MTS SYSTEMS

Moderator: Jeff Oldenkamp
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Operator: Please stand by. We are about to begin. Good day and welcome to the MTS Systems Fourth Quarter 2015 Earnings conference call. Today's conference is being recorded.

At this time I would like to turn the conference over to Andy Cebulla, Director of Investor Relations. Please go ahead sir.

Andrew Cebulla: Thank you Erik. Good morning and welcome to MTS' Fiscal 2015 Fourth Quarter Investor teleconference. Joining me on the call today is Jeff Graves, President and Chief Executive Officer, and Jeff Oldenkamp, Senior Vice President and Chief Financial Officer.

I want to remind you that statements made today which are not an historical fact should be considered forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995.

Future results may differ materially from these statements depending upon risks, some of which are beyond management's control. A list of such 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 the 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 on our fourth quarter and full-year results.

Jeffrey Graves: Thank you Andy and good morning everyone. Thank you for joining us for our Fourth Quarter Investor call. We appreciate having the opportunity to discuss our financial results for the quarter and for our fiscal year 2015, which ended in early October.

In addition to the recap of last year's results we'll also provide you with our outlook for fiscal '16. First let me remind you about the nature of our two business units.

This may be particularly helpful for those newer to following the company. The larger of our two businesses is Test, which provides highly engineered testing systems and services largely to R&D and product development groups within automotive, aerospace, energy and infrastructure OEMs worldwide.

This business is fueled by our customer spending on research and new product development worldwide. Our second business unit is Sensors, which provides products that are essential for automating heavy industrial equipment and increasing the precision and safety of heavy vehicle systems that utilize hydraulic controls.

These Sensor markets are tied more directly to industrial capacity utilization and heavy equipment demand than are our Test business markets. With this backdrop I'll start with the headlines.

There are three key takeaways for the call today. First, we were very pleased with our orders growth in the fourth quarter and for the full fiscal year, both of which set new company records even in the face of substantial currency impacts.

Orders for the fourth quarter were up 4% on a GAAP basis but were up 10% on a constant currency basis, while orders for the full year were up modestly on a GAAP basis but were up 7% on a constant currency basis.

This reflects the compelling value of our technology offerings combined with the continued strength of investments being made in R&D, and new product development by our global customer base ranging from universities to OEMs and their key suppliers worldwide.

We were particularly pleased with the orders growth in our Test Services business, which grew an outstanding 54% in the quarter on a constant currency basis and from a geographic standpoint with the orders performance in Europe, which delivered a 35% increase on a constant currency basis.

I'll provide you with additional orders related information in a few moments. Second, revenue for fiscal 2015 was flat on a GAAP basis at $564 million but up a solid 6% on a constant currency basis, consistent with our long-term view of the organic growth potential for the company.

EPS growth for the - for fiscal 2015, although lower than what we had originally expected when the year began last October, was consistent with our revised outlook.

These results were driven largely by a significant negative currency impact along with product mix in our Test business, which was unusually high in custom projects.

From a cash perspective we were very pleased with our record cash performance for the year in which we generated over $100 million in operating cash flow.

This performance further strengthens our balance sheet, supporting our consistent return of cash to shareholders, which has now surpassed 39 consecutive years, while expanding our opportunities for strategic acquisitions in the future.

Finally, our third key message today is regarding our outlook for fiscal ’16. Given our record orders performance from last year we enter the year with a company record backlog of $353 million, and continuing strength in our Test in-markets as reflected in our opportunity pipeline of roughly $900 million.

While this bodes well for the future, the conversion of custom projects into revenue from our Test backlog will mute revenue and earnings per share growth in fiscal ’16.

Given this product mix and backlog and the other common risk factors inherent in today’s volatile macroeconomic and currency markets, we’re forecasting revenues in the range of $570 million to $600 million and earnings per share in the range of $3.03 to $3.28 for our fiscal 2016.

I’ll provide some additional color around our guidance range later in the call. With that I’ll now review orders in more detail for the quarter and the full year.

Total company orders of $170 million, which as I mentioned was a new quarterly record, increased 4% but were up 10% on a constant currency basis. Drilling down one level Test orders were up 6% on a GAAP basis and up 12% on a constant currency basis.

Sensor orders were down 9% but up 1% on a constant currency basis, reflecting their more direct exposure to the industrial markets worldwide. Even with the full currency effects included backlog ended the quarter once again at a new record level of $353 million, an increase of $27 million or 8% compared to the prior year and up 3% on a sequential quarterly basis, a trend that reaffirms our view of current market conditions.

All of the increase was expectedly Test driven given the comparatively short lead-times for our Sensor products. In addition the custom content in our backlog at the end of the fiscal year, while still higher than historical norms, declined from 75% to 72%.

Looking forward we continue to see strength in our core markets with the Test opportunity pipeline sitting at a healthy $884 million at the end of the quarter.

We're very pleased with this continuing demand profile as it demonstrates the strength of our core Test markets around the world, reflecting the continued investments our OEM customers are making.

Now I'll provide you with some additional context on orders by business and I'll begin with our Sensors business unit. As I mentioned Sensors orders in the quarter declined 9% but were up a modest 1% on a constant currency basis.

The macroeconomic environment for Sensors continues to be challenging this year. We're seeing modest strength in some segments of the market, primarily wind energy and plastics, but weakness in segments that are tied to oil and gas, mining and steel markets.

From a market perspective the industrial Sensor market was down 11% compared to the prior year, but was up 3% on a constant currency basis. On the positive side we saw modestly improving demand in the plastics market in the U.S. and Japan, and strength in the wind energy market and industrial OEMs broadly in Europe.

These strengths were offset by weakness in oil and gas related markets worldwide driven by low oil prices, and weakness in steel and other metals processing markets along with mining and other heavy industrial markets in China.

We believe this is related in part to the continued weak manufacturing environment in China. Moving on to the mobile hydraulics market for Sensors, orders were down 16% and down about 4% on a constant currency basis.

Continued weakness in agriculture, oil and gas and mining segments as well as the negative effects of currency drove the results lower. Despite the lack of growth in the quarter and the tepid economic conditions in the mobile hydraulics market, we continue to believe that over the long-term the market remains very bright.

Our OEM customers continue to put a priority on developing smart machines for their end customers, which will drive sustainable future growth, and we have continued gaining design wins in these new machines.

When in demand strengthens we expect to benefit from these investments. Next, let’s review the Sensors order results from a geographic perspective. America’s orders were up a modest 1%.

Europe orders were down 13% but up 3% on a constant currency basis with strength in wind energy and industrial OEM accounts as I mentioned previously.

Asia excluding China was down 6% but was up 10% on a constant currency basis. China orders were weak in the quarter, down 20% and down 5% on a constant currency basis driven by a general slowing in the Chinese economy.

And finally, looking at full year's order performance for Sensors, orders of $99 million for fiscal 2015 was down 8% in absolute terms but up 2% on constant currency basis.

The industrial market declined 9% driven by negative currency effects with modest organic growth, and the mobile hydraulic market declined 11% from currency and weak global demand.

Our demonstrated success over the long-term combined with improving market trends give us confidence about our future growth prospects in Sensors both for the new fiscal year and well beyond.

Next, I'll spend a few minutes on our Test business order results. Test orders in the quarter were $146 million, up 6% in absolute terms and up a strong 12% on a constant currency basis.

The overall order increase was driven by strong core product orders in ground vehicles and materials markets in Europe and Asia. Ground vehicles market orders increased 10% in the quarter from continued demand for new technologies to validate durability, performance, safety and fuel efficiency.

Particularly encouraging was the growth in the materials markets, which was up 7% driven by improving demand from contract test labs specifically for high temperature metals and composite testing in the aerospace market segment.

These orders demonstrate the continued strength broadly across our markets and geographies, fueled by the continuing need for new products and materials in advanced vehicles and infrastructure applications worldwide.

The vast majority of these orders were from existing long-term MTS customers demonstrating their continued confidence in MTS technology and quality, which is helping enable them to meet their evermore demanding customer expectations.

Geographically for our Test business Europe was very strong for the quarter, up 27% on a GAAP basis and up 49% on a constant currency basis. The increase was driven by strong ground vehicle demand that I had previously mentioned.

We were especially pleased with the performance given the currency headwinds which we're facing particularly with the euro, which demonstrate our Test technology strength with our key customers in this region of the world.

Asia orders were solid for the quarter, up 3% in absolute terms and up 5% on a constant currency basis. The order growth was impacted by a tough comparison to the prior year, which had included two larger orders totaling $16 million.

Excluding these large orders the growth rate was an impressive 35% driven by strong demand for our core materials products from Asian universities and research laboratories, as well as continuing strong demand in the ground vehicles market.

For China specifically we were very pleased with the growth in the quarter. Despite the tepid manufacturing environment in China our orders were up 27% driven by strong demand in the ground vehicles and materials markets for our core Test products.

Overall we continue to believe this market strength is driven by China's desire to compete on a global scale, driving a significant investment in the R&D markets which we support.

We remain very favorable on our prospects in China and it remains a key growth market for our Test products in the years ahead. In the Americas orders were down 5% as we faced tough comps from prior year, and a surprisingly weak investment climate in 2015.

This was primarily driven by non-recurring investments in performance test systems used for tire testing capability in the ground vehicles market, and a continued restraint in government funded research projects year-over-year.

For the full year Test orders were $519 million, up 2% over fiscal '14 on a GAAP basis and up 8% on a constant currency basis. This strong performance was led by growth in Asia and Europe.

From a market perspective this full year performance was driven by growth in ground vehicles, which was up 10% for the full year. In broad terms this market was propelled by the focus of our customers to understand vehicle dynamics in an environment of rapidly increasing complexity in automobile technology.

Next I'd like to spend a few minutes discussing our Test Service business. As I previously mentioned our Test Service business gained significant momentum this quarter, with orders increasing 42% on a GAAP basis and an impressive 54% on a constant currency basis.

All geographic regions posted double-digit growth. This significant growth was driven by our entering into strategic partnerships with customers to extend the life of our existing install base, growth in the product business where we're finding success in attaching new service contracts through our new equipment sales, and full service contract wins with key customers in Asia and in Europe.

This is of significance as it moves us toward our strategic goal of building deeper customer relationships that include an intelligent lab value proposition that brings improved operating efficiencies and enhanced performance to our customers' testing environment.

Although at some level our service engineers continue to be redirected to support the installation of the unusually high level of large custom projects in the fourth quarter, we believe our increased service headcount and strategy to expand the level of service contracts are beginning to have a positive impact on the orders results.

We continue to receive a positive reception from our customers regarding our service offerings. Our large and continually growing install base of test equipment worldwide, which is over $4 billion and rising, continues to provide us with an opportunity for sustained profitable growth in our Test Services business.

We believe that orders will continue to be strong as our workforce expands and becomes more efficient, and as we work through the high demand for custom test systems.

We're continuing to add field service engineers as quickly as we can to support the Service business and help drive future growth. For the full year Service orders were up a solid 5% over fiscal '14 on a GAAP basis, and up an impressive 14% on a constant currency basis.

This growth for the year is attributed to the drive for multiyear service contracts, increases in software solution sales and increased staffing to support the business growth.

Finally, I'd like to comment on the Test opportunity pipeline as it is a good indicator for future growth. As I previously mentioned at the end of our - the fourth quarter our 12 month pipeline of opportunities stood at $884 million, relatively flat to the prior year given the currency impact implicit in this number.

However it remains at historically high levels. These identified opportunities for future sales were reflective of the healthy continuing demand we see for expanded and enhanced testing capability in R&D, and new product development by our customers worldwide across our automotive, aerospace, infrastructure and advanced materials market segments.

This visibility into future demand builds confidence in our ability to deliver sustained growth going forward. Another key metric we use to monitor the health of our opportunity pipeline is the deferral rates within our pipeline.

This is measured as total dollars deferred as a percentage of beginning of quarter pipeline. This metric increased slightly in the quarter to 60% compared to 58% a year ago.

The rate, while not as high as we experienced during the recession several years ago, is higher than our historical average in the mid-50 percentile. As the deferral percentage increases the volatility of our orders performance tends to increase.

This can make predictability in resource planning more of a challenge compared to the volatility we experienced when the deferral rate is lower. We will continue to update you on this view of our markets as - in the quarters ahead.

To conclude my remarks on Test we’re proud of achieving 8% growth in the full year on a constant currency basis, including 14% growth in our Test Services business.

Our results confirm that our Test business has the product and service solutions that our global customers need to confidently develop new products worldwide.

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

Jeffrey Oldenkamp: Thank you Jeff. My remarks today will summarize our fourth quarter and full year results based on a year-over-year comparison. The strengthening of the U.S. Dollar caused fourth quarter revenue to be flat at $143 million.

On a constant currency basis revenue was up a solid 7%. Looking more specifically at revenue by business Sensors revenue of $27 million was down 2% on a GAAP basis, with Asia down 15% and the Americas down 1% while Europe increased 3%.

On a constant currency basis revenue for Sensors overall was up 10%. Europe led the way and was up 23% while Asia was down 2% and the Americas were down 1%.

Backlog conversion as well as short cycle orders that were up 3% year-over-year on a constant currency basis fueled the strong performance in Europe. Moving on to Test revenue was $117 million, an increase of 1% on a GAAP basis and of 6% on a constant currency basis from the conversion of higher opening backlog and the favorable impact of an additional week in the fiscal quarter.

As a reminder our fourth quarter included an extra week due to the timing of our fiscal year-end. And on - another bright spot was the performance of the Service business.

On a GAAP basis Service revenue increased 8% and on a constant currency basis revenue increased 18% in the quarter, reflecting continued success in growing our Service business.

Test backlog ended the quarter at $340 million, another record high. As Jeff mentioned custom backlog as a percent of total backlog decreased slightly from 75% to 72%.

This will continue to have a negative impact on margins throughout the majority of fiscal year 2016 as we work through the custom backlog. Moving on to the rest of the P&L gross margin was $53 million, a decrease of 5% as the rate to revenue gross margin decreased 200 basis points from 39% to 37%.

Sensors gross margin was down 4% to $15 million on lower volume. The gross margin rate decreased 90 basis points from 55% to 54.1% from the negative impact of product mixed within the industrial market.

We expect the margin rates to stay in the mid-50% range going forward. Test gross margin of $38 million was down 6% and the gross margin rate decreased 230 basis points from 35.3% to 33%.

During the past year we have hired approximately 65 engineers to scale our operation, to support the higher order and backlog levels and future growth. This caused a higher level of inefficiencies as the engineers are onboarded and trained, resulting in decreased margin rates for the quarter.

My next topic is operating expenses. Operating expenses increased $1 million or 3% to $41 million and were 28% of revenue within our normalized range of 27% to 29%.

Higher R&D expense up $1.6 million drove the increase as we invested in more resources to accelerate technology advances. Selling costs decreased approximately $700,000 primarily due to favorable impact of currency translation, partially offset by additional headcount resulting from continued investment in selling resources.

G&A expense was flat compared to the prior year with an approximate $600,000 favorable impact of currency translation being offset by increased compensation and benefit costs.

EBIT decreased 21% to $12 million primarily driven by the lower gross margins in Test. EBIT as a rate of revenue decreased 230 basis points to 8.7%.

My next topic is taxes. The tax rate in the quarter was 25%, lower than the expected range and down 5 points from the rate in the same quarter last year. A favorable geographic mix of earnings in the period drove the lower rate.

For fiscal year 2016 we expect the tax rate to be around the 30% range. Earnings per share decreased 14% to 61 cents compared to 71 cents in the prior year.

The lower gross margins in both businesses as well as the negative impact of currency continue to negatively affect the business. If Q4 were adjusted for translation and transaction losses EPS would've been approximately 4 cents higher.

Moving on to a summary of cash the cash balance remained strong at $52 million, and the net debt level is now $31 million of net cash. In the quarter solid earnings and improvement in our working capital requirements caused operating cash flow to be strong at $29 million.

We reduced our debt by $15 million in the quarter, paid out $9 million in dividends and spent $6 million on capital expenditures. Next I'll provide a brief summary of results for the full year.

Revenue was flat compared to the prior year but was up 6% on a constant currency basis. Excluding currency Test and Sensors revenue each increased 6% compared to the prior year.

Generally higher volumes from converted prior year backlog as well as the favorable impact from an extra week in the fiscal year drove the increase. Gross margin decreased 2% to $220 million and the gross margin rate decreased 70 basis points to 38.9%.

The unfavorable mix of custom projects in the Test business as well as investments in engineering resources in both the Test product and Services business to fuel future revenue growth caused the decline.

Operating expenses were down $5 million and were 28% of revenue, within our normal expected range. The effective tax rate declined to 23.2% and was below the normal 30% range.

Three items favorably impacted the tax rate during the fiscal year. The retroactive extension of U.S. R&D tax credits improved the rate by 3.5 points.

Tax adjustments associated with the conclusion of an IRS audit improved the rate by 3.1 points, and a favorable mix of geographic earnings accounted for the remaining difference in the tax rate from what we would normally expect.

Now we want to explain the impact that foreign currency had on our full year results. As we discussed foreign exchange was a significant headwind during the fiscal year.

We estimate the translation of foreign currency negatively impacted our orders by $39 million and revenue by $33 million, while translation and transaction losses negatively impacted earnings per share by approximately 24 cents.

These numbers reflect an estimate of the impact foreign currency had on our actual results if exchange rates had remained consistent with the prior year. Finally, I'll conclude my remarked with a brief discussion about our internal controls over financial reporting.

As you will see in our 10-K we have a material weakness in our internal control over financial reporting related to controls over revenue arrangements with multiple deliverables and controls over accrued project costs.

While these weaknesses created a reasonable possibility that inerrant financial reporting may go undetected, after exhaustive review and analysis no revisions to previously issued financial statements were required.

Furthermore we have plans in place and are committed to remediating these deficiencies by implementing changes to our internal control over financial reporting in the future.

That concludes my remarks for today. I’ll turn the call back to Jeff for his final comments. Thank you.

Jeffrey Graves: Thanks Jeff. Before we open up the call for Q&A I’ll briefly recap fiscal ’15 results and our fiscal ’16 guidance. Let’s begin with a brief recap of fiscal ’15.

There were several noteworthy positives. Despite significant currency headwinds that Jeff just reviewed and a challenging macroeconomic environment, we achieved new record order levels for the company of $618 million.

We’re proud of that. On a constant currency basis orders grew 7% for the year including 14% growth in our Service business. These achievements were driven by our consistent investments in R&D and sales over the last few years, our specific focus on growing the Test Service business, the expansion of our technology offerings and the aggressive introduction of new products to the market.

Also for fiscal 2015 our revenue grew 6% on a constant currency basis, consistent with our long-term outlook for the business and our $100 million of operating cash flow was excellent, setting a new record for the company.

However these results were largely overshadowed by the significant negative impact currency had on our revenue and earnings performance for the year, as well as the negative mix in our orders for the Test business.

In addition we invested heavily in engineering resources in our Test business to drive future growth in both our product and service businesses, which further muted earnings performance for the year.

These investments, the majority of which are nearing completion, while being a short-term drag on our P&L we view as critical to meeting the rising demand we see for our products and services in the years ahead.

As I commented in the past few quarters we're aggressively working to improve our product and service flow so that we can significantly improve operational efficiency and business predictability.

We'll continue to focus on optimizing engineering, production and service execution through implementation of new processes and full utilization of our updated and expanded IT infrastructure.

To further drive improvements in our performance beginning this year we're implementing lean initiatives aggressively across the entire MTS enterprise with the goal of enhancing customer satisfaction, improving operating margins and reducing working capital as we tackle our record backlog while facing what we believe will be sustained market strength in the years ahead.

I was pleased last month to announce that a new role had been created at my staff level to lead this critical initiative for MTS around the world. To fill this role we hired Mister David Saylor, a veteran lean process leader who has established a proven track record of success in driving operational excellence throughout his career.

I'm excited to have Dave as a part of the MTS executive team, and I look forward to communicating the progress we make in the months and years ahead.

My last topic for today is our fiscal '16 guidance. We continue to see confirmation of the favorable long-term global macro trends and steady market momentum that we've discussed in prior quarters.

We believe this is supported by the strong Test opportunity pipeline and a larger order flow during the fourth quarter and fiscal year. Further, we feel good about the record level of backlog for the company, which will help drive the results for fiscal 2016 and beyond.

These factors as well as the strategic initiatives we're push - pursuing in both Test and Sensors businesses position us well for the long-term. As I mentioned in the headlines we're forecasting revenues in the range of $570 million to $600 million, and earnings per share of $3.03 to $3.28 for fiscal 2016.

Although we entered the year with record backlog levels, the expected timing of the conversion of backlog into revenue will push a portion of this revenue into fiscal 2017.

Historically approximately 85% to 90% of our backlog at the end of most quarters was expected to be converted into revenue in the following 12 months.

Due to the unusually high level of custom projects in our backlog, of the $353 million of backlog at the end of fiscal 2015 approximately 75% is expected to be converted to revenue in fiscal 2016.

A slower conversion rate impacted our revenue projections for the coming year. With regards to earnings per share our guidance range of $3.03 to $3.28 for the year is volume driven, but also includes two other important aspects to consider: custom projects and investments.

Custom projects which remain at an elevated level in our backlog have a negative effect on margins in Test. In addition we've added significant engineering resources over the last nine months to support both product and service growth in Test, while maintaining our research and development efforts to support our strong technology position in the years ahead where we believe customer demand will remain high.

This additional headcount will produce a short-term drag on margins until they're fully trained, which will take the major part of fiscal 2016 to accomplish.

In addition given the economic and political instability in the world combined with the risk of ongoing currency volatility, we believe it's prudent to provide a widened range for our forecasted results at the outset of the year.

Our hope is that these factors that significantly impacted fiscal 2015 will be less impactful in the year ahead. We do anticipate the revenue and EPS in the first half of the year will be less than the second half of the year.

Even more specifically for the first quarter we expect revenue and earnings to be slightly down from our fourth quarter of fiscal 2015 and increasing thereafter.

We continue to focus on enhancing our product capabilities to maintain our technology leadership position in the markets we serve, to develop new products to further propel our growth and to improve our operational capabilities in Test.

With the long-term macro trends that we see supporting growth for both of our businesses, the large number of Sensors sales pursuits that have advanced to the customer prototyping phase, the strength of the Test opportunity pipeline and the overall favorable market environment for R&D spending, we remain bullish about our long-term prospects for sustained growth and profitability improvements in the year ahead and those to follow.

That concludes my prepared remarks. Erik I'll turn the call back over 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're using a speakerphone please make sure your mute function is turned off to allow your signal to reach out equipment.

Again press star 1 to ask a question. And we'll take the first question from Ben Hearnsberger with Stephens Incorporated.

Benjamin Hearnsberger: Hey thanks for taking my question. A first question on service people. Can you give us the number that you hired in the year?

Jeffrey Graves: We were up about 10% Ben so that's - it's roughly 30-ish.

Benjamin Hearnsberger: Okay.

Jeffrey Graves: Thirty and we can get you a more precise number. But we have a work - services workforce of about 300 people. We - we're adding about 10% a year so it's roughly 30.

Benjamin Hearnsberger: And the expectation is that you add 10% in ’16 as well?

Jeffrey Graves: Yes correct. I think - yes so - yes exactly. And it may be, you know, in that - and it will be in that 30- to 40-person range so as a percentage Ben and if you project out over the next few years it’ll - as a percentage it’ll probably decline. We’ll be hiring and training 30 to 40 folks each year over the next few years.

Benjamin Hearnsberger: Okay.

Jeffrey Graves: And they’re mainly field service engineers that actually provide the service to our customers.

Benjamin Hearnsberger: And these are separate from the 60 engineers that you hired in the Test segment?

Jeffrey Graves: It was probably all-inclusive. That 60-ish number was probably all-inclusive in total in Test, right, for services and for designing our new products.

Benjamin Hearnsberger: Okay got it. Got it.

(Crosstalk)

Jeffrey Oldenkamp: Yes so Ben I - the 65 I mentioned around the R&D/around the engineering - that was engineering specific, not including the service folks.

Benjamin Hearnsberger: Okay understood.

Jeffrey Oldenkamp: My apologies Ben.

Benjamin Hearnsberger: Okay so is the expectation that you need to continue to hire engineering folks not on the service side in fiscal year ’16?

Jeffrey Graves: No we’re pretty well there Ben. Now we hired a lot in the second half and, you know, we were recruiting all year. We ended up - we have tough standards so it took us a while.

But we basically fully staffed in the second half of the year and largely in the fourth quarter - coming into the fourth quarter and those people are now coming up the curve.

We have, you know, some isolated additions and retirements to replace, things like that but we’re largely there on the Test product side. In Test Services we’ll continue to, you know, to hire field service engineers to the magnitude I mentioned this year and in following years to come.

Benjamin Hearnsberger: Okay. Maybe that goes to answering my next question, which is the guidance looks like it assumes some gross margin improvement even on the low end.

You’ve got some incremental service hirings and it sounds like the mix issue’s going to continue, so can you take us through the drivers of gross margin improvement in ’16?

Jeffrey Graves: Yes let me talk in general and then if there’s any supplement you want to do Jeff that’s great too. So in general we do see improvements in the backlog. It’s coming down.

You know, if you remember we peaked out several quarters ago at about 85% custom content - very, very high a few quarters back. That’s slowly ratcheting downward, you know.

And as we - basically we continue to land custom projects but we land a lot more standard orders. That continues to get diluted in backlog so that drives margin improvement.

We do expect to see some growth in the Sensor business and in Services which will help our gross margins as well and then just baked in productivity, you know, from volume effects and from our lean initiative.

So those factors are really what drives the gross margin improvement throughout the year and I would expect that to continue.

Benjamin Hearnsberger: Okay. And then I had a question on capacity. If we do see a sudden pickup in standard orders do you have engineering capacity to quickly turn these, or are you tied up on the complex side and these would have to go to the back of the line?

Jeffrey Graves: No we're just fine on standard products. It - it's actually the -by - the way we define standard products is basically it's, you know, pre - largely pre-designed systems with a lot of accessory options.

Those designs are all in place and in fact a couple of years ago we invested heavily in a configuration software program that can help automatically configure products.

So very little engineering content is required for incremental standard product sales so we're fine on that. We've got plenty of capacity. We're not tapped out on engineering.

Benjamin Hearnsberger: Okay and one last one. We've seen the Dollar strengthen recently and I know that's been one of the issues driving the increased custom versus standard.

It sounds like the mix is getting a little bit better. What's really driving the improvement in the mix?

Jeffrey Graves: Oh I, you know, I think it, I mean, honestly if you go back a year for reasons we can't fully explain there was just a big spike up in custom project orders. The - now I would tell you I think if you go back a year ago when the euro really plunged and the yen really plunged, I think we had outstanding quotes for standard products.

And with the currency being very highly volatile in a short period of time I think we lost some of that so we probably dropped some share a year ago. And now you see that kind of returning to normalcy as the world has kind of, you know, flattened out in terms of currencies today.

In the second half of the year we saw a rebound in our standard product sales. Custom remained strong and we saw a rebound in our standard product sales so that drove some mix improvement and backlog.

So again very short-term volatility can impact outstanding quotes but in general I, you know, I think, you know, our technology is - we generally have a leadership position in all of our equipment and generally customers tend to go with that unless there's, you know, again some very short-term currency impacts that favorably impact our competitors.

So I think all in all the world normalized more in the second half Ben frankly, and we saw a rebound in standard product sales that will gradually impact our backlog over time.

Benjamin Hearnsberger: Okay thank you very much.

Jeffrey Graves: Thanks Ben.

Operator: Next is Jim Ricchiuti with Needham & Company.

James Ricchiuti: Thank you. Good morning.

Jeffrey Graves: Morning Jim.

Jeffrey Oldenkamp: Morning Jim.

James Ricchiuti: First question - just with respect to the extra week in the quarter, can you maybe talk about the impact that had on revenues and operating expense? Was it a bigger impact on operating expense in the quarter?

Jeffrey Oldenkamp: Yes Jim this is Jeff. First on the revenue standpoint, you know, when we look at that extra week we believe it was somewhere in that $8 million to $10 million range on the top line.

From an operating expense, you know, the normal flow through, you know, we'd have an extra week of operating expenses, salaries, et cetera. So on that extra $8 million to $10 million it'd be the normal flow through down to EBIT.

James Ricchiuti: Okay. And, you know, the - you - Jeff you've mentioned R&D being higher and it was significantly higher than I was expecting. And I'm just wondering as we think about that R&D line going forward, some of the projects sounds like are nearing completion.

But how should we think about R&D say in Q1 and, you know, should that begin to decline over the course of the year sequentially?

Jeffrey Graves: Yes Jim I would - I'd say kind of steady to a very slight decline. We've got a lot of R&D activity going on because the world is just changing so fast for our customers and their new products that we have a real opportunity to bring some new both hardware and software to market, especially on the Test side of the business that can really continue to position us well for the future so we plan to continue that.

We may see a slight decline. It was unusually high kind of in the fourth quarter but we may see a slight decline but I wouldn't expect to see a dramatic change.

James Ricchiuti: Okay. And, I mean, is it - if we think about your R&D levels, you know, should it grow in - would you assume it would grow in line with your revenues? In other words at the higher end of your...

Jeffrey Graves: Yes.

James Ricchiuti:...revenue guidance you've got revenues up about 6%. Would you anticipate that your R&D would be growing at those levels?

Jeffrey Graves: Well we'd be challenged to take it up that fast but I think on a long-term basis Jim you can expect it to be in that, you know, 4-ish percent range of revenue over the long-term.

And with the amount of backlog we have now and the revenue growth we're projecting we'll probably be hard pressed to take it up, because it's strictly a function of manpower and...

(Crosstalk)

James Ricchiuti: Okay 4% of revenues. Now I was referring to the increase year-over-year. No I got you Jeff.

Jeffrey Graves: Right.

James Ricchiuti: Okay.

Jeffrey Graves: Right.

James Ricchiuti: Okay great.

Jeffrey Graves: So on a Dollar basis - yes on a Dollar basis it could be steadier than that. It won't go up as fast.

James Ricchiuti: Okay and Test Service business - I may have missed it but, I mean, clearly you had some big increases in orders in that area of the business. Can you - did you quantify the revenue number that you're - or the order - actual dollar number of the order in Test Services?

Jeffrey Graves: I'm sure we can. While the guys pull it up here Jim it's a - but I would tell you what we were quite pleased about, just what drove the increase, is the amount of customers that are embracing our lab assessments and upgrading of whole laboratories, you know, that contain our equipment.

There's - we've got a very big install base the last 20 or 30 years. And for large OEMs that are looking at really taking on a lot of new product development, the idea of having us come in and upgrade their labs and bring all that older equipment up to, you know, modern day technologies is just a - is - we're seeing a wonderful reception to and that's what's really driving the growth. Jeff do you have the...?

Jeffrey Oldenkamp: Yes so orders on a GAAP basis Jim in the quarter was $25 million and revenue was roughly $22 million.

James Ricchiuti: Okay. And so when we think about backlog in this part of the business is it multiyear? Does it extend beyond a year? I'm trying to get a sense as to, you know, how this...

Jeffrey Graves: Yes.

James Ricchiuti:...flows through in fiscal '16.

Jeffrey Graves: Yes so specifically in '14 we saw, you know, continued interest in multiyear contracts but there is a - there was a real keen interest in having us come in and do an overall upgrade of a laboratory, okay, so those are - we're pursuing both of those avenues.

And in prior quarters it had been more driven by multiyear contracts, which would sit in backlog so when you see a backlog number for Test Services it's generally multiyear contracts, okay.

There might be a little carryover quarter-by-quarter but generally we turn things within a quarter. It's the multiyear contracts that provide a backlog there.

And while that is a growing part of the business and we're really happy about it/we're really pushing that, the other thing we're really looking at is going in to customers that have a lot of MTS equipment and doing a shorter-term upgrade of the equipment, you know, hardware, software, you know, putting in new cloud-based monitoring systems, things like that.

And that's really getting a lot of traction. That really helped us in the fourth quarter so that would not sit as much in backlog. We turn that within a quarter or two.

James Ricchiuti: Okay and at pretty healthy margins versus...

Jeffrey Graves: Yes. It's...

James Ricchiuti: Yes.

Jeffrey Graves: Yes we're quite pleased with that and it's - yes it's really taken off nicely for us.

James Ricchiuti: Now, I mean, again you talked about the headcount you've added there, so there's a near-term drag on the margins in that business. But as you...

Jeffrey Graves: Yes.

James Ricchiuti:...think about the year as a whole if we think about fiscal '16 do you see the benefit - do you see - do we see more leverage? I'm trying to get to the improvement.

It relates to the prior question as well that you're - you seem to be implying in the back half of the year for gross margins and to what extent Services is going to play into that.

Jeffrey Graves: Yes. So I wouldn't, you know, I - again I think we'll see nice growth Jim. In terms of margins I think they'll still be suppressed because of the hiring and training we're doing, and even the guys we brought on last year aren't fully up to speed.

And we still have this big backlog of custom equipment, which we do bring those guys over to help install sometimes because it's just difficult. It's very complicated stuff.

So I would expect to see nice growth and hopefully continue the orders momentum like we've seen. I wouldn't expect to see tremendous gross margin shifting.

I think we'll be in the low 40s, you know, in that - in terms of gross margin because we just won't get the leverage from the folks for probably another year and that'll - then that'll gain momentum.

Again we'll - again our hiring plan right now as we go is we hire a fairly constant number of people because we're limited by training frankly, so we hire a fairly constant number of people.

So as the workforce gets bigger the percentage of those folks go down and the drag goes down. So we'll see it in '16 be about constant from a gross margin perspective, and then we'll start seeing - I would expect to see some gross margin improvement as we go into '17 and beyond.

James Ricchiuti: Okay. And then, you know, going back to last year I think you talked about, you know, when you filed - or at least in last year's K about 78% of the backlog being converted.

And I'm just kind of curious how that actually played out or if you as you went through the year or if in fact, you know, you saw things maybe cycle out a little longer than that.

Jeffrey Graves: Jeff you want to comment on that?

Jeffrey Oldenkamp: Yes Jim it was less than the 70% that we disclosed in the K last year and it was really driven around the engineering resources. We needed to get the engineering resources up to speed and in Q3 we added, you know, 50 engineers year-to-date in Q3 and then we continue to add in Q4.

So we didn't see that realization of that 77%, 78% around the custom backlog.

Jeffrey Graves: Now the good news Jim is that the Achilles heel in 2015 for us was really engineering - the engineering bottleneck that we had. We have, you know, we have - we're a company of engineers and we had such an uptick in custom orders.

They were in big demand. That workforce really didn't come on strongly until Q3 and then ramping into Q4. So as I answered the earlier question we're pretty much where we need to be now given our backlog and orders projection.

And we have onesie/twosie hirings to do but we're pretty much there on the product side, and you'll see improving productivity as we go so our turn rate should get better.

The overall percentage in the backlog of custom's dropping so that's good news - not fast but it's dropping. And our turn rate through the - through engineering and the factory should be improving as those engineers come up to speed.

James Ricchiuti: Got it. Okay thanks. I'll jump back in the queue.

Jeffrey Graves: Okay thanks Jim.

Operator: The next question is from John Franzreb with Sidoti & Company.

John Franzreb: Good morning everybody.

Jeffrey Oldenkamp: Hi John.

Jeffrey Graves: Hey John.

John Franzreb: Could you just, you know, could you just walk me through the gross margin on the Services side in the fourth quarter because if I did my back of the envelope calculation correctly, it seemed like there's a nice improvement but I'm not certain about that.

Jeffrey Graves: Jeff you want to take that one and we'll look at the gross margin?

Jeffrey Oldenkamp: Yes. So John within the, you know, we do break that out. You know, if you look in the fourth quarter around Services we did see some growth there, and it was really driven off the revenue increase that we saw in Q4.

So we've hired the people. We'll continue to hire that, you know, that 30 to 40 individuals per year, but we're starting to see that leverage come through.

Jeffrey Graves: So we just want to - we're - John we're trying to set expectations so that, you know, it's - and to frame of world that says with our hiring that we'll continue this year we'll continue to see, you know, gross margins in that low - because of the drag we'll continue to see gross margins in that low 40% range.

If we get nicely surprised on revenue then we'll get some more benefit there and they should come through higher. The actual sold margins on work that we're doing are quite nice so we should start seeing that flowing through over time.

John Franzreb: Okay Jeff. And you talked about having more success in tying service contracts to new equipment sales. Can you kind of give us a, I don't know, like a sense of, you know, what the hit rate is today versus what it was a year or two ago?

Jeffrey Graves: Yes if you go back two to three years John we didn't make much of an attempt to do that to sell those. And so it was if a customer initiated it we would be - we would do it so it was very low.

I mean, it's - you could say it's, you know, 0% to 5% probably. I'm making a number up but a few years back we did very little of it. I think our attach rate now is over 30% of new equipment we sell has service contracts.

And then - and that's climbing because we're actively working that with each sale now with the sales force and trying to attach a service agreement with each one of them.

John Franzreb: Okay and I guess...

Jeffrey Graves: So we've seen a nice uptick. Now I wouldn't expect that John to flip into revenue for some time, right. You got to get through, you know, the warranty period and all of that but the...

John Franzreb: Right.

Jeffrey Graves: But at the end of the day that's really building in sustained customer intimacy over the long-term so we're really pleased about that.

John Franzreb: Okay. And you talked about revenue just now and it's - kind of dovetails, right, nicely into my next question. If I look over the last three years and I look at the order improvement's been great, the backlog's been great but the top line, okay, has been flat.

Now I understand the impact on mix on margin, okay. But with the rising revenue order backlog for three straight years and a flat top line and the currency's only been, I don't know, I guess over the last year or so can you kind of reconcile what's going on there? Help us out.

Jeffrey Graves: Yes sure John. It's pretty straightforward. The - so obviously in the last year or so currency's been a big hit and that's - we try to be very clear about that. But it's - a lot of it's attached to the gross margin of a custom project versus the - versus a standard project.

So the - in general that can be up to a 10-point difference in gross margin. Now you remember there's a lot of IP generated. There's a lot of ancillary benefits in these custom projects and that's, you know, that's the nature of our business is to do custom and standard.

And custom generally sets a new - well our custom business generally sets a new level of technology in the world for testing. That's why we do it.

John Franzreb: But Jeff...

Jeffrey Graves: Okay.

John Franzreb:...I'm actually talking about the top line not the gross margin because the order in backlog is really a top line function.

Jeffrey Graves: Yes so with the mix chain there's - so the two biggest factors John in terms of revenue growth have been the shift toward custom projects, which flow through on a much slower basis than standard projects do, right. Standard are three to six months kind of turn times and...

John Franzreb: Right.

Jeffrey Graves:...I'm giving you broad numbers but three to six months. Custom is more 12 to 24 months of turn time.

John Franzreb: Right.

Jeffrey Graves: And revenue is recognized more on the back end than the front of the custom projects and then currency. So I think those are the two big effects that you've seen in the last three years is the shift toward custom, which we believe is not a one-year effect.

It's a - it may be a multiyear effect here but it's a - but it is a transient effect, right.

John Franzreb: Yes.

Jeffrey Graves: And...

(Crosstalk)

John Franzreb: I just thought it would catch up at some point. I'm...

Jeffrey Graves: Oh yes.

(Crosstalk)

John Franzreb: I just thought we'd catch up and I just...

Jeffrey Oldenkamp: Yes, I mean, John that's why I highlighted it in my section. I mean, currency had a big headwind on us in fiscal year '15.

John Franzreb: Right.

Jeffrey Oldenkamp: So on a constant currency basis revenue was impacted $33 million...

John Franzreb: Right.

Jeffrey Oldenkamp:...you know, from a - from currency. And so if you look at it on a constant currency revenue would've been up 6% so we would've started seeing that flow through. You know, it's just that currency really masked it in fiscal year '15.

John Franzreb: Okay. All right. Maybe I'll take the rest of this offline. One last question. You brought up the accounting issue that was mentioned in the K. Is it - should we think about like higher SG&A costs going forward?

As you addressed that you said, you know, you have there some things in place to do that.

Jeffrey Oldenkamp: Yes so John it's a good question. You know, we wanted to make sure we highlighted that so we have taken it into account. We do not expect it to be a major cost. We have taken it into account in the guidance range that we have provided.

John Franzreb: Okay. All right. Thank you for taking my questions.

Jeffrey Oldenkamp: Thanks John.

Operator: The next question is from Liam Burke with Wunderlich.

Liam Burke: Thank you. Good morning Jeff.

Jeffrey Oldenkamp: Morning Liam.

Jeffrey Graves: Hey Liam.

Liam Burke: Jeff could you give us some color on blanket orders in the Sensor business?

Jeffrey Graves: While the guys are looking for a number here, Liam I would tell you they were - my guess - they were probably down in the quarter. Jeff any color on that?

I - we - they were certainly - Sensors has remained a challenging business. I mean, the markets are really flattish out there. You know, the frustrating thing Liam for us is we're winning a lot of new designs.

You know, we're getting designed into a lot of new equipment, but our customers just aren't selling much equipment and so you don't see the flow through.

I'd be - I believe blanket orders were unimpressive in the quarter because our customers just don't have great visibility and confidence into their in-market sales.

So I'd put it in the non-meaningful category in the quarter and that's - it's reflected in us not having a number here for you frankly because it was not a big deal.

Liam Burke: Okay fair enough. And Jeff Oldenkamp the working capital metrics closing out the year were very, very strong. Is there a timing issue in there or is this a sustainable trend?

Jeffrey Oldenkamp: You know, it's sustainable Liam. I mean, working capital as you recall, you know, got to all-time highs, you know, in fiscal year '14. And we've put a lot of focus on working capital, and we'll continue to put focus on it to bring it down to help generate strong cash flows to continue to invest in the business.

Liam Burke: Great. Thank you very much.

Jeffrey Oldenkamp: Thanks Liam.

Operator: The next question is from Paul Moomaw with Goshawk Global Investments.

Paul Moomaw: Yes just following up on that operating cash flow question the number was really high. Is there anything else that you would point to that got you over that $100 million level besides just the working capital or any other comments on timing?

Jeffrey Oldenkamp: No. No Paul. So it was really around the working capital. I mean, of course it's driven off of the earnings. We continue to have strong earnings but it's really around that working capital focus.

Paul Moomaw: Okay and on the Test Services growth in Q4 which you addressed - but was that driven by one or two large customers and if so is there any characterization that you would make of who's taking that?

Jeffrey Graves: No. I would tell you there's a - it's, you know, broad across our in-markets. You see in automotive. You see it in aerospace - anyone that has a large laboratory, which really spans our customer base with the exception probably of universities.

The rest of the OEM customer base generally has a large install base of MTS equipment and it's going in and looking at, you know, doing an assessment of what they own from the past and then proposing how to upgrade and bring it up to modern technology standards.

So they can wring a lot of value out of, you know, relatively small investments in incrementally upgrading older equipment. And so we're really going after that in a bigger way and we got a lot of traction with it.

I - it was not driven by a small number of customers and/or geographies or markets frankly, so it was a fairly uniform intake of orders that we turned and we'll continue to in the coming year.

Paul Moomaw: Okay. And a question on expenses. I noticed stock-based comp up quite a bit for the year - $7.4 million, up 28% year-over-year and up 100% over two years.

Earnings, you know, are down over that time period. What are the dynamics there that are leading that line to be larger?

Jeffrey Oldenkamp: Yes. So, I mean, so I'll take that question Paul. So when you look at it it's - the stock-based comp over the last couple of years has increased and it's really driven off of - if you look at the cash flow it's really driven off of the timing.

We did change when we issued the stock comp for the executives. It used to be in June so that's part of the increase that you've seen over the last couple of years and why 2013 was unusually low.

Jeffrey Graves: Yes we pushed - we wanted to align it with the end of the fiscal year and the rest of our compensation changes. So the - you see a push from '13 to '14 when we made that change.

So we went from a summer-based grant process to a late fall or early winter-based grant process, which pushed the '13 numbers into '14 so that's why you see the step up in '14.

Paul Moomaw: Okay thanks very much.

Jeffrey Graves: Okay.

Operator: And we have a follow up question from Ben Hearnsberger with Stephens.

Benjamin Hearnsberger: Hey thanks for taking my follow up. I had a question on the average order size. It looks like it was about - this is within the Test business.

It looks like it was about half of what it was in fiscal year ’14. I know there are a lot of moving parts there. Maybe if you could take time to walk us through that.

Jeffrey Oldenkamp: Yes. I’ll take that one Ben. So you’re right. If - it did - it’s at a roughly $77,000 now when you look at it and it did come down compared to last year. It was really driven off of two things.

One, we made the purchase of Roehrig last year and their average selling price is significantly lower than the rest of the Test business. And then as we’re, you know, converting this since we’ve had more custom business in the backlog and that’s what we’re converting into revenue, we have been able to push some standard through it.

So it’s really just driven off the mix and Lexington had a very big impact on it even though it was relatively - from a revenue standpoint relatively small.

Benjamin Hearnsberger: Okay. Is Roehrig selling primarily what you would consider standard Test?

Jeffrey Graves: Roehrig has two pieces of business. They do have standard Test but they do have what I’d call an engineered product as well so it’s a pretty even mix in...

Benjamin Hearnsberger: Okay.

Jeffrey Graves:...fiscal year ’15.

Benjamin Hearnsberger: Got it. Okay thank you.

Jeffrey Graves: Thanks Ben.

Operator: And we have a question from Kevin Sonnett with RK Capital.

Kevin Sonnett: Thanks. Hi guys.

Jeffrey Oldenkamp: Morning Kevin.

Jeffrey Graves: Kevin.

Kevin Sonnett: So just thinking about the higher mix of custom work in the backlog still, I know it's down from the peak in the higher deferral rate. And understanding some of this is driven by the customers it would seem like the custom work given the, you know, higher level of collaboration involving those sales and those products would be less likely to be canceled or deferred.

And so I'm just wondering, you know, what's the team perhaps doing differently in trying to go out there and secure orders that - that's maybe contributing to the higher mix of custom or the higher deferral rate?

Jeffrey Graves: Yes there's a couple of questions in what you just said Kevin. So in terms of, you know, customer spending on custom projects I think what we've concluded is it really reflects our customers going to significantly higher technology level in their vehicles, whether it's a car or an airplane or a train.

The technology level of those vehicles is going up substantially, and so the complexity of testing if you will and the need for very precise testing's going up pretty fast.

So we - that's what I believe has been driving this higher order rate for our custom projects and it came through the industry like a wave. And as you might imagine if you just think about the automotive industry, these things happen in waves as they go through and we saw a lot of influx of custom orders.

The - and eventually that spreads itself into standard orders in the future and you kind of see that trend happening now. The - in terms of the deferral rate - you asked about the deferral rate.

The - our customers have - actually financially the - most of them have been doing very well in terms of driving earnings and cash so they have money to invest.

Their need for new products is very high so the deferral rate really was dropping fairly significantly up until, you know, the last couple of quarters and then it kind of leveled off.

And it's - it actually ticked up a little bit for the first time and I think the deferral rate is more indicative of how they feel about a quarter-to-quarter performance.

By the I mean our customers - how they feel about a quarter-to-quarter cash performance in their business because these - generally our equipment goes into big buildings that require big cash outlays by our customers.

And it's quite easy for them to push that off a quarter if they want to defer a - an investment - a capital investment. So when you see the deferral rate going up it's kind of what they feel about their future and their future cash flows, so you start seeing a little bit of edginess there and a little bit of uptick.

But I would still tell you 60% is just fine. It's higher than our historical norms but nothing to be alarmed at. Right now it's - it could either be coincidental or it could just be, you know, short-term uncertainty in the world with, you know, the macroeconomic conditions.

But we're not concerned about it yet. We just like to report on it every quarter and, you know, look at what it is.

Kevin Sonnett: Okay and just one more if I could. In the - is there, you know, you mentioned some of the backlog's a little bit longer-term backlog. Some of that - some of that's custom and some of it's service and these longer-term contracts.

And I'm wondering is that, you know, when you're signing some of the long - some of the work that's going to be delivered over a longer time period than perhaps what you have historically, is that work that you would not have otherwise received in the future or is that work that perhaps you would've gotten anyway? You just historically wouldn't have secured those orders until a later date.

Jeffrey Graves: Oh I think it's the former. I mean, the window opens to take the order and basically, you know, if you're an automotive or an aerospace company you say, "Hey I got to have a new product out, you know, two years from now.

I need a new laboratory or I need an upgraded laboratory." You're going to place those orders and the, you know, the window opens. They're going to place it with someone and that's your opportunity.

If - there is no going back later for that same order. It'll be issued and done. These are generally - even in our standard products these are all individual orders.

They're - it's not like they have a big - it's not like they're filling a factory with equipment over a several year period. These are laboratories and the window opens for them to purchase the equipment.

They buy it and they're finished and they go on. So our ongoing play for business with that lab is in the services area. That's why we're working on our services so hard but the equipment orders are very time-sensitive.

Kevin Sonnett: Got it. Okay thank you.

Jeffrey Graves: Thanks Kevin.

Operator: It appears there are no further questions at this time. Mister Graves I'd like to turn the conference back to you for any additional or closing remarks.

Jeffrey Graves: Okay thanks Erik. So listen thank you for participating in our call today. Let me say in closing that on behalf of all the employees of MTS we wish you all a happy, healthy and very safe holiday season.

We look forward to updating you on our progress again next quarter. Thank you and have a great day.

Operator: This concludes today's call. Thank you for your participation.

END