MTS SYSTEMS

Moderator: Jeff Oldenkamp
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Operator: Good day ladies and gentlemen and welcome to the MTS Systems Third Quarter 2016 Earnings conference call. Today's conference is being recorded. At this time I would like to turn the conference over to Andy Cebulla, Director of Investor Relations. Please go ahead.

Andy Cebulla: Thank you (Charelle). Good morning and welcome to MTS's Fiscal 2016 Third Quarter Investor Teleconference. Joining me on the call today is Jeff Graves, President and Chief Executive Officer and Jeff Oldenkamp, Senior Vice President and Chief Financial Officer. I want to remind you that statements made today which are not a historical fact should be considered forward looking statements as defined by the Private Securities Litigation Reform Act of 1995. Future results may differ materially from these statements depending upon risks, some of which are beyond management's control. A list of such risk can be found in the company's latest SEC form's 10-Q and 10-K. The company disclaims any allegations revised forward looking statements today based on future events.

This presentation may also include reference to financial measures which are not calculated in accordance of generally (accepted) accounting principles or GAP. These measures may be used by managers to compare the operating performance of the company over time. They should not be considered in isolation or as subsidy for GAP measures. A reconciliation of any non-GAP measures, the nearest GAP measure can be found in the company's earnings release. Jeff will now begin his update on our third quarter results.

Jeff Graves: Thank you Andy and good morning everyone. Thank you for joining us for our Third Quarter Investor call. We appreciate having the opportunity to discuss our financial results for the quarter and update you on our outlook for fiscal 2016.

First let me remind you about the focus of our company and the nature of our two business units. This may be particularly helpful for those newer to following our company. Our mission at MTS is simple. We are a focused test to measurement company dedicated to making our customers' new products more precise, safer and more reliable - and enabling them to get to market more quickly and confidently each year. We carry out this mission through two operating business units.

The larger of our two businesses is test - which provides highly engineered testing systems and services largely to R&D and product development groups within automotive, aerospace, energy and infrastructure OEM's - as well as leading research laboratories in universities worldwide. Our test business is fueled by our customer spending on research and new product development - markets that are less sensitive to the short-term economic swings that have generated such volatility for many companies in recent years.

Our second business unit is sensors. Well MTS has been in the position sensor business for over 30 years. Following the close of our third quarter we were very pleased to announce the completion of our acquisition of PCB group, a global leader in the design, manufacture, and distribution of a broad range of sensor products. This acquisition significantly expands our sensor technology offerings across a number of key market segments including the test market where we will leverage our very deep customer relationships for testing equipment and service.

Historically MTS has been a leader in linear position centers which are essential for automating heavy industrial equipment and increasing the precision and safety of heavy vehicle systems that utilize hydraulic controls. These sensor markets are tied more directly to industrial capacity utilization and heavy equipment demand then our test business markets. With PCB's leadership and ((inaudible)) sensing technology we will now also provide sensors and components used for acceleration, vibration, motion, pressure and force measurement. These sensor technologies both enhance the performance of our customer's products and through their application in the product development testing enable our customer's new products to enter the market more rapidly and reliably.

Approximately 65% of the PCB sensor markets are fueled by our customer spending on research and new product development similar to our test business. The remaining sensor markets are tied more directly to industrial capacity utilization and heavy equipment demand similar to our historic position centers. Going forward we will integrate our historic sensor business with that of PCB to create a single sensor business unit serving a wide range of both industrial and test markets worldwide.

With this backdrop I'll start with the headlines for the quarter. There are three key takeaways for the call today. First we were pleased with our results for the quarter. Revenue for the third quarter grew an outstanding 18% to a record $138 million driven by strong backlog conversion in our test business. We were able to realize a significant portion of the revenue shortfall we experienced in the second quarter from improved custom project execution and direct labor headcount additions from the quarter. Earnings were solid with test gross margins improving 510 basis points on a sequential quarter comparison.

Second we're very excited to have completed the acquisition of PCB in the opening days of our fourth quarter. The combination of our historic sensor business with PCB is an ideal outcome for MTS transforming the company into a larger more competitive technology leading test and measurement solutions provider. With a broad product portfolio serving diverse growing in markets and with a large and deeply intimate global customer base. PCB brings scale to our sensor business with more rapidly growing in markets, higher margins and strong free cash flow. It also brings greatly enhanced synergies between our test and sensor business units generated by the use of PCB's sensors by our currently test customer base in support of their new product testing.

This combination will bring long term value to our customers through scale, to our employees through growth and to our shareholders through expanded profit margins and strong pre-cash flow. We're truly excited to add PCB to the MTS family. With the close of the deal in early Q4 integration of PCB has begun full force and we're on track with our plan integration efforts. We validated many of the synergies we modeled in our assumptions and have started the work to realize the value from the acquisition.

The third key method for today is regarding our outlook for the remainder of fiscal 2016. With regard to revenue we're refining our revenue guidance range to $630 million to $640 million and we're finding our earnings guidance to $1.35 to $1.50 per share. These guidance ranges are inclusive of a contribution from the PCB acquisition and all restructuring and acquisition related charges. Jeff Oldenkamp will provide more detail regarding our guidance in a few minutes.

With that I'll now review orders in more detail for the quarter. Total company orders decreased 18% or $28 million to $125 million in third quarter driven largely by the test business. Test orders which were down 21% in the quarter were impacted primarily by the timing of two large custom projects totally roughly $21 million. Given the abnormally high custom order rate over the last two years this volatility is not unexpected. While test product orders were softer in the quarter we were very pleased with the moment of our test service business which continued to deliver strong orders growth.

Orders for test services increased an impressive 34% to a record $27 million bringing the year to date increase orders to 22%. This increase was driven by a focus on upgrades of software platforms in our install base, a continued focus on strategic relationships with customers to extend the life of their existing equipment and full service contract wins in this case with customers in Europe.

We continue to perform lab assessments for many of our customers. This results in building deeper engagement - which often leads to orders for critical spare parts and lab upgrade services that will enhance the productivity and efficiencies of our customer's laboratories. Our large and continually growing install base of equipment which now exceeds $4.5 billion and the investments we have made over the last few years in expanding our field service organization and to modernize the tools they use to serve our customers continues to provide us with an opportunity for sustained profitable growth in our service business.

We're continuing to add field service engineers and to invest in our service infrastructure as appropriate to support the service business which will help drive future growth for our test business unit.

Moving to our sensor business, orders were down 70 - 7%, at 7% reflecting largely the timing of blanket orders. With the shore lead times available for our sensor products customers have moved to a just in time ordering approach rather than placing annual blanket orders for products. Omitting the blanket order affect order rates will flat in the quarter for sensors if new design wins and the mobile hydraulics markets largely offset continue softness in the industrial machinery markets worldwide.

Our backlog continues to be very strong driven by our test business ending the quarter at $352 million, an increase of $9 million or 3% compared to the prior year. And finally I'd like to comment on the opportunity pipeline as we believe it's a good indicator of market strength and the potential for future growth. Given the nature of the sales process the 12 month opportunity pipeline is dominated by test opportunities today however this may change with the increasing scale of our sensor business in the future.

At the end of the second quarter our 12 month pipeline of opportunity stood at a new record of $978 million up 12% compared to the third quarter last year and up 3% sequentially. That was a third quarter number, $978 million. These identified opportunities for future sales reflective of the healthy continuing demand we received for expanded and enhanced testing capability in R&D and new product development by our customers worldwide. This visibility into future demand builds confidence in our ability to deliver sustained organic growth going forward.

A key metric we use to monitor the health of our opportunity pipeline is the deferral rates within the pipeline. This is measured as total dollars deferred as a percentage of beginning a quarter pipeline. The metric improved slightly to 50% compared to 54% on a sequential quarterly basis and is slightly better than our historical average rate of the mid-50% range.

As a reminder, as the deferral percentage in the pipeline increases the volatility of orders performance must increase. This can make predictability and resource planning more challenging compared to the volatility we experience when the deferral rate is lower. Relatively normal deferral rate provides us with confidence in our ability to secure future orders and deliver on these orders in the most productive manner. We'll continue to update you on this view of our markets and the quarters ahead.

Now I'd like to turn the call over to our CFO, Jeff Oldenkamp, for some additional financial detail on the quarter. Jeff?

Jeff Oldenkamp: Thank you Jeff. My remarks today will summarize our third quarter results based on a year-over-year comparison. Overall as Jeff mentioned in his remarks we feel good about our results for the third quarter. As we expected revenue growth was very strong in the quarter field by strong conversion of backlog and test. Earnings were largely in line with our expectations but were significantly impacted by non-recurring restructuring and acquisition related charges. Now moving on to more detail about the quarter.

Third quarter revenue of $158 million increased 18% reaching a new company record. Looking more specifically at revenue by business. Sensor's revenue of $24 million was relatively flat. While orders were down 7% in the quarter we were able to convert backlog which kept the revenue comparable to the prior year.

Moving on to test. Revenue was a record $134 million in the quarter increasing an outstanding 22%. As Jeff mentioned we were able to improve our conversion of backlog into revenue during the quarter from improved project execution and the direct labor ((inaudible)) additions that we made during the quarter. This was a nice result for test and something we expect to continue into the fourth quarter.

One item that I want to correct from the earnings release in the headlines we stated that test service revenue for the quarter was a quarterly record. Although it was a strong quarter for service revenue it was not a record for the quarter. Test backlog ended the quarter at $338 million. Custom backlog as a percent of total backlog was approximately 67%, a decrease of ten percentage points compared to the end of our second quarter.

This improved mix in our annual backlog is good news for the test business going forward however the shift is not expected to have a significant impact on our fourth quarter results. We will continue to monitor our mix of orders as we progress through the year and we'll provide more detail regarding how this makeshift may impact a result going forward when we issue guidance for fiscal year 2017.

Moving onto the rest of the PNL. Gross margin was $58 million, an increase of 9% from higher volume in the test business. As a rate to revenue, gross margin decreased 280 basis points from 39.7% to 36.9% from a decline in margin rates in both businesses. Sensors growth margin was down 8% to $12 million on lower volume. The gross margin rate decreased 370 basis points from 54.9% to 51.2% primarily resulting from lower volumes and higher indirect labor costs. We expect the center business margin inclusive of PCB to remain in the low to mid-50% range going forward with improvements expected as volume increases. Test gross margin came in at $46 million up 15% on higher revenue that I previously mentioned.

However the gross margin rate decreased 210 basis points from 36.3% to 34.2%. Point six percentage points of the decrease resulted from pricing pressures on standard products sold in the material markets in China from increase competition. A half a percentage point resulted from higher proportion of customer revenue which typically carries a lower margin and the remaining margin rate decline resulted from higher compensation and benefits.

We expect the test business margin to be in the 33% to 35% range in the fourth quarter. My next topic is operating expenses. Operating expenses increased $11 million or 28% to $48 million and more 31% of revenue. In the increase in operating expenses has resulted from $5 million of acquisition related expenses, $1 million of restructuring cost and $5 million from higher commission expense increase compensation and benefits and higher professional fees. Excluding the acquisition related in restructuring costs, operating expenses were 27% of revenue, the bottom end of our forecasted range.

Going forward we expect operating expenses inclusive of the PCB business to be in the previously communicated 27% to 29% range excluding acquisition related and transaction related (amortization) expense. Operating income decreased 37% to $10 million primarily driven by the acquisition in restructuring related charges.

Next I want to briefly discuss net interest expense. In recent history net interest expense has generally not been material. Year to date net interest expense in fiscal 2016 was less than $1 million. As you know we took on more debt at the beginning of our fourth quarter to fund the PCB acquisition. More specifically in addition to the issuance of $460 million of term loan B debt we issued tangible equity and it's partially from the acquisition which resulted in approximately $27 million of debt that is required to be paid down over the next three years.

As part of that arrangement we are required to pay a coupon rate of 8.75%, a portion of which is interest expense and a portion is a reduction in principle. The term loan B debt interest rate is ((inaudible)) plus a credit risk spread of 4.25%. There's also a ((inaudible)) of .75% so the current all in interest rate we are paying on the debt is 5%. We're committed to paying down this debt as quickly as we can and given our projected free cash flow we believe that we will be able to deliver fairly quickly.

However due to the higher level of debt net interest expense will be material for the foreseeable future. We are forecasting net interest expense for our fourth quarter to be approximately $7 million.

My next topic is taxes. The tax rate in the quarter was 28.4% which was slightly below the prior year rate of 28.8% and was slightly below our anticipated rate of 29%. The decline in the tax rate primarily resulted from a decrease in operating income. With the addition of forecasted income from PCB we expect the tax rate to be approximately 29% consistent with our previous guidance. Earnings per share decreased from 72 cents in the prior year to 46 cents primarily driven by the acquisition, restructuring related charges and a higher share count which negatively impacted earnings per share by 32 cents in the quarter.

Excluding these charges non-gap earnings per share would have been 78% - up 8%, a reconciliation of these earnings to gap earnings is included in our earnings release which is available on our Web site and the FDC's Web site.

Moving on to a summary of cash. The cash balance increased $109 million in the quarter to $173 million. The increase was driven by the issuance of common stock and tangible equity that's associated with the purchase of the PCB group which increased cash $186 million net of issuance cost. Partially offsetting this increase in the quarter was $44 million to fund an escrow account associated with the PCB acquisition, $21 million to reduce our debt balance, $8 million to purchase a (cab) call related to the tangible equity in an offering and $4 million for dividends.

Now I'd like to update you on our full year revenue and EPS guidance ranges. As Jeff mentioned in the headlines we are refining our full year revenue range to $630 million to $640 million - including the contribution from the PCB business. We are confident in our ability to achieve this revenue range given the confirmed demand from our technologies across our test markets as evidence by strong order performance in the first nine months of the year. The high level backlog we have entering the fourth quarter and the expected contributions from a newly acquired PCB business.

Regarding our earnings per share for the full year as Jeff mentioned in the headlines we are narrowing the expected range to $1.35 to $1.50 per share. This guidance range includes the contribution from the PCB business, all non-recurring severance, acquisition and integration related charges, transaction related ammonization of intangible assets, higher interest expense from the new debt we issued and the negative impact of a higher share account.

We narrowed the previously issued guidance because we have lower than anticipated non-recurring acquisition related charges from our acquisition of PCB that are partially offset by higher than anticipated ammonization expense and share account. We previously anticipated acquisition related charges to be in the range of $27 million to $29 million in fiscal 2016. But we now foresee these charges being the range of $18 million to $20 million for the full year. In the fourth quarter we anticipate in transaction related ammonization expense to be approximately $3 million to $3.5 million and as I mentioned that interest expense to be approximately $7 million.

Finally I'll conclude my remarks with a brief update regarding the report in material weaknesses and internal controls over financial reporting. We continue to make progress on the various measures that we have in place. We've implemented new procedures in our sales and contracting processes to include identification of specific deliverables contained within multiple element revenue arrangements and to defer an appropriate amount of revenue.

These actions include the hiring of new personnel as well as providing additional training for existing personnel. We believe that we are on track to remediate the material weaknesses by the end of our fiscal year. This concludes my remarks for today; I will turn the call back to Jeff for his final comments, thank you.

Jeff Graves: Thanks Jeff. In summary overall we were happy with our quarterly performance and believe we're on the right track to deliver improving results in the quarters ahead. While the (orders) growth was not as robust as recent quarters, given the strength of our opportunity pipeline we believe it's largely timing related and we expect our markets to remain robust.

We have a tremendous long term global customer base and continue to see rising demand from technologies across our test markets. Our test services business continues to perform well reflected in four consecutive quarters of double digit growth. Lastly we completed the PCB acquisition and integration activities are well under way. All of this provides us with confidence to deliver the revised guidance for 2016 and revenue and earnings growth for 2017 and beyond.

That concludes our prepared remarks and I'll turn the call back to you (Charelle) to host the Q&A session.

Operator: Thank you sir. Ladies and gentlemen we will now begin the question and answer session. If you have a question please press the Star followed by the 1 on your touch-tone phone. If you would like to withdraw your question you may press the Star followed by the 2. And if you are using speaker equipment you will need to lift your handset before making your selection. Once again ladies and gentlemen, its Star 1 to ask a question.

And our first question comes from the line of Ben Hearnsberger with Stephens.

Ben Hearnsberger: Hey thanks for taking my question, Jeff. I'm sorry I missed it - I know you called out the custom mix - could you give that to us again?

Jeff Oldenkamp: Yes it was 67%.

Ben Hearnsberger: Okay so - sorry go ahead.

Jeff Oldenkamp: No, 67% in backlog.

Ben Hearnsberger: So the 67% - and that's the lowest we've seen in a while, are you doing - are you doing something differently when you're pricing large custom bids to try to shift the mix or is just timing around the decrease?

Jeff Graves: Well obviously Ben we're looking for pricing opportunities every time we get the chance. You know the technology we offer we believe is the best in the world so we're looking to you know be paid fairly for it and the investments we make to sustain that. I would say there's no - there's no push to overtly change the mix of product. If you look at our opportunity pipeline, we don't go into that level of detail to break the pipeline down into categories but all the categories remain very robust. They're custom, they're engineered order which we all lump in these calls in the custom category and the standard products.

So we've got great opportunities in every branch of this, it's more timing related. So you know a year and a half ago I struggled to explain the uptick in custom orders as strong as it was. It - those waves tend - seem to tend to wash across our customer base. For example in automotive you know we see upgrades of large facilities which require custom equipment and that started a year and a half to two years ago. And really came in very quickly. And now that some of that's taken route and those orders are placed we see more of a return toward normalcy overtime.

So I wouldn't oversell you know this mix improvement and backlog and to Jeff's point it's not going to really impact our earnings performance until 20 - until fiscal '17 but it is a nice trend and we're pleased with it and we think all of our categories remain strong and very competitive.

Ben Hearnsberger: Okay and then I wanted to look at test margins starting in test services. So we saw it pick up nicely for the first time in a while. Did you do hiring in your test service businesses this quarter?

Jeff Graves: Yes Ben we're going to - we're continuing to hire because we just got such an opportunity for growth out there. The customers want more and more of field service engineers and we're hiring and training as quickly as we can. What you're starting to see now is that pivot from you know it being dominated by the investments we're making to landing more - not only more volume but an increasingly rich volume or an increasingly rich mix of services that we're selling.

So you know I would expect that to continue over time. There will be some volatility, there will be you know quarters that are up and down in terms of margin performance but because we continue to make consistent investments in the business but I think you'll you know if you average them out over the coming quarters you'll see a nice trend upward in margin over time.

So again I'm not overselling the improvements we made in the quarter. I think they were great and I'd love to see them continue every quarter. There will still be some volatility because we continue to invest a lot of money in our services business because there's such demand out there.

Ben Hearnsberger: Okay.

Jeff Oldenkamp: Yes Ben I just want to add one thing on that. So yes it was a nice uptick I mean gross margins were above 43%. Year to date services in that 39% to 40% and that's the range we expect going forward is that 39% to 40% in service margins because we will continue hiring FSE's, field service engineers as we see this as a big opportunity for MTS.

Jeff Graves: Ben that's the safe thing to do from your modeling standpoint is lay it in like that. There will be some volatility around that number and obviously we're driving to make it as rich as we can every quarter.

Ben Hearnsberger: You said 39% to 40%?

Jeff Graves: Yes that's where we're at year to date and we expect that going forward.

Ben Hearnsberger: Aspirational longer term - how do you think about the opportunity there?

Jeff Graves: Oh I think it'll be mid-40's and above Ben, so that's where we'll really see. When we get to you know a critical mass if you will of installed field service engineers so the percentage we're adding every year drops you know the drag on the business from the investment we're making will decrease and I think we're making some marvelous investments in terms of software upgrades and things that are going to bring a lot of value to the customer base. So I think you'll see a - you will see over time returning to the kind of the mid-40 range, mid-40% gross margins but it'll take some time just given the tradeoff between investments and people and the - and the richer mix of business that we're starting to win.

Ben Hearnsberger: Okay and then in your test systems business the gross margin improved, is it fair to say the worst is behind us from a margin standpoint?

Jeff Graves: You know Ben I like the mixed change in our backlog. It depends on how it flows through every quarter. You know we still have a lot of custom content and highly customized kind of engineer to order product in that backlog. So there will still be some volatility quarter to quarter. I think you know the shocks that we saw earlier in the year in terms of projects that we had won you know kind of 12 to 18 months ago I do believe that is past us. I think we'll see much improved smoothness of performance if you will and a gradually improving margin going forward in the test product business.

Ben Hearnsberger: Okay that's helpful, thank you.

Jeff Graves: Thanks Ben.

Jeff Oldenkamp: Thanks Ben.

Operator: Thank you. Our next question comes from the line of John Franzreb with Sidoti and Company, please go ahead.

John Franzreb: Good morning guys.

Jeff Oldenkamp: Hey John.

Jeff Graves: Good morning John.

John Franzreb: Jeff I'd actually like to start with the PCB acquisition. As you mentioned about 1/3 of the business overlaps with what you're, you know, you're current, you know, heavy industrial kind of sensor market but 2/3 doesn't. Could you talk a little bit about the growth profile and those businesses? Especially most recently what that looks like versus maybe expectations when you announced the acquisition?

Jeff Graves: Yes in terms of growth profiles John clearly the 2/3 of the business that overlaps with our test business you know we're very confident in seeing growth in that because again we're - we have such excellent visibility into the opportunity pipeline looking forward in our test business because those projects are planned so far in advance. So we know, we know there's going to be investment in new R&D and product development that will fuel our test business. We also believe that that will fuel 2/3 of the PCB center sales to conduct those tests in the lab and outside of the lab.

So we feel very good about the growth prospects there. The part of their business and our historic business that's exposed to industrial machinery it remains you know frustratingly sluggish. It's - you know I think they've delivered some nice grown in the last few years they've been exposed to the same headwinds that we have in terms of just the overall GDP of the world and especially capacity utilization and machinery demand.

So we -- and I think PCB -- are winning a lot of business - it's just the overall demand has been sluggish or even negative at times so it's kind of offsetting. So it leaves you with fairly unexciting growth rates on the industrial and equipment side. On the test driven side which again is 2/3 of the PCB business is related to our test markets, I think we'll see the same kind of demand drivers that we do in our current business. And as we said our opportunity pipeline and test is at record levels approaching a billion dollars. So we feel very good about the demand looking out the next couple of years.

John Franzreb: Does PCB on the test side benefit from the ongoing digitalization of the sensor market and as such maybe the growth rate is somewhat about the normal growth rate just in the overall test R&D market?

John Graves: Oh absolutely John, I have no doubt about it. I can’t put a number to that but obviously to shorten development cycles by our customers they’re trying to get more and more data out of each test they run which requires more and more sensors and more and more data handling from those sensors. So we you know that was a big rationale for us investing in this business. I just think the - our customer’s under immense pressure to shorten development cycle times to get these new cars, new planes you know sold to customers more quickly.

And as they drive to take time out of that cycle it’s pushing our test equipment business into interfacing more and more with simulation environments so we’re investing a lot in the interface with simulation technology to link our test equipment into that. And a key part of that is data collection from the test itself.

And so I love those fundamental drivers - I don’t believe they’re ever, you know, they’re ever going to go away you know for years and years to come. And it was a big rationale because of the depth of our customer knowledge in test, a big rational for the acquisition of PCB.

John Franzreb: Got it, and in your test (segment) ((inaudible)) revenue ((inaudible)) been lumpier than in prior years and part of it is more custom projects. But you know it also seems like delivery times have been shortened. Could you talk a little bit about how much you know you had a good conversion in the third quarter, is there any pull forwards from 4Q into 3Q? Could you talk a little bit to the lumpiness we're seeing in test and when do you expect that to even out? Or is this something we're just going to have to live with?

Jeff Graves: No I think you'll see a smoothing going forward John particularly as our backlog you know improves in mix you know toward the more historic custom versus standard product mix. It makes it just much, much easier to plan (ordinary) resources and to run a factory. So we feel good about that you know the long term you know move back to normalcy in our backlog.

The lumpiness really it's almost the inverse. If you look back into Q2 there was a couple of very big complex projects or clusters of similar project that really - that we had taken probably a year and a half ago or a year ago that really filed us up near the end of their time in manufacturing. We had to go back and do some design modifications to meet our customer's desires as they had evolved. So with that it really did file us up and I would say it was quite the (aberration). I think I feel very good about you know the improvements we made in the quarter, some of that was relief from the second quarter. I don't think there was any real pull forward from Q4. I think we just ran the business better, it was a strong focus on turning backlog and you saw natural improvements.

John Franzreb: Got it, and one last question, when I was going through the queue last night I saw that you were having a pricing, prices on standard equipment in China. I don't remember ever reading that before. Can you just kind of talk a little bit about what's going on at landscape and standard test in China?

Jeff Graves: Yes we have a little bit stronger competitive base in China and the China economy's been slow. So it's - actually it surprised me that we didn't have more pressure than we've had in the last year and a half. Clearly in the last couple of quarters there's been some pricing pressure within China again on standard product. The things that we're less differentiated on so we still have dominant positions in custom and is highly engineered to order products there but our standard products where we have a few more competitors have shown some more pricing competition and I think that's why we called it out.

John Franzreb: Okay.

Jeff Graves: One thing I would mention John is we've launched some - a couple of very nice new product families over there in the last few quarters and as those grow in volume going forward it's meant to directly address the differentiation question in the Chinese market. So we're responding to that pricing pressure by launching some new products that we think are more highly differentiated in that standard category.

John Franzreb: Right.

Jeff Graves: So that's our approach to fending off the price competition there.

John Franzreb: Great, good luck, thank you for taking my questions Jeff.

Jeff Graves: Thanks John.

Jeff Oldenkamp: Thanks John.

Operator: Thank you, our next question comes from the line of Paul Coster with JP Morgan, please go ahead.

Paul Coster: Yes thanks for taking my question so just following on from the last question really. You've got this massive visibility I suppose through the pipeline opportunity of maybe a billion. Could you give us some sense of the geographic breakdown of that pipeline and what it says in terms of the risk - profile risk of conversing and the nature of the projects that subsequently follow through in terms of their risk profile as well.

Jeff Graves: Yes Paul thanks for the question. It's nicely distributed around the world, the demand if you looked at it versus history between - and we kind of divide it between the Americas which is dominated by North America, obviously the United States, Europe which is dominated by Western Europe and Asia and now increasingly dividing Asia into individual countries it's very well distributed. If you look at the pipeline not only for the next 12 months that we report on but if you look out a year or two you see OEM's you know around the world in virtually every geography making very similar investments in their laboratories.

So clearly there's a pre-dominance to invest in Asia because that's where their demand is coming from and they want their labs closer to the customers. But they're still spending - a lot of OEM's are still spending a lot of money in the US and in Western Europe and especially on the very high end laboratories that are moving toward more simulation and integration of testing simulation is where their engineering base is. So I would tell you its great business and it's very well distributed around the world.

We - so and from a risk standpoint we feel good about that. It's not dominated by any one customer or one geography as opposed to the others.

Paul Coster: Okay and then I realize it's very early days but can you say anything about the integration process? Any revelations, any issues that you've encountered so far?

Jeff Graves: No Paul it's been remarkably smooth. I've been very pleased with the PCB management team that we've asked to lead the combine business going forward. I think their leader ((inaudible)) and the quality of the team that he built over the last decade really shines through and they've you know embraced our historic business and are getting to know that and a lot of the synergies we had modeled they validated and have put their own spin on them. And we feel very good about it.

So again on both the cost and the revenue side our plans have been validated. We worked hard at those plans during diligence. We had time and invested resources to do it and it's paying dividends now. I think those are - those have been confirmed and we've got a lot of heavy lifting to do over the next two to three years to realize it. But on both the cost and revenue side I would expect we'll hit our targets.

Paul Coster: Excellent thank you very much.

Jeff Graves: Thanks Paul.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions please press the star followed by the one on your touch-tone phone. If you are using speaker equipment you will need to lift your handset before making your selection.

And we have a question from the line of Liam Burke with Wunderlich, please go ahead.

Liam Burke: Thank you, good morning Jeff, good morning Jeff.

Jeff Graves: Hey Liam.

Jeff Oldenkamp: Good morning Liam.

Liam Burke: Jeff you talked a lot about automotive tests. Could you give us some color on how the balance of the test business is doing?

Jeff Graves: Yes you mean the other market?

Liam Burke: The other markets, aerospace materials.

Jeff Graves: Yes, yes it's a great discussion Liam. The aerospace business has been very solid for us. Again it tends to be a little lumpier you know depending on when customers are launching new aircraft but - and we see some you know move between the large body aircraft company and the regional jet kind of companies. But it's very fairly robust, we feel very good about it and again bringing PCB into the family now they participate in that aerospace testing as much as we do. So in terms of ground based testing and even air testing of airplanes. So we love that addition, it's been a good market.

Civil size testing has been nice and consistent. Now the problem with that is that business is essentially large projects so it's lumpier by nature. But the overall demand for civil size test equipment has been high and particularly there in China. China and the other areas in Asia that are really active geologically for earthquakes which really is a driver for those laboratories.

So I think you see a lot of Chinese spending in universities and that's driving investments in size testing not only for earthquake resistance but in terms of building a bridge design for performance. Things like that they really are spending nicely and consistently over time. And again mainly driven out of Asia which would include Japan and Indonesia and other countries in Asia as well that are exposed to earthquakes or tsunamis.

I'm trying to think, materials testing to support you know materials are going through an evolution right now into carbon fiber reinforced composites. And you see those clearly taking route in the new aircraft. The new airbus, airplanes, blowing aircraft you see a lot of composite usage and it's expanding down into the smaller aircraft sizes now. So a lot of composite usage which is very good for our materials testing business. We've got some of the leading equipment for testing composite materials. We feel very good about our position there and those materials by their nature require a lot more testing than do (metal alloys).

So it's very good long term for our business so again that market while it was a little bit softer in the last quarter just driven by some specific you know engine and aircraft programs all in all looking at the next couple of years we feel very good about the materials testing business. And that's generally standard product for us within our standard category, good margin product that should again be very nice to have in our backlog.

So I think that covers the major markets. Jeff have I missed anything?

Jeff Oldenkamp: No you covered it.

Jeff Graves: Got it, okay. Any other questions on the markets or geographies Liam.

Liam Burke: No, no, just to flip over on sensors though. I believe Jeff mentioned that there was some design wins in mobile hydraulic on the sensor side. Is that business starting to get some legs? It's been a long time developing?

Jeff Graves: Yes you know, absolutely Liam its legs are growing, I'd still say they're kind of short but they're growing.

Liam Burke: Okay.

Jeff Graves: The frustration - well the frustration there is they bring a lot of value to a customer's products. Okay, they you know they make the you know earth moving equipment, mining equipment, cranes, they make them a lot smarter. The problem really has been an in demand for those products. So while we're getting designed into platforms it's been offset somewhat by volume in the world. I think we've used probably a 10% number Jeff in terms of growth?

Jeff Oldenkamp: 10% year to date in orders of motor hydraulics, yes.

Jeff Graves: So motor hydraulics for us is up 10% Liam in a very tepid in demand market. So when that volume does pick up for people you know that are in the earth moving mining you know heavy lifting crane business and stuff you're going to see a lot of growth in that business. So we feel really good about the design limbs, so the legs may be short but they're running fast.

Yes you know we're really waiting on the global GDP improvement to drive more demand. I will say there's no - there's not much product in the pipeline, I mean in inventory in the pipeline so when you do see an uptick in demand or major construction equipment companies, things like that, it should really flow through nice and quickly to our business.

But it's you know to date I'll take the 10% growth, I feel good about it, but it's got a lot more potential than that.

Liam Burke: Great, thank you Jeff.

Jeff Graves: Thanks Liam.

Jeff Oldenkamp: Thanks Liam.

Operator: Thank you and there are no further questions in the queue.

Jeff Graves: Okay (Charelle), thank you very much. And thank you all for participating in our call today. We look forward to updating you on the progress again next quarter and thank you and have a great end to your summer.

Operator: Thank you. Ladies and gentlemen this does conclude today's conference call. We thank you for your participation and you may now disconnect.

END