Company: **MTS Systems**

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Moderator: **Laura Fox-Anderson**

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Operator: Good day and welcome to the MTS Second Quarter 2020 Earnings Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Brian Ross, MTS Executive Vice President and Chief Financial Officer. Please go ahead, sir.

Brian Ross: Thank you (Brandon). Good morning and welcome to MTS Systems Fiscal 2020 2nd Quarter Investor Teleconference. Joining me on the call today is Jeff Graves, our President and Chief Executive Officer. I want to remind you that we will make forward-looking statements today as defined by the Private Securities Litigation Reform Act of 1995. Future results may differ materially from these statements depending upon risks, some of which are beyond management's control.

A list of such risks can be found in our latest SEC Forms 10-Q and 10-K. We disclaim any obligation to revise the forward-looking statements made today based on future events. This presentation will also include reference to non-GAAP financial measures. These measures are used by management to evaluate the operating performance of the company over time. They should not be considered in isolation or as a substitute for GAAP measures.

A reconciliation of our non-GAAP measures to the nearest GAAP measures can be found in our earnings release. I will now turn the call over to Jeff.

Jeff Graves: Thank you Brian and good morning, everyone. We appreciate you joining us on our call this morning. Our business updated provided on April 16th described the many actions we've taken to help successfully navigate near-term economic headwinds created by the COVID-19 crisis. Yesterday we reported earnings for the 2nd Quarter of Fiscal 2020 which provided more detail around the announced actions already implemented.

My comments today will provide additional color on these items and on our current market environment. First I'd like to address the status of our employees, our operations and the measures we've taken to ensure that we protect our colleagues to the greatest extent possible. This has been our Number 1 priority and it will remain so. Given our global footprint, we were faced with the need to develop safety protocols and remote work methods first in China when the virus erupted on a major scale early in the quarter.

We then refined and enhanced these methods throughout the quarter as the virus spread to Europe and the United States. These protocols have been highly effective in maximizing employee safety while maintaining required continuity in our operations. By following these procedures, all of our production facilities have remained open throughout the pandemic with the only exception being the temporary shutdown of production by our contract manufacturer in China.

While we've been pleased with our ability to maintain support for our customers, the safety procedures adopted for the protection of our employees did impact our operational efficiencies, decreasing our production capacity by an estimated 10 to 20%. As China has increasingly emerged from their shutdown in our 3rd Quarter, our employees have been able to return to a near-normal operation routine while following all the recommended safety protocols, guidelines and best practices.

We plan to apply this same approach to our European and U.S. operations as conditions improve in each of our specific areas of operation. It's a testament to the diligence of our 3500 employees worldwide that we've had very few suspected cases of infection to date. I want to thank every one of our MTS colleagues for their commitment so safety, their thoughtfulness toward one another, their dedication, their flexibility and their continued focus on meeting out customer commitments throughout this pandemic.

Their attitudes and performance have been absolutely outstanding. Second to our fantastic customers worldwide, I would simply reinforce that we're here to support you in the same manner we always have through so many crisis periods over the last half a century by providing the highest quality and most innovative and testing simulation and sensing solutions to meet your critical new product needs. Third, I'd like to speak to the actions we've taken to reduce our operating costs. Brian'll be providing more financial detail on these actions in a few moments.

Despite record order levels within the quarter, cost-reduction actions were required in our test and simulation business to address both long-term and short-term headwinds in the business. From a longer-term perspective, our Legacy test and simulation business in Europe has been increasingly challenging over the last several years, forcing us to revisit our operational footprint and market strategy. From this analysis we've taken action to rebalance our resources toward the fastest-growing markets such as renewable energy, entertainment and simulation and in doing so significantly reduce our cost structure.

While costly, the actions taken to pursue a global restructuring effort and test and simulation were appropriate, in order to right-size and refocus the business for the long term, improving operating efficiencies and helping ensure that we have a sustainable operations platform to support our customers in this important region of the world. These changes were enabled in part by the investments we've made over the last two years in our operating infrastructure as well as the product mix and geographic shift in our businesses as we have purposefully refined our test and stimulation end-of-market exposure.

These restructuring efforts are viewed as permanent changes to our cost structure and will bring benefits for years to come. In addition to these restructuring actions, we also took incremental short-term cost actions across the company, including reductions in discretionary spending, temporary salary reductions, furloughs, extended paid time off and reduced work schedules. These actions while painful are intended to address the immediate impact of the virus on our customer suppliers and our own internal operations.

From a sensors business standpoint with record ordered levels, a near-record backlog and continuing strength in the end markets we serve, the impact of the virus has primarily been felt through an inability to maintain a full complement of assembly workers in our operations. This stems from the safety measures we've taken for our employees, an important element of which is increased physical separation. In spite of moving to a multi-shift production schedule, our factory output was materially impacted in the quarter.

With continuing strong demand for our sensing products, we would expect operational efficiencies to improve when the crisis subsides and there's a return towards normalcy in our operations. Although significant cost savings actions have now been taken across the company to address the current crisis, we are prepared to take additional action if these uncertain market conditions were to be prolonged or become more severe in order to position the company for continued future success.

Let me move on to describe the current market environment for each of our business units. Starting with test and simulation, a number of conflicting themes played across the test and simulation business over the course of the quarter. Nascent orders momentum as we entered the quarter consistent with our strong second-half orders forecast that we mentioned in our last earnings call was truncated by the COVID-19 crisis, first in Asia and then the rest of the world as the quarter progressed.

Coupled with soft orders in the last half of Fiscal 2019 and the 1st Quarter of 2020, we experienced lower-than-expected 2nd Quarter revenues exacerbated by the COVID-19-induced production closures in China and our contract manufacturing facility and our inefficiencies in our global production facilities as the virus spread around the world. While we still delivered record orders performance in the quarter by a wide margin, the pandemic significantly weakened orders from our prior expectations in all regions of the world and in nearly all sectors of the business, hitting flight simulation, theme parks, test services, ground vehicles and materials sectors particularly hard.

As customers restricted access to their facilities, deferred capital expenditures and discretionary spending and furloughed their work forces, we saw an increase in order deferral rates within our opportunity pipeline, a metric we monitor closely. Order placement delays increased from the prior year and on a consecutive quarter basis providing a clear measure of the dramatic turn in short-term sentiment brought by the virus during the quarter. Fortunately, in spite of these headwinds, our market diversification efforts from the last few years were still highly effective in delivering record orders performance fueled by strong growth in several of the markets comprising our structures category.

One particular project I'd like to tell you about this morning is the $70 million contract we were awarded by Tianjin University in China, the largest single order in our company's 53-year history. Established in 1895, Tianjin University is one of the oldest and most respected academic institutions in China. This expansion project has been several years in planning and is dedicated to research on building and bridge designs that can better withstand the effects of earthquakes and tsunami events. With the growth rate of China's infrastructure and their exposure to often-violent seismic and tsunami events, Chinese researchers for some time have participated in earthquake simulation studies that other universities including those in Japan, Taiwan and the U.S.

The benefits of this research have been clear with survival rates improving as large-scale building collapse from seismic events have been dramatically reduced in modern cities. This new facility at Tianjin University will be the largest and most advanced of its kind in the world, enabling experts to study the combined effects of ground and water motion on infrastructure integrity. MTS has been at the heart of these efforts for decades providing the highest technology equipment and simulation software to researchers worldwide. We're very proud of the benefits this research will bring to mankind as new buildings and bridges are designed that will reduce the risk to thousands of people each day through the creation of safer, more energy-efficient buildings in cities around the world.

In addition to our seismic project win in the quarter, our R&D business in Denmark delivered strong wind energy orders in Europe and our aero testing solutions performed very well in all regions. As a result amidst a severely-impacted baseline business tests and simulation delivered record orders of $176 million in Q2 producing a near-record backlog of $412 million. Notably our goal of rebalancing our test and simulation business from being a ground vehicles-dominated portfolio a few years ago to a much more robust mix of ground vehicles, structures, materials and test services today has proven to be very beneficial for our business as demonstrated in our record order performance this quarter.

The balance we have now attained not only from an end-market perspective but also with respect to our geographic exposure combined with our increased scale creates a much larger and more diverse business capable of withstanding short-term headwinds while capitalizing on emerging growth opportunities wherever they may arise in the future. In short our test and simulation business is better-positioned than ever before with a balanced market and geographic exposure, critical mass, market-leading technologies and an outstanding customer base in each of our sectors.

Looking ahead for our test and simulation business, in spite of the COVID-19 virus, we still anticipate increasing orders momentum in the second half of Fiscal Year compared to the first half although more muted compared to our original projections. We would caution that the business outlook remains dependent on the ability of the global economies to begin recovering from the pandemic. Inclusive in these forecasts is our belief that our E2M business will be depressed due to its dependence on pilot training platforms and theme parks, two markets undergoing unprecedented disruption.

However, R&D's pipeline for turnkey projects and particularly wind energy test solutions is anticipated to remain strong for the remainder of the year. We also believe the test services which was heavily impacted in the 2nd Quarter due to customer facility closures will begin a slow but consistent recovery as customers increasingly return to work and allow access to their laboratories for service and installation of new equipment. Regionally we're seeing an uptick in strength in China which we expect to be followed by Europe and the U.S. as these regions begin to reopen in earnest in the coming weeks.

It's worth noting that R&D our Danish acquisition that closed earlier this year continues to perform very well in the face of the COVID-19 virus. Denmark has weathered the crisis well and is now returning to a normalized operating environment. Specific to R&D's business, they brought with them a strong backlog of projects in excess of $35 million with contract duration stretching into 2021. The earn-out associated with the acquisitions based upon achieving specific performance targets for this business with anticipated final payments occurring late in the 4th Quarter of 2021.

R&D continued their positive momentum into the 1st Quarter of ownership by MTS here in our 2nd Fiscal Quarter, having a strong pipeline of opportunities ahead and an ability to rapidly leverage MTS technology platforms and service infrastructure globally. Now let's turn to discussion of our sensors business. As you know the three largest sectors for this business is the test sector which includes laboratories that test new products as well as our Department of Defense contracts, our industrial sector which is primarily targeted toward machine automation and our position sector which comprises both industrial automation and heavy equipment applications such as earthmovers, construction and farming equipment.

Sensors posted a record orders of $101 million in Q2, up 27% from the prior year comparable quarter. This strong performance was led by our sensors' test sector driven by additional funding under the Department of Defense program of approximately $16 million and significant contributions from the newly-acquired Endevco operations which recorded exciting wins from both energy and military customers. Orders within our industrial sector were weaker in the 2nd Quarter compared to a record performance last year. This order's decline was led by slower energy market demand and predictive maintenance business.

Geographically Europe saw the most significant declines in the industry sector. In terms of key markets within the position sector, while still weak mobile hydraulic orders were up were offset by order declines in other industrial machine markets. We continue to see application expansion in this market with new design wins; however, we saw many of our large OEMs start revising volume forecasts down in the last month of the quarter due to the COVID-19 crisis.

To summarize all of this then for the full company, our prior expectations have certainly been dampened by the COVID-19 and effects on our markets. The good new, however, is that order rates reached record levels in spite of these effects and our opportunity pipeline is extremely strong reflecting the long-term robustness of our customer spending on new product development which is the source of our revenue. The uncertainty of timing and the reopening of the global economies led us to withdraw our specific guidance for the year.

We remain excited about our growth prospects as the world moves towards normalization more broadly in the months ahead. We will continue to provide updates on marketing conditions as the opportunity arises. Let me end by answering a question that we commonly receive in uncertain times which relates to the risk of order cancellation by our customers. Similar to the last recession cycle and the previous ones, in spite of widespread customer impact we have seen no order cancellations of significance. This reflects the financial strength of our customers and the importance they place on their long-term research and development investments.

Instead what we have seen is a slowdown of product deliveries due to closed facilities and more difficult logistics and as for replacement of orders from our pipeline. Our customers have long proven their commitment to invest in research in new product development even during these times of down markets in order to position themselves for the future when the crisis subsides. A key element of our long-term success is our ability to weather these storms with them and to be there for them long into the future. We have further diversified our company and doubled the size of our revenue base since the Great Financial Recession in 2008-'09.

We remain confident that our business will emerge even stronger as the current economic crisis winds-down in the weeks and months ahead. Now I'll turn the call over to Brian to discuss our 2nd Quarter results and provide more financial detail on our cost-reduction actions as well as our balance sheet and liquidity position. Brian?

Brian Ross: Thank you, Jeff. Before I review 2nd Quarter and Fiscal Year to Date financial performance, I would like to provide more detail on our cost reduction and global restructuring actions. Given the current level of economic uncertainty near-term, we have significantly reduced our cost structure both in permanent restructuring measures as well as temporary measures to address shorter-term conditions. In short through the actions we have taken, we will realize in excess of $10 million in savings in the second half of this Fiscal Year and then in excess of $10 million in annualized savings going forward.

Savings this year comprises a combination of permanent restructuring savings in addition to temporary cost-reduction actions. As previously announced, we expect to incur total restructuring charges of approximately $8 million to $12 million during Fiscal Year 2020 and Fiscal Year 2021 based on notice period requirements. We recognize $6.1 million of restructuring charges in the 2nd Quarter of Fiscal Year 2020.

The majority of the remaining restructuring charges are expected to be recognized in the second half of Fiscal Year 2020 with a small portion recognized in the first half of Fiscal Year 2021. The global restructuring was targeted towards our test and simulation segment and we expect these actions to yield annual cost savings exceeding $10 million on slowly implemented by the end of

Fiscal Year 2020. Additionally we have implemented temporary incremental cost reduction measures across our entire business that will provide for further short-term flexibility and will remain in place until we begin to see marked improvement in the markets we serve.

These measures included reductions in cash compensation for our board of directors and executive management team, reductions in expected variable compensation benefits, furloughs, reduced working hours and significant reduction in discretionary spending. These temporary measures will save greater than $5 million through the end of Fiscal Year 2020 and could be prolonged or made permanent depending on the strength of our business and pace of recovery.

While we expect these actions will be sufficient to provide the needed flexibility to weather the current economic environment, we continue to evaluate the ongoing impact of the COVID-19 and may take further cost-reduction actions or other actions in the future. Now on to the financial results. Our 2nd Quarter consolidated revenue was $211.5 million, a decline from the prior year of 9.3%. This brings our year-to-date revenue to $417.3 million, a decline from the prior year of 4%. Based upon our order trends leading up to Fiscal Year 2020, we expected declines in year-over-year comparisons to the first half of the year predominantly in our test and simulation business offset by continued growth in our sensors business.

Revenue was also impacted during the quarter by COVID-19-related issues although difficult to specifically quantify. Our sensors business grew revenue for the quarter by $3.8 million or 4.6% providing the 11th consecutive quarter with quarter-over-quarter growth. This brings the year-to-date growth to 7.1% compared to the same period last year. Although difficult to definitively quantify, COVID-19 impacted the quarter with less revenue generated as the effect of the pandemic progressed in severity.

Given the time of the Endevco acquisition very late in our Fiscal Year 2019 and rapid integration of the Endevco product line into our sensors production facilities, the growth in sensors for the first six months was fairly split between organic and Endevco additional revenue. Organic growth continues to be largely driven by the ramp-up if our DOD business. Test and simulation revenue declined 16.9% in the 2nd Quarter mainly attributable to the previously-mentioned slower orders profile in the last half of Fiscal Year 2019 and 1st Quarter of Fiscal 2020.

This decline continued to be predominantly led by a decline in the automotive portion of our ground vehicle sector and continued weakness in European markets served. These declines are being offset by the R&D acquisition and contribution of $14.7 million in the quarter. Gross margin rate was 33.7% for the quarter, a significant decline from 37.5% in the prior year mainly attributable to one-time restructuring charges of $3.9 million.

Excluding these one-time charges, our grow margin rate would have been approximately 36% and closer to our expectations for the quarter. Year-to-date gross margin rate was 35.4%, a decline from the prior year mainly due to the one-time charged in the 2nd Quarter. Excluding these costs the rate would have approximated 36.6% compared to 38% in the prior year same period. The decline was due to mix shift in both businesses and the startup of Endevco production recently transferred into our sensors production facility.

Gross margin included $600,000 of inventory at fair value step-up charges in the 2nd Quarter relating to the Endevco acquisition and $1.1 million year-to-date compared to $1 million of inventory at fair value step-up charges in the first half of last year relating to the E2M acquisition. Operating expenses of $63.3 million were flat from the prior year quarter inclusive of operating expenses from the acquisition of E2M, Endevco and R&D. Operating expenses included $2.3 million of restructuring charges and $1.4 million of acquisition-related charges.

Excluding restructuring and acquisition-related charges, we have been able to implement cost-containment programs to effectively reduce operating expenses within the quarter by $3.6 million inclusive of operating costs for the newly-acquired businesses. We continue to manage our operating cost structure to increase bottom-line performance and selectively use some of these savings to make prudent investments for future growth of a company.

In addition our restructuring and cost actions implemented will further reduce our operating expenses. Net interest expense of $8.9 million increased by $1.5 million compared to the prior year quarter primarily due to an increase to that position related to the issuance of our senior unsecured notes in the 4th Quarter of Fiscal Year 2019. We continue to expect interest expense to be within the range previously announced of approximately $8.7 million to $9.3 million per quarter for the remaining Fiscal 2020 quarters.

The effective tax rate of 21.4% year-to-date was slightly higher than expected mainly due to the net loss incurred during the quarter from additional restructuring charges. After a few years of unusually low tax expense due to tax reform and discrete tax benefits, it is important to note the following tax rates and calculated earnings per share comparisons as we experience consolidated tax benefit of 9% in Fiscal 2017, a benefit of 38.7% Fiscal Year 2018.

Furthermore, we add consolidated tax expense of 11.4% in Fiscal 2019 and we expect a more normalized rate for full-year Fiscal 2020. We also continue to explore additional tax savings opportunities for our company including the CARES Act. It's an additional discrete item that will help to lower our tax rate. Second Quarter adjusted EBITDA of $31.5 million was down 16% from the prior year quarter mainly due to the decline in revenue for the quarter.

This metric includes adjustments for $2.9 million of stock-based compensation expense, $1.4 million of acquisition-related expenses, $600,000 of acquisition inventory fair value adjustments and $6.1 million of restructuring expenses. For the six months to date adjusted EBITDA was $61.2 million or 14.7% as a percent of revenue for the 2nd Quarter compared to $67.7 million or 15.5% of revenue in the prior year quarter. We ended the quarter with $66.6 million in cash, a slight increase from the end of the 1st Quarter this year.

Year-to-date we have used $2.6 million of operating cash flow with a new outflow in the 1st Quarter and a return to cash generation in the 2nd Quarter. Year-to-date capital investments totaled $16.3 million to meet the growing demand in our sensors business and to address the long-term needs of our facilities ultimately generating negative free cash outflow of $18.9 million year-to-date. Cash flow improved in the 2nd Quarter after incurring acquisition-related cost for R&D and a cost burden of moving Envesco manufacturing operations to our sensors production facility in the 1st Quarter.

Moving forward we expect improvement in free cash flow as we return to a more optimal working capital profile, lower our cost structure and improved bottom-line performance. In addition we have significantly slowed capital spending for the second half of the year as we work to preserve cash and liquidity measures for the company. We ended the quarter with total debt of $612 million, an increase from the 1st Quarter due to the acquisition of R&D. Our current debt profile includes $171 million of term loan B debt due July of 2023, $91 million on a revolving line of credit with a maturity of July of 2023 and our senior unsecured bond of $350 million due in August of 2027.

The outlook for generating cash and managing debt is driven by expectations that each of our recent additions to the MTS portfolio will generate incremental free cash flow in addition to our Legacy business generating free cash flow to pay down the existing net balance. We ended the 2nd Quarter with a gross debt leverage ratio of 4.5 times and a net debt leverage ratio of 4 times. The current maximum leverage ratio covenant remains at 5 times until declining to 4.75 times for the 4th Quarter of Fiscal Year.

We estimate that we have the ability to draw additional cash up to $60 million on a revolving credit facility if needed and we expect to continue to maintain compliance with our existing covenants. Based upon our existing cash position, ability to draw additional cash from our revolving credit facility if required and financial projections through the end of this year, we believe that this will provide adequate liquidity for our business to fund operations.

Our liquidity position remains sound with over $100 million including our cash and undrawn credit available through our revolving credit facility. As previously stated, we have suspended our guidance for the rest of the fiscal year. However, I feel it is important to note a few items within our adjustments from GAAP to non-GAAP measures. Our adjusted earnings-per-share does not adjust-out amortization expense for acquired intangible assets related to our multiple M&A transactions. The amortization of purchased intangible assets decreased our earnings by 26 cents per share for the 2nd Quarter and 45 cents per share year-to-date.

Amortization expense is expected to impact earnings per share in the range of 80 cents to $1 per share for the full year. The quarterly increase in amortization expense from the 1st Quarter to the 2nd Quarter is attributable to the acquisition of R&D. In addition, adjusted earnings per share does not adjust-out stock compensation expense which approximates 12 cents per share on a quarterly basis. In summary we have shifted our priorities to be laser-focused on the company and economic effects of COVID-19. We have taken aggressive actions to deal with immediate disruptions; however, the impacts have the potential to be longer-term in nature and we have put in place steps to secure the company for the future.

In addition to the significant cost-reduction efforts implemented, we have additional levers in our cost structure to decrease spending and we are prepared to take further action when and if warranted. We are continually monitoring order rates, production and customer needs and adapting as quickly as possible our forecasts and expectations for the near-term to preserve cash flow and maintain adequate liquidity. I will now turn the call back over to Jeff.

Jeff Graves: Thanks, Brian. Let me conclude with what we believe are the keys to navigating through these current economic conditions. MTS is a complex business that employs some of the smartest most insightful engineers in the industry. Although our story has become more complicated in the current market environment, it remains consistent. First we're a heavily-backlog-driven company. Our strong backlog position has provided stability through crisis periods before and with our backlog at near-record levels currently, it will see us through once again.

Second, liquidity availability and managing our cash flow will be essential for our success in these uncertain times. We're taking all necessary steps to ensure that we have adequate liquidity to meet our cash requirements over the foreseeable future. Third, we will continue to prioritize lowering our cost structure and executing well on our integration activities while supporting our customers and our employees. By doing so we'll be rewarded for this focus coming-out of the current crisis.

Fourth, we will leverage the strength of our non-vehicle-related test and simulation equipment and service opportunities to maintain a healthy orders balance and revenue profile along with executing on our restructuring activities to expand margins and continually rationalize cost in our operations and fifth, above all we must ensure our employees remain in a healthy, supportive and safe environment as we emerge from this crisis period. They are our greatest assets and our highest priority. Executing well in these five ways will help ensure that we navigate through these uncertain times, creating a strong value proposition for our customers, employees and shareholders alike.

While the world may never be the same as it was before the crisis, we will adapt to our new operating environment and continue as the leader in our markets creating sustainable value for all of our stakeholders for decades to come, with that, Brian and I are happy to take questions.

Operator: Thank you. If you would like to ask a question, please signal by pressing star 1 on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star 1 to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions. And again ladies and gentlemen that is star 1 if you would like to ask a question. The first question will come from (John Branford) with Sidoti and Company. Please go ahead with your question.

(John Branford): Good morning, guys. Nice quarter. We had a (inaudible) tough environment. I guess I want to start with the restructuring that you're doing. You talked about $10 million realized in the second half and $10 million on a go-forward basis. How should I be thinking about that? Am I dropping my cost structure by 10 and then an additional 10 going forward or is that $10 million on a go-forward basis based on the total operating business for the full-year 2020? I'm kind of confused how to think about that (throw).

Brian Ross: Yes, sure (John), so what the specific to the restructuring actions, the annual savings that we expect going forward once fully implemented will be $10 million. The way to think about the rest of the six months of our Fiscal Year here is the combination of both temporary as well as restructuring actions that we've taken so approximately $10 million for the rest of this year, about half from temporary, about half from restructuring and then the rest into 2021 will be permanent restructuring savings.

Jeff Graves: So (John) our embedded assumption there is that the $5 million piece for the rest of this year that's temporary will roll-off as the world reopens. That's the embedded assumption. We've given ourselves six months for that and that's an estimate on our case but we're confident of the $10 million this year and then $10 million on an annualized basis going forward.

Operator: Thank you. Again that is star 1 if you have a question at this time. We have a question from Joseph Thomas with VOYA Investments. Please go ahead.

Joseph Thomas: Good morning. Can you talk a little bit about order, you know, backlog conversion? Does it have any remaining backlog sort of at the 500 (inaudible). How long does it specifically take for your backlog to, you know, become revenue?

Brian Ross: Yes, so historical measures are about 70% of backlog, turns in about one year's time. It is a little bit slower at the time that we're at right now, closer to 60% of that churning within a year and part of that is due to some of the longer-term projects that we have in backlog so approximately 60% of backlog today will churn in the next 12 months.

Joseph Thomas: Okay, okay, that's helpful and could you also talk a little bit about, you know, orders that see in the pipeline? I think, you know, in the prepared remarks, you know, you said expectations for orders in the test (inaudible) for the second half it's significantly lower but, you know, still you expect improvement versus the first half? Is that how, you know, was that a correct way to understand it?

Jeff Graves: Yes, so we've been forecasting for some time in the second half would be stronger than the first half, yes, we would begin seeing that in the 2nd Quarter we just finished which we did. Now I'd have to say at the beginning of the quarter we would have estimated even stronger orders performance but we were pleased with hitting record levels obviously in the 2nd Quarter. The second half we continue to expect to be strong because our pipeline is very strong.

The question mark is always the deferral rate within the pipeline so what we see in our business is customers virtually never stop planning for our project. They'll just defer its placement so our pipeline is at clear record levels going forward. The question is how fast will those opportunities convert to hard orders? They virtually all will over time. The question is when and we would anticipate the second half being a strong half for quarters.

Joseph Thomas: Thank you and finally a question on free cash flow so it was good to hear that second half free cash flows, you know, should be better than first half and do you expect to reduce (growings under the wall we're in) and end the year the Fiscal Year on a lower debt level, absolute debt level?

Brian Ross: Yes, so at this point there's a lot of uncertainty into the future that we've talked about and probably why we've pulled guidance so it's dependent upon that in the first case but we do anticipate with other levers regards to additional free cash flow generation which hadn't been there in the first path and any free cash flow that we generate would go towards reducing debt.

Joseph Thomas: Thank you. That's all I have.

Operator: Thank you and as a reminder …

Jeff Graves: Did you have anything else, hey (Brenda) just wanted to say, did you have anything else you wanted to add on the orders question, second-half orders that would cover it? Okay, (Brandon) go ahead.

Operator: Yes, sir, just a quick reminder that it's star 1 if you have a question. We have a follow-up question from (John Branford) with Sidoti and Company. Please go ahead.

(John Branford): Yes, I guess I talked a little bit about the cancellation risks and some of the jobs. You know, can you kind of comment how frequently that happens, you know, are some industries more vulnerable than others or is it just a scenario where just see deferrals and maybe some changes? I'm not sure, could you just, you know, a little commentary around that topic?

Jeff Graves: Yes, (John) it's always a great question so we see simple answer is we see virtually no order cancellation of any material nature at all. It's been that way through every prior recession. It's certainly that way now. Once a customer places an order, they let it go through to fulfillment. We are seeing some slight delays in deliver of that equipment just due to facilities being closed with this a very short-term issue and by that point in project we've recognized most of the revenue.

There's just some residual work to do as we install and revenue recognition so no, we see no risk to cancellation. I've no reason to think it's any higher than it ever has been in the past 50 years and we've seen nothing to date as we move through this. You know in terms of customer commitment to projects, while there's always a risk around the world of customers deferring the placement of an order, thosetend to be more, you know, U.S.-oriented and more automotive-oriented customers.

The rest of the world and even the other market sectors of the United States are very inclined to continue their R&D spending, even their capital spending for R&D because it's usually a smaller piece of their overall capital spending so those projects are very resilient and we see a slight increase in deferral rates but they end-up being very resilient and once placed they're virtually never cancelled.

(John Branford): Thank you.

Operator: Thank you. As a quick reminder, that is star 1 to ask a questions. I'm showing nothing further. I'll turn it back to you Dr. Jeffrey Graves for any further remarks.

Jeff Graves: Thank you, (Brandon). So once again let me thank you for participating in our call today and for your interest in MTS. We look forward to updating you on our progress again next quarter. Be well, be safe, thanks for calling.

Operator: Thank you. Ladies and gentlemen, this concludes today's event. You may now disconnect your line.