment Per Share	8.0%	15.4%	15.6%
Basic Earnings Per Share	\$.60	\$ 1.05	\$ 1.08
Diluted Earnings Per Share	\$.59	\$ 1.01	\$ 1.05

Income before Income Taxes (pretax income) in 1999 decreased \$14.7 million from 1998. 1999 pretax income included \$5.7 million for restructuring (see Note 8 of "Notes to Consolidated Financial Statements") and \$1.4 million for acquisition expenses (see Note 7 of "Notes to Consolidated Financial Statements"). Also, leading to a decline in the 1999 pretax income was higher interest expense related to higher debt outstanding for the entire 1999 fiscal year relative to the debt carried in fiscal 1998

and a change in other expense (income) principally related to a currency transaction loss of \$375 recognized in 1999 as compared to a gain of \$2,340 in 1998. Pretax income was also affected by higher costs on certain custom entertainment projects, an inventory charge for realignment of certain products, and lost productivity related to the implementation of our new enterprise-wide software system.

Pretax income in 1998 increased \$3.4 million or 11.3% from 1997 (1997 pretax income excluding the \$4.3 million land sale gain amounted to \$30.0 million or 9.3% of net revenue). The improved pretax in both 1998 and 1997 reflects revenue growth that was achieved with lower operating expense ratios.

The MT&S 1999 operating income, before restructuring and acquisition charges, of \$22.3 million was \$2.7 million lower than 1998. FA 1999 operating income, before restructuring, of \$10.4 million increased \$1.8 million from 1998 reflecting a strong European demand offset by an operating loss associated with the startup of our laser direct metal deposition process for manufacturing titanium parts (see Note 2 of "Notes to Consolidated Financial Statements").

Net income in 1999 decreased \$9.1 million from 1998 to \$12.4 million or \$.59 per diluted share (includes \$.18 for restructuring and \$.04 for acquisition charges). Net income in 1998 increased \$2.3 million or 12% from 1997 (excluding the gain from the sale of land which amounted to \$2.7 million after taxes, or \$.13 per diluted share).

The effective tax rate is influenced by the level of tax credits available from the Company's Foreign Sales Corporation and qualified Research and Development expense; and on the level of foreign sourced income which is taxed at a higher rate than domestic sourced income. See Note 4 of "Notes to Consolidated Financial Statements" for the reconciliation between the federal statutory and effective income tax rates and other related tax information.

Foreign Currencies Effects

The Company is exposed to market risk from changes in foreign currency exchange rates, which can affect its results from operations and financial condition. To minimize the risk, the Company manages exposure to changes in foreign currency rates through its regular operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments, principally forward exchange contracts. Foreign exchange contracts are used to hedge the Company's overall exposure to exchange rate fluctuations, since the gains and losses on these contracts offset losses and gains on the assets, liabilities, and transactions being hedged.

Approximately 50% of the Company's revenue occurs outside of the United States and about 65% (approximately 30% of the Company's net revenue) of these revenues are

denominated in currencies other than the U.S. dollar. As a result, a strengthening of the U.S. dollar decreases translated foreign currency denominated revenues and earnings. Conversely, weakening of the U.S. dollar has the reverse impact on revenues and earnings. During 1998, 1997 and 1996, the U.S. dollar was generally stronger against other major currencies. In 1999, the dollar slightly strengthened against European currencies but weakened against the Yen. Gains and losses attributed to translating the financial statements for all non-U.S. subsidiaries and the gains and losses on forward exchange contracts used to hedge these exposures, are included in other expense (income).

The total effect of foreign exchange rate fluctuations on translation of orders, net revenue, and net income plus transaction gains and losses reported in other expense (income) is set forth in the following table:

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Increase (Decrease) from Translation:			
New orders	\$ 4,961	\$(10,838)	\$(13,150)
Net revenue	3,313	(6,704)	(8,852)
Net income	60	(236)	(237)
Transaction Gain (Loss) in "Other Expense (Income)"	\$ (375)	\$ 2,340	\$ 1,266

Liquidity and Capital Resources

	1999	1998	1997
	<i>(expressed in thousands except per share data)</i>		
Total Interest Bearing Debt	\$ 71,637	\$ 74,682	\$ 12,865
% of Total Capitalization	30.5%	32.8%	8.8%
Shareholders' Investment	\$162,859	\$152,689	\$133,524
Per Share	\$ 7.80	\$ 7.39	\$ 6.56

At September 30, 1999, the Company's capital structure was comprised of \$11.4 million of current debt, \$60.2 million of long-term debt and \$162.9 million of shareholders' investment. The ratio of total debt to total capitalization was 30.5% compared to 32.8% at September 30, 1998.

Total debt decreased \$3.1 million during 1999 to \$71.6 million. This resulted from a \$18.2 million decrease in notes payable to banks offset by a \$15.1 million increase in long-term debt.

In May 1998, the Company amended its multi-currency revolving credit facility with its principal bank, increasing the commitment to \$35 million, and extending the commitment to September 2001. There was \$9.3 million outstanding under this facility at September 30, 1999. Additionally, the Company has an additional \$35 million of uncommitted lines of credit, of which none was outstanding at year end.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Shareholders' investment increased \$10.2 million in 1999 to \$162.9 million. The increase was primarily due to an increase in retained earnings of \$12.4 million from current year net earnings and \$2.5 million from the Company's employee stock option and purchase plans. These increases were offset by \$4.6 million of dividend payments and \$.1 million of treasury stock purchases.

The Company believes that the combination of present capital resources, internally generated funds, and unused financing sources will be adequate to finance on-going operations, allow for reinvestment in the business and strategic acquisitions.

Cash Flows

During 1999 operating activities generated \$26.7 million of cash, compared with \$3.1 million that was used in 1998 and \$11.7 million that was generated in 1997. The increase in cash generated in 1999 was largely due to lower increases in accounts receivable and inventory over 1998 and 1997. Major uses of cash included \$16.0 million for additions to property and equipment and \$4.6 million of dividend payments.

Capital expenditures for property and equipment additions totaled \$16.0 million in 1999, \$25.5 million in 1998, and \$13.0 million in 1997. Significant additions in 1998 were associated with an enterprise-wide financial and operations software system.

Capital spending in 2000 is planned to be about \$18 million. The Company anticipates that 2000 capital expenditures will be financed primarily with funds from operations.

Dividends

The Company's dividend policy is to maintain a payout ratio, which allows dividends to increase with the long-term growth of earnings per share, while sustaining dividends in down years. The Company's dividend payout ratio target is about 25 percent of earnings per share. The current quarterly dividend of 6 cents per share equates to 27 percent of the 1997 through 1999 average net earnings per share.

Share Repurchase Plan

In 1999, the Company repurchased 8,292 shares of common stock on the open market for \$.1 million, at an average cost of \$11.36 per share. The Company repurchased 76,000 shares in 1998 for \$1.2 million, at an average cost of \$15.56 per share. The Company's purpose for share repurchases is to offset the dilutive effect of shares of common stock issued from the Company's stock option and stock purchase plans, and for other corporate stock-based programs. During the past two years, the Company issued 600,000 shares of its common stock from these stock option and stock purchase plans.

In November 1996, the Company's Board of Directors authorized the repurchase of 1,000,000 shares of common stock in the open market within the Securities and Exchange Commission guidelines. At September 30, 1999, 525,488 shares remained available to be repurchased under this authorization.

The above share amounts have been adjusted for the Company's two-for-one stock split in the form of a 100% stock dividend, effective February 2, 1998.

Quarterly Stock Activity⁽¹⁾

The Company's common shares trade on The Nasdaq Stock Market's National Market under the symbol MTSC. The following table sets forth the high, low and volume of shares traded (expressed in thousands) for the periods indicated:

	1999			1998		
	High	Low	Shares Traded	High	Low	Shares Traded
1st Quarter	15 ⁷ / ₁₆	10 ⁷ / ₈	2,631	20	17 ³ / ₈	3,049
2nd Quarter	14 ³ / ₈	9 ⁵ / ₈	2,486	19	13 ¹ / ₂	5,298
3rd Quarter	13 ¹ / ₄	9 ¹³ / ₁₆	2,379	19 ¹ / ₄	15 ¹ / ₂	2,379
4th Quarter	14 ⁵ / ₈	10	3,259	17 ³ / ₄	119 ¹ / ₁₆	1,600

(1) Source: The Nasdaq Stock Market

The above prices and share volumes have been adjusted for the Company's two-for-one stock split in the form of a 100% stock dividend, effective February 2, 1998.

Quarterly Financial Information (Unaudited)

Quarter-to-quarter revenue and earnings comparisons do not necessarily reflect changes in the demand for the Company's products or its operating efficiency. Revenues and earnings in any quarter can be significantly affected by delivery delays or acceleration of one or more high-value systems, not accounted for using the percentage-of-completion accounting method. The use of the percentage-of-completion revenue recognition method for large long-term projects helps alleviate those fluctuations. (See Note 1 of "Notes to Consolidated Financial Statements"). High-value, state-of-the-art custom orders can also contain leading-edge applications of the Company's technology, which in some cases have resulted in lower gross profit margins, albeit not necessarily low marginal profit contribution. Product development in these state-of-the-art custom orders is as essential to the Company's long term growth as is Company funded research and development.

Quarterly earnings also vary based on the use of estimated, effective income tax rates for providing federal, state, and foreign income taxes. See Note 4 of "Notes to Consolidated Financial Statements" for more information on the Company's income taxes.

Euro Conversion

On January 1, 1999, certain member countries of the European Economic and Monetary Union (EMU) adopted a common currency, the Euro. For a three-year transition period, both the Euro and individual participants' currencies will remain in use. The Company is upgrading systems, where necessary, to properly handle the Euro. It is expected that the Company's European operations will formally begin reporting in euro currency starting in October, 2001. However, beginning January 1, 1999, the Company began processing euro transactions with its customers. The costs of addressing the euro conversion are not expected to have a material impact on the Company's financial condition or operating results.

Year 2000

The following is a Year 2000 Readiness Disclosure pursuant to the Year 2000 Information and Readiness Disclosure Act. The Company continues to evaluate the potential impact of what is commonly referred to as the Year 2000 issue, concerning the inability of certain computer-based products and systems to operate correctly into and during the year 2000. If not corrected, these products and systems could fail or create erroneous results. Following preliminary work done in fiscal 1997, in early 1998 the Company established a full-time Year 2000 central project office led by a senior technical manager reporting directly to an executive.

The central project office worked with each of the Company's twelve producing sites to evaluate the following areas:

1. Site Infrastructure, Equipment and Vendors
 - Business Information Systems
 - End User Computing Systems
 - Telecommunications Infrastructure
 - Service Providers
 - Material Suppliers
 - Manufacturing and Metrology Equipment and Facilities
2. Products Manufactured at Site

A summary of the results of these audits is presented below.

Site Infrastructure, Equipment and Vendors

The Company's major Business Information, End User Computing and Telecom Systems have been identified at each site. The vast majority of these systems were tested and found to be compliant. Each site developed a plan for completion of testing and remediation of critical systems.

The Company believes its greatest Year 2000 exposure lies with a limited number of critical/sole source service providers and material suppliers. A failure of these vendors to be able to operate up to and through the year 2000 could have a material adverse effect on the Company's business, financial condition and operating results. The Company has sent surveys to such vendors and has received responses about their Year 2000 readiness. Where the Company does not have sufficient comfort that a critical vendor will be ready, site management has obtained more detailed information and during the first quarter of fiscal 1999 began to develop contingency plans, where feasible, in those cases where such interruption remains reasonably possible.

The Company's manufacturing and metrology equipment and facilities contain embedded processors and code which have been inventoried and evaluated for Year 2000 readiness. A few instances required remediation.

The Company completed testing and where necessary remediation of the above items by June 30, 1999 as scheduled. The Company will continue to monitor events and information relevant to Year 2000 issues so that additional action can be taken where necessary.

Products Manufactured at Site

The Company's Factory Automation products contain few date sensitive computer and embedded processors. The Company has completed an evaluation of these products. All of the products evaluated have been found to be Year 2000 ready, in some cases with stipulations.

The Company's MT&S products are by their nature computer intensive. The Company has evaluated these products and advised its customers as to their Year 2000 readiness via its web site and written communication. In those cases where MT&S's products were found to be non-compliant, less than 2%, or in the case of discontinued products that were not evaluated, the Company is working with its customers to provide upgrades that are Year 2000 ready.

Summary

The Company estimates that the costs directly related to its Year 2000 project were \$400,000 in fiscal 1999 and \$300,000 in fiscal 1998. Total costs remaining are expected to be immaterial. Such costs are expensed as incurred.

This Readiness Disclosure is a Forward Looking statement as defined by the Securities and Exchange Commission and the Company recognizes that, although not expected, there are risks of project delays, costs incurred, vendor compliance, and loss of business which are outside the direct control of the Company and/or could prove to be material.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Selected quarterly financial information, for the three fiscal years ended September 30, 1999, is presented below.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
<i>(expressed in thousands except per share data)</i>					
1999					
Net revenue	\$96,142	\$93,262	\$95,363	\$105,775	\$390,542
Gross profit	38,064	36,775	37,818	38,514	151,171
Income before income taxes	5,722	4,666	8,269	113	18,770
Net income	\$ 3,726	\$ 3,146	\$ 5,293	\$ 280	\$ 12,445
Net income per share					
Basic	\$.18	\$.15	\$.25	\$.01	\$.60
Diluted	.18	.15	.25	.01	.59
1998					
Net revenue	\$80,338	\$87,160	\$91,899	\$102,766	\$362,163
Gross profit	33,753	34,560	35,691	38,223	142,227
Income before income taxes	7,937	8,009	8,521	8,981	33,448
Net income	\$ 5,192	\$ 4,921	\$ 5,667	\$ 5,759	\$ 21,539
Net income per share ²					
Basic	\$.25	\$.24	\$.28	\$.28	\$ 1.05
Diluted	.24	.23	.27	.27	1.01
1997					
Net revenue	\$71,755	\$78,374	\$79,268	\$ 94,027	\$323,424
Gross profit	30,002	32,445	32,476	37,150	132,073
Income before income taxes	5,377	6,548	12,173 ¹	10,220	34,318 ¹
Net income	\$ 3,775	\$ 4,055	\$ 7,928 ¹	\$ 6,133	\$ 21,891 ¹
Net income per share ²					
Basic	\$.19	\$.20	\$.39 ¹	\$.30	\$ 1.08 ¹
Diluted	.18	.19	.38 ¹	.29	1.05 ¹

¹ Includes \$4.3 million pretax gain on land sale equal to \$.13 per share after taxes.

² Net income per share has been restated retroactively for the two-for-one stock split effective February 2, 1998.

Consolidated Balance Sheets

(September 30)

Assets	1999	1998
	<i>(expressed in thousands except share and per share data)</i>	
Current Assets:		
Cash and cash equivalents	\$ 18,083	\$ 12,589
Accounts receivable, net of allowance for doubtful accounts of \$2,232 and \$2,285	102,011	93,313
Unbilled contracts and retainage receivable	38,628	35,891
Inventories	56,948	57,982
Prepaid expenses	7,981	4,536
Total current assets	223,651	204,311
Property and Equipment:		
Land	3,247	3,202
Buildings and improvements	42,332	40,702
Machinery and equipment	101,140	93,726
Accumulated depreciation	(73,086)	(67,688)
Total property and equipment, net	73,633	69,942
Other Assets	36,063	38,769
	\$333,347	\$ 313,022
Liabilities and Shareholders' Investment	1999	1998
Current Liabilities:		
Notes payable to banks	\$ 10,071	\$ 28,243
Current maturities of long-term debt	1,308	1,180
Accounts payable	21,062	20,274
Accrued compensation and benefits	28,662	26,919
Advance billings to customers	25,943	17,360
Other accrued liabilities	17,667	16,247
Total current liabilities	104,713	110,223
Deferred income taxes	5,517	4,851
Long-term debt	60,258	45,259
Commitments and Contingencies (Note 9)		
Shareholders' Investment:		
Common stock, 25¢ par; 64,000,000 shares authorized: 20,883,639 and 20,657,186 shares issued and outstanding	5,221	5,164
Additional paid-in capital	8,122	5,818
Retained earnings	147,615	139,782
Accumulated other comprehensive income	1,901	1,925
Total shareholders' investment	162,859	152,689
	\$333,347	\$313,022

The accompanying Notes to Consolidated Financial Statements are an integral part of these consolidated balance sheets.

Consolidated Statements of Income and Shareholders' Investment

(For the Years Ended September 30)

Income	1999	1998	1997
	<i>(expressed in thousands except per share data)</i>		
Net Revenue	\$390,542	\$362,163	\$323,424
Cost of Revenue	239,371	219,936	191,351
Gross Profit	151,171	142,227	132,073
Operating Expenses:			
Selling	61,490	56,479	54,610
General and administrative	30,038	27,833	26,402
Research and development	26,966	24,348	19,798
Restructuring	5,711	—	—
Acquisition	1,391	—	—
Income From Operations	25,575	33,567	31,263
Interest expense	5,067	2,327	1,531
Interest income	(470)	(379)	(406)
Other expense (income), net	2,208	(1,829)	(4,180)
Income Before Income Taxes	18,770	33,448	34,318
Provision for Income Taxes	6,325	11,909	12,427
Net Income	\$ 12,445	\$ 21,539	\$ 21,891
Net Income Per Share			
Basic	\$.60	\$ 1.05	\$ 1.08
Diluted	.59	1.01	1.05

Shareholders' Investment

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Investment
	Shares Issued	Amount				
	<i>(expressed in thousands except share and per share data)</i>					
Balance, September 30, 1996	11,251,223	\$2,812	\$ 2,468	\$111,262	\$ 4,036	\$120,578
Comprehensive income:						
Net income				21,891		
Foreign currency translation				(82)	(2,300)	
Total Comprehensive income						19,509
Exercise of stock options	311,313	78	4,617			4,695
Common stock purchased and retired	(349,065)	(87)	(3,073)	(4,453)		(7,613)
Cash dividends, 20¢ per share				(3,645)		(3,645)
Balance, September 30, 1997	11,213,471	2,803	4,012	124,973	1,736	133,524
Comprehensive income:						
Net income				21,539		
Foreign currency translation					189	
Total Comprehensive income						21,728
Stock split 2 for 1	9,204,424	2,301		(2,301)		
Exercise of stock options	300,091	75	3,405			3,480
Common stock purchased and retired	(60,800)	(15)	(1,599)			(1,614)
Cash dividends, 24¢ per share				(4,429)		(4,429)
Balance, September 30, 1998	20,657,186	5,164	5,818	139,782	1,925	152,689
Comprehensive income:						
Net income				12,445		
Foreign currency translation					36	
Unrealized loss on investment, net of tax					(60)	
Total Comprehensive income						12,421
Exercise of stock options	234,745	59	2,396			2,455
Common stock purchased and retired	(8,292)	(2)	(92)			(94)
Cash dividends, 24¢ per share				(4,612)		(4,612)
Balance, September 30, 1999	20,883,639	\$5,221	\$ 8,122	\$147,615	\$ 1,901	\$162,859

The accompanying Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

(For the Years Ended September 30)

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Operating Activities:			
Net income	\$ 12,445	\$ 21,539	\$ 21,891
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	14,424	10,880	9,608
Deferred income taxes	889	127	(11)
Gain from sale of real estate	—	—	(4,332)
Changes in operating assets and liabilities, exclusive of acquisitions:			
Accounts receivable, unbilled contracts and retainage receivable	(11,285)	(27,765)	(26,645)
Inventories	373	(7,644)	(7,655)
Prepaid expenses	(3,493)	647	221
Advance billings to customers	8,711	(2,874)	8,949
Other liabilities, net	4,676	2,015	9,708
Net Cash Provided by (Used in) Operating Activities	26,740	(3,075)	11,734
Investing Activities:			
Property and equipment additions	(15,990)	(25,545)	(12,963)
Proceeds from sale of real estate	—	—	5,700
Acquisition of businesses, net of cash received	(1,036)	(29,012)	(5,947)
Other assets	(132)	(1,026)	(537)
Net Cash Used in Investing Activities	(17,158)	(55,583)	(13,747)
Financing Activities:			
Net borrowings under notes payable to banks	(18,168)	23,770	3,743
Proceeds from issuance of long-term debt	16,837	38,637	1,008
Repayments of long-term debt	(924)	(1,152)	(2,745)
Cash dividends	(4,612)	(4,429)	(3,645)
Proceeds from employee stock option and stock purchase plans	2,455	3,480	4,695
Payments to purchase and retire common stock	(94)	(1,614)	(7,613)
Net Cash Provided by (Used in) Financing Activities	(4,506)	58,692	(4,557)
Effect of Exchange Rate Changes on Cash	418	(3)	(1,001)
Net Increase (Decrease) in Cash and Cash Equivalents	5,494	31	(7,571)
Cash and Cash Equivalents at Beginning of Year	12,589	12,558	20,129
Cash and Cash Equivalents at End of Year	\$ 18,083	\$ 12,589	\$ 12,558
Supplemental Disclosures of Cash Flows Information:			
Cash paid during the year for:			
Interest	\$ 4,291	\$ 1,881	\$ 1,531
Income taxes	6,731	8,756	13,523

The accompanying Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies:

Consolidation and Translation

The consolidated financial statements include the accounts of MTS Systems Corporation (the Company) and its wholly and majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

All balance sheet accounts of foreign subsidiaries are translated to U.S. dollars at the current exchange rates as of the end of the fiscal year. Income statement items are translated at average exchange rates during the year. The resulting translation adjustment is recorded as a separate component of shareholders' investment. Gains and losses from translation of foreign currency denominated transactions and from foreign exchange hedge contracts are included in "Other expense (income), net" in the Consolidated Statements of Income and amounted to a loss of \$(375,000) in 1999, a gain of \$2,340,000 in 1998 and a gain of \$1,266,000 in 1997.

Revenue Recognition

Revenue is recognized upon shipment of equipment when the customer's order can be manufactured, delivered, and installed in generally less than a year. Revenue on contracts requiring longer delivery periods (long-term contracts) and other customized orders that permit progress billings is recognized using the percentage-of-completion method based on the cost incurred to date relative to estimated total cost of the contract (cost-to-cost method). The cumulative effects of revisions of estimated total contract costs and impact on revenues are recorded in the period in which the facts become known. When a loss is anticipated on a contract, the amount is provided currently.

Long-term Contracts

The Company enters into long-term contracts for customized equipment sold to its customers. Under terms of such contracts, revenue recognized using the percentage of completion method may not be invoiced until completion of contractual milestones, upon shipment of the equipment, or upon installation and acceptance by the customer. Unbilled amounts for these contracts appear in the Consolidated Balance Sheets as Unbilled Contracts and Retainage Receivable. Amounts unbilled or retained at September 30, 1999 are expected to be invoiced during fiscal 2000.

Long-term contracts consider the duration of the manufacturing and collection cycles at the time the contract is bid. Accordingly, accounts receivable in the accompanying Consolidated Balance Sheets approximate fair value.

Warranty Obligations

The Company warrants its products against defects in materials and workmanship under normal use and service, generally for one year. The Company maintains reserves for warranty costs based upon its past experience with warranty claims.

Research and Development

Research and product development costs associated with new products are charged to operations as incurred.

Cash Equivalents

Cash equivalents represent short-term liquid investments which have original maturities of three months or less and are recorded at cost, which approximates fair value.

Accounts Receivable

The Company grants credit to customers, but generally does not require collateral or other security from domestic customers. International receivables, where deemed necessary, are supported by letters of credit from banking institutions.

Inventories

Inventories consist of material, labor and overhead and are stated at the lower of cost or market, determined by the first-in, first-out method. Inventory components as of September 30, were as follows:

	1999	1998
	<i>(expressed in thousands)</i>	
Customer projects in various stages of completion	\$ 3,625	\$12,701
Components, assemblies and parts	53,323	45,281
Total	\$56,948	\$57,982

Property and Equipment

Property and equipment is stated at cost. Additions, replacements and improvements are capitalized at cost, while maintenance and repairs are charged to operations as incurred. Depreciation is provided over the following estimated useful lives of the property:

Buildings and improvements: 10 to 40 years.

Machinery and equipment: 3 to 12 years.

Most major building and equipment purchases are depreciated on a straight-line basis for financial reporting purposes and on an accelerated basis for income tax purposes.

Derivative Financial Instruments

The Company periodically enters into forward exchange contracts principally to hedge the eventual dollar cash flow of foreign currency denominated transactions (primarily British Pound, German Deutschemark, French Franc, Swedish Krona, Italian Lira, and Japanese Yen). Gains and losses on forward exchange contracts entered into to hedge foreign currency denominated undelivered orders and net exposed assets are included in "Other expense (income) net" in the Consolidated Statements of Income, when the underlying transaction is closed.

The Company's accounting policy for these contracts is based on the Company's designation of foreign currency contracts as hedging transactions. The Company does not use derivative financial instruments for speculative or trading purposes. The criteria the Company uses for designating a contract as a hedge include the contract's effectiveness in risk reduction and matching of contracts to underlying transactions. On September 30, 1999, there were open hedge contracts totaling \$7,300,000 with an unrealized loss of \$202,000. On September 30, 1998, there were open hedge contracts totaling \$2,800,000 with an unrealized loss of \$3,000.

Other Assets

Other assets consist principally of patents and excess cost over net assets acquired (goodwill), net of accumulated amortization. The carrying value of goodwill less accumulated amortization was \$27.5 million and \$31.6 million in 1999 and 1998, respectively. These assets are being amortized on a straight basis over various periods ranging from 7 to 40 years. Amortization expense was \$3.3 million in 1999, \$1.5 million in 1998 and \$1.0 million in 1997.

The Company periodically evaluates whether events and circumstances have occurred that may affect the estimated useful life of its goodwill and other long-lived assets.

If such events or circumstances were to indicate that the carrying amount of these assets would not be recoverable, an impairment loss would be recognized. No such impairment has occurred which would require recognition during the year ended September 30, 1999.

Pensions and Other Postretirement Benefit Plans

Effective September 30, 1999, the Company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits." The provisions of SFAS No. 132 revise employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement or recognition of these plans. It standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable.

Net Income Per Share

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings per Share" during the first quarter of fiscal 1998. As a result, all prior periods presented have been restated to conform to the provisions of SFAS No. 128, which requires the presentation of basic and diluted earnings per share. Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. Diluted earnings per share includes the dilutive effect of potential common shares. Weighted average common shares and per share computations have been restated retroactively for the two-for-one stock split effective February 2, 1998.

	1999	1998	1997
	<i>(expressed in thousands except per share data)</i>		
Weighted average common shares outstanding	20,763	20,519	20,285
Dilutive potential common shares	421	811	660
Total dilutive common shares	21,184	21,330	20,945
Basic net income per share	\$.60	\$ 1.05	\$ 1.08
Diluted net income per share	.59	1.01	1.05

Comprehensive Income

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income" during fiscal 1999. This statement establishes rules for the reporting of comprehensive income and its components. Comprehensive income consists of net income, foreign currency translation adjustments and unrealized loss on investment and is presented in the accompanying Consolidated Statement of Shareholders' Investment. The adoption of SFAS No. 130 had no impact on total shareholders' investment. Prior year financial statements have been reclassified to conform to the SFAS No. 130 requirements.

Reclassifications

Certain amounts included in the consolidated financial statements have been reclassified in prior years to conform with the 1999 financial statement presentation. These amounts had no effect on previously reported shareholder's investment or net income.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make assumptions and estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Ultimate results could differ from reported amounts based upon those assumptions and estimates.

The Company undertakes significant technological innovation on some of its long-term contracts. These contracts involve performance risk which may result in delayed delivery of product and/or in revenue and gross profit variation from difficulties in estimating the ultimate cost of such contracts.

Future Accounting Pronouncements

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The statement establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000.

The Company anticipates that the effect of adopting SFAS No. 133 will not have a material impact on the Company's financial statements.

Notes to Consolidated Financial Statements

(Continued)

2. Business Segment Information:

In 1999, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments on an Enterprise and Related Information". SFAS No. 131 supersedes SFAS No. 14 replacing the "industry segment" approach with the "management" approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of the Company's reportable segments. SFAS No. 131 also requires disclosures about products and services, geographic areas and major customers. The adoption of SFAS No. 131 did not affect results of operations or financial condition but did affect the disclosure of segment information.

The Company evaluated its business activities that are regularly reviewed by the Chief Executive Officer for which discrete financial information is available. As a result of this evaluation, the Company has determined that it has five operating segments: Vehicle Testing Systems, Material Testing Systems, Advanced Systems, Automation and Sensors. The Vehicle Testing Systems business manufactures and markets systems for vehicle and component manufacturers to aid in the acceleration of design development work and decrease the cost to manufacture their products. The Material Testing Systems business manufactures and markets systems to aid their customers in product development and quality control through material and product characterization. The Advanced Systems business provides highly customized systems for principally simulation and manufacturing. The Automation business manufactures

and markets products for high performance industrial machine applications in a wide range of industries. The Sensor business manufactures and markets displacement and liquid level sensors used in various applications to monitor and automate industrial processes. The economic characteristics, nature of products and services, production processes, type or class of customer, method of distribution and regulatory environments are similar for the Vehicle Testing Systems, Material Testing Systems and Advanced Systems business segments. As a result of these similarities, these segments have been aggregated into one reportable segment called Mechanical Testing and Simulation (MT&S) for financial statement purposes. Also, the economic characteristics, nature of products and services, production processes, type or class of customer, method of distribution and regulatory environments are similar for the Automation and Sensor business segments. As a result, these segments have been aggregated into one reportable segment called Factory Automation.

The accounting policies of the business segments are the same as those described in Note 1. In evaluating the segment performance, management focuses on income from operations. This measurement excludes special charges (e.g. restructuring charges, acquisition expenses, etc.), interest expense, interest income, income tax expense and other non-operating income or expense. Corporate expenses are allocated to segments primarily on the basis of revenue. This allocation includes expenses for various support functions such as human resources, information technology and finance. Financial information by reportable segment follows:

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Net Revenue by Segment			
Mechanical Testing & Simulation	\$ 313,685	\$287,761	\$260,650
Factory Automation	76,857	74,402	62,774
Total	\$ 390,542	\$362,163	\$323,424
Income (Loss) from Operations by Segment			
Mechanical Testing & Simulation			
Before restructuring and acquisition	\$ 22,289	\$ 25,011	\$ 25,219
Restructuring	(5,510)	—	—
Acquisition	(1,391)	—	—
Total	\$ 15,388	\$ 25,011	\$ 25,219
Factory Automation			
Before restructuring and acquisition	10,388	8,556	6,044
Restructuring	(201)	—	—
Total	\$ 10,187	\$ 8,556	\$ 6,044
Total Income from Operations	\$ 25,575	\$ 33,567	\$ 31,263
Identifiable Assets by Segment			
Mechanical Testing & Simulation	\$272,491	\$255,816	\$190,456
Factory Automation	60,856	57,206	38,619
Total Assets	\$333,347	\$313,022	\$229,075
Other Segment Data			
Mechanical Testing & Simulation:			
Capital expenditures	\$ 13,822	\$ 21,251	\$ 11,203
Depreciation and Amortization	11,028	8,333	7,409
Factory Automation:			
Capital expenditures	\$ 2,168	\$ 4,668	\$ 1,787
Depreciation and Amortization	3,396	2,547	2,199

A geographic summary of the Company's operations and asset information as of and for the years ended September 30, were as follows:

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Total Net Revenue			
United States	\$200,556	\$200,490	\$156,877
Germany	47,172	37,643	31,778
Other Europe	69,185	51,495	38,826
Far East	56,897	53,652	77,851
Other	16,732	18,883	18,092
Total	\$390,542	\$362,163	\$323,424
Total Long-Lived Assets			
United States	\$232,177	\$227,816	\$153,707
Germany	42,913	39,882	36,648
Other Europe	38,799	30,626	22,228
Far East	18,882	14,242	16,226
Other	576	456	266
Total	\$333,347	\$313,022	\$229,075

Net revenue by geographic location is based on net revenue generated from each country's operations. No individual country, other than the United States and Germany, exceeded 10% of consolidated net revenue on a recurrent annual basis. The Company did not have sales to any individual customer greater than 10% of total net revenue in 1999, 1998 and 1997.

Notes to Consolidated Financial Statements

(Continued)

3. Financing:

Long-term debt as of September 30 was as follows:

	1999	1998
	<i>(expressed in thousands)</i>	
Variable Rate Note, due May 2015, collateralized by building	\$ 1,837	\$ —
6.6% Notes, unsecured, due in July 2008	35,000	35,000
5.4% Mortgage, due in October 2015, collateralized by building	5,742	6,444
5.3% Note, unsecured, due in March 2003	1,503	1,264
6.0% Note, unsecured, due in May 2008	1,943	1,943
7.5% Note, unsecured, due in July 2009	15,000	—
Other	541	1,788
Total	\$ 61,566	\$46,439
Less Current Maturities	(1,308)	(1,180)
Total Long-Term Debt	\$ 60,258	\$45,259

Aggregate annual maturities of long-term debt for the next five fiscal years are as follows: 2000—\$1,308,000; 2001—\$5,599,000; 2002—\$5,494,000; 2003—\$7,152,000; 2004—\$7,384,000 and \$34,629,000 thereafter. The carrying value of the Company's long-term debt at September 30, 1999, approximates the fair value at current interest rates offered to the Company for debt with the same remaining maturities.

The Company has credit agreements with two domestic banks totaling \$40,000,000. One credit agreement, for \$5,000,000, permits the Company to issue domestic and Euro-currency notes. The other credit agreement, for \$35,000,000, permits the Company to issue domestic notes, Euro-currency notes, and banker's acceptances. As part of the same credit agreement, the bank has agreed to issue term loans up to a maximum of \$10,000,000 until March 30, 2002. This agreement provides for repayment of these term loans through September 2005. The Company compensates both banks with loan commitment fees for

the unused portion of the credit lines. The Company also has three uncommitted lines of credit with banks that total \$35,000,000. In addition, the Company has standby letter-of-credit lines totaling \$30,000,000. At September 30, 1999, standby letters of credit outstanding totaled \$13,382,000.

Under the terms of its credit agreements, the Company has agreed, among other matters, that (a) its defined cash flow or fixed charge coverage will exceed a defined minimum level; (b) its interest bearing debt will not exceed a defined percentage of total capital; (c) repurchases of its common stock will not exceed a maximum amount. At September 30, 1999, net worth exceeded the defined minimum amount by \$38,000,000 and the Company had \$18,959,000 available for repurchases of its common stock. The Company was in compliance with the terms and covenants of its credit agreements and its lines of credit at September 30, 1999.

Information on short-term borrowings for the years ended September 30 were as follows:

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Balance outstanding at September 30	\$10,071	\$28,243	\$ 4,356
Average balance outstanding	24,903	23,498	11,903
Maximum balance outstanding	34,700	51,216	23,458
Year-end interest rate	6.0%	5.9%	6.0%
Weighted-average interest rate	5.7%	6.1%	6.0%

4. Income Taxes:

The provision for income taxes for the years ended September 30 consisted of the following:

	1999	1998	1997
		<i>(expressed in thousands)</i>	
Current payable (receivable):			
Federal	\$2,239	\$ 6,911	\$ 7,801
State	432	1,129	953
Foreign	2,773	4,104	3,658
Deferred	881	(235)	15
Total provision	\$6,325	\$11,909	\$12,427

A reconciliation from the Federal statutory income tax rate to the Company's effective rate for the years ended September 30 were as follows:

	1999	1998	1997
Statutory rate	35 %	35 %	35 %
Tax benefit of Foreign Sales Corporation	(3)	(2)	(2)
Foreign provision in excess of U.S. tax rate	4	3	3
State income taxes, net of Federal benefit	2	2	2
Research and development tax credits	(5)	(2)	(2)
Other, net	1	—	—
Effective rate	34 %	36 %	36 %

Deferred Tax Asset:

	1999	1998
		<i>(expressed in thousands)</i>
Accrued compensation and benefits	\$ 1,017	\$2,151
Inventory reserves	2,398	2,309
Allowance for doubtful accounts	194	244
Other assets	(1,276)	(11)
Total Deferred Tax Asset	\$ 2,333	\$4,693

Deferred Tax Liability:

	1999	1998
Property and equipment	\$ 5,517	\$4,851
Net Deferred Tax Liability	\$ 3,184	\$ 158

Notes to Consolidated Financial Statements

(Continued)

5. Stock Options:

The Company has made certain stock-based awards to its officers, non-employee directors, and key employees under various stock plans. Awards under these plans can include incentive stock options (qualified), non-qualified stock options, stock appreciation rights, restricted stock, deferred stock, and other stock-based and non stock-based awards.

At September 30, 1999, the Company had awarded incentive stock options and non-qualified stock options. These were granted at exercise prices that are 100% of the fair-market value at the day of grant. Beginning one year after grant, the options generally can be exercised propor-

tionately each year for periods of three, four, or six years, as defined in the respective plans. Options currently expire no later than seven years from the grant date, as defined.

Option holders may exercise options by delivering Company stock already owned, cash, or a combination of stock and cash. The shares tendered in the exchange are cancelled and, therefore, reduce shares issued. During 1999 and 1998, option holders exchanged 25,029 and 22,335 shares, respectively, of the Company's stock in payment of options exercised. All share and share price data herein have been restated retroactively for the two-for-one stock split, effective February 2, 1998.

A summary of the status of the Company's stock option plans as of September 30, 1999, 1998, and 1997, and changes during the years ended were as follows:

	1999		1998		1997	
	Shares	WAEP*	Shares	WAEP*	Shares	WAEP*
Outstanding at beginning of year	2,143	\$10.30	1,920	\$ 8.35	1,964	\$ 7.12
Granted	880	\$12.95	545	\$15.79	608	\$10.72
Exercised	(138)	\$ 7.25	(295)	\$ 6.51	(616)	\$ 6.78
Forfeited	(69)	\$13.38	(27)	\$10.40	(36)	\$ 7.87
Outstanding at end of year	2,816	\$11.21	2,143	\$10.30	1,920	\$ 8.35
Options exercisable at year-end	1,566	\$ 9.46	1,156	\$ 8.19	894	\$ 7.59

Shares in thousands

*Weighted-Average Exercise Price

The following table summarizes information concerning outstanding and exercisable options as of September 30, 1999:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life *	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$5.78-8.13	921	1.6	\$ 7.40	921	\$ 7.40
\$9.69-13.00	650	3.0	\$ 10.80	410	\$10.64
\$13.13-13.13	735	5.4	\$ 13.13	36	\$13.13
\$14.63-19.38	510	3.4	\$ 15.82	199	\$15.86
Total	2,816	3.2	\$11.21	1,566	\$ 9.46

Shares in thousands

*In Years

These options will expire if not exercised at specific dates ranging from January 2000 to September 2006. Prices for options exercised during the three-year period ended September 30, 1999 ranged from \$5.78 to \$15.75. Total options available for future grant as of September 30, 1999 were 370,162.

In January 1992 the Company's shareholders authorized an Employee Stock Purchase Plan (the Purchase Plan),

whereby 1,000,000 shares of the Company's common stock were reserved for sale to employees until April 2002. Participants in the 1999 and 1998 phases, all at dates specified in the Purchase Plan, were issued 121,810 shares in 1999 and 105,240 shares in 1998. During 1999, participants subscribed to purchase 147,869 shares at 85% of market price for issuance in 2000.

Pro forma Information: The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its employee stock options. Under this pronouncement, no compensation expense is recognized in the Company's financial statements because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant. However, Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," requires the use of option valuation models to estimate compensation expense from the granting of employee stock options and to present the pro forma effect of such expense on reported net income and earnings per share.

SFAS No. 123 requires this information be determined as if the Company had accounted for employee stock options granted in fiscal years beginning subsequent to December 31, 1994 under the fair value method of that statement. The fair value of options granted, as reported below, has been estimated at the date of grant using the Black-Scholes option valuation model with the following weighted average assumptions:

	1999	1998	1997
Expected life (in years)	2.7	2.0	2.1
Risk-free interest rate	5.8%	4.2%	5.8%
Volatility	.49	.40	.49
Dividend yield	2.3%	1.6%	1.2%

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models required the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's options have characteristics significantly different from those of traded options, and because change in the subjective input assumptions can affect materially the fair value estimate, in the opinion of management, the existing models do not necessarily provide a reliable measure of the fair value of its options. The weighted average estimated fair value of employee stock options granted during 1999 and 1998 was \$4.47 and \$4.39 per share, respectively.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information follows (in thousands except for earnings per share data):

	1999	1998	1997
Pro forma net income	\$10,553	\$20,247	\$21,048
Pro forma earnings per share, basic	\$.51	\$.99	\$ 1.04
Pro forma earnings per share, diluted	\$.50	\$.95	\$ 1.01

The effects on pro forma disclosures of applying SFAS No. 123 are not likely to be representative of the effects on pro forma disclosures of future years. Because SFAS No. 123 is applicable only to options granted in fiscal years subsequent to December 31, 1994, the pro forma effect will not be fully reflected until 2002.

6. Employee Benefit Plans:

The Company offers a 401(K) Pay Conversion Plan for all of its U.S. employees. Employees can supplement their retirement income by participating in this voluntary pre-tax savings plan by designating a percentage of their gross income, subject to limitations imposed by federal law. The Company will match \$.50 per each dollar of the first 3% that employees contribute capped at \$500 per fiscal year. Employees are automatically vested. The matching contributions under the 401(K) plan were \$730,000 in 1999, \$557,000 in 1998 and \$483,000 in 1997.

The Company's profit sharing plan functions as a retirement program for most U.S. and certain international employees. Employees who have completed 1,000 hours of service during the plan year are eligible to participate. The formula for calculating the Company's contribution is approved annually by the Board of Directors and is based primarily on operating results for the year, before management variable compensation. The plan provides for a minimum contribution of 4% of participant compensation, as defined, up to the social security taxable wage base, and 8% of participant compensation in excess of the taxable wage base up to the maximum profit sharing contribution allowed by federal law, so long as the entire contribution calculation does not exceed pretax income. The contributions were 4.3% of participant compensation in 1999 and 4.4% in 1998 and 1997, respectively. The provisions for profit sharing were \$3,883,000 in 1999, \$3,577,000 in 1998 and \$3,163,000 in 1997, and are distributed among the various operating expenses shown in the accompanying Consolidated Statements of Income.

Prior to 1998, two of the Company's international subsidiaries had noncontributory, unfunded retirement plans for eligible employees. These plans provide benefits based on the employee's years of service and compensation during the years immediately preceding retirement, early retirement, termination, disability, or death, as defined in the respective plans. In 1998, one of the plans was modified to provide for contributions based solely on annual compensation levels.

Notes to Consolidated Financial Statements

(Continued)

The expenses for these plans consist of the following components:

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Service cost-benefit earned during the period	\$ 209	\$178	\$ 327
Interest cost on projected benefit obligation	249	218	269
Net amortization and deferral	17	11	29
Net Periodic Pension Cost	\$ 475	\$407	\$ 625

The change in benefit obligation and plan assets consisted of the following for the years ended September 30, 1999 and 1998.

	1999	1998
	<i>(expressed in thousands)</i>	
Change in benefit obligation:		
Projected benefit obligation, beginning of year	\$ 5,110	\$ 4,723
Service cost	173	188
Interest cost	212	216
Translation difference	80	(20)
Actuarial (gain) loss	332	8
Benefits paid	(30)	(5)
Projected benefit obligation, end of year	\$ 5,877	\$ 5,110
Change in plan assets:		
Fair value of plan assets, beginning of year	\$ —	\$ —
Actual return on plan assets	—	—
Employer contributions	30	5
Benefits paid	(30)	(5)
Fair value of plan assets, end of year	\$ —	\$ —

The funded status of the Company's benefit plans and the amounts recognized in the consolidated financial statements are:

	1999	1998
	<i>(expressed in thousands)</i>	
Funded status	(5,877)	(5,110)
Unrecognized net gain	(88)	(460)
Unrecognized net liability being amortized	536	478
Adjustment required to recognize minimum liability	(33)	(25)
Accrued Pension Liability	\$(5,462)	\$(5,117)
Major assumptions at year-end are:		
Discount rate	3.5 to 6.0%	3.5 to 6.2%
Rate of increase in future compensation levels	3.0%	3.0%

7. Acquisitions:

On May 28, 1999, the Company completed a merger with DSP Technology, Inc. (DSP), an enterprise that is active in automotive engine development market segments. Under the terms of the agreement, the Company initially issued 2,076,913 shares of common stock and subsequently issued an additional 792 shares of common stock in exchange for all of the outstanding shares and vested stock options of DSPs' common stock. In connection with the acquisition, the Company incurred approximately \$1.4 million of acquisition related costs which were charged to operations in the third quarter of fiscal year 1999. The acquisition was accounted for as a pooling-of-interests. Accordingly, all periods included in these historical consolidated financial statements have been restated to give effect to the merger. The following are the results of operations for the separate companies for the years ended September 30:

	1999	1998	1997
	<i>(expressed in thousands)</i>		
Net Revenue:			
MTS	\$362,708	\$339,682	\$303,480
DSP	27,834	22,481	19,944
Combined Net Revenue	\$390,542	\$362,163	\$323,424
Income before income taxes (note A):			
MTS	\$ 18,445	\$ 31,473	\$ 32,712
DSP	325	1,975	1,606
Combined income before income taxes	\$ 18,770	\$ 33,448	\$ 34,318

Note A: 1999 amounts include \$0.3 million and \$1.1 million in acquisition related cost for the Company and DSP respectively.

No significant adjustments were made to the prior years financial statements of either the Company or DSP.

On September 29, 1999 the Company acquired the exclusive license for the PowerBlok product line technology, related inventory and fixed assets, and trade names from Semipower, Inc. The transaction was accounted for by the purchase method of accounting.

In fiscal 1998 the Company acquired three entities, all accounted for by the purchase method of accounting, with an aggregate purchase price of approximately \$29 million, net of cash acquired. The Company acquired all the outstanding stock of Performance Controls, Inc., a manufacturer of high performance power amplifiers for factory automation and magnetic resonance machine applications, in an all cash transaction. The Company acquired the stock of Nano Instruments Inc., a manufacturer of instrumented indentation systems for ultra-low force nanoindentation testing surfaces and thin films, for cash and debt. In addition to the stock purchase of Nano Instruments Inc., the Company purchased the rights to a patent from the two principal shareholders of Nano Instruments, Inc. The Company also acquired the assets and technology of SDRC's noise and vibration test software business along

8. Restructuring and Other Charges:

The Company has taken a series of actions to better align its organizational structure with market elements, improve operational performance and reduce costs. These actions resulted in a restructuring charge during the first quarter of fiscal year 1999 of \$2.1 million (\$1.4 million after tax, or \$.07 per share). This charge related principally to employee severance costs of \$1.8 million and \$0.3 million for other costs.

In the first quarter of fiscal year 1999, DSP Technology, Inc. (see note 7) announced its strategic decision to relocate its corporate headquarters and consolidate its Transportation Group operations in Ann Arbor, Michigan from Fremont, California. This decision resulted in a restructuring charge of \$0.5 million (\$0.3 million after tax

9. Commitments and Contingencies:

Litigation: The Company is a party to various claims, legal actions and complaints arising in the ordinary course of business. It is the opinion of management that the final resolution of these matters will not have a material adverse effect on the financial position or results of operation of the Company.

with a major portion of SDRC's noise and vibration consulting engineering services, in an all cash transaction.

The total purchase price exceeded the fair value of the net assets acquired by approximately \$23.2 million. This amount was recorded as goodwill and other intangibles with useful lives between 7 and 20 years. The results of the operations of the acquired companies are included in the Company's financial statements for the periods in which they were owned.

In fiscal 1997 the Company acquired the stock of Bregenhorn-Butow & Co., Freiburg, Germany (name subsequently changed to Custom Servo Motors Antriebstechnik GmbH & Co KG), a privately held supplier of low power, electronic servo motors and drives, for cash and debt. The transaction was accounted for by the purchase method of accounting.

The pro forma results, exclusive of the DSP merger, for 1999, 1998 and 1997, assuming these acquisitions had been made at the beginning of the year, would not be materially different from reported results.

or \$.01 cents per share). This charge relates to employee severance cost of \$0.3 million and \$0.2 million in idle facility and wind down costs. As of September 30, 1999, \$1 million of the restructuring charge remains to be paid.

In the fourth quarter of fiscal 1999, the Company identified actions necessary to rationalize certain of its business capacity. These actions resulted in a total restructuring charge during the fourth quarter of fiscal 1999 of \$3.1 million (\$2.1 million after tax, or \$.10 per share). This charge relates to employee severance costs of \$2.8 million and \$0.3 million of other costs. In conjunction with the rationalization of business capacity, the Company took an additional charge to cost of sales of \$0.9 million related to inventory write-downs. No amounts recorded in the fourth quarter have been paid.

Leases: The Company has noncancelable operating lease commitments for equipment and facilities that expire on various dates through 2005. Minimum annual rental commitments at September 30, 1999 for the fiscal years 2000 through 2004 and thereafter are \$3,647, \$2,644, \$1,626, \$1,225, \$980 and \$302. Total lease expense was \$4,197 in 1999, \$3,118 in 1998 and \$2,693 in 1997.

Reports on Consolidated Financial Statements

Report of Independent Public Accountants To MTS Systems Corporation:

We have audited the accompanying consolidated balance sheets of MTS Systems Corporation (a Minnesota corporation) and Subsidiaries as of September 30, 1999 and 1998, and the related consolidated statements of income, shareholders' investment and cash flows for each of the three years in the period ended September 30, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall

financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MTS Systems Corporation and Subsidiaries as of September 30, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1999 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Minneapolis, Minnesota,
November 24, 1999

Report of Management

The management of MTS Systems Corporation is responsible for the integrity and objectivity of the financial information presented in this report. The financial statements have been prepared in accordance with generally accepted accounting principles and include certain amounts based on management's best estimates and judgment.

Management is also responsible for establishing and maintaining the Company's accounting systems and related internal controls, which are designed to provide reasonable assurance that assets are safeguarded, transactions are properly recorded, and the policies and procedures are implemented by qualified personnel.

The Audit Committee of the Board of Directors, which is comprised solely of outside directors, meets regularly with management and its independent auditors to review audit activities, internal controls, and other accounting, reporting, and financial matters. This Committee also recommends independent auditors for appointment by the full Board, subject to shareholder ratification.

The financial statements included in this annual report have been audited by Arthur Andersen LLP, independent public accountants. We have been advised that their audits were conducted in accordance with generally accepted auditing standards and included such reviews of internal controls and tests of transactions as they considered necessary in setting the scope of their audits.

Sidney W. Emery, Jr
Chairman and Chief Executive Officer



David E. Hoffman
Vice President and
Chief Financial Officer



Corporate Information

Board of Directors

Sidney W. Emery, Jr.
*Chairman and
Chief Executive Officer
MTS Systems Corporation*

Charles A. Brickman
*President
Pinnacle Capital Corporation*

Jean-Lou Chameau
*Dean, College of Engineering
Georgia Institute of Technology*

Bobby I. Griffin
*Consultant; formerly
Executive Vice President
Medtronic, Inc.*

Russell A. Gullotti
*Chairman, President,
Chief Executive Officer
National Computer Systems*

Brendan C. Hegarty
*Consultant; formerly
Executive Vice President and
Chief Operating Officer, Seagate*

Thomas E. Holloran
*Professor
University of St. Thomas*

Linda Hall Whitman, Ph.D
*President
Ceridian Performance Partners*

Executive Management

Sidney W. Emery, Jr.
*Chairman and
Chief Executive Officer*

William G. Anderson
*Vice President
Automation Division*

William G. Beduhn
*Vice President, Advanced
Engineering Systems Division*

Marshall L. Carpenter
*Vice President
Chief Financial Officer (retired)*

Steven M. Cohoon
*Vice President
Vehicle Dynamics Division*

James M. Egerdal
*Vice President
Service & Support Division*

Hal J. Galvin
*Vice President, Corporate
Business Development*

David E. Hoffman
*Vice President
Chief Financial Officer*

Werner Ongyert
*Vice President
Europe*

Nancy L. Quist
*Vice President
Material Testing Division*

Mauro Togneri
*Vice President
Sensors Division*

Ryoji Yamaguchi
*Vice President
Asia/Pacific*

Keith D. Zell
Executive Vice President

Divisional Officers

Frank G. Arcella
President, AeroMet Corporation

Corporate Officers

Barbara J. Carpenter
Assistant Corporate Secretary

Robert J. Clobes
Corporate Controller

John R. Houston
*Secretary
Partner, Robins, Kaplan, Miller
& Ciresi LLP*

Thomas J. Minneman
Treasurer

References

Bank Reference
*US Bank
Minneapolis, MN*

Transfer Agent
*Norwest Bank Minnesota, N.A.
South St. Paul, MN
Shareholder Assistance:
800-468-9716*

General Counsel
*Robins, Kaplan, Miller &
Ciresi LLP
Minneapolis, MN*

Patent Counsel
*Westman, Champlin & Kelly
Minneapolis, MN*

Independent Public
Accountants
*Arthur Andersen LLP
Minneapolis, MN*

Notice of Annual Meeting

The annual meeting of stockholders will be held at 5:00 p.m. (Central Standard Time) on Tuesday, January 25, 2000 at the Company's Headquarters in Eden Prairie, Minnesota.

Stockholders who cannot attend the meeting are urged to exercise their right to vote by proxy. A proxy card, a proxy statement, and a return envelope are enclosed for this purpose.

10-K Report and Other Financial Information

Copies of the Annual Report on Form 10-K, filed with the Securities and Exchange Commission are available on request without charge from Marketing Communications MTS Systems Corporation 14000 Technology Drive Eden Prairie, Minnesota 55344-2290. Telephone: 612-974-6073

Common Stock

MTS Systems Corporation's common stock publicly trades on The Nasdaq Stock Market's National Market under the symbol "MTSC".

For News Releases and Other Information

Our latest news releases are available on the World Wide Web at <http://www.mts.com>.

Investor Relations

Securities analysts, portfolio managers, and representatives of financial institutions seeking information about the Company should direct their inquiries to: Thomas J. Minneman Treasurer and Manager of Investor Relations MTS Systems Corporation 14000 Technology Drive Eden Prairie, Minnesota 55344-2290. Telephone: 612-937-4647 Email: tom.minneman@mts.com

Dividend

Reinvestment Plan

Under the plan, shareholders can invest MTS Systems dividends in additional shares of MTS stock and make periodic voluntary cash investments for the purchase of MTS stock.

Both alternatives bear a nominal transaction charge which is netted against the funds used to purchase shares of MTS stock. Shareholders may obtain a brochure giving further details by calling Norwest Shareholder Services at 800-468-9716.

Trademarks

MTS, ADAPT, Bionix, Flat Trac, MaxPlus, Redline, RPC, and Temposonics are registered trademarks, and Aero-90, Alliance, MAST, Remote Parameter Control, SWIFT, and TestLine are trademarks of MTS Systems Corporation.

I-DEAS is a trademark of Structural Dynamics Research Corporation



Corporate Headquarters

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www.mts.com

North American Subsidiaries

AeroMet Corporation

International Subsidiaries

MTS International Ltd.
(Barbados, West Indies)
MTS (Japan) Ltd.
MTS Systems (China) Inc.
MTS Systems GmbH (Berlin)
MTS Systems (Hong Kong) Inc.
MTS Systems Limited (UK)
MTS Systems Norden AB (Sweden)
MTS Systems SRL (Italy)
MTS Sensors Technologie
GmbH and Co. KG (Germany)
MTS Sensors Technology K.K. (Japan)
MTS Testing Systems (Canada) Ltd.
MTS Korea, Inc.
MTS Holdings, SARL (France)
MTS Systems (France)
MTS Systems (Singapore) Pte Ltd.
MTS Systems do Brazil
MTS Services Ltd. (Japan)
MTS Automotive Sensors GmbH
MTS Sensor Technology Verwaltungs
GmbH and Co. KG
MTS Systems Holdings for Europe GmbH
Custom Servo Motors Antriebstechnik
Verwaltungs GmbH
Custom Servo Motors Antriebstechnik
GmbH & Co. KG