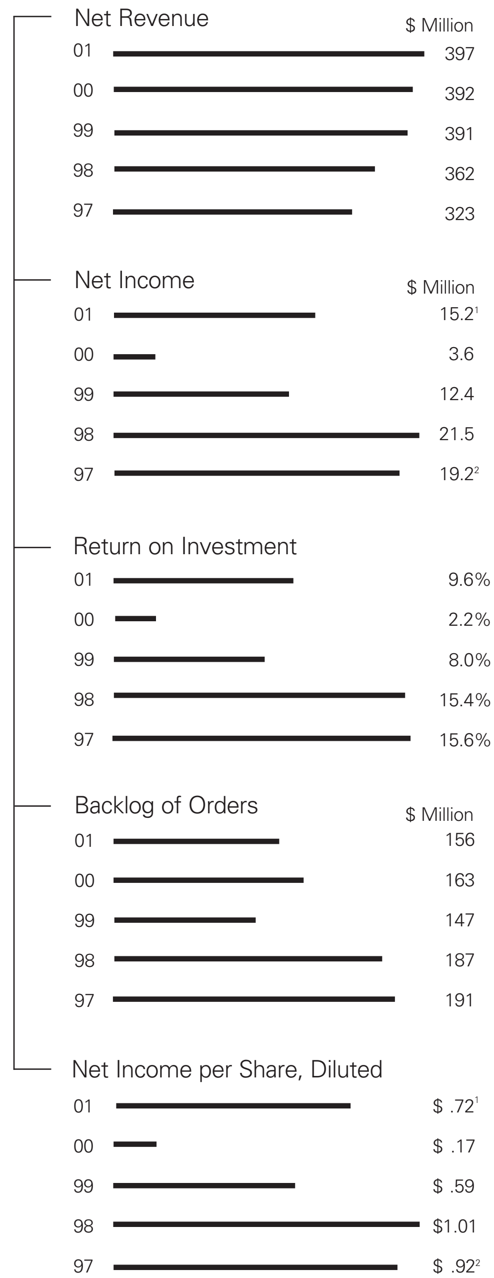
Annual Report to Shareholders 2001

delivering predictable and profitable results

Financial Highlights

(expressed in thousands except per share data)	**2001**	2000
Net revenue	**$396,641**	$391,853
Net income	**$ 15,176**[1]	$ 3,624
Net income per share, diluted	**$ .72**[1]	$ .17
Return on sales	**3.8%**	0.9%
Return on investment	**9.6%**	2.2%
Dividends per share	**$ .24**	$ .24
Shareholders' investment per share	**$ 7.95**	$ 7.61
Long-term capitalization ratio	**24.3%**	26.9%
Weighted average shares outstanding, diluted (000's)	**21,074**	20,935
New orders	**$384,900**	$415,900
Backlog of orders at year end	**$156,300**	$163,000



[1]Excludes the cumulative effect from the adoption of Staff Accounting Bulletin No. 101 as of October 1, 2000. The cumulative effect resulted in a reduction in net income of $2,263,000 ($0.11 per diluted share) in 2001.

[2]Excludes an after-tax gain of $2,654,000 ($0.13 per share) from the sale of land during 1997.

Our Mission

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

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

To Our Shareholders

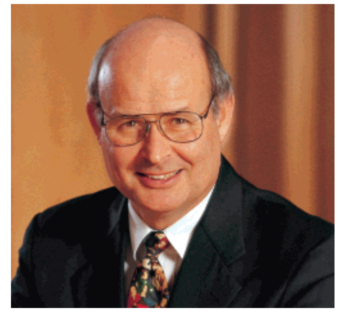
Fiscal 2001 was a recovery year for MTS, one in which we returned to our historical performance of predictability and improved profitability despite extraordinary swings in the market. The year began with a superheated demand for Factory Automation products that drove inventory up in attempts to secure enough material to meet forecasts. It ended with a thud, lackluster orders being depressed by the slowdown in spending across the North American automotive and industrial markets. With a decline in backlog during the second half of the year, it was clear that we were in a recession.

Despite these swings, earnings per share at 72 cents were on plan and up dramatically versus 17 cents last year on essentially flat revenue. We aggressively worked the process improvement actions focused on our project businesses with a very positive impact. Particularly important was the rigorous attention to what we term the “front-end” evaluations: assessing risks and mitigating actions on cost, performance, schedule, and contract terms. In the large-project world we paid particularly close attention to the timely availability of project staff. Furthermore, we reinforced the need for regular and consistent project reviews. We completed the downsizing and streamlining of our previously under-performing Powertrain and Materials Testing business units such that both were solidly profitable. By year-end, we were well into significant reduction actions in our Factory Automation units as well as selective staff reductions in each of the Mechanical Testing and Simulation units.

Despite all these actions, we still have much work to do on improving costs. At 36 percent, our gross margin, while much better than last year, still was not up to expectations. We did, however, offset increased pressure from competitive pricing in a very slow market by internal cost reductions.

On the balance sheet side we emphasized cash management, including better collection of receivables and negotiating more favorable payment terms on new business. As a result, we reduced working capital, paid down debt by $16 million, and put an additional $9 million cash on the books. We were not as successful as we had hoped in improving inventory turns. This was due in large part to the stock of purchased items built up late in fiscal 2000 and early in fiscal 2001 to meet forecasted demand, which ultimately did not materialize. At year-end we announced the sale of our Chaska, Minnesota, electronic assembly activities to PEMSTAR, thereby taking advantage of PEMSTAR’s high-volume electronics expertise and allowing us to focus on competencies more critical to our future. This will ultimately have a positive impact on both ongoing costs and the balance sheet.

Our strategy of becoming the preferred partner for integrated simulation solutions that improve and accelerate product development continues to be validated in the market. By



leveraging our knowledge of the physical world into software tools that complement and enhance our mechanical product offerings, we are seeing new opportunities. We are focusing this integration first on the automotive market, to be followed by similar thrusts into the aerospace and engineered materials markets. Our efforts at integrating physical and virtual tools have been well received, most recently at a widely attended symposium we co-hosted on intelligent digital prototyping strategies. To this end we strengthened knowledge of this market in the boardroom through the addition of two highly respected new board members: Bruce Hertzke, Chairman and CEO of Winnebago Industries, and Barb Samardzich, Chief Engineer at Ford Motor Company’s Automatic Transmission Engineering Operations.

We did see some positive market changes. Our aerospace structural testing business was strong, based largely on developments outside North America. New aircraft projects—both commercial and military—should continue this trend despite the slowdown in worldwide commercial air travel. We saw an increase in demand from automotive component and module suppliers, reflecting the flow down from the OEMs—also a trend that should continue. Orders for our very small force measurement systems—our Nano product line—were up significantly as were orders for our newly introduced analysis software products for the automotive market. While the latter are relatively small within the scope of the total Company, they represent growth opportunities for the future.

Over the year, the management team demonstrated its energy and ability to deliver predictable and profitable results to both customers and shareholders while quickly adjusting to market conditions. We have done what we said we would do in spite of a much different external marketplace than anyone anticipated. With the addition of Sue Knight as an experienced CFO, we expect this track record to continue.

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

Financial Comparison
(expressed in thousands)

	2001	2000	1999
Orders	**$308,181**	$314,872	$277,370
Net revenue	**$315,392**	$302,353	$313,685
Income from operations	**$ 26,835**	$ 3,250	$ 16,908
Percent of net revenue	**8.5%**	1.1%	5.4%

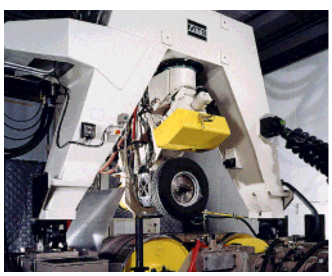
Auto Industry Solutions

At nearly $200 million, sales into the automotive design and development market comprise the largest component of this sector and of the company. While revenue was in line with our expectations, orders—at approximately $180 million—were well below, due largely to a reduction in spending by North American OEMs.

During the year we completed a broad strategic assessment of this market. The results pointed toward new opportunities for growth through developing and integrating analytical tools with our strong position in physical testing. In line with this, we enhanced our relationship with Mechanical Dynamics, Inc., of Ann Arbor, Michigan, and the U.K.-based company nCode International through a joint marketing and product development agreement named the SmartSim Community.SM Furthermore, we realigned our marketing and product development structure around the three main customer segments: automotive manufacturers, their suppliers, and the racing or motorsports market.

We created an automotive business strategy council to coordinate and prioritize multi-divisional activities into these markets and to facilitate the identification and capture of integrated solutions opportunities as they evolve.

Automotive Manufacturers



Our newest Flat-Trac tire testing system reliably simulates the dynamic forces involved in motorsports, SUV and other high-performance tire applications.

Because they operate in a fiercely competitive environment, automakers worldwide are focused on reducing their time to market and increasing their product offerings in specialty niches. This has driven more outsourcing of component and system development while reducing internal cost structures. Yet, as the ultimate integrator of vehicles they also bring the most comprehensive, sophisticated, and thus most technologically challenging demands. During the year we initiated the development of the world's first truly dynamic kinematics and compliance system targeted at validating ride and handling characteristics for a Japanese OEM. We completed the development of the first in a new family of high-speed, high-force vehicle tire development machines. At the same time we experienced increased demand for our tire performance testing products and continuing strong sales of our flagship road simulation equipment.

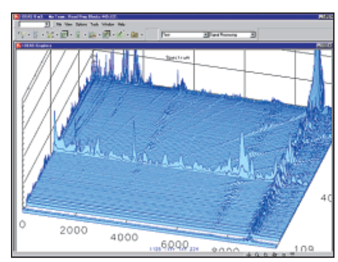
Addressing the evolution of physical to virtual testing, we announced new expanded versions of our Empirical Dynamics Models™ (EDM™) and Virtual Test Lab™ (VTL™) software products, putting then into practice at Mazda, Daimler Chrysler in Germany, and several other Japanese, Korean, and European auto manufacturers. New releases of our IDEAS-Pro™ noise and vibration software and Sound Quality™ software were widely applauded by customers worldwide. When coupled with jury evaluation software, our Sound Quality™ functionality for describing and predicting acoustic activity is unmatched. Overall sales of our new software products, while brisk, were hampered by lack of North American OEM funds for development process improvements.

The new SWIFT® HT extends the successful line of SWIFT wheel force transducers to the heavy truck market.

In the powertrain area we initiated a new development project for engine mapping and optimization software, to be introduced mid-2002. We expect these tools to strengthen our North American engine testing market position. During the year we were chosen to overhaul and upgrade diesel engine production test cells for Perkins Engine, a U.K. division of Caterpillar. This selection by a premier supplier to the off-road diesel engine market validates our strength in the rapidly growing diesel engine development world.

We ended fiscal 2001 with the largest project ever booked by MTS well underway. The advanced roadway simulator for the U.S. Army's Aberdeen Test Center will be the most sophisticated instrument in the world for testing the safety and performance of military vehicles. The $38 million project is progressing on schedule and on budget.

Automotive Suppliers



New user options give our I-DEAS Pro™ software more power and flexibility for noise and vibration engineering.

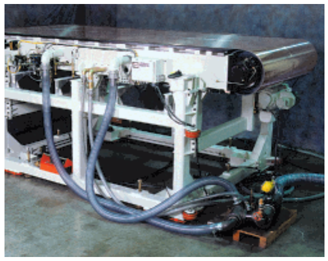
The outsourcing of component and module development from the OEMs to their suppliers is a dominant trend in North America and Europe and is growing in Japan and Korea.

With smaller budgets, less staff, and less complex validation needs, suppliers' buying decisions are driven by cost and meeting minimum OEM performance specifications. To meet these needs we expanded our TestStand business—based on our high-quality testing components and controls integrated locally for lowest cost delivery. TestStand volume has grown consistently in 2000 and 2001 through increased focus in North America and in Europe as well as new operations in Japan and Korea. This trend is likely to continue in 2002.

During the year we shipped new crash simulation projects to CIDAUT in Valladollid, Spain, and to CEAGA in Vigo, Spain, while initiating an extensive demonstration program at a number of elastomer suppliers worldwide on the capabilities of our EDM methods for product validation. We are completing the development of a new line of high-frequency, multi-axis simulation tables to meet these increased component testing demands. Consistent with our strategy, this new product family is being developed to meet both noise and vibration as well as durability requirements.

Motorsports

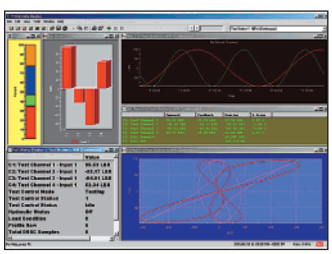
MTS has become the leading supplier of rolling road simulators used for aerodynamic optimization in the auto racing industry. We set the standard for performance in the Formula 1 arena, with projects underway or delivered to many of the leading racing teams. We are leveraging our technology leadership position to increase the use of our mainstream automotive simulation systems in the racing industry, and we are expanding our custom high-performance offerings into new areas, such as static and dynamic model support systems, along with racing transmission dynamometers. Selection by a major North American motorcycle manufacturer for a virtual engine application further enhanced our position here.



Motorsports teams "drive" actual cars or test models on our Rolling Road systems inside wind tunnels to study the effect of aerodynamics on vehicle performance.

Aerospace Industry Solutions

Our aerospace structures and materials business posted a record year. Despite a slowdown in the commercial transport sector, regional jet, military craft, and space systems activity grew significantly. This year we introduced AeroPro™ data-acquisition software to meet the industry's need to acquire and manage increasingly large amounts of test data. We plan to introduce significantly enhanced capabilities in this area in fiscal 2002. Major wins included structural testing at Embraer for the ERJ 170 and 190 regional jets, the Japanese Defense Agency for a major aircraft development program, several large Korean and Chinese developments, and the first order from the European Aeronautic Defence and Space Company in Hamburg, Germany, for A-380 component testing. Our noise and vibration business expanded in the aerospace sector also, with continuing sales of ground vibration test software and numerous wins in the European market.



AeroPro data-acquisition software is our latest state-of-the-art software package for managing aerospace structural tests.

We continue to see growing interest in the aerospace industry in our capabilities in friction stir welding. This technology reduces assembly costs by eliminating the need for thousands of airplane rivets. It also produces stronger, lighter joints more efficiently than traditional processes. In 2001 we received a contract from Eclipse Aviation to develop systems and processes for friction stir welding on the 6-passenger Eclipse 500 jet. This is the world's first application of this technology for the fabrication of sophisticated aircraft structures. During the year we were selected by the U.S. Office of Naval Research and the South Dakota School of Mines and Technology for a major process refinement project in both friction stir welding and laser formed parts manufacturing. We also commissioned the second of two linear friction welders, which uses a related technology, for a manufacturer of large jet engines.

Solutions Across Industries

Our mechanical testing and simulation sector serves a diverse range of other industries and markets. These include civil engineering; advanced manufacturing; plus development and testing of engineered materials, medical devices, and consumer products.

In civil engineering we remain the world's leading supplier of earthquake simulation systems. In 2001 we concentrated our North American efforts on universities that are involved in the National Earthquake Engineering Simulation program sponsored by the National Science Foundation. In Japan, we continued our support of what will be the world's largest seismic simulation system, the NIED project in the city of Miki, as well as upgrades at our other Japanese installations. In Asia, we won a large project at the prestigious China Academy of Building Research in Beijing. Overall we won or have been selected for more than $25 million of seismic simulation business—a record year in this market.

In material testing we focused primarily on enhancing our business processes to reduce costs and delivery times. By improving quality in our electromechanical testing product line, we reduced warranty costs by almost 50 percent. To reduce delivery times of our servohydraulic testing systems, we executed a pilot product standardization program. The first systems delivered through this program shipped in half the time previously required. We plan to expand this delivery-streamlining program to the balance of our servohydraulic products during the coming year.

The brightest growth area in our materials testing markets is nanomechanical testing, which involves highly precise testing of very small specimens and thin coatings and surfaces. We introduced a new system in this area to meet the quality control needs of the semiconductor industry, and we will continue to pursue new opportunities with new products aggressively in nanomechanical testing, where we anticipate double-digit growth in both revenue and earnings again in 2002.

Versatile and highly accurate, the new Nano Indenter® XPW system meets the ultraprecise testing needs of the semiconductor industry.

Financial Comparison
(expressed in thousands)

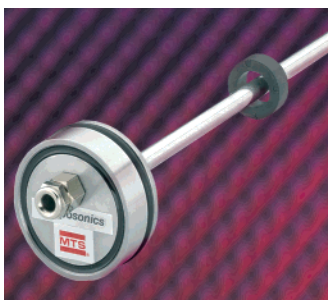
	2001	2000	1999
Orders	**$ 76,734**	$101,007	$ 72,820
Net revenue	**$ 81,249**	$ 89,500	$ 76,857
Income from operations	**$ 2,705**	$ 8,583	$ 6,429
Percent of net revenue	**3.3%**	9.6%	8.4%

Position Sensors

Revenues in our sensors business decreased slightly this year, due to lower durable goods production in our major markets, particularly in injection molding. The decrease was in the North American and Asian markets. Business in Europe grew 10 percent in local currency, although the trend slowed in the last several quarters. The strength of the dollar continues to shift business to Europe, where growth in the machine sector partially offset the declines in the United States and Japan. With our manufacturing facility in Germany, we are able to take advantage of such shifts.

The modular structure of our sensor technologies gives us the flexibility to aggressively pursue new markets, such as converting machines, printing presses and mobile equipment powered by hydraulic cylinders. We are able to quickly address special mounting, power, and packaging considerations to match customer specifications.

Last year we introduced new low-cost and high-performance products, which created exciting new sales, partially offsetting the effect of the worldwide economic slump. Additionally, we expanded the onboard automotive applications of our sensors from vehicle suspensions to potential volume in steering and transmission applications.



A compact design makes the new Temposonics® MH sensor easy to integrate into on- and off-road mobile equipment, such as farm and construction machinery.

Automation

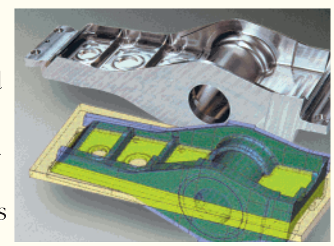
This unit suffered the most from the changes in the economy. We bounced from high production ramp-up rates in the first quarter to cancellations in the second quarter and to depressed order levels through the balance of the year. We were impacted most by the virtual cessation of demand from electronic assembly and semiconductor fabrication equipment manufacturers. The consolidation of facilities from prior acquisitions was accelerated in midyear and further so by year-end. While we wrote off the downsizing expenses in the fourth quarter, we expect the impact of these changes to take several quarters to be completely effective.

During the year we leveraged the previously acquired SensorlessServo™ motor drives along with a new digital amplifier product into several major new customer opportunities. Our high-power gradient amplifier product line for magnetic resonance imaging machines saw double-digit growth due to sales to new commercial customers and increased demand at research institutions.

New control technology makes our SensorlessServo™ motor drives ideal for simplifying control systems in OEM applications where size and weight are critical.

AEROMET℠

Our venture into laser additive manufacturing through our wholly owned subsidiary, AeroMet, continued to make progress in both process repeatability and proving that the results are acceptable for the rigorous demands of military aircraft. During the year we successfully completed titanium component article tests for Boeing, Lockheed Martin, and Northrop Grumman. We received our first qualification order for commercial aircraft parts and initiated work on engine cases for a major jet engine manufacturer. Just after year-end we won a study project for the U.S. Air Force to develop rapid repair capabilities for F-15 fighter aircraft components. Successful completion of this contract coupled with acceptance of ongoing prototype work on other fighter aricraft replacement parts should lead to production orders during fiscal 2002. Thus we expect AeroMet to transition from a development stage business to a self-sustaining company by mid-2003.



AeroMet's laser additive manufacturing process creates aerospace-quality titanium parts from software designs without forging or casting. Shown is a pylon rib preform for an F-15 fighter jet.

Also during the year we initiated activity on other metals using this process, including rhenium and tantalum. These metals appear to be promising candidates for our laser-additive manufacturing process.

Six Year Financial Summary
(September 30)

	2001	2000	1999	1998	1997	1996
	(expressed in thousands, except per share data and numbers of shareholders and employees)					
Operations[1]						
Net revenue	**$ 396,641**	$391,853	$390,542	$362,163	$323,424	$278,170
North America revenue	**192,990**	194,056	200,556	200,490	156,877	140,249
International revenue	**203,651**	197,797	189,986	161,673	166,547	137,921
Gross profit	**141,408**	132,940	151,171	142,227	132,073	116,047
Gross profit as a % of net revenue	**35.7%**	33.9%	38.7%	39.3%	40.8%	41.7%
Research and development costs	**22,485**	24,619	26,966	24,348	19,798	19,776
Research and development costs as a % of net revenue	**5.7%**	6.3%	6.9%	6.7%	6.1%	7.1%
Income before income taxes	**24,578**[2]	6,095	18,770	33,448	29,986[3]	21,813
Effective income tax rate	**38%**	41%	34%	36%	36%	31%
Net income	**15,176**[2]	3,624	12,445	21,539	19,237[3]	15,170
Net income as a % of net revenue	**3.8%**[2]	.9%	3.2%	5.9%	5.9%[3]	5.5%
Net income per diluted share of common stock	**.72**[2]	.17	.59	1.01	.92[3]	.72
Weighted average diluted shares outstanding during the year[4]	**21,074**	20,935	21,184	21,330	20,945	21,184
Net interest expense	**4,837**	4,892	4,597	1,948	1,125	1,123
Depreciation and amortization	**14,477**	15,294	14,424	10,880	9,608	8,673
Financial Position						
Current assets	**$ 230,249**	$225,273	$223,651	$204,311	$162,814	$ 137,584
Current liabilities	**105,073**	108,648	104,713	110,223	83,413	63,465
Current ratio	**2.2:1**	2.1:1	2.1:1	1.9:1	2.0:1	2.2:1
Net working capital	**125,176**	116,625	118,938	94,088	79,401	74,119
Property and equipment, net	**68,893**	72,081	73,633	69,942	51,790	49,476
Total assets	**331,759**	330,234	333,347	313,022	229,075	197,679
Interest bearing debt	**59,305**	75,712	71,637	74,682	12,865	11,836
Total shareholders' investment	**167,122**	157,854	162,859	152,689	133,524	120,578
Shareholders' investment per share	**7.95**	7.61	7.80	7.39	6.56	5.90
Interest bearing debt as a % of shareholders' investment	**35.5%**	48.0%	44.0%	48.9%	9.6%	9.8%
Return on beginning shareholders' investment	**9.6%**	2.2%	8.0%	15.4%	15.6%[3]	13.0%
Return on average net assets[5]	**13.4%**	4.9%	10.7%	20.9%	22.7%	17.6%
Other Statistics						
Number of common shareholders of record at year end[6]	**2,086**	2,229	2,055	1,760	1,575	1,523
Number of employees at year end	**2,224**	2,350	2,436	2,424	2,125	1,866
New orders received	**$ 384,900**	$ 415,900	$350,200	$352,300	$380,900	$ 302,800
Backlog of orders at year end	**$ 156,300**	$ 163,000	$146,800	$187,200	$190,800	$ 130,600
Cash dividends paid per share	**$ .24**	$ .24	$ .24	$ .24	$ .20	$ .16

[1] *All amounts have been restated to reflect the acquisition of DSP Technology, Inc.in 1999 that was recorded under the pooling-of-interest method.*

[2] *Excludes the cumulative effect from the adoption of Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements"as of October 1, 2000. The cumulative effect resulted in a reduction in net income of $2,263 ($0.11 per diluted share) in fiscal 2001.*

[3] *Excludes an after-tax gain of $2,654 ($0.13 per share) from the sale of land during 1997.*

[4] *Assumes the conversion of potential common shares using the treasury stock method.*

[5] *Income before income taxes and net interest expense divided by average net assets employed (exclusive of non-interest bearing liabilities).*

[6] *Does not include beneficial shareholders whose stock is held by nominees or broker dealers.*

Customer Orders and Backlog

	2001	2000	1999
		(expressed in thousands)	
Customer Orders:			
North America*	**$208,400**	$233,700	$196,400
International	**176,500**	182,200	153,800
Total	**$384,900**	$415,900	$350,200
Backlog of Undelivered Orders	**$156,300**	$163,000	$146,800

**Includes U.S. and Canada*

New orders from customers during 2001 totaled $384.9 million, a decrease of $31.0 million or 7.4% compared to customer orders of $415.9 million booked in 2000. In 1999, customer orders totaled $350.2 million. In 2001, the Company received an order from a customer for $10.8 million and in 2000 a contract totaling $18.6 million was received from another customer, each of which were customers of the Mechanical Testing and Simulation ("MT&S") Sector. No individual customer order over $10 million was booked during 1999.

Orders for the MT&S Sector totaled $308.2 million in 2001, a decrease of $6.7 million or 2.1%, compared to customer orders of $314.9 million for 2000. The MT&S Sector booked 80.1% of total Company orders in 2001, compared to 75.7% for 2000. During 2001, the Company continued to experience strong order demand worldwide for its aircraft structural testing equipment and in the custom project business of its Advanced Systems business unit, offset somewhat by the continuing slowdown in North American business levels especially as a result of cut backs in capital spending in the North American automotive market. Despite the overall slowdown in the North American automotive market place, the Company, along with its strategic alliance partners, continued to see growing demand for software and analysis products targeted principally at the automotive design validation marketplace. Orders from the ground vehicle industry in North America and for aerospace applications were particularly strong during 2000. Generally, orders from customers outside the United States (including Europe, Japan, Korea and Southeast Asia) during 2001 were strong for each of the business units comprising the MT&S Sector. Orders received during 2000 from the Asia/Pacific Region, especially Japan, were much stronger for vehicle testing systems and aerospace applications compared to 1999. Orders from Europe in 2000 were consistent with the order levels in 1999.

New orders for the Factory Automation ("FA") Sector totaled $76.7 million for 2001, a decrease of $24.3 million, or 24.1%, compared to new orders written during 2000 of $101.0 million. Customer orders in this sector were particularly weak during fiscal 2001, especially as the result of aggressive cut backs in capital spending in the North American automotive market and a precipitous drop in North American and European demand for the Company's automation components in the semiconductor, electronic assembly and industrial markets. The FA Sector accounted for 19.9% of total Company orders during fiscal 2001, compared to 24.3% in 2000. During fiscal 2000, the FA Sector experienced solid growth in Europe and Japan while orders for industrial automation applications (servo motors, amplifiers and motion controllers) and industrial sensors in the North American marketplace were much stronger, compared to the prior year.

On a geographical basis, orders from customers located in North America totaled $208.4 million during 2001, down $25.3 million or 10.8% compared to orders received of $233.7 million in 2000. North American orders received during fiscal 1999 totaled $196.4 million. International orders received during 2001 of $176.5 million decreased by $5.7 million, or 3.1%, compared to orders received during 2000 of $182.2 million. International orders in fiscal 1999 totaled $153.8 million. The following table reflects the geographical analysis of new orders received during the years ended September 30:

Geographic Analysis of New Orders

	2001	2000	1999
North America	**54%**	56%	56%
Europe, Africa, and Middle East	**23**	26	30
Asia Pacific, including Japan	**23**	18	13
Other	-	-	1

The backlog of undelivered orders at September 30, 2001 totaled $156.3 million, a decrease of approximately $6.7 million, or 4.1%, compared to backlog of $163.0 million at September 30, 2000. Backlog at the end of fiscal 1999 totaled $146.8 million.

Net Revenue

	2001	2000	1999
		(expressed in thousands)	
North America	**$187,998**	$205,781	$210,924
International	**208,643**	186,072	179,618
Total	**$396,641**	$391,853	$390,542

Net revenue of $396.6 million for fiscal 2001 increased $4.7 million or 1.2%, compared to $391.9 million for fiscal 2000. Net revenue for fiscal 1999 totaled $390.5 million. On a sector basis, revenue of the MT&S Sector totaled $315.4 million, comparing favorably to revenue of $302.4 million in fiscal 2000 and $313.7 million in fiscal 1999. The increase in revenue for fiscal 2001 was principally the result of strong demand worldwide for its aircraft structural testing equipment and the custom project business of its Advanced Systems business unit. Despite the slow down in capital spending in the North American automotive market during fiscal 2001, revenue backlog and new orders from customers in the automotive product development market remained at an adequate level during fiscal 2001 to allow the vehicle testing systems business unit to slightly exceed its revenue of fiscal 2000. Net revenue of the FA Sector totaled $81.2 million in fiscal 2001, compared to $89.5 million in fiscal 2000 and $76.9 million in fiscal 1999. Net revenue of the FA Sector during 2001 was negatively impacted by the aggressive cut backs in capital spending in the North American automotive market and a precipitous drop in North American and European demand for its automation components in the semiconductor, electronic assembly and industrial markets. The increase in revenue of the FA Sector during fiscal 2000, as compared to fiscal 1999, was the result of strong European demand for sensors and an expansion of the Company's product line offerings for amplifiers, servo-electric motors and motion control products. See Note 3 to Consolidated Financial Statements for additional information on industry sector and geographic information.

Net revenue in North America of $188.0 million decreased slightly, compared to $205.8 million in 2000. Net revenue for 1999 totaled $210.9 million. International revenue totaled $208.6 million, an increase of 12.1%, compared to revenue of $186.1 million for 2000. Net revenue from international sources totaled $179.6 million in 1999. Similar to the past several years, revenue from international sources grew at a faster rate than domestic revenue and is generally reflective of improved economic conditions in the international markets in which the Company participates, a broader product offering and stronger order activity in the vehicle dynamics and aerospace industries.

Although selective price changes were implemented during each of the three years, the overall impact of pricing changes did not have a material effect on reported revenue. During fiscal 2001, the Company implemented Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements," which had the effect of increasing reported revenue in fiscal 2001 by $4.9 million. See Notes 1 and 2 to Consolidated Financial Statements for additional information.

Gross Profit

	2001	2000	1999
	(expressed in thousands)		
Gross Profit	**$141,408**	$132,940	$151,171
% of Net Revenue	**35.7%**	33.9%	38.7%

Gross profit, as a percentage of net revenue, increased to 35.7% in 2001, compared to 33.9% in 2000. Gross margin for the MT&S Sector was 35.0% in fiscal 2001, up substantially from 31.8% in 2000, while the gross margin of the FA Sector declined to 38.1%, compared to 41.1% in 2000, primarily as the result of the significantly lower manufacturing and shipping volumes during fiscal 2001. Gross margin in the MT&S Sector increased during 2001 despite continued competitive pricing pressures and was the result of a number of factors, including a favorable mix of aerospace and custom projects shipped during the year, more aggressive negotiation strategies, better overall project planning, staffing and management and the positive impact of the Company's re-engineering and front-end project assessment activities initiated in previous periods. The lower gross profit percentage realized by the MT&S Sector during 2000 was the result of higher than expected costs that were required to complete certain custom entertainment and large complex custom projects of the Advanced Systems business unit.

Selling, General, and Administrative Expenses

	2001	2000	1999
	(expressed in thousands)		
Selling	**$ 57,669**	$ 58,747	$ 58,695
General & Administrative	**31,714**	36,531	35,071
Total	**$ 89,383**	$ 95,278	$ 93,766
% of Net Revenue	**22.5%**	24.3%	24.0%

Selling, general and administrative ("SG&A") expenses, as a percentage of net revenue, were 22.5%, 24.3% and 24.0% in 2001, 2000 and 1999, respectively.

Over the past three years, the Company has focused several initiatives on overall cost control and the alignment of resources with current and anticipated economic conditions and with markets having the greatest potential. Overall spending levels in each of the MT&S and FA Sectors were reduced during 2001 as a result of these management initiatives. During 2000, SG&A expenses of the FA Sector increased in anticipation of accelerated revenue growth of the Sensors and Automation business units. Administrative expenses of the MT&S Sector included a provision of $0.7 million in 2000 related to the closure of the Company's laboratory instrument business as discussed further in Note 9 to the Consolidated Financial Statements.

Research and Development Costs

	2001	2000	1999
	(expressed in thousands)		
Research & Development	**$22,485**	$24,619	$26,966
% of Net Revenue	**5.7%**	6.3%	6.9%

The Company provides funds for product, systems and application developments ("R&D") in the MT&S and FA Sectors. During 2001, approximately 70% of R&D spending was in the MT&S Sector, compared to 73% in fiscal 2000. R&D spending in each of the years presented is focused on the development of new systems and system components such as software, controls and mechanical products, new measurement products and accessories.

The overall decrease in R&D spending, as a percentage of net revenue, is primarily due to management initiatives to focus its spending in areas and on products having the greatest market potential and the highest return opportunity. As a result of these initiatives and management's planned cutback in spending in underperforming product lines and/or business units, R&D spending, as a percentage of net revenue, decreased to 5.7% in fiscal 2001, compared to 6.3% in 2000 and 6.9% in 1999.

Interest (Income) Expense

	2001	2000	1999
	(expressed in thousands)		
Interest Expense	**$ 5,209**	$ 6,371	$5,067
Interest Income	**(372)**	(1,479)	(470)

Interest expense of $5.2 million in 2001, a decrease of $1.2 million compared to fiscal 2000, primarily resulted from lower average borrowings during 2001 and a generally lower interest rate on its borrowings under its bank line of credit. Interest income in 2000 included interest earned of $0.7 million related to the overpayment of income taxes during a prior period.

Operating Results

	2001	2000	1999
	(expressed in thousands except per share data)		
Income Before Income Taxes*	**$24,578**	$ 6,095	$18,770
% of Net Revenue	**6.2%**	1.6%	4.8%
Income Before Cumulative Effect of Accounting Change, Net of Taxes	**$15,176**	$ 3,624	$12,445
% of Net Revenue	**3.8%**	.9%	3.2%
Effective Income Tax Rate	**38.3%**	40.5%	33.7%
Return On Beginning Shareholders' Investment*	**9.6%**	2.2%	8.0%
Earnings Per Share – Diluted*	**$ .72**	$ .17	$ .59

**excludes the cumulative effect of the accounting change for SAB 101 in 2001*

Income before income taxes totaled $24.6 million in 2001, compared with $6.1 million in 2000, primarily as the result of overall improved product margins and the continuing effect from the Company's cost control and more focused spending programs. Income before income taxes for 2000 included a provision of $3.0 million (of which, $1.2 million is reflected as restructuring, $1.1 million as an increase to cost of revenue and $0.7 million as an increase to administrative expenses) related to the closure of its laboratory instrument business acquired as part of its acquisition of DSP Technology, Inc. ("DSP"). During 1999, the Company recorded a restructuring charge of $5.7 million as a result of the closure of its manufacturing operations in France and the transfer of this product line to its electromechanical division in North Carolina and incurred costs of approximately $1.4 million directly related to its acquisition of DSP. For further information, see Notes 8 and 9 to Consolidated Financial Statements.

Income from operations of the MT&S Sector increased to $26.8 million in 2001, compared to $3.2 million in 2000. This increase in income from operations was primarily the result of increased net revenue of $13.0 million, improved gross margin of 3.2 percentage points and management's initiative of continued cost control and more focused spending. Income from operations of the MT&S Sector totaled $16.9 million in 1999. Income from operations of the FA Sector declined to $2.7 million in 2001, compared to $8.6 million in 2000 primarily as the result of the aggressive cut backs in capital spending in the North American automotive market, a precipitous drop in North American and European demand for its automation components in the semiconductor, electronic assembly and industrial markets and lower overall gross margins due to the significantly lower manufacturing and shipping volumes during fiscal 2001. Income from operations of the FA Sector totaled $6.4 million in 1999.

The effective tax rate for each of the years presented is impacted by the amount of tax credits available from the Company's Foreign Sales Corporation, Extraterritorial Income Exclusion and qualified R&D costs; and on the amount of foreign sourced income that is generally taxed at higher rates than domestic sourced income. A greater percentage of the Company's income was derived from foreign sources in fiscal 2000, compared to 2001 and 1999.

In 2001, income before cumulative effect of accounting change for SAB 101 increased to $15.2 million ($0.72 per diluted share), compared to $3.6 million ($0.17 per diluted share) in 2000 and $12.4 million ($0.59 per diluted share) in 1999. During 2001, the Company implemented SAB 101 that had the cumulative effect of reducing net income, net of taxes, by $2.3 million ($0.11 per diluted share) in fiscal 2001.

Changes in Foreign Currency Exchange Rates

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

Historically, approximately 50% of the Company's revenue occurs from shipments to customers outside of the United States and about 65% of this revenue (approximately 30% of the Company's total net revenue) is denominated in currencies other than the U.S. dollar. As a result, a strengthening of the U.S. dollar decreases translated foreign currency denominated revenue and earnings. Conversely, weakening of the U.S. dollar has the reverse impact on revenue and earnings. During the past three years, the U.S. dollar was generally stronger against other major currencies. Gains and losses attributed to translating the financial statements for all non-U.S. subsidiaries are included in the currency translation adjustments. The gains and losses on forward exchange contracts used to hedge these exposures are included as part of "Other expense (income), net" in the accompanying consolidated statements of income.

Liquidity and Capital Resources

	2001	2000	1999
	(expressed in thousands except per share data)		
Total Interest Bearing Debt	**$ 59,305**	$ 75,712	$ 71,637
% of Total Capitalization	**26.2%**	32.4%	30.5%
Total Shareholders' Investment	**$167,122**	$157,854	$162,859
Shareholders Investment Per Share	**$ 7.95**	$ 7.61	$ 7.80

The Company's capital structure as of September 30, 2001 included long-term debt (including current maturities) of $58.9 million, notes payable to banks of $0.4 million and total shareholders' investment of $167.1 million. The ratio of total interest-bearing debt to total capitalization was 26.2% at September 30, 2001, as compared to 32.4% and 30.5% at September 30, 2000 and 1999, respectively.

Total interest-bearing debt decreased by $16.4 million during 2001. This decrease resulted from the repayment of advances totaling $11.5 million under its domestic bank revolving credit agreement and scheduled payments of $4.9 million of long-term debt. At September 30, 2001, the Company had no borrowings outstanding under its $50.0 million domestic bank revolving credit agreement.

Shareholders' investment increased by $9.3 million during fiscal 2001 to $167.1 million. The change in shareholders' investment during 2001 was primarily the result of profitable operating results, funds received of $3.5 million from the exercise of employee stock options and employee purchases of the Company's stock under its stock purchase plan, offset in part, by the payment of cash dividends of $5.0 million and repurchases of the Company's stock totaling $1.6 million.

Cash Flows

Cash flows from operating activities provided cash of $39.1 million during 2001, compared to $3.0 million generated in 2000 and $26.7 million generated in 1999. The increase in cash during 2001 resulted primarily from improved operating results and the increase in advanced payments from customers of $8.3 million. Accounts receivables and inventory balances, in the aggregate, remained relatively unchanged at September 30, 2001 and 2000.

Cash flows from investing activities required cash usage of $10.5 million during 2001, compared to $13.2 million in 2000 and $17.2 million in 1999. Cash was used primarily for additions to property and equipment in each of the years. Capital expenditures for fiscal 2002, including investments in facilities and equipment to support the on-going operations, are planned to approximate $8.0 million.

Cash flows from financing activities required the use of cash of $19.6 million during 2001 primarily as a result of the repayment of interest-bearing debt of $16.6 million, the payment of cash dividends of $5.0 million and repurchases of its common stock of $1.6 million, partially offset by funds received in connection with employees' exercise of stock options and purchases under the Company's stock purchase plan. During 2000, the Company used cash of $1.0 million in its financing activities primarily as the result of paying cash dividends of $5.0 million and repurchasing $2.2 million of its common stock, partially offset by additional new borrowings of $6.1 million and the funds received in connection with employees' exercise of stock options and stock purchases.

During 2001, cash and cash equivalents increased by $9.3 million. The Company believes that the current capital resources, internally generated funds and unused financing sources will be adequate to finance on-going operations and anticipated capital expenditures, allow for investment in opportunities to internally grow its business and to make selected strategic acquisitions.

Other Matters

Euro Conversion

On January 1, 1999, certain member countries of the European Economic and Monetary Union adopted the "Euro" as a form of common currency. For a three-year transition period, both the Euro and the member countries' currencies remained in use. The Company has upgraded its information and reporting systems, where necessary, in order to appropriately effect conversion to the Euro. Although the Company began processing Euro transactions with its customers beginning in 1999, its European operations began reporting in this currency on various dates beginning in 2000. The cost of upgrading its systems to handle the Euro conversion did not have a material impact on the Company's financial condition or operating results for any period presented.

Restructuring and Other Charges

During 2000, the Company announced a restructuring charge related to the discontinuation of a line of data acquisition products acquired as part of its acquisition of DSP in 1999. The restructuring charge of $1.2 million included a provision for severance costs of $0.7 million, the write-off of leasehold improvements and production and other equipment no longer needed of $0.3 million and other costs of $0.2 million associated with the close-down of the facility and the wind-down of the related product line. During the year ended September 30, 2001, the restructuring reserve was reduced by severance costs of $0.8 million, the write off of leasehold improvements, equipment and other assets aggregating $0.2 million and costs associated with the closing of the facility and the wind-down of the product line of $0.2 million. In addition to the restructuring charge, the Company recorded an additional provision of $1.8 million in fiscal 2000 to cover excess and obsolete inventory, uncollectible receivables and the write off of the remaining book value of fixed assets no longer needed. Of this amount, $1.1 million was charged to cost of revenue and $0.7 million was charged to general and administrative expenses.

During 1999, the Company recorded a restructuring charge of $5.7 million as a result of the closure of its manufacturing operations in France and the transfer of this product line to its electromechanical division in North Carolina. In connection therewith, cash outlays of $2.6 million were made during 1999 and $3.1 million were made during 2000. Such costs were financed primarily with funds from continuing operations and borrowings under its bank line of credit.

Quarterly Financial Information

Revenue and operating results, as reflected on a quarterly basis, do not necessarily reflect changes in the demand for the Company's products or its operating efficiency. Revenue and operating results in any quarter can be significantly affected by shipment and/or installation delays or the acceleration of the completion of one or more high-value systems where revenue is not recognized on the percentage-of-completion accounting method. The Company's use of the percentage-of-completion revenue recognition method for large longer-term projects, generally helps to alleviate significant fluctuations between quarters. See Notes 1 and 2 to Consolidated Financial Statements for additional information on the Company's revenue recognition policy. High-value, state-of-the-art custom projects often contain leading-edge applications of the Company's technology that caused the Company to experience lower than expected gross margins during 1999 and 2000. Product development for these types of state-of-the-art custom projects, along with its funded research and development programs, are essential to the Company's long term growth.

Quarterly earnings also vary as the result of the use of estimations including, but not limited to the rates used in providing federal, state and foreign income taxes. See Notes 1 and 5 to Consolidated Financial Statements for additional information on the Company's use of estimates and income tax related matters.

Dividends and Other Stock Matters

The Company's dividend policy is to maintain a payout ratio that allows dividends to increase with the long-term growth of earnings per share, while sustaining dividends in down years. The Company's dividend payout ratio target is approximately 25% of earnings per share over the long term. The Company paid a quarterly dividend of 6 cents per share during 1999, 2000 and 2001.

During 2001, the Company repurchased 0.2 million shares of its common stock at an average cost of $8.19 per share. Pursuant to the plan adopted by its Board of Directors, the Company has authorization as of September 30, 2001 to repurchase an additional 0.5 million shares of its common stock. The Company also repurchased 0.3 million shares of its common stock ($7.28 per share) in 2000. The Company's primary long term objective relative to its share repurchase program is to offset the dilutive effect of shares of common stock issued in connection with its employee stock option and stock purchase programs. During the three years ended September 30, 2001, the Company has issued approximately 872,000 shares of its common stock under the stock option and stock purchase programs.

Quarterly Stock Activity (1)

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

	2001			2000		
	Price High	Price Low	Shares Traded	Price High	Price Low	Shares Traded
1st Quarter	**$ 7.88**	**$ 5.50**	**1,698**	$10.63	$ 7.50	3,526
2nd Quarter	**$ 9.19**	**$ 6.75**	**1,711**	$ 9.59	$ 5.38	4,318
3rd Quarter	**$14.60**	**$ 7.88**	**5,233**	$ 7.88	$ 6.19	4,648
4th Quarter	**$15.60**	**$10.00**	**5,365**	$ 7.50	$ 6.00	3,385

(1) Source: The Nasdaq Stock Market

Selected quarterly financial information for the three fiscal years ended September 30 is presented below:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
	(expressed in thousands except per share data)				
2001					
Net revenue	$ 91,563	$98,272	$99,031	$107,775	$396,641
Gross profit	31,951	35,600	37,210	36,647	141,408
Income before income taxes	2,772	6,408	6,933	8,465	24,578
Income before cumulative effect of accounting change, net of taxes	1,698	3,853	4,233	5,392	15,176
Cumulative effect of accounting change, net of taxes	(2,263)	-	-	-	(2,263)
Net income (loss)	$ (565)	$ 3,853	$ 4,233	$ 5,392	$ 12,913
Earnings per share					
Basic					
Before cumulative effect of accounting change	$ .08	.19	.20	$ .26	$ .73
Cumulative effect of accounting change, net	(.11)	-	-	-	(.11)
Net income (loss)	$ (.03)	$ .19	$ .20	$ .26	$ .62
Diluted					
Before cumulative effect of accounting change	$ .08	.18	.20	$ .25	$ .72
Cumulative effect of accounting change, net	(.11)	-	-	-	(.11)
Net income (loss)	$ (.03)	$ .18	$ .20	$ .25	$ .61
2000					
Net revenue	$ 87,214	$95,291	$94,988	$114,360	$391,853
Gross profit	22,786	34,470	34,797	40,887	132,940
Income (loss) before income taxes	(9,221)	2,213	5,831	7,272	6,095
Net income (loss)	$ (6,040)	$ 1,371	$ 3,697	$ 4,596	$ 3,624
Earnings per share					
Basic	$ (.29)	$ .07	$ .18	$ .22	$ .17
Diluted	(.29)	.07	.18	.22	.17
1999					
Net revenue	$ 96,142	$93,262	$95,363	$105,775	$390,542
Gross profit	38,064	36,775	37,818	38,514	151,171
Income before income taxes	5,722	4,666	8,269	113	18,770
Net income	$ 3,726	$ 3,146	$ 5,293	$ 280	$ 12,445
Earnings per share					
Basic	$ .18	$ .15	$ .25	$ .01	$ .60
Diluted	.18	.15	.25	.01	.59

Consolidated Balance Sheets
(September 30)

Assets	2001	2000
	(expressed in thousands)	
Current Assets:		
Cash and cash equivalents	**$ 17,515**	$ 8,211
Accounts receivable, net of allowance for doubtful accounts of $2,709 and $2,255	**97,661**	117,866
Unbilled contracts and retainage receivable	**45,287**	26,765
Inventories	**63,381**	62,520
Prepaid expenses	**6,405**	9,911
Total current assets	**230,249**	225,273
Property and Equipment:		
Land	**3,247**	3,247
Buildings and improvements	**45,785**	44,733
Machinery and equipment	**110,419**	107,325
Accumulated depreciation	**(90,558)**	(83,224)
Total property and equipment, net	**68,893**	72,081
Other Assets	**32,617**	32,880
Total Assets	**$331,759**	$330,234

Liabilities and Shareholders' Investment		
Current Liabilities:		
Notes payable to banks	**$ 428**	$ 11,945
Current maturities of long-term debt	**5,260**	5,663
Accounts payable	**16,672**	22,755
Accrued payroll-related costs	**33,661**	29,285
Advance payments from customers	**26,572**	18,673
Accrued warranty costs	**4,559**	6,487
Other accrued liabilities	**16,395**	13,680
Accrued income taxes	**1,526**	160
Total current liabilities	**105,073**	108,648
Deferred income taxes	**5,947**	5,628
Long-term debt, less current maturities	**53,617**	58,104
Commitments and Contingencies (Note 10)		
Shareholders' Investment:		
Common stock, 25¢ par value; 64,000 shares authorized:		
21,031 and 20,748 shares issued and outstanding	**5,258**	5,187
Additional paid-in capital	**8,946**	7,072
Retained earnings	**154,159**	146,234
Accumulated other comprehensive loss	**(1,241)**	(639)
Total shareholders' investment	**167,122**	157,854
Total Liabilities and Shareholders' Investment	**$ 331,759**	$330,234

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

Consolidated Statements of Income and Shareholders' Investment
(For the Years Ended September 30)

Income	**2001**	2000	1999
	(expressed in thousands except per share data)		
Net Revenue	**$396,641**	$391,853	$390,542
Cost of Revenue	**255,233**	258,913	239,371
Gross Profit	**141,408**	132,940	151,171
Operating Expenses:			
Selling	**57,669**	58,747	58,695
General and administrative	**31,714**	36,531	35,071
Research and development	**22,485**	24,619	26,966
Restructuring	**—**	1,210	5,711
Acquisition	**—**	—	1,391
Income From Operations	**29,540**	11,833	23,337
Interest expense	**5,209**	6,371	5,067
Interest income	**(372)**	(1,479)	(470)
Other expense (income), net	**125**	846	(30)
Income Before Income Taxes	**24,578**	6,095	18,770
Provision for Income Taxes	**9,402**	2,471	6,325
Income Before Cumulative Effect of Accounting Change	**15,176**	3,624	12,445
Cumulative Effect of Accounting Change, Net of Taxes (Note 2)	**(2,263)**	—	—
Net Income	**$ 12,913**	$ 3,624	$ 12,445
Net Income Per Share			
Basic			
Before Cumulative Effect of Accounting Change	**$ .73**	$ .17	$ .60
Cumulative Effect of Accounting Change	**(.11)**	—	—
Net Income Per Share	**$ .62**	$ .17	$ .60
Diluted			
Before Cumulative Effect of Accounting Change	**$ .72**	$ .17	$ .59
Cumulative Effect of Accounting Change	**(.11)**	—	—
Net Income Per Share	**$ .61**	$ .17	$ .59

Shareholders' Investment

	Common Stock		Additional		Accumulated Other	Total
	Shares Issued	Amount	Paid-In Capital	Retained Earnings	Comprehensive Income (Loss)	Shareholders' Investment
			(expressed in thousands except per share data)			
Balance, September 30, 1998	20,657	$5,164	$ 5,818	$139,782	$ 1,925	$152,689
Net income	—	—	—	12,445	—	12,445
Foreign currency translation	—	—	—	—	36	36
Unrealized loss on investment, net of tax	—	—	—	—	(60)	(60)
Total comprehensive income	—	—	—	12,445	(24)	12,421
Exercise of stock options	235	59	2,396	—	—	2,455
Common stock repurchased and retired	(8)	(2)	(92)	—	—	(94)
Cash dividends, 24¢ per share	—	—	—	(4,612)	—	(4,612)
Balance, September 30, 1999	20,884	5,221	8,122	147,615	1,901	162,859
Net income	—	—	—	3,624	—	3,624
Foreign currency translation	—	—	—	—	(2,594)	(2,594)
Unrealized gain on investment, net of tax	—	—	—	—	54	54
Total comprehensive income	—	—	—	3,624	(2,540)	1,084
Exercise of stock options	163	41	1,048	—	—	1,089
Common stock repurchased and retired	(299)	(75)	(2,098)	—	—	(2,173)
Cash dividends, 24¢ per share	—	—	—	(5,005)	—	(5,005)
Balance, September 30, 2000	20,748	5,187	7,072	146,234	(639)	157,854
Net income	—	—	—	12,913	—	12,913
Foreign currency translation	—	—	—	—	(391)	(391)
Derivative instruments	—	—	—	—	(72)	(72)
Unrealized loss on investment, net of tax	—	—	—	—	(139)	(139)
Total comprehensive income	—	—	—	12,913	(602)	12,311
Exercise of stock options	474	119	3,390	—	—	3,509
Common stock repurchased and retired	(191)	(48)	(1,516)	—	—	(1,564)
Cash dividends, 24¢ per share	—	—	—	(4,988)	—	(4,988)
Balance, September 30, 2001	21,031	$5,258	$ 8,946	$154,159	$(1,241)	$167,122

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

Consolidated Statements of Cash Flows
(For the Years Ended September 30)

	2001	2000	1999
		(expressed in thousands)	
Operating Activities:			
Net income	**$ 12,913**	$ 3,624	$ 12,445
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	**14,477**	15,294	14,424
Deferred income taxes	**232**	455	889
Restructuring provision	**—**	(1,210)	(5,711)
Provision for doubtful accounts	**(992)**	(645)	(544)
Provision for inventory obsolesence	**(4,132)**	(1,500)	(1,370)
Changes in operating assets and liabilities:			
Accounts, unbilled contracts, and retainage receivables	**2,716**	(8,914)	(10,741)
Inventories	**1,982**	(5,259)	1,743
Prepaid expenses	**3,570**	(2,395)	(3,493)
Accounts payable	**(6,032)**	2,025	884
Accrued payroll and related costs	**4,809**	4,232	(1,006)
Advance payments from customers	**8,317**	(5,919)	8,711
Accrued warranty costs	**(2,061)**	1,633	360
Other current liabilities	**3,317**	1,606	10,149
Net Cash Provided by Operating Activities	**39,116**	3,027	26,740
Investing Activities:			
Additions to property and equipment	**(7,583)**	(12,399)	(15,990)
Acquisitions, net of cash acquired	**(2,720)**	—	(1,036)
Increase in other assets	**(211)**	(841)	(132)
Net Cash Used in Investing Activities	**(10,514)**	(13,240)	(17,158)
Financing Activities:			
Net borrowings (repayments) under notes payable to banks	**(11,451)**	1,853	(18,168)
Proceeds from issuance of long-term debt	**—**	4,271	16,837
Repayments of long-term debt	**(5,122)**	(998)	(924)
Dividends paid	**(4,988)**	(5,005)	(4,612)
Proceeds from issuance of stock under employee stock option and stock purchase plans	**3,509**	1,089	2,455
Repurchases of common stock	**(1,564)**	(2,173)	(94)
Net Cash Used in Financing Activities	**(19,616)**	(963)	(4,506)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	**318**	1,304	418
Cash and Cash Equivalents			
Increase (decrease) during the year	**9,304**	(9,872)	5,494
Balance, beginning of year	**8,211**	18,083	12,589
Balance, end of year	**$ 17,515**	$ 8,211	$ 18,083
Supplemental Disclosures of Cash Flows Information:			
Cash paid during the year for:			
Interest	**$ 5,724**	$ 6,298	$ 4,291
Income taxes	**6,516**	5,105	6,731

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

1. Summary of Significant Accounting Policies:

Principles of Consolidation
The consolidated financial statements include the accounts of MTS Systems Corporation and its wholly and majority-owned subsidiaries (the "Company"). Significant inter-company balances and transactions have been eliminated.

Foreign Currency Translation
Assets and liabilities of the Company's foreign subsidiaries are translated to U.S. dollars at exchange rates prevailing at the end of the fiscal year. Income statement items are translated using average exchange rates for the year. The resulting translation adjustments are recorded as a component of accumulated other comprehensive income (loss) within shareholders' investment. Gains and losses resulting from translation of foreign currency transactions and from foreign exchange hedge contracts are included in "Other expense (income), net" in the Consolidated Statements of Income and amounted to gains aggregating $1.1 million in 2001 and losses aggregating $0.5 million and $0.4 million in 2000 and1999, respectively.

Revenue Recognition
The Company implemented Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements," in the fourth quarter of fiscal 2001 and has applied it retroactively to the beginning of fiscal 2001. SAB 101 provides guidelines on the timing of revenue recognition based on factors such as passage of title, installation, payment terms and customer acceptance.

Prior to the adoption of SAB 101, the Company recognized revenue on short-duration projects at the time the systems were shipped and title passed to the customer. Revenue on projects requiring longer delivery periods (longer-term contracts) and other customized orders that allow for progress billings to the customer was recognized using the percentage-of-completion method based on the cost incurred to date as compared to the total estimated cost of the contract (cost-to-cost method). The effect of any revision to the total estimated cost, on an individual contract basis, and its impact on revenue is recorded in the period in which the revision becomes known. When a loss is anticipated on a contract, the anticipated loss is provided in the period the loss is identified.

Under the guidelines of SAB 101, the Company changed its revenue recognition method to delay the recognition of revenue on short-duration projects from the date of shipment to the time the Company obtains customer acceptance. Revenue on longer-term contracts continues to be recognized on the percentage-of-completion method. Customer acceptance generally is received within a period of less than three months following shipment to the customer. See Note 2 to the Consolidated Financial Statements for additional information regarding the impact of SAB 101 on the Company's revenue and operating results.

Revenue for services rendered is recognized at the time the services are performed and ratably over the defined contractual period for service maintenance contracts.

Accounts Receivable and Long-term Contracts
The Company grants credit to its customers, but generally does not require collateral or other security from domestic customers. Receivables from customers residing outside of the United States, where deemed appropriate, are supported by letters of credit from financial institutions.

The Company enters into longer-term contracts for customized equipment sold to its customers. Under terms of such contracts, revenue recognized using the percentage of completion method may be invoiced upon completion of contractual milestones, upon shipment to the customer or upon installation and acceptance by the customer. Unbilled or retained amounts relating to these contracts are reflected as Unbilled Contracts and Retainage Receivables in the accompanying Consolidated Balance Sheets. Amounts unbilled or retained as of September 30, 2001 are expected to be invoiced during fiscal 2002.

Warranty Obligations
The Company warrants its products against defects in materials and workmanship under normal use and service, generally for one year after installation. The Company maintains reserves for estimated future warranty costs based on its past experience.

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

Cash Equivalents
Cash equivalents represent short-term highly liquid investments having a maturity of three months or less at the time of purchase and are recorded at cost which approximates fair value.

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

	2001	2000
	(expressed in thousands)	
Customer projects in various stages of completion	**$ 4,709**	$ 2,704
Components, assemblies and parts	**58,672**	59,816
Total	**$63,381**	$62,520

1. Summary of Significant Accounting Policies (continued):

Property and Equipment

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

Buildings and improvements: 10 to 40 years.

Machinery and equipment: 3 to 15 years.

Building and equipment additions are generally depreciated on a straight-line basis for financial reporting purposes and on an accelerated basis for income tax reporting purposes.

Derivative Financial Instruments

Effective October 1, 2000, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No.138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities—an amendment of SFAS Statement No. 133"("SFAS No. 133"), which requires the Company to recognize all derivative financial instruments on the balance sheet at fair value. Derivatives that are not classified as a hedge are required under SFAS 133 to be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the hedged assets, liabilities or firm commitments are recognized through earnings or in other comprehensive income (loss) until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company has determined that the impact of the adoption of SFAS 133 was not material to the earnings and financial position of the Company.

The Company periodically enters into forward exchange contracts principally to hedge the estimated cash flow of foreign currency denominated transactions (primarily the EURO, British Pound, Swedish Krona and Japanese Yen). Gains and losses resulting from forward exchange contracts that hedge undelivered orders denominated in foreign currency and net exposed assets are included in "Other expense (income), net" in the accompanying Consolidated Statements of Income. The Company's accounting policy for these contracts is based on its designation of foreign currency contracts as hedging transactions. The criteria used by the Company in designating a specific contract as a hedge include, among other items, the contract's effectiveness in reducing risk and the specific matching of a contract to the underlying transactions. The Company's documentation policies were revised as considered necessary to comply with the requirements of SFAS 133. However, the Company made no substantive changes to its risk management strategy as a result of adopting SFAS 133. Open hedge contracts totaled $39.4 million, $40.5 million and $7.3 million as of September 30, 2001, 2000 and 1999, respectively. The Company does not use derivative financial instruments for speculative or trading purposes.

Other Assets

Other assets principally consist of patents, other intellectual property and goodwill. Goodwill represents the excess of the purchase price over the fair value of the net assets acquired and has been amortized over periods up to 40 years. The carrying value of goodwill, net of accumulated amortization, was $21.5 million and $24.2 million at September 30, 2001 and 2000, respectively. Amortization expense was $3.0 million in 2001, $3.2 million in 2000 and $3.3 million in 1999. Effective October 1, 2001, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142 which requires that goodwill and intangible assets with indefinite lives are not to be amortized, but tested for impairment annually, except in certain circumstances, and whenever there is an impairment indicator.

The Company periodically evaluates whether events and circumstances have occurred which may affect the estimated useful life or the recoverability of the remaining balance of its goodwill and other long-lived assets. If such events or circumstances were to indicate that the carrying amount of these assets would not be recoverable, the Company would estimate the future cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) were less than the carrying amount of goodwill and other long-lived assets, the Company would recognize an impairment loss.

With the adoption of SFAS No. 142 on October 1, 2001, goodwill and intangible assets with an indefinite life will be assessed for impairment on an annual basis, except in certain circumstances, and whenever there is an impairment indicator. The assessment is a two step process. The first step is to compare the estimated fair value of a reporting unit to its carrying value. If the carrying value exceeds the fair value then the second step is to perform a valuation of all tangible and intangible assets to determine the amount, if any, by which goodwill and/or an intangible asset is impaired. The Company will assess the impact of SFAS No. 142 by performing the initial impairment study during the first half of fiscal 2002 and will complete any required goodwill impairment calculations by the end of fiscal 2002 as required by SFAS No. 142.

Income Taxes

Deferred tax assets and liabilities are recognized for the expected future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse.

1. Summary of Significant Accounting Policies (continued):

Earnings Per Share

Basic earnings per common share is based on the weighted average number of common shares outstanding in each year. Diluted earnings per common share is computed using the treasury stock method and includes the dilutive effect of potential common shares, such as stock options, that would have been outstanding if these shares had been issued. The computation of basic and diluted earnings per common share is as follows:

	2001	2000	1999
	(expressed in thousands except per share data)		
Income before cumulative effect of accounting change	**$ 15,176**	$ 3,624	$ 12,445
Cumulative effect of accounting change, net of taxes	**(2,263)**	—	—
Net income	**$ 12,913**	$ 3,624	$ 12,445
Weighted average common shares outstanding	**20,755**	20,842	20,763
Dilutive potential common shares	**319**	93	421
Total dilutive common shares	**21,074**	20,935	21,184
Earnings per share:			
Basic			
Before cumulative effect of accounting change	**$ .73**	$ .17	$ .60
Cumulative effect of accounting change, net of taxes	**(.11)**	—	—
Net income per share	**$ .62**	$ .17	$ .60
Dilutive			
Before cumulative effect of accounting change	**$ .72**	$ .17	$ .59
Cumulative effect of accounting change, net of taxes	**(.11)**	—	—
Net income per share	**$ .61**	$ .17	$ .59

Comprehensive Income

The Company follows the provisions of Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." This Statement establishes rules for the reporting of comprehensive income and its components. Comprehensive income consists of net income, unrealized gains or loss on investment, derivative instruments gains or losses and foreign currency translation adjustments and is presented as a component of Shareholders' Investment.

Reclassifications

Certain amounts included in the consolidated financial statements have been reclassified in prior years to conform to the current year presentation. These reclassifications had no effect on previously reported shareholders' investment or net income.

Use of Estimates

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

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

2. Change in Accounting for Revenue Recognition:

The Company implemented SAB 101 in the fourth quarter of fiscal 2001 and has applied it retroactively to the beginning of fiscal 2001. See Note 1 to the Consolidated Financial Statements for additional information regarding the Company's revenue recognition policy. In accordance with SAB 101, the new method of accounting for revenue recognition has been applied retroactively to the beginning of fiscal 2001. The cumulative effect adjustment of the change in accounting for all periods through September 30, 2000 was a reduction in net income of $2.3 million (net of income taxes of $1.4 million), or $0.11 per diluted share, which has been accounted for as a charge to the financial results for the first quarter of fiscal 2001. The effect of the change as compared to the revenue recognition policy previously followed in accounting for revenue recognition on the quarter ended September 30, 2001, was to decrease net revenue by $2.5 million and reduce income before cumulative effect of the accounting change, net of taxes, by $0.6 million, or $0.03 per diluted share. The effect of the change for the total fiscal year of 2001 was to increase revenue by $4.9 million and to increase income before cumulative effect of the accounting change, net of taxes, by $0.9 million, or $0.04 per diluted share. Pro forma accounts showing the retroactive application of SAB 101 for periods prior to 2001 could not be reasonably determined and have not been provided.

2. Change in Accounting for Revenue Recognition (continued):

The effect of the accounting change for revenue recognition for each of the first three quarters of fiscal 2001 is as follows:

	Quarter Ended		
	December 31 2000	**March 31** 2001	**June 30** 2001
	(expressed in thousands except per share data)		
Net revenue, as previously reported	$84,989	$97,935	$ 98,586
Effect of change in revenue recognition	6,574	337	445
Revenue, as restated	$91,563	$98,272	$ 99,031
Gross profit, as previously reported	$29,619	$35,059	$ 37,563
Effect of change in revenue recognition	2,332	541	(353)
Gross profit, as restated	$31,951	$35,600	$ 37,210
Net income, as previously reported	$ 264	$ 3,520	$ 4,446
Effect of change in revenue recognition, net of taxes	1,434	333	(213)
Income before cumulative effect of change in revenue recognition, net of taxes	1,698	3,853	4,233
Cumulative effect on prior years of the change in accounting, net of taxes	(2,263)	—	—
Net income (loss), as restated	$ (565)	$ 3,853	$ 4,233
Earnings per share:			
Basic-			
Net income, as previously reported	$ .01	$ .17	$ .21
Effect of change in revenue recognition, net of taxes	.07	.02	(.01)
Income before cumulative effect of change in revenue recognition, net of taxes	.08	.19	.20
Cumulative effect on prior years of the accounting change	(.11)	—	—
Net income (loss), as restated	$ (.03)	$ .19	$ .20
Diluted-			
Net income, as previously reported	$ .01	$ .17	$ .21
Effect of change in revenue recognition, net of taxes	.07	.01	(.01)
Income before cumulative effect of change in revenue recognition, net of taxes	.08	.18	.20
Cumulative effect on prior years of the accounting change	(.11)	—	—
Net income (loss), as restated	$ (.03)	$ .18	$ .20

3. Business Segment Information:

The Company follows the provisions of Statement of Financial Accounting Standards No. 131 ("SFAS No. 131"), "Disclosures about Segments on an Enterprise and Related Information." As such, the Company has determined that it has five operating business units: Vehicle Testing Systems, Material Testing Systems, Advanced Systems, Automation and Sensors. Vehicle Testing Systems manufactures and markets systems for vehicle and component manufacturers to aid in the acceleration of design development work and to decrease the cost of product manufacturing. Material Testing Systems manufactures and markets systems to aid customers in product development and quality control toward an effort of design improvement. Advanced Systems offers highly customized systems primarily for simulation and manufacturing purposes. The Automation business manufactures and markets products for high performance industrial machine applications in a wide range of industries. The Sensors business unit manufactures and markets displacement and liquid level sensors used in various applications to monitor and automate industrial processes.

The economic characteristics, nature of products and services, production processes, type or class of customer, method of distribution and regulatory environments are similar for the Vehicle Testing Systems, Material Testing Systems and Advanced Systems business units. As a result of these similarities, these units have been aggregated for financial statement purposes into one reportable segment called Mechanical Testing and Simulation ("MT&S"). The economic characteristics, nature of products and services, production processes, type or class of customer, method of distribution and regulatory environments are similar for the Automation and Sensors business units. As a result, these business units have been aggregated into a reportable segment called Factory Automation ("FA"). The Company's Chief Executive Officer reviews operating results of its MT&S and FA segments on a periodic basis.

The accounting policies of the reportable segments are the same as those described in Note 1 to the Consolidated Financial Statements. In evaluating the performance of each segment, management focuses primarily on income from operations and return on assets employed. This measurement excludes special charges (such as restructuring charges and acquisition-related expenses), interest income and expense, income taxes and other non-operating income or expense. Corporate administrative expenses, including expenses related to various support functions such as human resources, information technology and finance, are allocated to the reportable segments primarily on the basis of revenue.

	2001	2000	1999
		(expressed in thousands)	
Net Revenue by Segment			
Mechanical Testing & Simulation	**$315,392**	$302,353	$313,685
Factory Automation	**81,249**	89,500	76,857
Total	**$396,641**	$391,853	$390,542
Income from Operations by Segment			
Mechanical Testing & Simulation			
Income before restructuring and acquisition costs	**$ 26,835**	$ 4,460	$ 23,809
Restructuring charge	**—**	(1,210)	(5,510)
Acquisition costs	**—**	—	(1,391)
Total	**26,835**	3,250	16,908
Factory Automation			
Income before restructuring and acquisition costs	**2,705**	8,583	6,630
Restructuring charge	—	—	(201)
Total	**2,705**	8,583	6,429
Total Income from Operations	**$ 29,540**	$ 11,833	$ 23,337
Identifiable Assets by Segment			
Mechanical Testing & Simulation	**$270,703**	$267,666	$272,491
Factory Automation	**61,056**	62,568	60,856
Total Assets	**$331,759**	$330,234	$333,347
Other Segment Data			
Mechanical Testing & Simulation:			
Capital expenditures	**$ 3,509**	$ 10,057	$ 13,822
Depreciation and amortization	**10,600**	11,782	11,028
Factory Automation:			
Capital expenditures	**$ 4,074**	$ 2,342	$ 2,168
Depreciation and amortization	**3,877**	3,512	3,396

Geographic segment information was as follows:

	2001	2000	1999
		(expressed in thousands)	
Total Net Revenue			
United States	**$170,704**	$194,056	$200,556
Germany	**41,847**	49,771	47,172
Other European Countries	**54,313**	60,494	69,185
Far East	**98,711**	69,444	56,897
Other	**31,066**	18,088	16,732
Total	**$396,641**	$391,853	$390,542
Total Property and Equipment, Net			
United States	**$ 58,008**	$ 60,496	$ 59,926
Germany	**10,106**	10,604	12,821
Other European Countries	**413**	429	658
Far East	**288**	454	114
Other	**78**	98	114
Total	**$ 68,893**	$ 72,081	$ 73,633

Revenue by geographic location is based on revenue generated from each country's operations. No country, other than the United States and Germany, exceeded 10% of consolidated net revenue on a recurrent annual basis. No single customer accounted for 10% or more of consolidated net revenue during any of the periods presented.

4. Financing:

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

	2001	2000
	(expressed in thousands)	
6.6% Notes, unsecured, due in annual installments of $4,375 beginning in July 2001	**$30,625**	$35,000
7.5% Note, unsecured, due in semi-annual installments of $1,153 beginning in July 2003	**15,000**	15,000
Variable Rate Note, due in varying installments through April 2007, collateralized by building	**5,005**	5,519
5.4% Mortgage, due in quarterly installments of $39 through October 2015, collateralized by building	**4,843**	4,829
6.0% Note, unsecured, due in annual installments of $194 through July 2008	**1,943**	1,943
Other	**1,461**	1,476
Total Indebtedness	**$58,877**	$63,767
Less Current Maturities	**(5,260)**	(5,663)
Total Long-Term Debt	**$53,617**	$58,104

Aggregate annual maturities of long-term debt for the next five fiscal years are as follows: 2002—$5.3 million; 2003—$7.0 million; 2004—$6.4 million; 2005—$7.6 million; 2006—$7.1 million and $25.5 million thereafter. The carrying value of the Company's long-term debt at September 30, 2001 is approximately $0.4 million higher than the estimated fair value as determined using current interest rates available to the Company for debt having similar characteristics and remaining maturities.

At September 30, 2001, the Company has a $50 million revolving credit agreement with a domestic bank group that allows the Company to borrow funds at various interest rates. The revolving credit agreement expires in January 2003. Under the provisions of its revolving credit agreement, the Company is required, among other matters, to maintain certain financial ratios and to meet certain indebtedness and restricted payments tests. At September 30, 2001, the Company had $26.0 million available for restricted payments, as defined. No borrowings were outstanding under this credit agreement at September 30, 2001.

In addition, the Company has standby letter-of-credit lines totaling $30 million. At September 30, 2001, standby letters of credit outstanding totaled $9.7 million.

The Company was in compliance with respect to all such covenants and conditions of its revolving credit and other debt agreements as of September 30, 2001.

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

	2001	2000	1999
		(expressed in thousands)	
Balance outstanding at year end	**$ 428**	$11,945	$10,071
Average balance outstanding during the year	**8,553**	22,617	24,903
Maximum balance outstanding during the year	**24,000**	37,500	34,700
Interest rate at year end	**6.8%**	8.1%	6.0%
Weighted-average interest rate during the year	**7.4%**	7.0%	5.7%

5. Income Taxes:

The components of income before income taxes for the fiscal years ended September 30 are as follows:

	2001	2000	1999
		(expressed in thousands)	
Income before income taxes:			
Domestic	**$ 7,412**	$ (9,441)	$ 8,775
Foreign	**17,166**	15,536	9,995
Total	**$24,578**	$ 6,095	$18,770

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

	2001	2000	1999
		(expressed in thousands)	
Current provision (benefit):			
Federal	**$ 3,716**	$ (3,469)	$ 2,239
State	**694**	(413)	432
Foreign	**4,725**	5,974	2,773
Deferred	**267**	379	881
Total provision	**$ 9,402**	$ 2,471	$ 6,325

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

	2001	2000	1999
Statutory income tax rate	**35%**	35%	35%
Tax benefit of Foreign Sales Corporation/Extraterritorial Income Exclusion	**(2)**	(9)	(3)
Foreign provision in excess of U.S. tax rate	**2**	32	4
State income taxes, net of federal benefit	**2**	(4)	2
Research and development tax credits	**(1)**	(9)	(5)
Other, net	**2**	(4)	1
Effective income tax rate	**38%**	41%	34%

Following is a summary of the deferred tax assets and liabilities as of September 30:

	2001	**2000**
Deferred Tax Asset:	*(expressed in thousands)*	
Accrued compensation and benefits	**$ 1,147**	$ 1,073
Inventory reserves	**3,764**	3,649
Allowance for doubtful accounts	**347**	242
Other assets	**(859)**	(1,229)
Total Deferred Tax Asset	**4,399**	3,735
Deferred Tax Liability:		
Property and equipment	**5,947**	5,628
Net Deferred Tax Liability	**$ 1,548**	$ 1,893

6. Stock Options:

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

During the year ended September 30, 2001, the Company awarded incentive stock options and non-qualified stock options. These awards have been granted at exercise prices that are 100% of market value at the day of grant. Beginning one year after grant, the options generally can be exercised proportionately each year for periods of three, four or six years, as defined in the respective plans. Options currently expire no later than seven years from the grant date, as defined.

Option holders may exercise options by delivering Company stock already owned, cash or a combination of stock and cash. During 2001 and 2000, option holders delivered 85,075 shares and 7,145 shares, respectively, of the Company's stock in full or partial payment of options exercised.

A status of the Company's stock option plans is summarized below (in thousands of shares):

	2001		2000		1999	
	Shares	**WAEP***	**Shares**	**WAEP***	**Shares**	**WAEP***
Options outstanding at beginning of year	3,625	$ 9.98	2,816	$11.21	2,143	$10.30
Granted	728	$12.30	1,115	$ 7.17	880	$12.95
Exercised	(410)	$ 8.00	(19)	$ 6.44	(138)	$ 7.25
Forfeited	(863)	$ 8.81	(287)	$11.30	(69)	$13.38
Options outstanding at end of year	3,080	$11.12	3,625	$ 9.98	2,816	$11.21
Options exercisable at year-end	1,415	$11.58	1,891	$10.23	1,566	$ 9.46

**Weighted-Average Exercise Price*

The following summarizes information concerning stock options outstanding as of September 30, 2001 (in thousands of shares):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number Exercisable**	**Weighted Average Exercise Price**
$5.78-$7.25	450	2.66 years	$ 6.53	221	$ 6.30
$7.3125-$9.875	612	3.82 years	$ 7.43	188	$ 7.45
$10.00-$13.00	975	3.27 years	$ 12.15	354	$ 10.82
$13.125-$14.625	712	3.07 years	$ 13.41	321	$ 13.69
$15.375-$19.375	331	1.33 years	$ 16.23	331	$ 16.23
Total	**3,080**	**3.03 years**	**$11.12**	**1,415**	**$11.58**

The number of stock options scheduled to expire, if not exercised by specified dates in the following fiscal years are as follows: 2002: 513,000; 2003: 424,000; 2004: 300,000; 2005: 859,000; 2006: 984,000.

Prices for options exercised during the three-year period ended September 30, 2001 ranged from $6.25 to $14.55. Total options available for future grant as of September 30, 2001 were 2,077,828.

In 1992, the Company's shareholders authorized an Employee Stock Purchase Plan (the "Purchase Plan"), whereby 1.0 million shares of the Company's common stock were reserved for sale to employees. Participants of the Purchase Plan were issued 149,748 shares in 2001 and 157,818 shares in 2000. During 2001, participants subscribed to purchase 111,266 shares at 85% of market price for issuance in 2002.

6. Stock Options (continued):

Pro forma Information: The Company has elected to follow Accounting Principles Board Opinion No. 25, ("APB No. 25") "Accounting for Stock Issued to Employees," in accounting for its employee stock options. Under APB No. 25, no compensation cost for stock options is recognized for stock options granted at or above fair value. However, Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation," requires the use of option valuation models to estimate compensation cost from the granting of employee stock options and to present the pro forma effect of such cost on reported net income and earnings per share.

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

	2001	2000	1999
Expected life (in years)	**1.5**	1.8	2.7
Risk-free interest rate	**2.9%**	6.0%	5.8%
Expected volatility	**.54**	.49	.49
Dividend yield	**2.1%**	3.4%	2.3%

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models required the input of highly subjective assumptions, including the expected stock price volatility. The weighted average estimated fair value of employee stock options granted during 2001, 2000, and 1999 was $4.20, $2.14 and $4.47, respectively.

For purpose of the pro forma disclosure, the estimated fair value of the options is amortized to expense over the vesting period of the options. The Company's net income, as reported, and pro forma earnings per share are as follows (in thousands, except per share amounts):

Stock Option Pro Forma Disclosure

	Years Ended September 30		
	2001	2000	1999
Income Before Cumulative Effect of Accounting Change, Net of Taxes			
As Reported	**$15,176**	$ 3,624	$12,445
Pro forma	**13,700**	2,216	10,553
Basic Earnings Per Share*			
As Reported	**$ .73**	$ .17	$ .60
Pro forma	**.66**	.11	.51
Diluted Earnings Per Share*			
As Reported	**$ .72**	$ .17	$ .59
Pro forma	**.65**	.11	.50

**excludes the cumulative effect of the accounting change for SAB 101 in 2001*

7. Employee Benefit Plans:

The Company offers a 401(k) Pay Conversion Plan for eligible employees in the United States. Employees are able to supplement their retirement income by participating in this voluntary pretax savings plan by designating a percentage of their gross income, subject to limitations imposed by federal law. Employees are fully vested in their voluntary contributions. The Company matches a portion of the employees' voluntary contributions. This matching contribution totaled $647,000 in 2001, $843,000 in 2000 and $730,000 in 1999.

The Company also has a profit sharing plan that serves as a retirement program for most U.S. and certain international employees. Employees who have completed 1,000 hours of service during the plan year are eligible to participate. The Company's Board of Directors approves the contribution annually. The plan provides for a minimum contribution of 4% of participant compensation, as defined, up to the social security taxable wage base, and 8% of participant compensation in excess of the social security taxable wage base up to the maximum profit sharing contribution allowed by federal law, so long as the entire contribution does not exceed pretax income. The Company's contributions totaled $4.2 million in 2001, $4.4 million in 2000, and $3.9 million in 1999,

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

7. Employee Benefits Plans (continued):

The cost for these plans include the following components:

	2001	2000	1999
		(expressed in thousands)	
Service cost-benefit earned during the period	**$ 190**	$188	$ 209
Interest cost on projected benefit obligation	**237**	235	249
Net amortization and deferral	**14**	50	17
Net Periodic Pension Cost	**$ 441**	$473	$ 475

The following summarizes the change in benefit obligation and the plan assets:

	2001	2000
	(expressed in thousands)	
Change in benefit obligation:		
Projected benefit obligation, beginning of year	**$ 6,120**	$ 5,877
Service cost	**190**	177
Interest cost	**237**	211
Translation change	**(245)**	(156)
Actuarial loss	**42**	49
Benefits paid	**(44)**	(38)
Projected benefit obligation, end of year	**$ 6,300**	$ 6,120
Change in plan assets:		
Fair value of plan assets, beginning of year	**$ —**	$ —
Actual return on plan assets	**—**	—
Employer contributions	**44**	38
Benefits paid	**(44)**	(38)
Fair value of plan assets, end of year	**$ —**	$ —

The funded status of the Company's pension retirement plans at September 30 is as follows:

	2001	2000
	(expressed in thousands)	
Funded status	**$ (6,300)**	$ (6,120)
Unrecognized net gain	**(26)**	(31)
Unrecognized net liability being amortized	**584**	528
Required adjustment to recognize minimum liability	**(23)**	(34)
Accrued Pension Liability	**$ (5,765)**	$ (5,657)
Major assumptions used in the above calculation include:		
Discount rate	**3.5 to 6.0%**	3.5 to 6.0%
Expected rate of increase in future compensation levels	**3.0%**	3.0%

8. Acquisitions:

During 1999, the Company completed a merger with DSP Technology, Inc. ("DSP"), an enterprise active in the automotive engine development market segment. Under the terms of the merger agreement, the Company issued approximately 2.1 million shares of its common stock in exchange for all of DSP's outstanding shares of common stock. In connection with the acquisition, the Company and DSP incurred acquisition related costs, in the aggregate, of approximately $1.4 million that have been charged to operations during 1999. The acquisition qualified as a tax-free exchange and was recorded under the pooling-of-interests accounting method.

9. Restructuring and Other Charges:

During 2000, the Company announced a restructuring charge related to the discontinuation of a line of data acquisition products acquired as part of its acquisition of DSP in 1999. The restructuring charge of $1.2 million included a provision for severance costs of $0.7 million, the write-off of leasehold improvements and production and other equipment no longer needed of $0.3 million and other costs of $0.2 million associated with the closedown of the facility and the wind-down of the related product line. During the year ended September 30, 2001, the restructuring reserve was reduced by severance costs of $0.8 million, the write off of leasehold improvements, equipment and other assets aggregating $0.2 million and costs associated with the closing of the facility and the wind-down of the product line of $0.2 million. In addition to the restructuring charge, the Company recorded an additional provision of $1.8 million to cover excess and obsolete inventory, uncollectible receivables and the write off of the remaining book value of fixed assets no longer needed. Of this amount, $1.1 million was charged to cost of sales and $0.7 million was charged to general and administrative expenses in fiscal 2000. As the activity for which the restructuring charge and the additional provision were created is essentially complete as of September 30, 2001, the Company does not expect any significant additional charges to be incurred in future periods.

During 1999, the Company recorded a restructuring charge of $5.7 million as a result of the closure of its manufacturing operations in France and the transfer of this product line to its electromechanical division in North Carolina. In connection therewith, cash outlays of $2.6 million were made during 1999 and $3.1 million were made during 2000. Such costs were financed primarily with funds from continuing operations and borrowings under its bank line of credit. While certain of the effects from such restructuring were expected to be realized during fiscal 2000, other costs associated with the integration of the product line into the North Carolina facility offset much of the benefit expected from such restructuring. As a result, the Company has yet to realize substantial improvement in operating results from this restructuring.

10. Commitments and Contingencies:

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

Leases: The Company has noncancelable operating lease commitments for equipment and facilities that expire on various dates through 2011. Minimum annual rental commitments at September 30, 2001 for the fiscal years 2002 through 2006 and thereafter are $6.0 million, $5.2 million, $4.1 million, $3.2 million and $3.8 million, respectively. Total lease expense was $4.3 million in 2001, $3.9 million in 2000 and $4.2 million in 1999.

Reports on Consolidated Financial Statements

Report of Independent Public Accountants
To MTS Systems Corporation:

We have audited the accompanying consolidated balance sheets of MTS Systems Corporation (a Minnesota corporation) and subsidiaries as of September 30, 2001 and 2000, and the related consolidated statements of income, shareholders' investment and cash flows for each of the three years in the period ended September 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MTS Systems Corporation and subsidiaries as of September 30, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2001 in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, effective October 1, 2000, the Company changed its method of revenue recognition upon adoption of Staff Accounting Bulletin No. 101.

Arthur Andersen LLP

Minneapolis, Minnesota,
November 15, 2001

Report of Management

The management of MTS Systems Corporation is responsible for the integrity and objectivity of the financial information presented in this report. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and include certain amounts based on management's best estimates and judgment. Management is also responsible for establishing and maintaining the Company's accounting systems and related internal controls, which are designed to provide reasonable assurance that assets are safeguarded, transactions are properly recorded, and the policies and procedures are implemented by qualified personnel.

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

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

Sidney W. Emery, Jr
Chairman and Chief Executive Officer

Susan E. Knight
Vice President and
Chief Financial Officer

Corporate Information

Board of Directors

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

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President
Pinnacle Capital Corporation

Jean-Lou Chameau
Provost, Vice President
Georgia Institute of Technology

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Bruce D. Hertzke
Chairman, Chief Executive
Officer, President
Winnebago Inustries, Inc.

Barbara J. Samardzich
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Automatic Transmission
Engineering Operations
Ford Motor Company

Linda Hall Whitman, Ph.D
Consultant; formerly President
Ceridian Performance Partners

Executive Management

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Chief Executive Officer

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Vice President
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Development Division

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Vice President
Noise and Vibration Business and
Corporate Product Management

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Laura B. Hamilton
Vice President
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Aerospace Division

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Chief Financial Officer

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Engineering Solutions Division

Larry Moulton
Vice President
Powertrain Technology Division

Werner Ongyert
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Europe

Kathleen M. Staby
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Human Resources

Mauro Togneri
Vice President
Sensors and Automation
Divisions

M. Perry Walraven
Vice President
Electromechanical Material
Testing Division

Ryoji Yamaguchi
Vice President
Asia/Pacific

Subsidiary Officer

Frank G. Arcella
President, AeroMet Corporation

Corporate Officers

Barbara J. Carpenter
Assistant Corporate Secretary

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

Thomas J. Minneman
Treasurer

References

Bank Reference
US Bank
Minneapolis, MN

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South St. Paul, MN
Shareholder Assistance:
800-468-9716

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

Patent Counsel
Westman, Champlin & Kelly
Minneapolis, MN

Independent Public
Accountants
Arthur Andersen LLP
Minneapolis, MN

Notice of Annual Meeting

The annual meeting of shareholders will be held at 5:00 p.m. (Central Standard Time) on Tuesday, January 29, 2002 at the Company's Headquarters in Eden Prairie, Minnesota. **Shareholders who cannot attend the meeting are urged to exercise their right to vote by proxy. A proxy card, a proxy statement, and a return envelope are enclosed for this purpose.**

10-K Report and Other Financial Information

Copies of the Annual Report on Form 10-K, filed with the Securities and Exchange Commission are available on request without charge.
MTS Systems Corporation
14000 Technology Drive Eden
Prairie, Minnesota 55344-2290.
Telephone: 952-937-4213

Common Stock

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

For News Releases and Other Information

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

Investor Relations

Securities analysts, portfolio managers, and representatives of financial institutions seeking information about the Company should direct their inquiries to:
Thomas J. Minneman
Treasurer and Manager of
Investor Relations
MTS Systems Corporation
14000 Technology Drive Eden
Prairie, Minnesota 55344-2290.
Telephone: 952-937-4647
Email: tom.minneman@mts.com

Dividend Reinvestment Plan

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

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

Trademarks

MTS, Flat-Trac, Nano Indenter, SWIFT, and Temposonics are registered trademarks; AeroPro, Empirical Dynamics Models, EDM, SensorlessServo, Sound Quality, Virtual Test Lab, and VTL are trademarks; and AeroMet and SmartSim Community are servicemarks of MTS Systems Corporation.

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North American Subsidiaries
AeroMet Corporation

International Subsidiaries
MTS Automation Antriebstechnik Verwaltungs GmbH
MTS Automation Antriebstechnik GmbH
MTS Automotive Sensors GmbH
MTS Holdings France, SARL
MTS International Ltd.
MTS (Japan) Ltd.
MTS Korea, Inc.
MTS Powertrain Technology Ltd
MTS Sensor Technologie Verwaltungs GmbH
MTS Sensor Technologie GmbH and Co. KG
MTS Sensors Technology K.K.
MTS Systems (China) Inc.
MTS Systems do Brazil, Ltda.
MTS Systems SA
MTS Systems GmbH
MTS Systems Holdings for Europe GmbH
MTS Systems (Hong Kong) Inc.
MTS Systems Limited
MTS Systems Norden AB
MTS Systems (Singapore) Pte Ltd.
MTS Systems SRL
MTS Testing Systems (Canada) Ltd.

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