

Company Name: MTS Systems Corporation (MTSC)
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<<Ken Cooper, President & Managing Director at Four Hills Advisors LLC>>

Good morning. My name is Ken Cooper. I'm with Four Hills Advisors and one of the partners of the investment conference. Today, we have our first presentation company, MTS Systems Corporation. MTS is a global supplier of test systems and position sensors based here in Eden Prairie, Minnesota. We are honored and privileged to have their CFO, Jeff Oldenkamp, as well as their CEO, Dr. Jeffrey Graves.

And with that, I will turn it over to Dr. Graves.

<<Jeffrey A. Graves, President, Chief Executive Officer & Director>>

Great, thank you. And thank you all for coming out this morning. I'm going to hit a few high points for the Company. By the way, our investor presentation will be on our website as well. So, I will hit the high points today while I'm with you and leave some time for at least a few questions as we go. MTS has been around 50 years. Actually, 50 years next month is our birthday. We were founded here in Minneapolis as an engineering firm focused on testing systems. Is the mic okay? Yes, I think it's working okay. Everybody okay? I will speak up. Hear okay in the back? Okay.

So, we were founded as a Company – as a spinoff Company from a materials research organization that was founded based on the development of materials testing systems. And we expanded over that time, over the last 50 years, into various markets around the world that I will touch on today. And we expanded into sensors; sensors that are consumed in our own equipment and then sold externally as well.

So, we are by strict definition a test and measurement Company. So, if you look at what category to put us in, we are a test and measurement Company with some people lump into the industrial space and some lump into the technology space. We really sit in a niche in between those. We are a very technology and engineering-driven organization. And, importantly, if you remember one thing out of this presentation, our revenue stream, our sales, are driven by OEM spending on R&D. Okay.

So, our equipments, our testing machines, the services we provide to those machines and the sensors that we sell are largely driven off of how much OEMs are spending on new product development. So, if you open a newspaper today and you read about autonomous vehicles, you read about fuel efficiency standards going up, you read about new safety standards coming on, all of those kind of trends, you read about composite materials enabling aircraft to fly higher and faster and longer distances and burn less fuel while they do it, all of those technology trends require investment in new product development

by our customers and that in turn requires investment in testing equipment and sensors to enable those products to hit the market faster and more reliably each year.

So, it's a major difference between MTS and most other companies either in the industrial or technology space. We are driven off R&D spending in the world, okay, which – and the reason I point that out and make a big deal about it is we get a lot of questions around what happens if another recession comes because we have a record backlog – don't you hate that when you come in and draw all the attention to yourself?

We get a lot of questions where we have a record backlog and we have an enormous amount of opportunity for growth ahead of us. We get a lot of questions. Well, we have automotive exposure, we have aircraft exposure, doesn't that imply some risk going forward? Yes, it always does. But that risk is tied strongly to R&D spending in the world, which is much, much more stable than spending on factory capital and other spending in the world, spending by consumers because – and why, very simply, is our customers have to position themselves to sell more products in Asia.

They have to position themselves to address these regulatory issues coming up, and changing technologies like autonomy in cars is a great example. So, that requires them to spend R&D money. No matter how many cars or airplanes they're selling, they have to maintain that R&D spending. And in fact, I've got a chart later on that will that I'll show you that shows the stability of that, okay.

So, we are a test and measurement company by definition. We operate in two business units and not in this very intuitive; we call one test and we call one sensors, okay. They are highly related to one another. We operate, though, in those two business segments. By revenue, those segments are shown on the bottom right-hand part of this curve. Just over 60% of the revenue is derived from our test business, and almost 40% now is derived from our sensor business. But, importantly, if you shift to the bottom right-hand chart, in terms of EBIT and EBITDA, those divisions are roughly equivalent, okay.

So, what that tells you in simple math is sensor business is an even more profitable business than our testing systems, okay. So, the revenue streams are closely related; the profitability is a bit different. One helps enable the other, and we end up with a nicely balanced Company in the end, okay.

So, what drives our business? It is really the quest for precision, safety, reliability of new vehicles systems, cars, planes, trains in the world and a desire to get those to market faster than ever. If you go back a decade or more, cars or new-car – significant new-car developments were happening about every seven to 10 years. Then it went to three years, and our equipment was part of enabling that.

And now they want to drive it even further down. It requires more exotic testing, thank goodness. It requires better integration with simulation and modeling, which is -- we're very good at. So this whole drive for shorter cycle times and higher- performing products are very, very good for our business. We do worse in a stagnant world. So, if regulations

weren't going up, if autonomy wasn't coming on if composite materials weren't happening it would be bad for our business. The opposite is

The opposite is actually occurring. These technologies are moving faster than ever, and they want to get them to market faster than ever. In fact, if you look at the move into autonomous vehicles, it is outstripping the pace of regulatory changes. So, while insurance companies are struggling to say how do we insure these new cars that are driving themselves in a few years – I don't know if you saw the Ford announcement last year – last week. The completely autonomous vehicle won't have a steering wheel, blah blah blah; Mark Fields was talking about it. The insurance companies don't know how to deal with that today.

How are they going to insure that car? And for those of you who may own a Tesla, you have probably had a very interesting discussion with your insurance company on what to do with this car from an insurance standpoint because it has an autonomous feature. They really don't know how to handle that yet. So, for the first time in our nation's history, the pace of technology getting on the highways and flying in the sky is really starting to outstrip the regulatory environment. It leaves the testing world in real quandary for the OEMs. How do you test against things that aren't established yet? So, we are out there in front doing a lot of new development work on systems and concepts to help them test for things they have never tested before to prove that these vehicles work.

Why did customers buy from us? If you look at why are folks excited about the Company, why do people buy from us, quite frankly, we have the best customer base in the world for our industry. So if you name any automotive OEM, we do a significant amount of business with them. And it's a testament to the founders of this Company, seven years after its creation when we were doing about \$7 million of revenue, this little Minnesota-based US Company opened an office in Berlin and in Tokyo in order to address the emerging German economy and Japanese economy. And because of that today, we have a tremendous German automotive customer base.

For example, we do a nice business with Airbus, as an example. Obviously, all the American companies – GM, Ford, Boeing, others in America – and we do a tremendous business now in Asia. We grew from Japan into Korea, which is a very nice customer base now, and increasingly China. So you'll see our global map coming up shortly, and it's really a testament to the founders of the Company and the technology that we have invested in for 50 years to keep us out in front of those markets, and we do it largely out of the state of Minnesota.

So we are very proud of that. Because of our installed base of equipment, we have a tremendous aftermarket opportunity, which the Company really hasn't exploited until the last few years. We have an installed base today of over \$4.5 billion of equipment running, and our customers spend \$1 billion a year keeping those machines running. It's not money they are happy about spending, but they have to keep the equipment running because most of the equipment they are using of ours is running 50 weeks a year seven days a week, often multiple shifts because it's testing new products.

So, we are moving increasingly into servicing that equipment, spare parts, software upgrades or even routine maintenance. So you'll see our services backlog growing and our revenue stream growing today. We will do over \$80 million in revenue out of that business, and it's a \$1 billion addressable market for us, so we're excited about that. It's growing strong double digits today.

Then finally, sensors. We have had a sensor business for over 35 years measuring position. We recently completed an acquisition with a lovely company called PCB based out of Buffalo, New York, that is about twice the size of our sensor business. We consume those sensors in our testing machines. But the big opportunity for those sensors is selling into our ROE and customer base because these sensors measure not only position, but vibration, acceleration, even noise in new vehicle development, which is a big deal. If you know from driving your own car, a very big deal.

Their technology is very vertically integrated, very proprietary, and they build a lovely customer base around the world. We can help them move into our OEM customer base, which is the basic rationale for the acquisition. So, we are very excited about our growing sensor portfolio, very profitable business, very strong growing, very cash-generating. This chart – I apologize for the gray tones not showing up. It's actually a map of the world if you can envision three continents here. You've got Americas, Europe and China.

The important thing are the numbers. If you look at our revenue distribution today, 37% out of the Americas, largely U.S.; 25% out of Europe, largely Western Europe today; and 38% out of Asia. We are very proud of that number. That's Japan; that's Korea; that's increasingly China, which is over 20% of our revenue today. And why? Because you see it, and you saw it in the Olympics as well. China is trying to become – very hard trying to become a superpower. And what do most superpowers have? They have a domestic automotive industry and they have a domestic aircraft industry. That's what they have.

Well, how does China get there today? Well, they started decades ago learning how to build cars from General Motors and Daimler and other – many others. Now they are putting in their own laboratories and they are staffing those laboratories with our equipment, and they are putting our sensors on those development vehicles because they want to have a domestic automotive industry. They are determined to do that. So, that number has been growing very nicely for us in spite of the fits and starts in the Chinese economy.

So I will talk just a little bit more about the segments, and I will go through this pretty quickly because I've mentioned a lot of it. So again, we operate in two basic segments. Test, which includes ground vehicles – that is predominately cars. And remember, it's selling equipment into automotive R&D labs, okay, product development laboratories. It is advanced material testing systems, which is what the Company was founded on. So those are smaller machines that sell for hundreds of thousands of dollars versus our vehicle testing systems that often go for millions. Those machines test advanced materials, so new aluminums, new titaniums, and increasingly new carbon fiber

composite materials; great business for us. As the world shifts to composite technology for aircraft and cars, we are right there with the machines to test these materials.

And then services, I mentioned; servicing our equipment in the field is step one. We've got a lot of growth in the next five years in taking care of our own stuff. And then we will move beyond that.

In terms of sensors, we now offer position sensor measurement systems. We sell into the test space. We also sell those same sensors into industrial manufacturing equipment, so things like robotic systems. Anything else that moves in a factory, we can put sensors on it to measure the position and how fast it's moving for either maintenance or precision and manufacturing. So, while the industrial economy has been in the doldrums a little bit, that business is a lovely business as the GDP in the world ticks up again. So, it's been running kind of light. As that ticks up, we are very excited about that. The test marketplaces remain very strong.

And then finally, an area of sensors we call systems. We actually make now fully contained systems to measure noise. For example, that you can deploy around an airport. Most communities now have noise restrictions around airports, times you can fly airplanes and can't fly airplanes. For those you who live in Minneapolis, you see aircraft flying overhead. There's times of day where they can take different flight paths and fly different altitudes. They monitor that by noise measurement systems. So, we are now making noise measurement systems based on the microphone technology that PCB brought, and we are also able to do nondestructive testing for quality control in factories. So, this is more of our incubator for new sensory applications and selling into systems.

So, now let me go down a level and talk about test and sensors separately. I'm going to get off my X here, but otherwise I'm going to hurt my neck turning around so much. We have put in place a story of growth for the last few years. And why did we feel confidently about that growth? It's because in the test marketplace, because it's R&D capital spending largely by our customers, we have basically three-year visibility into that stuff, okay. So, we can look out with any automotive OEM and any major research university in the world, aircraft OEM, and we know their plans and their thinking for how much they're going to spend on R&D for the next two years.

Now, we can be wrong. It can change in time. It almost never changes in direction and magnitude, okay. So if they say they're going to spend \$100 million in two years, you can count on them spending \$100 million. Now, will it be two and a half or will it be one and half? That can vary. But we have good visibility into that. So, given that, we've been out talking about growth. And what you've seen in that is basically an uptick in orders and backlog, okay. And if you remember, 2015 – this is absolute numbers. 2015 had a heck of a currency impact. So if you really currency-corrected that, it was stronger growth, as shown on this chart. But we feel very good about opportunities in the future about our backlog position going forward.

Our issue in the last couple of years, and we have been very public about this, is our customers have wanted to buy a lot of custom equipment. We do everything from standard testing equipment – if a customer comes in, very seasoned customer, and says, I know exactly what I want, I want these machines and you sold to me for a long time, we can sell those again. Where we cut our teeth and where the market advances is on custom equipment because we try to target things that will become the new standard.

So just like Apple rolls out a new iPhone, go from the 6 to the 7, they try to raise the standard in the world and charge a premium for it, that is exactly what we do. We try in the testing world. We try to get a new machine out there, set a new standard of excellence for precision and speed and then sell that to everybody in the world. We take those first contracts – those fixed-price contracts. There's a lot of embedded R&D, so margins are lower. We take them purposely in order to own the IP and sell them to all the rest of the OEMs.

That's our business model for a long time. What started happening a couple of years ago was customers came in, especially out of automotive space, and said, I want a lot of custom equipment. I want – I need to do things much, much faster and better than I've ever done before. And we were swamped. And, quite frankly, it took us the better part of the last couple of years to catch up in engineering capacity and planning tools. We were in the middle of an SAP upgrade and things like this. So, it was operationally a real challenge. The good news was it was the very strong orders pipeline with the best customers in the world, and now those are largely moving behind us. We own the IP and we're selling those machines more broadly.

So, we feel very good about that. If you follow us on a quarterly basis, we had a tough second quarter. We were getting ready to ship some very challenging brand-new technology products to some very demanding customers. We shipped those. Those were working down. We had a good Q3, and we feel good about the backlog going forward. So, while we like standard product a lot – that's our objective is to get everything to be a standard product that we can sell – we want to do it, frankly, like Apple does. So, we want to get that new technology out there in the form of a custom machine, migrate it to become a standard product and sell it to everybody. That's how the world – that is how we drive the world to be friendlier for us. So, orders are trailing upward. Revenue is on an uptick now. If you watched our last quarter, it will be more typical of the quarters going forward in terms of revenue generation and turning backlog, so we feel good about that.

We still have challenges. We still are at record levels of volume coming through our test business. And that will continue to be a little bit of a drag on the business for the next year or so, that we feel very good about having some of the more difficult projects behind us and a really nice pipeline of opportunity ahead.

Just very quickly, we divide our test business in the way we think about it in the different markets. Ground vehicles is a tremendous market for us. It is 45% of the test business today, and that's related to the automotive industry, okay. And, again, how many new

products are coming out? We do durability testing equipments, which can simulate 200,000 road miles in one month in a lab. So, you can literally push a button and simulate roads in New York; Minneapolis; Pune, India; Tokyo – any city in the world, you can simulate those roads.

For those of you who have been around the world, you know how varied those roads can be. We can simulate 200,000 road miles to see if the new product design is going to last. And we now can test a lot of the aerodynamic performance of the car, which determines fuel efficiency. So, we are very pleased with those new technologies we've got in the market, and we continue to expand those applications. Materials is the core of the test business, has been for 50 years. This is testing of both composite materials and very high-temperature metals and ceramics now as the jet engine world is moving in that direction. We are very excited about the opportunity both in margin creation. This we put in our standard product category. Some of the best margins in the business and some really nice growth opportunities there.

And civil seismic – this is dramatic. If you go on YouTube and you Google – or you type in MTS and earthquake testing systems, things like this. We build these massive systems to simulate earthquakes for building designers and bridge designers so they can see how well their structure stands up to these. We even demonstrate them over at the state fair. We have a little tent every year to have kids come through and see how these systems work. But they are massive systems that simulate earthquakes and tsunamis. By massive, I mean the area of this room and three stories deep. A system that will move in six dimensions to simulate any earthquake in the world. We program it to actually reproduce any earthquake that is in – that existed in recorded history. So, the customers in Japan, China – increasingly China, and other seismically active areas in the world to see how their buildings will survive in an earthquake.

And then service – it's up to 15% of our test revenue today and growing double digits. If you followed us last quarter, we did \$20 million in revenue last quarter, which was up substantially year-over-year. Jeff, we were up in revenue year-over-year, services...

<<Jeffrey Paul Oldenkamp, Senior Vice President, Chief Financial Officer>>

Yes, 5%, so the quarters was up...

<<Jeffrey A. Graves, President, Chief Executive Officer & Director>>

So, revenue up 5%. Orders were up over 15%. \$27 million in orders; a new record for us. So when a business has been doing \$80 million – we landed \$27 million in orders. So, we feel very – and that won't happen every quarter, but we feel very good about this business delivering double-digit growth rates. And as with most service related businesses, it is some of the best margin we do in the test business. Again, spare parts, software upgrades and other maintenance activities.

Let me shift gears to sensors. How am I doing on time?

<<Ken Cooper, President & Managing Director at Four Hills Advisors LLC>>

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<<Jeffrey A. Graves, President, Chief Executive Officer & Director>>

10 minutes? Okay. I will move through sensors quickly. I have talked about this quite a lot. Sensors today – we've completed acquisition of a company called PCB in July. First day of our new quarter, we closed the deal and brought them into the MTS family. We combined this \$180 million sensor business with our \$100 million business, so today it is \$280 million in revenue roughly on a trailing basis. We believe this business will deliver high single-digit type sustainable organic growth. And why? It's because they sell largely into our test business – into our test customer base, if you will. Not just our testing machines, but into our test customer base.

How does it work? Our customers – if you picture them, if you are any OEM, pick one – GM, Ford, Chrysler. They all do it the same way, basically. They design a car. They all use different tools to design the car, by the way, different suite of tools. But they create a prototype, they put it in our machine for testing and they apply sensors all over the vehicle. It could be an airplane, if we're – same thing. They apply sensors all over the vehicle and they test it. They test it for durability. They test it for aerodynamics. Our sensors will measure the vibration, the acceleration, the position of different things going on in the testing system.

And these sensors, while they have a wonderful lifetime, wonderful is measured in terms of a few years. It's not like our testing machines that last 20 years or 30 years and have a big aftermarket service component. These are largely consumable sensors that our customers consume when they do the testing after a few years. They also require calibration, which gives us another service opportunity in the lab.

So, we are really high on the whole sensor space. These are sensors that are low-volume, high-mix. They sell for typically thousands of dollars apiece. We are not in the dollar-apiece sensors that might go into a toaster or a coffee maker. These are very high-end sensors and sell for thousands of dollars. Very precise, extremely fast-reacting sensors to develop new products, or to go on industrial machines in the market to measure their position – their precision, safety, reliability.

If you look at – I will just compare – if you look at EBITDA margins and you look at gross margins, just to calibrate you, sensors typically were selling for 50% plus gross margin. They're generating EBITDA margins in the 20% to 25% range depending on the exact sensor type. But we're in that low 20% range of EBITDA generation. And this business, like our test business, consumes 2% to 3% of its cash for capital. It's largely a design and assemble business. So we don't – we aren't very capital intensive.

So, our Company in general, we say, is maybe 3% to 4%, typically more like 3% of sales into capital equipment to sustain our organic growth. What that leaves is 97% of our operating cash to be used for servicing our debt, for paying out our dividend, for reducing our debt level. It's free cash flow. In the past, before we carried much debt, we did a lot of share buybacks. Now, obviously, we levered up a bit for this acquisition. We want to delever as quickly as we can, and the remainder of the cash we return to shareholders in the form of dividends. So, we love the business. The two businesses have great synergies together. We feel very good about them.

I've touched on the applications. They go into position measurement for industrial equipment. 34% going to the test market itself. That's a little bit in the testing machines, but a lot to our test customers that are consuming these for prototype testing across automotive, aerospace and other industrial applications. And they are measuring things like pressure levels in engines. We have extended this technology now to measure the combustion environment for engines. Very, very critical to emissions and fuel efficiency. So, we have some of the best pressure sensors now that go into flight engines and other engines that operate on the ground to measure fuel efficiency that – the combustion dynamics that will lead to fuel efficiency and overall performance. And then systems, I mentioned noise calibration and other self-contained systems for deployment.

In terms of industry overview, I will point your eyes to the bottom of this chart. And I apologize for moving quickly here, but, again, this will be up on our website. The bottom chart shows the R&D spending in the world by our customer base from 2005 to 2015. And I would challenge you to find a massive dip during the recession. If you look at this trajectory, it is basically up and to the right. Now, if you limited it to U.S. automotive companies, you would have seen a big dip in the recession.

But, nicely, the U.S. is only 30% of our business – 30% to 40% of our business every year. The remainder of the business goes – or is generated by the Europeans, the Germans, the French and others. It is generated more and more by the Asians who were less affected by this. So, our global diversity and our customer diversity really allows us to tap into this R&D spending on a consistent basis around the world. I love this plot. This is the plot that says we can sustain our growth trajectory that we've talked about in the world. Sensors as well – and you know from everything you read, sensors are going into virtually every product now. We are particularly pleased with them, obviously, in the test market and industrial equipment space.

So I mentioned we have purchased PCB. We closed the deal in early July. We paid \$580 million for the Company. It is \$180 million of what was then a \$500 million business in total. So, it was a big acquisition for us. It makes our sensor and test business very well-balanced. It creates a lot of synergy between the units, and it creates – immediately, it's margin-accretive. And it will be accretive on a cash basis in 2017, on a GAAP EPS basis in 2018, so we're quite pleased with that. Lovely profitability and free cash generating. In terms of growth, sensors obviously is a big component of our growth. Services in the test arena is very low-hanging fruit for us, so we will continue pushing hard on servicing our

test equipment in the field. Then the equipment business has very good legs to it as well as we look forward.

Services increasingly – we have been investing in development activity around tools to take data from our machines so we can get out in front of health monitoring and doing proactive maintenance. I'm not a big government guy by nature, but the regulatory environment really helps us, quite frankly, as a Company higher fuel efficiency standards, higher safety standards, those all help drive the need for testing, and that drives the need for testing equipment, okay, and the sensors to do the test.

So, those trends are well-established, well-advertised, and we're seeing the benefit of it. So, punch line because I'm going to run short and I want to save a couple minutes for questions. What we see going forward is we're going to be a Company that can grow at 6% to 7% on the top line organically, okay. And our strategy in the next couple of years is focus on operational excellence, integrating our acquisition well and landing the opportunities we see in our pipeline. So, it's really for us all around our own four walls and executing well because we see a big demand for the product going forward. We believe that will drive consistently 6% to 7% organic growth every year in this GDP environment, okay.

If the industrial GDP picks up, we could see some upside on that. But we're not counting on that. We just see the testing marketplace growing. We've got good visibility into that, and we believe that will drive 6% to 7% growth on the top line. We break that down by markets so you can go and see what it is really driving it. I would tell you the big two drivers are sensors and servicing our equipment, although the demand for new equipment is still quite high, okay. And, by the way, every quarter we talk about the backlog, the opportunity pipeline for the next 12 months. We run salesforce.com. We have very good visibility into that number. It's right at \$1 billion.

So, for a \$500 million testing business, we have \$1 billion of opportunity we're chasing out there. We won't win it all, obviously, but we feel very good about supporting these kind of growth numbers. From a bottom-line perspective, what we see happening is improving product mix. So, going forward, we will have more sensor component, obviously, than tests than we have in the past. And sensors brings with it a higher gross margin, a higher EBIT margin. So, we see that growing preferentially, so it will help us from a mix standpoint. Within tests, we see services growing faster than equipment, and that will drive improving mix as well. And it's quite an easy business to manage, frankly. The service business is a good business to manage.

We see that plus just volume contributions from increasing demand in the factories, giving us 3 to 4 points of lift on the bottom line, okay, from the EBIT standpoint. So, top-line growth, 6% to 7% organically each year for the next few years. And bottom-line improvement of 3 to 4 points of EBIT, okay. We will be generating strong free cash flow which we'll largely use for the next few years to reduce our debt level. We don't have a history of being a highly levered Company nor any intent of being a highly levered Company for long, so we will be bringing our debt down.

We do pay about 2%, 2.5% yield on the stock today, and we have paid that for 39 years. So, you can count on us continuing our dividend and reducing the debt strongly over the next few years.

You can look at the financials. We have always been very proud of our return on invested capital. We actually put it in our compensation metrics last year. So, our stock compensation – our equity comp for all the executives is tied to ROIC performance. We feel that aligns us very well with shareholders. We've been consistently in the very high end of the top quartile of test and measurement companies in ROIC. We have been running around the high teens to low 20% range.

We definitely want to stay in the top quartile from an ROIC perspective, which is why we put it in our comp program as well. And we see that being 15% plus over the next few years. We don't expect any surprises on CapEx, so, given our revenue and EBITDA estimations, it leaves a lot of free cash to deploy, as I've mentioned. Capital allocation I've covered, dividend payment, debt reduction.

In a few years, we should be down to very reasonable debt-to-EBITDA ratios, meaning our leverage has come down nicely. Then we'll have other options so we can increase the dividend, we can get more share buybacks, we can do other acquisitions as they make sense. But we love our core businesses. We have no intent to diversify. We love tests; we love measurement to sensors. That's what we plan to spend more money in. It's a lovely space. And why is it lovely? I would tell you, frankly, because for customers to trust you in their laboratories – in their development laboratories, they are engineers. They're very conservative people.

They are not out to make a nickel by squeezing suppliers down ever lower on price like the automotive industry is known for. Those guys get fired if the test fails. So they want reliability, they want precision, they want to do their testing faster and better each year, and it's very hard to earn their trust.

So, we took some tough orders in the last couple of years because we have been servicing these guys for 40, 50 years in some cases. We've had very deep relationships, which lets us know their labs better than anybody in the world. And so they know us; they trust us. As long as we stay at the leading edge on technology, we continue to earn the lion's share of their business going forward. And it's very hard for newcomers to get into the business. So, we love the business we're in. We have no intention of diversifying beyond that.

Okay. I think I will wrap it up, then. We're excited. We see a lot of good growth even in this economy, improving profitability, strong cash generation. Those are the key metrics most folks care about. And our customers are financially very healthy and very diverse. So, we see that. I would tell you, I am also excited about India. India, we hired a country leader this last year. India for us is the next China. And you won't see it in the next few years, but we are planting the seeds right now that when China matures and starts acting

like the rest of the world in terms of growth rates, India is right behind us. It's an exciting place to be in.

And they were doing \$15 million, \$20 million worth of business there, and we see that growing nicely in the years to come. Okay, with that, I think I will wrap up. Do I have any time for questions? Okay, good. Thanks for your attention so early in the morning. Questions? Yes, Don?

Q&A

<Q>: [Question Inaudible]

<A – Jeffrey A. Graves>: So fiscal 2018 – we took on some debt, so we have debt servicing to do which will certainly be a drag on our earnings over the next 12 months. It was strategically a very important acquisition. It will drive sustainable long-term growth, very high profitability, strong cash-generating business. If you look at it, Don, in reality, there were a lot of growth synergies – a lot of revenue synergies. There were some significant cost synergies, but more modest. It wasn't strictly a cost take-out acquisition, okay, because it was a very complementary market to our position sensors.

So, most companies can drive accretion fast by closing factories and laying folks off. We are doing some of that. We have a factory footprint that is probably one factory too large, and we're taking action on that over the next 12 months. Realistically, Don, it takes about 12 months to work through that. So, we will see cost synergies start to flow through – some in the next 12 months, more in the next 24 months – and revenue synergies kick in next year and beyond.

If you just do the math, it means we are on a GAAP basis EPS-accretive in fiscal 2018. As we've said to the world, I would love to do better than that, but that's what we have advertised to the world. And on a cash EPS basis, which a lot of companies are talking about these days, it is accretive starting in fiscal 2017, which for us starts in October. Jeff, do you want to expand on that?

<A – Jeffrey Paul Oldenkamp>: It's very important that we integrate this business practice. So it will also continue to be some integration practice this year. So we go back to April of the \$507 million of integration transfer will occur in next year which will be bring down the EPS as well. So we need to get this integration right, so that's one of those concepts.

<Q>: Great thanks.

<A – Jeffrey A. Graves>: Thanks, Don. Any other questions? Okay, thank you. Oh, I'm sorry. There you go.

<Q>: [Question Inaudible]

<A – Jeffrey A. Graves>: Correct.

<Q>: [Question Inaudible]

<A – Jeffrey A. Graves>: Yes, it's a great question. For those that listen online later, it's about how do we factor in industrial GDP growth. Yes, I love – as most CEOs do, I wanted to be as optimistic as I can, but I have my alter ego over here my CFO, who always says that's not going to happen. So, GDP we're counting on just being sluggish. I think we probably model a couple of percent growth around the world. And that drives – that GDP drives the industrial machinery space that we sell sensors into. On the good side, there's nothing in the supply chain. Everybody is hand-to-mouth because nobody knows when it's going to get better.

So, we sell to some big industrial machinery manufacturers who just say, hey, we will get back to you again next quarter. So, they are buying – I would tell you – I came in late 2012, and they are buying literally probably a third of the amount they bought back in 2012 because they are not anticipating a lot of improvement. Everything I said about top-line growth assumes that is just going to be the same. So, I would love to be more optimistic than that, but I would rather be safe. On the sensor industrial equipment side of the business, we go off economic models because we don't have a lot of visibility into the demand profile for quarters and quarters to come. In the test space, we do, because they are driven by capital spending largely.

In the sensor space for industrial machinery, it is driven by the current demand the customers see. And we have lead times that are kind of two to four weeks. So they don't really need to be a lot more proactive in talking to us about product. So, the good news is when the economy picks up, we will feel it fast. The bad news is I don't – personally, we are not modeling it, and I would like to think with the election coming, the world is going to be a better place and everything is going to be good. I just can't connect those dots today.

So, what I told you is without any industrial economy recovery. China will remain pretty impressive on an absolute basis but slower than history. We sell into, for example, the Chinese steel market, which has been a real drag in the last 12 months. That goes into automotive industry and others. Now, I think in the long term, that will be a great industry and they will buy a lot of sensors from us. In reality, in the last 12 months it's hurt us, and I don't see that really changing much. And you probably don't disagree with them?

<Q>: [Question Inaudible]

<A – Jeffrey A. Graves>: Sure. It's okay. Yes.

<Q>: [Question Inaudible]

<A – Jeffrey A. Graves>: Yes. It was – no, no, no. It was founded by two brothers. The family name was Lally. And you can still – you can Google them online. Actually turned into very famous guys in the sensor business. They developed really good vibration and acceleration sensors, and they did it back in the 1960s. They are 50 years old, by the way – the company is 50 years old next year. MTS is 50 years old this year.

So, the Lally brothers started the business. One brother really spearheaded it then. He had five sons he passed it onto. They are all now basically retiring. So, they knew they were going to retire.

They planned this transition about 10 years ago, so they brought in a professional management team which came with the business. They have done a lovely job in driving strong growth and profitability improvements. So, per their plan, they went through a public auction process. It started last November, and it was a tough process. There were over 80 companies in competition for them – companies that have, like their profile, sensor companies, strong growth doing 20%- plus EBITDA margins and big demand. So, it was a very competitive process.

I would tell you at the end of the day, other companies could have paid more than us and probably offered more than us, quite frankly. But it is an outstanding cultural and market fit for our Company, and the family really did care about the employees and their future. They didn't want to see somebody buy it just to lay a lot of people off. And we had much more of a growth story around that acquisition than other competitors did. So that is my feeling. I don't think we underpay. I don't think we were far from the guys that would have paid more money from us. But where we saw it was we had more difficult financing to do because it's a bigger part of our company, and they trusted us to get that done. So – and I think that was a testament to them wanting the employees have a good future.

Marvelous cultural fit. I grew up at General Electric, and I lived through a lot of difficult cultural integrations of businesses that GE bought, and it was painful. So, one of the criteria as CEO I had is, look, we are too small to deal with that. We have to have a good cultural fit from day one if we're going to make this work. They are very much a Midwestern engineering-based company whose customers love them. And they are the same customers we have. So, when customers found out we were buying these guys, they said, good, I will get two companies together. You guys are going to do a great job for us. So, very good cultural fit. Obviously very good financial profile. It was expensive, so it was a big thing. And we are not a highly acquisitive Company, so I would like to think we waited a long time to do something like this, and we picked the right one. And now we will integrate it well and run it to be a part of the MTS family. Yes.

<Q>: [Question Inaudible]

<A – Jeffrey A. Graves>: There were two things – the question is what do we need to do to execute on our service opportunity. There are two things we needed if you go back a few years. We needed a modern, if you will, state-of-the-art scheduling and management system for the service business. We were doing it three years ago on spreadsheets and

yellow lined paper and people's trucks. And what kind of a business it is, is it is field service engineers largely going out. And they are educated people. They are very technical guys. They're going to laboratories around the country and the world fixing equipment, upgrading equipment, doing that. So, they are living in the field. They are working – in the past; we had scheduling systems which were very individually done on a piece of paper. It prevented us from optimizing our resources.

So over the last year, we installed a mature IT system to schedule and plan better for services. And other than that, it was manpower. We just needed to hire and train field service engineers, and that is about a two-year process. It takes us the better part of a year to find a good field service engineer and a better part of a year to train him once we get him hired. And they are really a drag on the business until then. They're not carrying their weight from a revenue-generating standpoint. So, we started this journey back in late 2012, and we have built and built. We were probably doing mid \$50 million range back then. We are doing \$80 million today. And obviously from how you can tell us – see us talk about orders, we are accelerating. So we feel good that we are – a lot of the people we have invested in are starting to get traction and really going now. But it's manpower-limited right now, so we just need to keep hiring and training field service engineers.

<Q>: [Question Inaudible]

<A – Jeffrey A Graves>: Yes, so, week two on the job – we have a lot of user groups. So, we host – people that have bought our equipment for a long time and for a new CEO is a great opportunity going – you talk to 50 customers in a room about why they buy your stuff. So, I happen to have an user group in town two weeks after I started my job.

And I would tell you it's been the same since with automotive. But I went around person-to-person, and we had drinks, I said, hey, what do you like about MTS? What shouldn't I screw up basically in being here? What should I invest in, and what new stuff do you need us to do? And to a person, I would tell you every one of them said, please, Jeff, take services seriously.

We have to know right now today – this is back in 2012. We have got to know the guy that designed the machine in order to get services if we critically need it. So, please just answer the phone and enable our people and all the right processes to get it done. But please take services seriously; we need it. So it's wonderful to have a group of customers that say as fast as you can hire and train people, I will use them. So that's what we're doing. I would like to say it's more sophisticated than that, but that is really it. We are meeting customer demand.

Now, I will tell you – I'm going to wrap up. What we're going out and doing – what we're doing is free lab assessments for customers. So, we will go to a Boeing or a General Motors or something. Often these guys are [indiscernible]. They don't know what equipment they bought in the last 40 years. It's not centrally – and they have done a lot of acquisitions. They have picked up a lot of laboratories. So we go out and we canvass their

laboratories, we document what they've got and we give them a plan to say if you buy this stuff, this is what you can do for your testing speed and reliability. And more and more, those are leading to nice orders coming in.

So now that we have the manpower, it's getting the right orders on the books and going. And I feel really good about the momentum in that. So it is manpower-limited now. We hire and train about 30 folks on a workforce of 300 people for field service engineers every year, and it takes them a year or two to become productive.

<<Jeffrey A. Graves, President, Chief Executive Officer & Director>>

Okay, I should wrap up. We are here all day, so if anybody wants to chat in the hallways, we've also got some one-on-ones and probably a little bit of free time. Happy to talk to you. But thanks for the interest this morning.

<<Ken Cooper, President & Managing Director at Four Hills Advisors LLC>>

Thank you every much.