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Operator: Please standby. Good day, and welcome to the MTS Fourth Quarter 2017 Earnings Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Brian Ross, MTS Senior Vice President and Chief Financial Officer. Please go ahead sir.

Brian Ross: Thank you, Kathy. Good morning, and welcome to MTS Systems fiscal 2017 fourth quarter investor teleconference. Joining me on the call today is Jeff Graves, President and Chief Executive Officer.

I want to remind you that statements made today, which are not historical facts, 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 risks can be found in the company's latest SEC Forms 10-Q and 10-K. The company disclaims any obligation to revise forward-looking statements made today based on future events.

This presentation may also include reference to financial measures, which are not calculated in accordance with generally accepted accounting principles, or GAAP. These measures may be used by management to compare the operating performance of the company over time. They should not be considered in isolation or as a substitute for GAAP measures. A reconciliation of any non-GAAP measures to the nearest GAAP measure can be found in the company's earnings release.

Jeff will now begin his update with an overview of our industry and business performance for fiscal year 2017 and the expectation for fiscal year 2018.

Jeff Graves: Thank you, Brian, and good morning, everyone. Thank you for joining us for our investor call today. We appreciate having the opportunity to discuss our results for the fourth quarter of fiscal 2017, which ended on September 30. In addition to recapping the full year, we will also provide you with the outlook for our fiscal 2018. As a general summary, fiscal 2017 was a watershed year for MTS as we completed our evolution into a comprehensive test and measurement company having the scale, technology, leadership, and the operational footprint to support our customer base worldwide. With our 50 years of success behind us we've never been better positioned in both our sensors and test businesses for sustained growth and profitability in the years ahead.

So let me begin with the key takeaways from the fourth quarter and full year. First, we were pleased to end the fiscal year on a high note driven by both our testing and sensor businesses. The fourth quarter we delivered over $200 million of revenue and record new orders that reflect the strength of our product technologies and our intense focus on total customer satisfaction.

Sensors continued their positive momentum from the third quarter as anticipated while test surpassed even our highest expectations delivering 12% orders growth year-over-year and 28% growth sequentially from the third quarter. This strong sales performance drove our yearend backlog for the full company to well over $350 million with our test backlog alone rebounding to over $300 million for the first time in several quarters.

I'll comment in more detail on specific market segments that drove this performance in a moment. Second, we were very pleased to have met our goals for the integration of the PCB Group in

2017 as the PCB organization and our legacy sensor business were successfully consolidated into one MTS sensors business unit, operating under a unified, high performing leadership team.

In addition to optimizing our operations footprint and organization culture during the year a significant amount of time and effort was devoted to implementing processes across PCB to comply with the various regulatory and legal standards that were required as a publicly traded company. Completing this phase of the integration process provides a strong internal control foundation that coincides with the enhancements we've been diligently implementing to ensure the MTS code of conduct standards are being met around the world each day in our company. With these efforts now complete, we're better positioned than ever before to meet the exciting demand environment for industrial sensors around the world.

Reflecting this progress, in the fourth quarter our sensors business delivered record revenues of $77 million up 12% year-over-year with adjusted EBITDA margins of over 21%. Given the market outlook and the strength of our product and geographic positions we anticipate this momentum of double-digit growth to continue in the new fiscal year.

Third, from a full year perspective we were pleased to delivery record revenues of $788 million an increase of 21% year-over-year with a gross margin of 38% on a GAAP basis which represents an increase of 3 percentage points over the prior year. This equated to adjusted EBITDA margins of over 15% for the company. With our backlog strengthening at year end and much of the heavy lifting of integrating PCB into the company now complete, we look forward to an exciting year ahead.

Brian will expand on our financial performance in a few moments, but before he does, let me give you a little color on our end markets and the demand drivers as we look ahead. Beginning with our test business, we discuss these markets in three broad categories; vehicles, structures, and materials test. For our global vehicles test markets after a slow start in new orders for the first half of the year, upward momentum accelerated robustly in the latter half of fiscal 2017 as we had expected culminating in record orders in Q4. This growth in orders was driven by strong demand for our core durability and aerodynamic test products across all geographies including large custom orders that exceeded last year's levels.

This rebound in orders was consistent with our belief that investment decisions early in the year were being delayed as automotive OEMs reassess the rapid changes in their long term demand outlook for electric vehicles and for those incorporating advance driver assist symptoms to what's now commonly referred to as A-D-A-S or ADAS. These vehicle trends are pervasive and global in reach driven by the need for reduced emissions and increased fuel efficiency and a desire for smarter, more autonomous vehicles.

Fortunately for MTS our core test products those the folks are measuring a vehicle's durability and aerodynamic performance remained critical to the success of these new vehicles. In addition, the added challenges integral to electric vehicles and those offering greater autonomy bring expanded growth opportunities for us. One of the most exciting beneficiaries of these changes is the accelerating demand for vehicle dynamic simulators or better known simply as driving simulators.

Recently in partnership with McLaren Technologies we introduced the first of a new generation of advanced driving simulators that will allow OEMs to test and validate new vehicle technologies at the concept phase, accelerating their introduction to the market. Critical technologies such as those targeted to the increasing vehicle autonomy are assessed by bringing together a human driver with a sophisticated motion system combined with a computer generated virtual driving environment.

In this way, new driver assist technologies can be validated quickly and safely under a wide range of human and environmental conditions. Given the pace and magnitude of the new vehicle changes expected over the next decade we believe the demand for these new simulation systems will be significant.

With the first generation of simulators now entering the market, our sights are already set on the next generation which will introduce enhancements through augmented reality, improved graphics and real-time connectivity to peripheral mechanical testing systems that will evaluate the real-time performance of key materials, components and subsystem technologies at the concept phase further accelerating new vehicle introductions.

Looking ahead to physical 2018 we anticipate continued growth in vehicle test sales with the potential for fewer large custom projects as new products begin the evolution into standard offerings along with increased component sales and services. From a geographic standpoint all regions are anticipated to participate in this growth due to the global nature of the automotive industry, with China and later India will be increasingly important to future sales as the transition to environmentally friendly automobiles is of critical importance to these rapidly growing economies. Our technology leadership, long term customer intimacy and global presence for both sales and service our competitive strengths for our vehicles test business.

In the structural test market sales were strong but down in Q4 compared to the prior year driven by the timing of large nonrecurring custom seismic testing projects last year. Our structures test markets are dominated by aerospace, wind energy and infrastructure testing, the latter of which is largely led by universities and other government civil engineering organizations. New aircraft test systems were down somewhat in the last year reflecting a decline in new aircraft platforms from the prior year.

Wind energy however remains robust driven in large part by European and U.S. OEMs while infrastructure testing is benefiting from the increasing university investments in China and other areas of the world where seismic activities are a threat to human lives. We expect these trends to continue and drive growth in fiscal 2018. While the timing will always vary due to the large project nature of the structures test market, with the strength of our technology position and global service infrastructure we expect this business to deliver sustainable growth over the years ahead.

Moving on to materials test, we saw a very strong Q4 driven by broad based demand across all global regions and end markets which we expect to continue in 2018. In North America, significant growth came from new testing requirements driven by automotive light weighting as aluminum and carbon fiber composites increasingly displaced steel particularly in electric and hybrid power vehicles the increased range and fuel efficiency as well as the explosive growth of additive manufacturing across many industrial segments.

Additive manufacturing which is the use of 3D fabrication methods to produce structural components instead of traditional casting, forging and machining operations is enabling great strides in both performance and cost of aerospace, ground vehicles and other industrial systems. Components made in this way often have the unique mechanical properties that require extensive testing before introductions.

We expect this growth in additive manufacturing to continue its acceleration for many years to come. Given our historic technology leadership and systems for dynamic testing of materials and our increasing capabilities for monotonic testing symptoms we're very well positioned to capitalize on this growing demand worldwide.

Moving next to our sensor business unit, we look at this business currently in four market sectors with the first being our historic position sensors. Within this sector the mobile hydraulics demand, that is demand for sensors used in hydraulically powered equipment rebounded strongly in fiscal 2017. This growth was driven by increased production of heavy construction and mining equipment as well as strength in the broad fluid power market. In addition with the rebound in steel and aluminum production, demand accelerated for position sensors that are used for critical operation control and the basic materials processing markets.

Geographically, demand in China was very strong and included sales to the first Chinese mobile hydraulics customer in the heavy construction industry, a target market for MTS for several years. These trends are expected to continue in the new fiscal year as the economic recovery continues.

Moving next to our sensor sales into the test markets, in fiscal 2017 the demand profile was positive all year that followed a similar pattern to our test business unit with significant strengthening in the second half of the year to yield a very strong double-digit bookings growth by year end. Adding to the streak in Q4 of fiscal 2017 was the initial ramp of shipments of our new product developed for the U.S. Military.

As we've discussed previously we expect shipments of sensors for the U.S. Department of Defense to continue growing in fiscal 2018 and are excited about new follow-on contracts that we expect to be awarded in last fiscal 2018 which will then extend over the next decade and if the refresh of key U.S. Military platforms is executed. This U.S. Military program alone is expected to generate an incremental $200 million to $300 million in revenue over the next 10 years. Other DoD and space system applications are also being pursued.

In our nonmilitary test markets for sensors we expect growth to also continue driven by the same fundamentals as discussed previously. We're particularly pleased to see this growth in the test sector as it was one of the unique and fundamental reasons for acquisition of PCB last year.

The industrial sector for our sensor business was unexpectedly soft in the first half of the year, but finished on a stronger note in the second half. This performance was driven by an unexpected drop in sensor sales to the industrial gas turbine manufacturers as their volumes sharply declined in the year. While one manufacturer was particularly hard hit the softness extended across the power industry. Based upon recently published articles, we expect to see the power market begin to stabilize in the new year but the near term pace of recovery is as yet uncertain.

A bright spot for demand in our industrial sensors was in fact for the automation markets and particularly in the second half of the year. Our industrial sensors help enable predictive maintenance and process control that is increasingly critical to product quality, productivity, safety and liability of advanced manufacturing systems. We expect this growth to continue for many years to come.

Netting out all these factors, we expect our industrial sensor sales to continue its recent growth momentum as we move through fiscal 2018 and further strengthen with a rebound in the energy segment in future years.

Finally, our fourth sector for sensors comprising our turnkey nondestructive mobile testing, calibration and sound measurement systems, which we broadly refer to as sensor systems, grew slowly in fiscal 2017 driven largely by order timing, but is expected to deliver solid growth in fiscal 2018. This growth is tied in part to commercial space systems and defense related testing as well as economic strength in China and elsewhere in the emerging markets.

So looking altogether at the four sensors sectors that we serve, we are pleased with our market position and believe it will allow us to capitalize on the increasing demand we see from our customers worldwide. We look forward to a year in which we anticipate delivering double-digit organic growth in this exciting global marketplace for industrial sensors.

From a full company perspective, in short as we look ahead we believe we're positioned well globally across both of our business units and anticipating a continued strengthening of our core markets with the added positive impact of increased U.S. Military and aerospace exposure.

That concludes my comments about our global markets and now I'd like to turn the call over to our CFO, Brian Ross, to further discuss our financial results and our outlook. Brian?

Brian Ross: Thank you, Jeff. My remarks today will briefly summarize our results for the fourth quarter of fiscal year 2017 as well as recap key results for the full year. In addition, I will provide financial guidance for fiscal year 2018.

Let's begin with the total company Q4 performance. We are pleased with our fourth quarter fiscal 2017 results noting record quarterly orders for the company led by test orders of $153 million. Total company revenue was $201.5 million which continued the second half revenue performance of fiscal 2017 that was expected. Gross margin of 36.9% for consolidated MTS improved 1.7 percentage points quarter-over-quarter as a result of the decrease in acquisition inventory expenses and acquisition related expenses as well as from the increase in proportion of higher margin sensors revenue in the overall MTS mix. The decline in test revenue and restructuring expenses from actions taken during the quarter partially offset the increase.

Moving on to operating expenses, consolidated operating expenses of $62 million for the quarter were unchanged compared to fiscal 2016 results. The decrease in acquisition integration expenses from fiscal year 2016 to fiscal year 2017 was offset by increased legal and professional fees and higher spending for marketing and selling. Going forward we expect operating expenses to be in the range of 30% to 32% of revenue excluding restructuring charges.

These spending levels include investments to drive product and service revenue growth that will start to be realized in the latter part of fiscal 2018 as well as investments in our test business for systems and process improvements that will generate efficiencies and lower operating costs in the future.

My next comments will address interest expense. For the quarter net interest expense of $8.4 million came in as expected and was $700,000 higher than the prior consecutive quarter due to an additional $1.7 million of debt re-pricing expense incurred in the fourth quarter. This increase in expense was partially offset by savings from the lower interest rate that took effect in July 2017 and lower interest expense as debt levels have declined from the prior year. Our forecast for quarterly net interest expense of approximately $6 million to $7 million per quarter in fiscal year 2018 remains unchanged from our last update.

Now let's move on to income taxes. In the fourth quarter our tax rate includes additional U.S. R&D tax credits and a more favorable geographic mix of earnings. The combination of these factors resulted in reporting a negative actual tax rate of 33% for the fourth quarter. I will provide more guidance on our expected effective tax rate for fiscal 2018 later.

The next item that I'm going to discuss is earnings per share. On a GAAP basis earnings per share was $0.29 which is unchanged from our comparable prior year results. The consistent EPS amount is due to lower test revenue and an increase in restructuring expenses offset by the non-recurrence of acquisition inventory step up expense and acquisition related expenses incurred in the prior year. In addition, 2017 results benefited from a decrease in acquisition integration expenses and the previously discussed negative tax rate.

Non-GAAP adjusted EPS was $0.44 per share for the quarter. A reconciliation of non-GAAP earnings per share to GAAP earnings per share is included in our earnings release which is available on the company's Web site and the SEC's Web site.

Now I will discuss revenue and gross margin for each of our business segments starting with sensors. Sensors revenue was a record $77 million for the quarter an increase of $8 million or 12% from the prior year comparable quarter. This increase was driven by higher demand across the industrial markets as Jeff described previously and initial shipments for the Department of

Defense program. We are pleased to see the solid growth in revenue from our PCB acquisition in addition to our historical positional sensors business which generated our fourth consecutive quarter of growth under the new integrated sensor leadership team.

Test revenue was $125 million for the quarter a decrease of 15% primarily due to record revenue in fiscal 2016 that was driven by improved manufacturing efficiencies and high production output to reduce backlog in order to achieve customer commitments. In addition the decline in revenue was the direct effect by many customers delaying investment decisions in late 2016 and early 2017 waiting until the second half of 2017 to finalize their commitments. Test backlog ended the quarter at $312 million driven by the strong order rates in the second half of fiscal 2017.

Moving on to gross profit and gross margin by business segments, sensors gross profit was $38 million a 48% increase from the prior year and was consistent with the growth in sensors revenue. Our sensors business generated a gross margin of 49.3% and is expected to generate gross margins in the future of 50% or higher as volume continues to grow and operational efficiencies are realized.

Gross profit for our test business was $37 million or 29.3% of revenue including $2.4 million of one-time expenses related to restructuring actions taken during the quarter. Gross profit was below the prior year by $14 million due to lower revenue and higher one-time expenses. Looking ahead to fiscal year 2018 test gross margins are forecasted to be in the 33% to 36% range driven by sequential rise in quarterly volumes throughout fiscal 2018.

Moving on to review our total company cash position and balance sheet items, our cash balance increased by $7 million in the quarter to end the fiscal year at $109 million with approximately 70% of the total being held by foreign affiliates.

Operating cash flow for the quarter and full year was $19 million and $72 million respectively primarily due to net income levels, depreciation and amortization expense and stock compensation expense. Other cash flow highlights for this quarter include dividend payments of $5 million, capital expenditures of $5 million and $3.5 million of payments on our term loan intangible equity unit debt.

Disciplined working capital management kept our average working capital as a percent of revenue to under 25% for fiscal 2017 which contributed a $11 million to our annual operating cash flow. Under the provisions of our credit agreement, we expect that during the first quarter of fiscal 2018 we will make an excess cash flow debt payment on our term loan for fiscal year 2017 of approximately $18 million.

Next I'll provide a brief summary of our results for the full year fiscal 2017. We finished the fiscal year with record revenue of $788 million and diluted EPS of $1.31 exceeding our previous range estimates. These results were primarily driven by higher than expected Test revenue due to continued improvements in manufacturing efficiencies and accelerated backlog conversion. Along with a more favorable geographic earnings mix we were also able to identify additional credits within our tax structure which resulted in lower tax rate than expected.

For the full year revenue increased by 21% predominantly due to the PCB acquisition which contributed 20% growth along with 2% growth in our legacy sensors business. Test partially offset the revenue growth by 1% as a result of reduced opening backlog and orders that were weighted toward the second half of fiscal 2017. Gross margin of 34.8% exceeded the prior year rate by 280 basis points primarily due to the increase in proportion of higher margin sensors business to the overall mix and effective process improvements around project management in our Test business.

Restructuring and integration expenses negatively impacted the rate by 40 basis points. Operating expenses as a percent of revenue were 31.4% including the China investigation, onetime integration of restructuring expenses. Excluding these charges in both years as well as the prior year acquisition related expenses, operating expenses were 29.7% of revenue compared to 27.1% in fiscal 2016. Incremental spending included higher engineering and product development expenses driven by customer and market requirements and increase in professional and legal fees and higher compensation expenses.

Our effective tax rate was negative 9% for the full fiscal year primarily due to benefits from discrete tax credits earned in the prior fiscal years. These credits include domestic manufacturing, deductible PCB acquisition related expenses and the U.S. R&D tax credit. Our effective tax rate would have been 3% without the benefit of these discrete tax items and is lower than the prior year rate due to a decrease in income before taxes and a more favorable geographic mix of earnings.

In summary we achieved new record levels for total company revenue. We exited the year with record quarterly Test orders and record annual sensors revenue. We strengthened our total company gross margins by 2.8 percentage points and we generated solid operating cash flows. In addition we hit a momentous 40-year continuous mark of paying dividends to our shareholders. Important to note is that we have never reduced the dividend payout and we will continue to focus on providing shareholders with return on their investment.

Now I'd like to provide our fiscal year 2018 guidance ranges. We expect full year revenue for fiscal 2018 to be in the range of $780 million to $820 million with our GAAP diluted earnings per share to be in the range of $2.05 to $2.30 per share for the fiscal year. I will provide more detail on these estimates in a moment. We are also forecasting our non-GAAP adjusted EBITDA to be between $120 million and $140 million.

We calculate EBITDA by adding back interest, taxes, depreciation and amortization expense to net income. Adjusted EBITDA is calculated by adding back stock based compensation and restructuring expenses to EBITDA. A reconciliation of the range for these non-GAAP measures to net income the closest GAAP measure is included in Exhibit E of our earnings release which is available on our Web site and SECs Web site. Our revenue guidance is a continuation of the similar themes that have been driving the performance of our Test business over the last 18 months and our sensors business over the last two quarters.

First Test backlog was driven down over the first six months of fiscal year 2017 as strong revenue generation exceeded order closures by $27 million, primarily due to customers delaying their finalization of their investment allocations. Order levels for the Test business rebounded in the last six months of fiscal 2017 and backlog began to gain momentum in the fourth quarter of fiscal 2017 reaching just over $310 million on record setting orders of $153 million for the Test business in the fourth quarter of fiscal 2017.

Against the backdrop of higher revenue in the first half of 2017 compared to the last half of the year, the time lag in closing fiscal 2017 orders and the conversion cycle of backlog, we expect Test revenue generation to be much stronger in the last half of fiscal 2018 compared to the first half of next year. For the full year fiscal 2018 Test revenue will be flat to slightly down compared to fiscal 2017.

Moving on to sensors, the rising demand for our sensors products that started in the third quarter of fiscal 2017 is expected to continue throughout fiscal 2018 with strong growth primarily from our industrial, aerospace and defense markets. We are confident that our technology and the new products being introduced are aligned with customer requirements and will generate sales momentum that underlies these markets. In addition, now that the substantial efforts to integrate our organic sensors business with PCB are largely behind us we are confident that our sensors business has the resources and structure in place to focus further on driving strong low double-digit revenue growth in fiscal 2018.

With regard to earnings per share our GAAP EPS guidance of $2.05 to $2.30 per share is mainly the result of growth in sensors revenue offsetting lower test revenue. This will generate a favorable mix in gross margin and EBIT margin due to an increase in the proportion of higher margin sensors revenue, also GAAP EPS will improve compared to fiscal 2017 from the non-reoccurrence of China investigation expenses which were approximately $9 million or $0.35 of EPS and acquisition related expenses of $11 million or $0.41 EPS.

We consider adjusted EBITDA which is a non-GAAP measure to be an important measure for our company over the last two fiscal years as a result of the acquisition of PCB for which we incurred significant acquisition related integration costs. For fiscal 2018 adjusted EBITDA will more closely align with non-adjusted EBITDA except that we expect to incur restructuring expenses in the range of $1 million to $3 million or approximately $0.04 to $0.12 of EPS due to actions already initiated in fiscal 2017. These actions will provide an improved operating structure and efficiencies in the business going forward.

For fiscal 2018 we expect to have an effective tax rate of approximately 21% to 25% of earnings which does not reflect any pending tax reform that may be enacted during fiscal 2018. We ended the current fiscal year at 3.9 times leverage and we'll continue to focus on the leverage in the company in fiscal 2018 with our continued ability to generate strong cash flows along with our re-pricing of our term loan B in July 2017 which will save approximately $4 million in cash and interest expense for fiscal 2018 we expect that we will de-lever more quickly going forward and expect to be at a leverage ratio only slightly above three times at the end of fiscal 2018.

This concludes my remarks for today. I will now turn the call back to Jeff for his comments. Thank you.

Jeff Graves: Thanks Brian. So I'd like to conclude our earnings call with a few comments on fiscal 2017 and our direction for fiscal ’18. Fiscal year 2017 got off to a tough start because of our investigation into a violation of our own code of conduct by the leaders of our China Test business which delayed the filing of our financial results for several months. Despite the noise this caused internally in the first half of the year, the employees of MTS maintain their focus both on the complex integration of PCB and are delivering value to our customers in a manner consistent with our 50-year commitment to them.

As a result of these efforts and with strengthening markets we are very proud to bring these tasks to a successful conclusion and report strong sales performance in the second half of the year. With increasing backlog, improving margins, solid operating cash flows and a strengthening balance sheet we face the New Year with confidence and optimism believing our company and our customer base have never been better.

We're going into fiscal ‘18 a much stronger company with both our Test and sensors businesses well position from the perspective of technology leadership, customer service driven mindset and global capabilities to meet the rapidly emerging trends that are occurring on both the regional and global basis across the markets we serve. In addition, given the strengthening fundamentals in our markets we're continuing to invest in our businesses during fiscal ’18 to ensure that we have the infrastructure and processes in place to improve our efficiencies and to deliver on our customer commitments.

The strategic alignment between the MTS business model and the fundamental demand profile of our markets gives us the confidence that our long term ambitions and goals are attainable. As we look to the future we're truly excited about the value it will bring to our customers, our employees and our shareholders as we execute on our plans.

That concludes our prepared remarks and Kathy I'll turn the call back to you for the Q&A session.

Operator: Thank you. If you would like to ask a question, please signal by pressing Star 1 on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press Star 1 to ask a question. And we'll take our first question from John Franzreb with Sidoti and Company.

John Franzreb: Good morning Jeff and Brian and I'm sure you are glad fiscal 2017 is over.

Jeff Graves: Good morning John.

Brian Ross: Good morning John.

John Franzreb: I actually want to start with the service side of the business. Revenue in the quarter is kind of flat year-over-year. I'm wondering your thoughts about where you are in the progression of that business, you talked about the growth trajectory in the past, you also talked about being able to leverage into PCB what are your thoughts on how that business progresses in 2018?

Jeff Graves: Yes, John so actually as far as the service business where we're well positioned in that. As you know we've been adding field service engineers to help cultivate revenue growth in that and it takes some time to actually train those engineers and now we're deploying those out there to help with our growth. In addition the sensors business also has some calibration revenues that's out there that will also feed for some additional growth. So I think that we're well positioned for that.

Brian Ross: And I think John, if you look at the numbers and I'm not sure how much time you've had with them yet, but we were up about 10% in revenue year-over-year and there is a contribution from PCB starting to evolve in that too. But I would tell you in general John, our service business is terrific. It's going to continue growing we believe and the high single to low double-digit range over the next several years. Our customers continue to really value that and want to provide more business in that vein and we're very excited about it.

In the developed markets in the U.S. and Western Europe it's driven as much by a cost from a cost and efficiency perspective and our customers and they want to take over some of that business in the developing markets interestingly it's viewed not only in the vein of maintaining the sophisticated equipment but also helping them with coming up the curve on testing itself. So the value proposition in the U.S. and Western Europe is a bit different than China and India but in both cases it is strong and we would expect to continue saying right at double-digit growth in that service sector going forward.

John Franzreb: Okay, alright if that's the case then does that kind of suggest that the hole you've dug yourself in Test equipment will be such that test hardware will be down in 2018 versus 2017?

Jeff Graves: Yes, John I'd probably use different words than that, but based on the order timing, not surprising, but based on the order profile back in late ’16 and early ‘17 the backlog was depleted quite a lot, so we're in the process now with order strengthening and record orders in Q4, we see our backlog beginning to tick up nicely. It's just timing of revenue flow through from an equipment standpoint. Obviously the service business turns faster than that, so service revenue will come faster.

So I view you know equipment is kind of going through a reset of backlog right now and a buildup of backlog. That will flow through into revenue much more substantially in the second half of 2018 than the first half. So yes in a full year perspective you can say service will grow better than equipment in 2018 but a lot of that is a timing issue based on backlog turning.

John Franzreb: Okay, and in the commentary it's sounded like the aerospace business not only was impacting the structures side of tests but also some of the sensor sales, is that the business that's kind of holding back the most or I'm I just speaking into it too much?

Jeff Graves: Yes, John aero has never been a huge business for us. It's been in the traditional test business it was about 10% of revenue, but yes it was certainly soft in the year and it's simply because there weren't a lot of new aircraft platforms that were going into the Test cycle in '17. We do expect that to rebound a bit in '18 and for different reasons, so there's going to be more military testing, there is going to be life extension programs on old aircraft and what you're going to increasingly see our new aircraft being designed in China for the commercial markets and elsewhere that they're going to be buying Testing equipment for, so I love our aerospace franchise.

It's a little small and lumpy but it's a great, great business for us and I would expect we'll see an upturn, not a tremendous upturn but an upturn in 2018 driven by those two factors, aging aircraft in the western world, life extension if you will, a little bit of military and then some of the emerging market new platforms especially in China.

John Franzreb: Got it. All right, thanks for taking my questions guys. I'll get back in the queue.

Jeff Graves: Thank you, John.

Operator: If you find your question has been answered, you may remove yourself from the queue by pressing star followed by 2. We'll now take our next question from Rich Kwas with Wells Fargo Securities.

Deepa Raghavan: Good morning. This is Deepa Raghavan for Rich Kwas. A question on PCB, you mentioned much of the heavy lifting is done but could you update us on cost synergy achievements there with PCB and any color on what kind of revenue synergies you would expect in 2018?

Jeff Graves: See, so let me talk a little bit about what we accomplished in 2017 and then we'll come back to the longer term numbers and I'll let Brian comment on those which we've had out there for a while we still feel good about. So if you look back on 2017 obviously converting a 50-year old private family run company into a public company was a lot of work, so there was a lot of infrastructure work to do there to implement stocks controls and bring them into our corporate structure.

And also integrate our historic sensor business into PCB itself. So those were fully basically fully accomplished in 2017 including the closing of one of our operations in Asia and redistributing volume back into the U.S. and a little bit in Europe. So those activities were done they met all of our internal objectives and goals in terms of cost savings and creating the right control environment.

We don't put out annual numbers in terms of goals. I would tell you the revenue synergies obviously we're not counting on a lot of those early on it takes a lot of work to get everybody on the same CRM platform and really driving the leads into real sales so those are a bit backend loaded in the out years. But certainly from a cost synergy standpoint we met or exceeded our year one goals and I'll come back and remind you of the long term goals we've set up here publicly, Brian I wanted to recap those numbers.

Brian Ross: Right, so we still believe we will achieve the $20 to $28 million of annual revenue synergies in the long term in the four to five year period as well as cost synergies and $5 million to $7 million annually which we've already as Jeff stated we've already seen the benefit of some of those synergies over the last 18 months.

Jeff Graves: And just to finish I would tell you the customer reception to the combination of PCB and MTS was absolutely outstanding around the world, so weather was automotive testing, aircraft testing, the industrial sectors, heavy equipment upgrading with smart systems, customer reception of the combination of a company's was outstanding. The fact that we can serve customers globally now across both of our business units is a tremendous competitive advantage and we have we have a real scale.

So we feel great about the rationale for the acquisition originally. The state of the of our integration which again is largely complete and our ability now to focus on driving sales and driving it through operational efficiencies.

Deepa Raghavan: That’s great, that’s very helpful. Thanks. Could you talk about mix of test orders, custom projects versus maybe standard projects and what impact it could have on your second half margins?

Jeff Graves: Yes, so I’ll comment and then Brian you can supplement with anything else you would like. So what we’ve been – we’ve certainly if you look back over the last few years, our test markets have been changing dramatically because of their customer demand.

So if you look at just take the vehicles market because it’s the easiest one to talk about this shift from gasoline powered engines into first hybrid electric systems and now electric and more autonomous vehicles has created the need for some very unique testing equipment in the world.

So we've been challenged as the leader in doing custom testing equipment to produce that for our long-term customers and again we've been with these customers for half a century in many, many cases.

So we met their needs to our best capabilities in custom content what we're looking forward to now is turning a lot of that custom first of a kind equipment into repetitive more engineered order and standard products if you will over the next several years as that new level of testing technology really takes root in the industry.

Our model of business is we do these first of a kind custom projects, we do them at a fixed price nominally and we own the IP out of the project in order to be able to proliferate that new testing technology around the world.

So we've paid the price for the last few years to support our customers and deliver their custom equipment and we see that turning into more standard products over the next few years. So I think the - while I don't expect a huge drop in custom orders in the foreseeable future either the super challenging first of a kind subset of those, I think will diminish and we'll see much more standardization of the equipment which generally for us carries not only simplified execution but higher margins in executing. So I think we're certainly over the hump in terms of really, really challenging custom equipment and we'll see that getting a bit easier going forward from here. Brian, do you have anything else to add?

Brian Ross: Yes I think as Jeff stated the focus around as growing our standard product revenue which does have a higher margin and working on process efficiencies, manufacturing efficiencies in our custom product line and are embedded in our guidance shows an increase of gross margins for the year which is inherent with that.

Deepa Raghavan: Okay. All right. Last question on guidance. So the primary reason EBITDA is driven higher is your sensors mix in margins, is there anything else to that or that’s predominantly the reason EBITDA is just pretty strong that's why don’t expect revenues?

Brian Ross: Yes so we're certainly we're going to get some help from the overall business mix, sensors will be growing at what we said were double-digit type rates going forward and they do carry a higher EBITDA margin with them.

So we'll get a business mix effect, we'll also get general efficiencies in both businesses as we get volume flow through and based on some of the investments we're making although in tests that it will certainly be more backend loaded in the year. So as we see revenue flow through more strongly in the second half of 2018 in test, we have volume benefits and we'll start seeing the benefit in efficiencies for some of our investments then as we move into 2019 as well.

So there's an overall business mix which is the predominant effect in fiscal '18 and then there is efficiency flow-throughs with volume across both businesses as they grow.

Deepa Raghavan: Got it. Thank you very much.

Jeff Graves: Anything else, Brian?

Brian Ross: Okay. Thank you.

Operator: We'll now take our next question from Paul Coster with J.P. Morgan.

Paul Chang: Hi, this is Paul Chang on for Coster. Thanks for taking my questions, so just following up on your test comparison outlook which is up from last year. Given the customer mix, do you expect similar conversion rates throughout the year?

Jeff Graves: Similar conversion rates…

Paul Chang: Of your backlog?

Jeff Graves: You mean the rate at which we term backlog?

Paul Chang: Yes.

Jeff Graves: Yes I would assume, so Brian it's probably better than our assumptions is we're getting, we got I would tell you we got dramatically better term backlog in late 2016, early 2017 was part of the reason with orders decline was part of the reason backlog was down.

I expect now there will still be incremental improvements, we've seen a lot of improvement in the past but our big push now is better integration with our suppliers and being able to drive efficiencies predominantly and a little bit higher turn rate out of backlog in test as well.

Paul Chang: Okay, thanks for that. And then I know you spoke about backend weighted test revenues but how should we think about the seasonality of test orders throughout the year, do you expect similar pattern through last year and should we expect a sequential drop in orders in Q1 similar to previous years and you had a big ramp in 4Q as well? Thank you.

Jeff Graves: Yes I think for the reason you just mentioned yes it's a reasonable assumption. I mean we're – we always drive hard and try to be optimistic but in reality we had a record Q4, we do historically have a bit of a seasonal effect here in Q1, so I wouldn't be surprised to see that continue, it's a little, it's always a little unpredictable with big projects depending on what customers really want to do.

Most of them financially are strong and they have an ability to place orders but if you go on history yes you'd see you would expect the kind of profile that you just laid out.

Paul Chang: Okay. And then can you confirm the PCB's contribution in the quarter?

Jeff Graves: As far as the contribution the PCB is considered an overall MTS sensors business now, so we haven't historically broken out the PCB contribution in total nor do we look at that fashion anymore, it's completely integrated now. So you have to just look at the overall sensor business and the overall test business now going forward?

Paul Chang: Okay. And then my last question is on margins, so your guidance is calling for close to 100 basis point increase year-on-year, so how should we think about the longer path towards EBITDA target of 22% to 24%? Should we expect some gradual improvements in the out years or maybe accelerating margins given PCB is fully integrated? Thank you.

Jeff Graves: Thanks Paul. So for overall for the company just with the mix of higher gross margin and EBITDA margin business from sensors, you're going to see more immediate effect of overall gross margins and EBITDA margins increasing for all of MTS. As far as individually within the businesses, I think the sensors business will maintain a consistent and slowly improving gross margin and EBITDA margin. The test business will be slightly slower but still on a continued path for margin improvement on both sides.

Paul Chang: I appreciate it, thank you.

Operator: As a reminder, if you'd like to ask a question, please press Star 1. We’ll now take our next question from Liam Burke with B. Riley FBR.

Liam Burke: Thank you. Good morning, Jeff. Good morning, Brian.

Jeff Graves: Good morning, Liam.

Brian Ross: Good morning, Liam.

Liam Burke: Jeff, typically the legacy MTS systems, MTS sensor business in China didn’t have much of a foothold, you’re seeing growth there on the sensor side, is that primarily PCB or are you getting some additional pickup in legacy MTS sensor side?

Jeff Graves: Yes, Liam it's a very insightful question. If you look at the - I don't know the last half a decade here, where we had penetration and it was relatively small to your point in China it was in the basic materials industry so it was Chinese steel primarily and other ferrous and non-ferrous metals. So we have some sensors in those applications, those certainly went into the doldrums for a few years and we worked hard in those few years Liam to get into new markets in China that were related to mobile hydraulics and, that again is the main use for those is in heavy construction equipment.

So earth moving, mining other heavy construction equipment road building all of that, so what you're seeing now in the last 12 months is the basic materials industries that we were in historically while the small have really come back in China and on top of that you've got this mobile hydraulics growth now which is fantastic. So we just I think we mentioned either in the script or the earnings release that we landed our first mobile hydraulics heavy construction customer this past quarter which was great.

We've been working at that as a design and it takes about three years and so that was really good and I would also tell you the reception of the PCB sensors into the test market which was one of the premises for combining the companies was excellent. So, Chinese customers are very receptive to PCB sensors coming in there. PCB was obviously a much smaller company had a lower Chinese exposure. We've been able to have our sales teams all work together now to get them into the Test Labs in China so the rest start to get a little traction that will take some time but it's really exciting growth.

So you really see it across the sensors portfolio we have right now and China had I think a record year for us since sensors and we expect that to continue growing it's an excellent market for us.

Liam Burke: Thanks Jeff and Brian you highlighted the amount of cash that you had that was held overseas if you look into ‘18 do you expect the same proportion of cash flow to be between North America and then the rest of the world and how does that fit into your plans to repay debt.

Brian Ross: So our as far as international cash it remains fairly consistent over the past few years that are roughly that 70% ratio and barring any changes in repatriation tax changes, we expect as of today that same going forward I guess as far as paying down our debt we’ll experience more leverage in the U.S. in cash generation which will help pay down more quickly.

Jeff Graves: Hey Liam, if you could call your local congressman and senator and help us with this repatriation changes it would be helpful.

Liam Burke: Yes, I live in the District of Columbia, I can’t be of much help to you there. Thank you. That’s it.

Jeff Graves: Thanks Liam.

Operator: Once again, if you would like to ask a question, please press Star 1. And we'll pause for a moment to allow everyone an opportunity to signal. It appears there are no further questions at this time. Mr. Jeff Graves, I’d like to turn the conference back to you for any additional or closing remarks.

Jeff Graves: Thanks Kathy. So thank you all for participating in the call today. I know it's early but let wish everyone a very Merry Christmas and a happy holiday season. We look forward to updating you on our progress again next quarter and early in Calendar 2018. Thanks and have a great day.

Operator: That concludes today's conference. Thank you for your participation. You may now disconnect.