

MTS SYSTEMS CORP
Form 10-Q
August 05, 2013

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United States

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the quarterly period ended June 29, 2013

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission File Number 0-2382

MTS SYSTEMS CORPORATION

(Exact name of Registrant as specified in its charter)

MINNESOTA 41-0908057
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

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14000 Technology Drive, Eden Prairie, MN 55344

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (952) 937-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer (Do not check if a smaller reporting company)
Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes

No

The number of shares outstanding of each of the issuer's common stock as of August 2, 2013 was 15,607,369 shares.

MTS SYSTEMS CORPORATION

REPORT ON FORM 10-Q
FOR THE THREE AND NINE FISCAL MONTHS ENDED JUNE 29, 2013

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Table of Contents**PART 1 – FINANCIAL INFORMATION****Item 1. Financial Statements**

MTS SYSTEMS CORPORATION

Consolidated Balance Sheets

(unaudited - in thousands except per share data)

	June 29, 2013	September 29, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	\$53,568	\$79,852
Accounts receivable, net of allowances for doubtful accounts of \$1,992 and \$2,247, respectively	90,618	84,119
Unbilled accounts receivable	61,876	51,306
Inventories	79,875	67,979
Prepaid expenses and other current assets	11,476	6,982
Deferred income taxes	10,055	10,665
Total current assets	307,468	300,903
Property and equipment, net	74,897	61,653
Goodwill	16,589	16,239
Other intangible assets, net	20,587	23,077
Other assets	4,399	4,696
Deferred income taxes	2,530	2,870
Total Assets	\$426,470	\$409,438
LIABILITIES AND SHAREHOLDERS' INVESTMENT		
Current Liabilities:		
Short-term borrowings	\$10,000	\$230
Accounts payable	28,159	33,744
Accrued payroll and related costs	31,057	30,731
Advance payments from customers	54,057	65,833
Accrued warranty costs	5,132	3,984
Accrued income taxes	1,877	3,510
Deferred income taxes	2,682	2,627
Other accrued liabilities	17,267	19,573
Total current liabilities	150,231	160,232

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Deferred income taxes	8,672	8,671
Non-current accrued income taxes	2,045	1,666
Defined benefit pension plan obligation	8,174	7,761
Other long-term liabilities	3,459	4,389
Total Liabilities	172,581	182,719
Shareholders' Investment:		
Common stock, \$0.25 par; 64,000 shares authorized: 15,620 and 15,640 shares issued and outstanding as of June 29, 2013 and September 29, 2012, respectively	3,905	3,910
Additional paid-in capital	6,126	652
Retained earnings	233,493	211,256
Accumulated other comprehensive income	10,365	10,901
Total Shareholders' Investment	253,889	226,719
Total Liabilities and Shareholders' Investment	\$426,470	\$409,438

The accompanying condensed notes to consolidated financial statements are an integral part of these statements.

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MTS SYSTEMS CORPORATION

Consolidated Statements of Income

(unaudited - in thousands, except per share data)

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Revenue:				
Product	\$118,396	\$125,339	\$362,810	\$355,578
Service	16,663	16,358	51,834	48,835
Total revenue	135,059	141,697	414,644	404,413
Cost of sales:				
Product	70,511	69,831	220,030	201,351
Service	9,952	8,198	29,511	24,291
Total cost of sales	80,463	78,029	249,541	225,642
Gross profit	54,596	63,668	165,103	178,771
Operating expenses:				
Selling and marketing	20,337	19,596	59,035	55,811
General and administrative	11,620	13,043	37,109	40,156
Research and development	6,211	5,097	16,851	16,124
U.S. Government settlement	—	7,750	—	7,750
Total operating expenses	38,168	45,486	112,995	119,841
Income from operations	16,428	18,182	52,108	58,930
Interest (expense) income, net	(50)	264	(194)	(154)
Other income (expense), net	405	81	(97)	(341)
Income before income taxes	16,783	18,527	51,817	58,435
Provision for income taxes	5,236	8,918	15,426	22,130
Net income	\$11,547	\$9,609	\$36,391	\$36,305
Earnings per share:				
Basic-				
Earnings per share	\$0.73	\$0.60	\$2.32	\$2.29
Weighted average number of common shares outstanding - basic	15,733	16,048	15,708	15,878
Diluted-				
Earnings per share	\$0.72	\$0.59	\$2.29	\$2.26
Weighted average number of common shares outstanding - diluted	15,945	16,197	15,906	16,045

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Dividends declared per share	\$0.30	\$0.25	\$0.90	\$0.75
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The accompanying condensed notes to consolidated financial statements are an integral part of these statements.

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MTS SYSTEMS CORPORATION

Consolidated Statements of Comprehensive Income

(unaudited - in thousands)

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Net income	\$ 11,547	\$ 9,609	\$ 36,391	\$ 36,305
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	1,070	(3,366)	(2,313)	(4,137)
Derivative instruments:				
Unrealized net gain	32	312	2,271	437
Net (gain) loss reclassified to earnings	(107)	179	(587)	486
Defined benefit pension plan:				
Unrealized net loss	(150)	(343)	(120)	(258)
Net loss reclassified to earnings	90	13	271	41
Currency exchange rate change	(104)	105	(58)	123
Other comprehensive income (loss)	831	(3,100)	(536)	(3,308)
Comprehensive income	\$ 12,378	\$ 6,509	\$ 35,855	\$ 32,997

The accompanying condensed notes to consolidated financial statements are an integral part of these statements.

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MTS SYSTEMS CORPORATION

Consolidated Statements of Cash Flows

(unaudited - in thousands)

	Nine Fiscal Months Ended	
	June 29, 2013	June 30, 2012
Cash flows from operating activities:		
Net income	\$36,391	\$36,305
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	3,105	2,429
Excess tax benefits for stock-based compensation	(823)	(676)
Net periodic pension benefit cost	963	503
Depreciation and amortization	12,008	9,865
Deferred income taxes	784	316
Bad debt (recovery) provision	(155)	950
Changes in operating assets and liabilities:		
Accounts and unbilled accounts receivable	(18,974)	2,438
Inventories	(11,733)	(73)
Prepaid expenses	(639)	(1,655)
Accounts payable	(5,512)	1,753
Accrued payroll and related costs	843	(1,278)
Advance payments from customers	(11,928)	(1,475)
Accrued warranty costs	1,137	(1,587)
Other assets and liabilities	(3,610)	4,366
Net cash provided by operating activities	1,857	52,181
Cash flows from investing activities:		
Purchases of property and equipment	(23,216)	(11,668)
Cash flows from financing activities:		
Net receipts (repayments) under short-term borrowings	9,708	(40)
Excess tax benefits from stock-based compensation	823	676
Cash dividends	(14,405)	(11,950)
Proceeds from exercise of stock options and employee stock purchase plan	4,251	14,629
Payments to purchase and retire common stock	(2,698)	—
Net cash (used in) provided by financing activities	(2,321)	3,315
Effect of exchange rate on changes in cash	(2,604)	(2,411)
Net (decrease) increase in cash and cash equivalents	(26,284)	41,417

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Cash and cash equivalents, at beginning of period	79,852	104,095
Cash and cash equivalents, at end of period	\$53,568	\$145,512

Supplemental disclosure of cash flow information:

Cash paid during the period for -

Interest	\$85	\$781
Income taxes	18,470	25,449

Non-cash financing activities:

Dividends declared not yet paid	\$4,607	\$3,924
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The accompanying condensed notes to consolidated financial statements are an integral part of these statements.

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

The consolidated financial statements include the accounts of MTS Systems Corporation and its wholly owned subsidiaries (the “Company”). All significant intercompany balances and transactions have been eliminated.

The interim consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The information furnished in these consolidated financial statements includes normal recurring adjustments and reflects all adjustments which are, in the opinion of management, necessary for a fair presentation of such financial statements. The consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”), which require the Company to make estimates and assumptions that affect amounts reported. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations. The accompanying consolidated financial statements of the Company should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended September 29, 2012 filed with the SEC. Interim results of operations for the three and nine-fiscal month period ended June 29, 2013 are not necessarily indicative of the results to be expected for the full year.

Summary of Significant Accounting Policies

The Company believes that of its significant accounting policies, the following are particularly important to the portrayal of the Company’s results of operations and financial position and may require the application of a higher level of judgment by the Company’s management and, as a result, are subject to an inherent degree of uncertainty.

Revenue Recognition. The Company recognizes revenue on a sales arrangement when it is realized or realizable and earned, which occurs when all of the following criteria have been met: persuasive evidence of an arrangement exists; delivery and title transfer has occurred or services have been rendered; the sales price is fixed and determinable; collectability is reasonably assured; and all significant obligations to the customer have been fulfilled.

Orders that are manufactured and delivered in less than six months with routine installations and no special acceptance protocols may contain multiple elements for revenue recognition purposes. The Company considers each deliverable that provides value to the customer on a standalone basis a separable element. Separable elements in these arrangements may include the design and manufacture of hardware and essential software, installation services, training and/or post contract software maintenance and support. The Company initially allocates consideration to each separable element using the relative selling price method. Selling prices are determined by the Company based on either vendor-specific objective evidence ("VSOE") (the actual selling prices of similar products and services sold on a standalone basis) or, in the absence of VSOE, the Company's best estimate of the selling price. Factors considered by the Company in determining estimated selling prices for applicable elements generally include overall economic conditions, customer demand, costs incurred by the Company to provide the deliverable, as well as the Company's historical pricing practices. Under these arrangements, revenue associated with each delivered element is recognized in an amount equal to the lesser of the consideration initially allocated to the delivered element or the amount for which payment is not deemed contingent upon future delivery of other elements in the arrangement. Under arrangements where special acceptance protocols exist, installation services and training are not considered separable. Accordingly, revenue for the entire arrangement is recognized upon the completion of installation, training and fulfillment of any other significant obligations specific to the terms of the arrangement. Arrangements that do not contain any separable elements are typically recognized when the products are shipped and title has transferred to the customer.

Certain contractual arrangements require longer production periods, generally longer than six months (long-term contracts), and may contain non-routine installations and special acceptance protocols. These arrangements often include hardware and essential software, installation services, training and support. Long-term contractual arrangements involving essential software typically include significant production, modification, and customization. For long-term arrangements with essential software and all other long-term arrangements with complex installations and/or unusual acceptance protocols, revenue is recognized using the percentage-of-completion method, based on the cost incurred to-date relative to estimated total cost of the contract. Elements of an arrangement that do not separately fall within the scope of the percentage of completion method (e.g. training and post contract software maintenance and support) are recognized as the service is provided in amounts determined based on VSOE, or in the absence of VSOE, the Company's best estimate of the selling price.

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Under the terms of the Company's long-term contracts, revenue recognized using the percentage-of-completion method may not, in certain circumstances, be invoiced until completion of contractual milestones, upon shipment of the equipment, or upon installation and acceptance by the customer. Unbilled amounts for these contracts appear in the Consolidated Balance Sheets as Unbilled Accounts Receivable.

Revenue from arrangements for services such as maintenance, repair, consulting and technical support are recognized either as the service is performed or ratably over the defined contractual period for service maintenance contracts. Revenue from post-contract software maintenance and support services is recognized ratably over the defined contractual period of the maintenance agreement.

The Company's sales arrangements typically do not include specific performance-, cancellation-, termination-, or refund-type provisions. In the event a customer cancels a contractual arrangement, the Company would typically be entitled to receive reimbursement from the customer for actual costs incurred under the arrangement plus a reasonable margin.

Revenue is recorded net of taxes collected from customers that are remitted to governmental authorities, with the collected taxes recorded as current liabilities until remitted to the relevant governmental authority.

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. Inventories at June 29, 2013 and September 29, 2012 were as follows:

	June 29, 2013	September 29, 2012
	(expressed in thousands)	
Customer projects in various stages of completion	\$20,002	\$ 17,704
Components, assemblies and parts	59,873	50,275
Total	\$79,875	\$ 67,979

Software Development Costs. The Company capitalizes certain software development costs related to software to be sold, leased, or otherwise marketed. Capitalized software development costs include purchased materials and services, salary and benefits of the Company's development and technical support staff, and other costs associated with the development of new products and services. Software development costs are expensed as incurred until technological feasibility has been established, at which time future costs incurred are capitalized until the product is available for general release to the public. Based on the Company's product development process, technological feasibility is generally established once product and detailed program designs have been completed, uncertainties related to high-risk development issues have been resolved through coding and testing, and the Company has established that

the necessary skills, hardware, and software technology are available for production of the product. Once a software product is available for general release to the public, capitalized development costs associated with that product will begin to be amortized to cost of sales over the product's estimated economic life, using the greater of straight-line or a method that results in cost recognition in future periods that is consistent with the anticipated timing of product revenue recognition.

The Company's capitalized software development costs are subject to an ongoing assessment of recoverability, which is impacted by estimates and assumptions of future revenues and expenses for these software products, as well as other factors such as changes in product technologies. Any portion of unamortized capitalized software development costs that are determined to be in excess of net realizable value will be expensed in the period such a determination is made. Amortization expense for software development costs for each of the three-fiscal month periods ended June 29, 2013 and June 30, 2012 was \$0.7 million. Amortization expense for software development costs for the nine-fiscal month periods ended June 29, 2013 and June 30, 2012 was \$2.1 million and \$1.9 million, respectively. See Note 3 in the Condensed Notes to Consolidated Financial Statements for additional information on capitalized software development costs.

Impairment of Long-Lived Assets. The Company reviews the carrying value of long-lived assets or asset groups, such as property and equipment and intangibles subject to amortization, when events or changes in circumstances such as market value, asset utilization, physical change, legal factors, or other matters indicate that the carrying value may not be recoverable. When this review indicates the carrying value of an asset or asset group exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group, the Company recognizes an asset impairment charge against operations. The amount of the impairment loss recorded is the amount by which the carrying value of the impaired asset or asset group exceeds its fair value.

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Goodwill. Goodwill represents the excess of acquisition costs over the fair value of the net assets of businesses acquired. Goodwill is not amortized to income, but instead tested for impairment at least annually, during the fourth quarter of each fiscal year. Goodwill is also tested for impairment as changes in circumstances occur indicating that the carrying value may not be recoverable. Goodwill impairment testing first requires a comparison of the fair value of each reporting unit to the carrying value. If the carrying value of the reporting unit exceeds fair value, goodwill is considered impaired.

Warranty Obligations. Sales of the Company's products and systems are subject to limited warranty obligations that are included in customer contracts. For sales that include installation services, warranty obligations typically extend for a period of twelve to twenty-four months from the date of either shipment or acceptance. Product obligations typically extend for a period of twelve to twenty-four months from the date of purchase. Under the terms of these warranties, the Company is obligated to repair or replace any components or assemblies it deems defective under the terms of the applicable agreement. The Company reserves the right to reject warranty claims where it determines that failure is due to normal wear, customer modifications, improper maintenance, or misuse. The Company records general warranty provisions based on an estimated warranty expense percentage applied to current period revenue. The percentage applied reflects historical warranty claims experience over the preceding twelve-month period. Both the experience percentage and the warranty liability are evaluated on an ongoing basis for adequacy. In addition, warranty provisions are also recognized for certain nonrecurring product claims that are individually significant. Warranty provisions and claims for the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012 were as follows:

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	June	June	June	June
	29,	30,	29,	30,
	2013	2012	2013	2012
	(expressed in thousands)			
Beginning balance	\$4,438	\$4,468	\$3,984	\$5,290
Warranty provisions	2,236	416	5,382	1,899
Warranty claims	(1,569)	(1,204)	(4,395)	(3,787)
Adjustments to preexisting warranties	—	—	151	300
Currency translation	27	(86)	10	(108)
Ending balance	\$5,132	\$3,594	\$5,132	\$3,594

Income Taxes. The Company records a tax provision for the anticipated tax consequences of the reported results of operations. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those deferred tax assets and liabilities are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized. The Company believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining net realizable value of its deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. In addition, the

calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's financial condition and operating results. See Note 11 in the Condensed Notes to Consolidated Financial Statements for additional information on income taxes.

2. Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-08, "Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment." ASU No. 2011-08 amends Accounting Standards Codification ("ASC") Topic 350, "Intangibles – Goodwill and Other," and provides an entity with the option of first performing a qualitative assessment to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after completion of the qualitative assessment, an entity determines that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value to the carrying amount of the reporting unit as described in ASC 350. Under the amendments in ASU No. 2011-08, an entity has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to the first step of the two-step impairment test. The provisions of ASU No. 2011-08 are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company's adoption of ASU No. 2011-08 during the first quarter of fiscal year 2013 did not affect the Company's financial position, results of operations or cash flows.

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In June 2011, the FASB issued ASU No. 2011-05, “Comprehensive Income (Topic 220) - Presentation of Comprehensive Income.” ASU No. 2011-05 amends ASC Topic 220, “Comprehensive Income,” to allow an entity the option to present the components of net income and other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. For both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders’ investment. The amendments to the ASC in ASU No. 2011-05 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. In December 2011, the FASB issued ASU No. 2011-12, “Comprehensive Income (Topic 220)” which deferred certain provisions of ASU No. 2011-05 that specifically relate to the presentation of separate line items on the income statement for reclassification adjustments of items out of accumulated other comprehensive income into net income for all periods presented. With the exception of the specific provisions deferred under ASU No. 2011-12, the provisions of ASU No. 2011-05 are to be applied retrospectively and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. In the first quarter of fiscal year 2013, with the exception of the provisions specifically deferred under ASU No. 2011-12, the Company adopted the provisions of ASU No. 2011-05 and elected to present the components of net income and comprehensive income in two separate but consecutive statements. As a result, the Company included a new financial statement labeled “Consolidated Statements of Comprehensive Income.” The adoption of ASU No. 2011-05 did not affect the Company’s financial position, results of operations or cash flows.

In February 2013, the FASB issued ASU No. 2013-02, “Reporting Amounts Reclassified Out of Accumulated Comprehensive Income” which requires an entity to present, either on the face of the statement where net income is presented or in the notes to the financial statements, significant amounts reclassified out of accumulated comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The amendments to the ASC in ASU No. 2011-05 do not change the current requirements for reporting net income of other comprehensive income in the financial statements. The provisions of ASU No. 2013-02 are to be applied prospectively for reporting periods beginning after December 15, 2012. In the second quarter of fiscal year 2013, the Company adopted the provisions of ASU No. 2013-02 and elected to present significant amounts reclassified out of accumulated comprehensive income by the respective line items of net income in the Condensed Notes to the Consolidated Financial Statements. The adoption of ASU No. 2013-02 did not affect the Company’s financial position, results of operations or cash flows.

See Note 9 in the Condensed Notes to Consolidated Financial Statements for additional information on other comprehensive income and accumulated other comprehensive income.

3. Capital Assets

Property and Equipment

Property and equipment at June 29, 2013 and September 29, 2012 consist of the following:

	June 29, 2013	September 29, 2012
	(expressed in thousands)	
Land and improvements	\$ 1,711	\$ 1,711
Buildings and improvements	53,956	53,545
Machinery and equipment	139,450	118,838
Total	195,117	174,094
Less accumulated depreciation	(120,220)	(112,441)
Property and equipment, net	\$ 74,897	\$ 61,653

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Goodwill at June 29, 2013 and September 29, 2012 was \$16.6 million and \$16.2 million, respectively. The increase in goodwill during the nine-fiscal month period ended June 29, 2013 was due to currency translation.

Other Intangible Assets

Other intangible assets at June 29, 2013 and September 29, 2012 consist of the following:

	June 29, 2013			Weighted Average Useful Life (in Years)
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	
	(dollar amounts expressed in thousands)			
Software development costs	\$ 15,860	\$ (8,194)	) \$ 7,666	5.7
Patents	10,305	(3,489)	) 6,816	15.3
Trademarks and trade names	6,149	(1,194)	) 4,955	30.2
Land-use rights	1,270	(120)	) 1,150	47.8
Total	\$33,584	\$ (12,997)	) \$ 20,587	14.3

	September 29, 2012			Weighted Average Useful Life (in Years)
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	
	(dollar amounts expressed in thousands)			
Software development costs	\$ 15,860	\$ (6,125)	) \$ 9,735	5.7
Patents	10,073	(2,871)	) 7,202	15.3
Trademarks and trade names	6,020	(1,024)	) 4,996	30.2
Land-use rights	1,241	(97)	) 1,144	47.8
Total	\$33,194	\$ (10,117)	) \$ 23,077	14.3

Amortization expense recognized during each of the three-fiscal month periods ended June 29, 2013 and June 30, 2012 was \$0.9 million. Amortization expense recognized during the nine-fiscal month periods ended June 29, 2013 and June 30, 2012 was \$2.8 million and \$2.6 million, respectively.

4. Stock Purchases

During the fourth quarter of fiscal year 2012, the Company entered into an accelerated share purchase agreement with an unrelated third party investment bank. In connection with the agreement, the Company made an initial \$35.0 million payment to the investment bank and immediately received an initial delivery of approximately 0.5 million shares of its common stock with a fair value of \$28.0 million as of the purchase date. Effective as of the date of the initial 0.5 million stock purchase, the transaction was accounted for as a share retirement, resulting in a reduction of common stock, additional paid-in capital and retained earnings of \$0.1 million, \$26.1 million and \$1.8 million, respectively. The remaining \$7.0 million of the Company's initial payment to the investment bank was reported as a reduction in retained earnings. The agreement specified that the Company had the option to settle any obligation that it may have at the conclusion of the contract in either cash or shares of the Company's common stock. These settlement alternatives had the same economic value to the Company. Based on the facts, during the entire term of the agreement, the forward contract met the requirements of ASC 480-10 and ASC 815-40 to be classified as permanent equity.

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During the third quarter of fiscal year 2013, the Company received approximately 0.1 million shares of its common stock from the bank pursuant to the settlement of the accelerated share purchase program. The amount of shares received at settlement was determined based on the volume weighted average price of the Company's stock during the purchase period. Upon settlement of the contract, the Company accounted for the 0.1 million shares received as a share retirement, resulting in a less than \$0.1 million reduction and corresponding increase in common stock and paid-in capital, respectively.

5. Earnings Per Common Share

Basic earnings per share are computed by dividing net earnings by the daily weighted average number of common shares outstanding during the applicable periods. Diluted earnings per share include the potentially dilutive effect of common shares issued in connection with outstanding stock-based compensation awards using the treasury stock method. Under the treasury stock method, shares associated with certain stock options have been excluded from the diluted weighted average shares outstanding calculation because the exercise of those options would lead to a net reduction in common shares outstanding. As a result, stock options to acquire less than 0.1 million and 0.3 million weighted common shares have been excluded from diluted weighted shares outstanding for the three-fiscal month periods ended June 29, 2013 and June 30, 2012, respectively. Stock options to acquire less than 0.1 million and 0.4 million weighted average common shares have been excluded from diluted weighted average shares outstanding for the nine-month fiscal periods ended June 29, 2013 and June 30, 2012, respectively. The potentially dilutive effect of common shares issued in connection with outstanding stock options is determined based on net income. A reconciliation of these amounts is as follows:

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
	(expressed in thousands, except per share data)			
Net income	\$11,547	\$9,609	\$36,391	\$36,305
Weighted average common shares outstanding	15,733	16,048	15,708	15,878
Dilutive potential common shares	212	149	198	167
Total diluted weighted shares outstanding	15,945	16,197	15,906	16,045
Earnings per share:				
Basic	\$0.73	\$0.60	\$2.32	\$2.29
Diluted	\$0.72	\$0.59	\$2.29	\$2.26

6. Business Segment Information

The Company's Chief Executive Officer and management regularly review financial information for the Company's two operating segments, "Test" and "Sensors." Test provides testing equipment, systems, and services to the ground vehicles, materials and structures markets. Sensors provides high-performance position sensors for a variety of industrial and mobile hydraulic applications.

The accounting policies of the reportable segments are the same as those described in Note 1 to the Consolidated Financial Statements found in the Company's Annual Report on Form 10-K for the fiscal year ended September 29, 2012. In evaluating each segment's performance, management focuses on income from operations. This measure excludes interest income and expense, income taxes and other non-operating items. Corporate expenses, including costs associated with various support functions such as human resources, information technology, finance and accounting, and general and administrative costs, are allocated to the reportable segments primarily on the basis of revenue.

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Financial information by reportable segment for the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012 was as follows:

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
	(expressed in thousands)			
Revenue by Segment:				
Test	\$110,378	\$116,338	\$345,424	\$327,879
Sensors	24,681	25,359	69,220	76,534
Total revenue	\$135,059	\$141,697	\$414,644	\$404,413
Income from Operations by Segment:				
Test	\$10,878	\$13,674	\$39,275	\$42,141
Sensors	5,550	4,508	12,833	16,789
Total income from operations	\$16,428	\$18,182	\$52,108	\$58,930

7. Derivative Instruments and Hedging Activities

The Company's results of operations could be materially impacted by changes in foreign currency exchange rates, as well as interest rates on its floating rate indebtedness. In an effort to manage exposure to these risks, the Company periodically enters into forward and option currency exchange contracts, interest rate swaps and forward interest rate swaps. Because the market value of these hedging contracts is derived from current market rates, they are classified as derivative financial instruments. The Company does not use derivatives for speculative or trading purposes. The derivative contracts contain credit risk to the extent that the Company's bank counterparties may be unable to meet the terms of the agreements. The amount of such credit risk is generally limited to the unrealized gains, if any, in such contracts. Such risk is minimized by limiting those counterparties to major financial institutions of high credit quality. For derivative instruments executed under master netting arrangements, the Company has the contractual right to offset fair value amounts recognized for the right to reclaim cash collateral with obligations to return cash collateral. The Company does not offset fair value amounts recognized on these derivative instruments. As of June 29, 2013, the Company does not have any foreign exchange contracts with credit-risk related contingent features.

The Company's currency exchange contracts and interest rate swaps are designated as cash flow hedges and qualify as hedging instruments pursuant to ASC 815. The Company also has derivatives which are accounted for and reported under the guidance of ASC 830-20-10. Regardless of the designation for accounting purposes, the Company believes that all of its derivative instruments are hedges of transactional risk exposures. The fair value of the Company's outstanding designated and undesignated derivative assets and liabilities are reported in the June 29, 2013 and September 29, 2012 Consolidated Balance Sheets as follows:

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	June 29, 2013	
	Prepaid	
	Expenses	
	and	Other Accrued
	Other	Liabilities
	Current	
	Assets	
Designated hedge derivatives:	(expressed in thousands)	
Foreign exchange cash flow hedges	\$ 1,817	\$ 241
Total designated hedge derivatives	1,817	241
Derivatives not designated as hedges:		
Foreign exchange balance sheet derivatives	83	—
Total hedge and other derivatives	\$ 1,900	\$ 241

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	September 29, 2012	
	Prepaid	
	Expenses	
	and	Other Accrued
	Other	Liabilities
	Current	
	Assets	
	(expressed in	
	thousands)	
Designated hedge derivatives:		
Foreign exchange cash flow hedges	\$ 432	\$ 1,157
Total designated hedge derivatives	432	1,157
Derivatives not designated as hedges:		
Foreign exchange balance sheet derivatives	—	415
Total hedge and other derivatives	\$ 432	\$ 1,572

Cash Flow Hedging – Currency Risks

Currency exchange contracts utilized to maintain the functional currency value of expected financial transactions denominated in foreign currencies are designated as cash flow hedges. Qualifying gains and losses related to changes in the market value of these contracts are reported as a component of Accumulated Other Comprehensive Income (“AOCI”) within Shareholders’ Investment on the Consolidated Balance Sheets and reclassified into earnings in the same period during which the underlying hedged transaction affects earnings. The effective portion of the cash flow hedges represents the change in fair value of the hedge that offsets the change in the functional currency value of the hedged item. Each month, the Company assesses whether its currency exchange contracts are effective and, when a contract is determined to be no longer effective as a hedge, the Company discontinues hedge accounting prospectively. Subsequent changes in the market value of ineffective currency exchange contracts are recognized as an increase or decrease in Revenue on the Consolidated Statement of Income, because that is the same line item in which the underlying hedged transaction is reported.

At June 29, 2013 and June 30, 2012, the Company had outstanding cash flow hedge currency exchange contracts with gross notional U.S. dollar equivalent amounts of \$49.8 million and \$53.5 million, respectively. Upon netting offsetting contracts to sell foreign currencies against contracts to purchase foreign currencies, irrespective of contract maturity dates, the net notional U.S. dollar equivalent amount of contracts outstanding was \$41.5 million and \$43.6 million at June 29, 2013 and June 30, 2012, respectively. At June 29, 2013, the net market value of the foreign currency exchange contracts was a net asset of \$1.6 million, consisting of \$1.8 million in assets and \$0.2 million in liabilities. At June 30, 2012, the net market value of the foreign currency exchange contracts was a net asset of \$0.3 million, consisting of \$0.8 million in assets and \$0.5 million in liabilities.

The pretax amounts recognized in AOCI on currency exchange contracts for the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012, including gains and losses reclassified into earnings in the Consolidated

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Statements of Income and gains (losses) recognized in other comprehensive income (“OCI”), are as follows:

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
	(expressed in thousands)			
Beginning unrealized net gain (loss) in AOCI	\$2,138	\$ (12)	\$ (648)	\$ (365)
Net (gain) loss reclassified into Revenue (effective portion)	(168)	100	(928)	229
Net gain recognized in OCI (effective portion)	50	498	3,596	722
Ending unrealized net gain in AOCI	\$2,020	\$ 586	\$ 2,020	\$ 586

The amount recognized in earnings as a result of the ineffectiveness of cash flow hedges was less than \$0.1 million in each of the three and nine-fiscal month periods ended June 29, 2013. The amount recognized in earnings as a result of the ineffectiveness of cash flow hedges was less than \$0.1 million in each of the three and nine-fiscal month periods ended June 30, 2012. At June 29, 2013 and June 30, 2012, the amount projected to be reclassified from AOCI into earnings in the next 12 months was a net gain of \$2.0 million and a net gain of \$0.2 million, respectively. The maximum remaining maturity of any forward or optional contract at June 29, 2013 and June 30, 2012 was 1.1 years and 2.1 years, respectively.

Table of Contents*Cash Flow Hedging - Interest Rate Risks*

During the three and nine-fiscal month periods ended June 30, 2012, the Company used floating to fixed interest rate swaps to mitigate its exposure to future changes in interest rates related to its floating rate indebtedness. The Company had designated these interest rate swap arrangements as cash flow hedges. As a result, changes in the fair value of the interest rate swaps were recorded in AOCI within Shareholders' Investment on the Consolidated Balance Sheets throughout the entire contractual term of each of the interest rate swap arrangements. During the fiscal year ended September 29, 2012, the Company's interest rate swap arrangements expired at various times from July 25, 2012 through September 28, 2012.

At June 30, 2012, the Company had outstanding interest rate swaps with total notional amounts of \$40.0 million. During the nine fiscal month period ended June 30, 2012, the Company paid fixed interest in exchange for interest received at monthly U.S. LIBOR. At June 30, 2012, the weighted-average interest rate payable by the Company under the terms of the credit facility borrowings and outstanding interest rate swaps was 2.09%. At June 30, 2012, there was a 45 basis-point differential between the variable rate interest paid by the Company on its outstanding credit facility borrowings and the variable rate interest received on the interest rate swaps. As a result of this differential, the overall effective interest rate applicable to outstanding credit facility borrowings, under the terms of the credit facility and interest rate swap agreements, was 2.54%.

The total market value of interest rate swaps at June 30, 2012 was a liability of \$0.1 million. The pretax amounts recognized in AOCI on interest rate swaps for the three and nine-fiscal month periods ended June 30, 2012 was as follows:

	Three Fiscal Months Ended June 30, 2012 (expressed in thousands)	Nine Fiscal Months Ended June 30, 2012	
Beginning unrealized net loss in AOCI	\$ (282)	\$ (617))
Net loss reclassified into Interest expense (effective portion)	186	545)
Net loss recognized in OCI (effective portion)	(2)	(26))
Ending unrealized net loss in AOCI	\$ (98)	\$ (98))

Foreign Currency Balance Sheet Derivatives

The Company also uses foreign currency derivative contracts to maintain the functional currency value of monetary assets and liabilities denominated in non-functional foreign currencies. The gains and losses related to the changes in

the market value of these derivative contracts are included in Other Income (Expense), net on the Consolidated Statement of Income.

At June 29, 2013 and June 30, 2012, the Company had outstanding foreign currency balance sheet derivative contracts with gross notional U.S. dollar equivalent amounts of \$33.9 million and \$50.1 million, respectively. Upon netting offsetting contracts by counterparty banks to sell foreign currencies against contracts to purchase foreign currencies, irrespective of contract maturity dates, the net notional U.S. dollar equivalent amount of contracts outstanding at June 29, 2013 and June 30, 2012 was \$6.7 million and \$15.1 million, respectively. At June 29, 2013, the net market value of the foreign exchange balance sheet derivative contracts was a net asset of less than \$0.1 million. At June 30, 2012, the net market value of the foreign exchange balance sheet derivative contracts was a net liability of less than \$0.1 million, consisting entirely of liabilities.

The net gains recognized in the Consolidated Statements of Income on foreign exchange balance sheet derivative contracts for the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012 are as follows:

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	June	June	June	June
	29,	30,	29,	30,
	2013	2012	2013	2012
	(expressed in thousands)			
Net gain recognized in Other income (expense), net	\$334	\$ 29	\$62	\$228

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8. Fair Value Measurements

In determining the fair value of financial assets and liabilities, the Company currently utilizes market data or other assumptions that it believes market participants would use in pricing the asset or liability in the principal or most advantageous market, and adjusts for non-performance and/or other risk associated with the Company as well as counterparties, as appropriate. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

Level 1 Inputs: Unadjusted quoted prices which are available in active markets for identical assets or liabilities accessible to the Company at the measurement date.

Level 2 Inputs: Inputs other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date.

The hierarchy gives the highest priority to Level 1, because this level provides the most reliable measure of fair value, while giving the lowest priority to Level 3.

Financial Instruments Measured at Fair Value on a Recurring Basis

As of June 29, 2013 and September 29, 2012, financial assets and liabilities subject to fair value measurements on a recurring basis were as follows:

	June 29, 2013			
	Level 1	Level 2	Level 3	Total
	1	2	3	
Assets:	(expressed in thousands)			
Currency contracts ⁽¹⁾	\$—	\$1,900	\$ —	\$1,900
Total assets	\$—	\$1,900	\$ —	\$1,900

Liabilities:

Currency contracts ⁽¹⁾	\$—\$241	\$ —	\$241
Total liabilities	\$—\$241	\$ —	\$241

September 29, 2012

	Level 1	Level 2	Level 3	Total
(expressed in thousands)				
Assets:				
Currency contracts ⁽¹⁾	\$—\$432	\$ —	\$432	
Total assets	\$—\$432	\$ —	\$432	

Liabilities:

Currency contracts ⁽¹⁾	\$—\$1,572	\$ —	\$1,572
Total liabilities	\$—\$1,572	\$ —	\$1,572

(1) Based on observable market transactions of spot currency rates and forward currency rates on equivalently termed instruments.

Nonfinancial Assets Measured at Fair Value on a Nonrecurring Basis

The Company's goodwill, intangible assets and other long-lived assets are nonfinancial assets that were acquired either as part of a business combination, individually or with a group of other assets. These nonfinancial assets were initially, and are currently, measured and recognized at amounts equal to the fair value determined as of the date of acquisition. Periodically, these nonfinancial assets are tested for impairment, by comparing their respective carrying values to the estimated fair value of the reporting unit or asset group in which they reside. In the event any of these nonfinancial assets were to become impaired, the Company would recognize an impairment loss equal to the amount by which the carrying value of the reporting unit, impaired asset or asset group exceeds its estimated fair value. Fair value measurements of reporting units are estimated using an income approach involving discounted or undiscounted cash flow models that contain certain Level 3 inputs requiring management judgment, including projections of economic conditions and customer demand, revenue and margins, changes in competition, operating costs, working capital requirements, and new product introductions. Fair value measurements of the reporting units associated with the Company's goodwill balances are estimated at least annually in the fourth quarter of each fiscal year for purposes of impairment testing. Fair value measurements associated with the Company's intangible assets and other long-lived assets are estimated when events or changes in circumstances such as market value, asset utilization, physical change, legal factors, or other matters indicate that the carrying value may not be recoverable.

Table of Contents*Financial Instruments not Measured at Fair Value*

Certain of the Company's financial instruments are not measured at fair value but nevertheless are recorded at carrying amounts approximating fair value, based on their short-term nature or variable interest rate. These financial instruments include cash and cash equivalents, accounts receivable, accounts payable and short-term borrowings.

9. Other Comprehensive Income

Other Comprehensive Income (Loss), a component of Shareholders' Investment, consists of foreign currency translation adjustments, gains or losses on derivative instruments, and defined benefit pension plan adjustments.

Income tax expense or benefit allocated to each component of Other Comprehensive Income (Loss) for the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012 was as follows:

	June 29, 2013			Nine Fiscal Months Ended		
	Three Fiscal Months Ended			Nine Fiscal Months Ended		
	Pretax	Tax	Net of	Pretax	Tax	Net of
	Amount	(Expense)	Tax	Amount	(Expense)	Tax
		or Benefit	Amount		or Benefit	Amount
	(expressed in thousands)					
Foreign currency translation adjustments	\$1,070	\$ —	\$ 1,070	\$(2,313)	\$ —	\$(2,313)
Derivative instruments:						
Unrealized net gain	50	(18)	32	3,596	(1,325)	2,271
Net gain reclassified to earnings	(168)	61	(107)	(928)	341	(587)
Defined benefit pension plan:						
Unrealized net loss	(215)	65	(150)	(172)	52	(120)
Net loss reclassified to earnings	129	(39)	90	389	(118)	271
Currency exchange rate change	(104)	—	(104)	(58)	—	(58)
Other comprehensive income (loss)	\$762	\$ 69	\$ 831	\$514	\$ (1,050)	\$(536)

	June 30, 2012			Nine Fiscal Months Ended		
	Three Fiscal Months Ended			Nine Fiscal Months Ended		
	Pretax	Tax	Net of	Pretax	Tax	Net of
	Amount	(Expense)	Tax	Amount	(Expense)	Tax
		or Benefit	Amount		or Benefit	Amount
	(expressed in thousands)					
Foreign currency translation adjustments	\$(3,366)	\$ —	\$(3,366)	\$(4,137)	\$ —	\$(4,137)
Derivative instruments:						
Unrealized net gain	498	(186)	312	696	(259)	437

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Net loss reclassified to earnings	286	(107)	179	774	(288)	486
Defined benefit pension plan:								
Unrealized net loss	(446	)	103	(343	)	(316	)	58
Net loss reclassified to earnings	19	(6	)	13	59	(18	)	41
Currency exchange rate change	105	—		105	123	—		123
Other comprehensive loss	\$(2,904)	\$	(196)	\$(3,100))	\$(2,801)	\$
						(507)	\$(3,308)

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The changes in the net-of-tax balances of each component of AOCI during the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012 were as follows:

	June 29, 2013 Three Fiscal Months Ended				Nine Fiscal Months Ended			
	Foreign Currency Translation Adjustments	Unrealized Gain on Derivative Instruments	Defined Benefit Pension Plan Adjustments	Total	Foreign Currency Translation Adjustments	Unrealized (Loss) Gain on Derivative Instruments	Defined Benefit Pension Plan Adjustments	Total
	(expressed in thousands)							
Beginning balance	\$13,351	\$ 1,351	\$ (5,168	) \$9,534	\$16,734	\$ (408	) \$ (5,425	) \$10,901
Other comprehensive income (loss) before reclassifications	1,070	32	(254	) 848	(2,313)	2,271	(178	) (220)
Amounts reclassified to earnings	—	(107	) 90	(17)	—	(587	) 271	(316)
Other comprehensive income (loss)	1,070	(75	) (164	) 831	(2,313)	1,684	93	(536)
Ending balance	\$14,421	\$ 1,276	\$ (5,332	) \$10,365	\$14,421	\$ 1,276	\$ (5,332	) \$10,365

	June 30, 2012 Three Fiscal Months Ended				Nine Fiscal Months Ended			
	Foreign Currency Translation Adjustments	Unrealized (Loss) gain on Derivative Instruments	Defined Benefit Pension Plan Adjustments	Total	Foreign Currency Translation Adjustments	Unrealized (Loss) gain on Derivative Instruments	Defined Benefit Pension Plan Adjustments	Total
	(expressed in thousands)							
Beginning balance	\$18,086	\$ (184	) \$ (1,821	) \$16,081	\$18,857	\$ (616	) \$ (1,952	) \$16,289
Other comprehensive (loss) income before reclassifications	(3,366)	312	(238) (3,292)	(4,137)	437	(135) (3,835)
Amounts reclassified to earnings	—	179	13	192	—	486	41	527

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Other									
comprehensive									
(loss) income	(3,366)	491	(225)	(3,100)	(4,137)	923	(94)	(3,308)	
Ending balance	\$ 14,720	\$ 307	\$ (2,046)	\$ 12,981	\$ 14,720	\$ 307	\$ (2,046)	\$ 12,981	

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The effect on certain line items in the Consolidated Statements of Income of amounts reclassified out of AOCI for the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012 was as follows:

	Three Fiscal Months Ended		Nine Fiscal Months Ended		Affected Line Item in the
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012	Consolidated Statements of Income
Derivative instruments:	(expressed in thousands)				
Currency exchange contracts	\$168	\$(100)	\$928	\$(229)	Revenue
Interest rate swaps	—	(186)	—	(545)	Interest (expense) income, net
Total net gains (losses) included in income before income taxes	168	(286)	928	(774)	
Income tax (expense) benefit	(61)	107	(341)	288	
Total net gains (losses) included in net income	107	(179)	587	(486)	
Defined benefit pension plan:					
Actuarial losses	(43)	(6)	(128)	(19)	Cost of sales
Actuarial losses	(38)	(6)	(116)	(18)	Selling and marketing
Actuarial losses	(48)	(7)	(145)	(22)	General and administrative
Total losses included in income before income taxes	(129)	(19)	(389)	(59)	
Income tax expense	39	6	118	18	
Total net losses included in net income	(90)	(13)	(271)	(41)	
Total net-of-tax reclassifications out of accumulated other comprehensive income included in net income	\$17	\$(192)	\$316	\$(527)	

10. Financing

Short-term borrowings at June 29, 2013 and September 29, 2012 consist of the following:

	June 29, 2013	September 29, 2012
	(expressed in thousands)	
Bank line of credit, monthly U.S. LIBOR plus 87.5 basis points (0.20% rate		

in effect at June 29,
2013), maturing July
2013, with optional
month-to-month term

renewal and loan repricing until September 2017	\$	10,000	\$	—
Notes payable, non-interest bearing		—		230
Total short-term borrowings	\$	10,000	\$	230

The Company's credit facility provides for up to \$100 million for working capital financing, acquisitions, share purchases, or other general corporate purposes and expires in September 2017. At June 29, 2013 outstanding borrowings under the credit facility were \$10.0 million. At June 29, 2013, under the terms of the credit facility borrowings, the interest rate applicable to outstanding credit facility borrowings was 1.075%. At September 29, 2012, the Company had no borrowings outstanding under the \$100 million credit facility. Short-term borrowings at September 29, 2012 consisted of non-interest bearing notes payable to vendors by the Company's Japanese Sensors' subsidiary. At June 29, 2013, the Company had outstanding letters of credit drawn from the credit facility totaling \$13.0 million, leaving \$77.0 million of unused borrowing capacity. At September 29, 2012, the Company had outstanding letters of credit drawn from the credit facility totaling \$10.1 million, leaving \$89.9 million of unused borrowing capacity.

11. Income Taxes

As of June 29, 2013, the Company's liability for unrecognized tax benefits was \$2.0 million, of which \$0.8 million would favorably affect the Company's effective tax rate if recognized. At September 29, 2012, the Company's liability for unrecognized tax benefits was \$1.7 million, of which \$0.5 million would favorably affect the Company's effective tax rate if recognized. As of June 29, 2012, the Company does not expect significant changes in the amount of unrecognized tax benefits during the next twelve months.

As was previously disclosed, in the fourth quarter of fiscal year 2012, the Company reached an agreement with the U.S. Department of Commerce ("DOC") and the U.S. Attorney's Office for the District of Minnesota ("USAO"), settling for \$7.8 million the DOC and USAO's investigation into the Company's past disclosures on its government certifications and its government contracting compliance policies, general compliance record and practices in areas including export controls and government contracts. During the third quarter of fiscal year 2012, the Company accrued a loss contingency equal to the settlement amount. The \$7.8 million accrual was non-deductible for income tax purposes.

On January 2, 2013, the American Taxpayer Relief Act of 2012 ("Act") was signed into law. The Act includes legislation that reinstated the United States Research and Development ("R&D") tax credit retroactively from January 1,

2012 and extends it through December 31, 2013. As a result of this legislation, during fiscal year 2013, the Company recognized a tax benefit of approximately \$1.0 million for the retroactive period January 1, 2012 through September 29, 2012.

Table of Contents**12. Retirement Benefit Plan**

One of the Company's German subsidiaries has a non-contributory, defined benefit retirement plan for eligible employees. This plan provides 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 plan.

The cost for the plan for the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012 included the following components:

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
	(expressed in thousands)			
Service cost	\$172	\$101	\$516	\$312
Interest cost	190	206	574	633
Expected return on plan assets	(171)	(163)	(516)	(501)
Net amortization and deferral	129	19	389	59
Net periodic benefit cost	\$320	\$163	\$963	\$503

The weighted average expected long-term rate of return on plan assets used to determine the net periodic benefit cost for the three and nine-fiscal month periods ended June 29, 2013 and June 30, 2012 was 5.2% and 5.4%, respectively.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

About MTS Systems Corporation

MTS Systems Corporation is a leading global supplier of high-performance test systems and position sensors. The Company's testing hardware and software solutions help customers accelerate and improve their design, development, and manufacturing processes and are used for determining the mechanical behavior of materials, products, and structures. MTS' high-performance position sensors provide controls for a variety of industrial and vehicular applications. MTS had 2,147 employees at September 29, 2012 and revenue of \$542 million for the fiscal year ended September 29, 2012.

Financial Results

Total Company

Orders and Backlog

Three Fiscal Months Ended June 29, 2013 ("Third Quarter of Fiscal 2013") Compared to Three Fiscal Months Ended June 30, 2012 ("Third Quarter of Fiscal 2012")

Nine Fiscal Months Ended June 29, 2013 ("First Nine Fiscal Months of 2013") Compared to Nine Fiscal Months Ended June 30, 2012 ("First Nine Fiscal Months of 2012")

The following is a comparison of Fiscal 2013 and Fiscal 2012 orders, separately identifying the estimated impact of currency translation (in millions):

Three Fiscal Months Ended	Estimated	Three Fiscal Months Ended	Nine Fiscal Months Ended	Estimated	Nine Fiscal Months Ended
June 29, 2013	Business Change	June 30, 2012	June 29, 2013	Business Change	June 30, 2012
	Currency Translation			Currency Translation	

Orders \$ 130.3 \$(16.3) \$ (1.4) \$ 148.0 \$ 407.2 \$(6.3) \$ (4.9) \$ 418.4

Orders

Orders in the Third Quarter of Fiscal 2013 totaled \$130.3 million, a decrease of \$17.7 million, or 12.0%, including an estimated 0.9% unfavorable impact of currency translation, compared to \$148.0 million for the Third Quarter of Fiscal 2012. This decrease was driven by variability in large (in excess of \$5.0 million) orders as well as a 4.0% decline in base orders (those under \$5.0 million) in the Test segment (“Test”). Orders in the Third Quarter of Fiscal 2013 included one large custom Test order of approximately \$6 million. Orders in the Third Quarter of Fiscal 2012 included two large custom Test orders totaling approximately \$20 million. Test orders declined 14.7% while Sensors segment (“Sensors”) orders grew 1.6%.

Orders in the First Nine Fiscal Months of 2013 totaled \$407.2 million, a decrease of \$11.2 million, or 2.7%, including an estimated 1.2% unfavorable impact of currency translation, compared to \$418.4 million for the First Nine Fiscal Months of 2012. This decrease was primarily driven by a decrease in base orders and an unfavorable impact of currency translation, partially offset by an increase in large custom orders. Orders in the First Nine Fiscal Months of 2013 included four large Test orders totaling approximately \$32 million. Orders in the First Nine Fiscal Months of 2012 included three large Test orders totaling approximately \$25 million. Test orders declined 2.4% and Sensors orders declined 3.8%.

Backlog

Backlog of undelivered orders at the end of the Third Quarter of Fiscal 2013 was \$282.5 million, a decrease of 1.4% compared to \$286.5 million at the end of the Third Quarter of Fiscal 2012. While the Company’s backlog is subject to order cancellations, the Company has not historically experienced a significant number of order cancellations. Second Quarter of Fiscal 2013 beginning backlog was unfavorably impacted by a custom order in Test totaling approximately \$2.1 million that was cancelled during the First Quarter of Fiscal 2013. This order was booked in the previous fiscal year.

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The following is a comparison of Fiscal 2013 to Fiscal 2012 statements of operations (in millions, except per share data):

	Three Fiscal Months				Nine Fiscal Months			
	Ended June 29, 2013	June 30, 2012	% Variance		Ended June 29, 2013	June 30, 2012	% Variance	
Revenue	\$ 135.1	\$ 141.7	-4.7	%	\$ 414.6	\$ 404.4	2.5	%
Cost of sales	80.5	78.0	3.2	%	249.5	225.6	10.6	%
Gross profit	54.6	63.7	-14.3	%	165.1	178.8	-7.7	%
Gross margin	40.4	% 44.9	%		39.8	% 44.2	%	
Operating expenses:								
Selling and marketing	20.3	19.6	3.6	%	59.0	55.8	5.7	%
General administrative	11.6	13.0	-10.8	%	37.1	40.1	-7.5	%
Research and development	6.3	5.1	23.5	%	16.9	16.1	5.0	%
U.S Government settlement	—	7.8	-100.0	%	—	7.8	-100.0	%
Total operating expenses	38.2	45.5	-16.0	%	113.0	119.8	-5.7	%
Income from operations	16.4	18.2	-9.9	%	52.1	59.0	-11.7	%
Interest income (expense), net	—	0.2	-100.0	%	(0.2)	(0.2)	0.0	%
Other income (expense), net	0.4	0.1	300.0	%	(0.1)	(0.4)	-75.0	%
Income before income taxes	16.8	18.5	-9.2	%	51.8	58.4	-11.3	%
Income tax provision	5.3	8.9	-40.4	%	15.4	22.1	-30.3	%
Net income	\$ 11.5	\$ 9.6	19.8	%	\$ 36.4	\$ 36.3	0.3	%
Diluted earnings per share	\$ 0.72	\$ 0.59	22.0	%	\$ 2.29	\$ 2.26	1.3	%

The following is a comparison of Fiscal 2013 to Fiscal 2012 results of operations, separately identifying the estimated impact of currency translation (in millions):

Three Fiscal Months Ended June 29,	Estimated Business	Currency	Three Fiscal Months Ended June 30,	Nine Fiscal Months Ended June 29,	Estimated Business	Currency	Nine Fiscal Months Ended June 30,
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	2013	Change	Translation	2012	2013	Change	Translation	2012
Revenue	\$ 135.1	\$(4.2)	\$ (2.4)	\$ 141.7	\$ 414.6	\$ 16.6	\$ (6.4)	\$ 404.4
Cost of sales	80.5	4.0	(1.5)	78.0	249.5	28.1	(4.2)	225.6
Gross profit	54.6	(8.2)	(0.9)	63.7	165.1	(11.5)	(2.2)	178.8
	40.4 %			44.9 %	39.8 %			44.2 %
Operating expenses:								
Selling and marketing	20.3	1.0	(0.3)	19.6	59.0	4.1	(0.9)	55.8
General administrative	11.6	(1.4)	—	13.0	37.1	(2.9)	(0.1)	40.1
Research and development	6.3	1.2	—	5.1	16.9	0.8	—	16.1
U.S. Government settlement	—	(7.8)	—	7.8	—	(7.8)	—	7.8
Total operating expenses	38.2	(7.0)	(0.3)	45.5	113.0	(5.8)	(1.0)	119.8
Income from operations	\$ 16.4	\$(1.2)	\$ (0.6)	\$ 18.2	\$ 52.1	\$(5.7)	\$ (1.2)	\$ 59.0

Revenue

Revenue in the Third Quarter of Fiscal 2013 was \$135.1 million, a decrease of \$6.6 million, or 4.7%, compared to \$141.7 million for the Third Quarter of Fiscal 2012. The decrease was driven by lower beginning backlog in both segments and reduced base order volume in Test, as well as an estimated \$2.4 million unfavorable impact of currency translation. Test revenue decreased 5.1% to \$110.4 million and Sensors revenue decreased 2.8% to \$24.7 million.

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Revenue in the First Nine Fiscal Months of 2013 was \$414.6 million, an increase of \$10.2 million, or 2.5%, compared to \$404.4 million for the First Nine Fiscal Months of 2012. The increase was primarily driven by strong backlog execution in Test, partially offset by a lower beginning backlog and reduced order volume in Sensors, as well as an estimated \$6.4 million unfavorable impact of currency translation. Test revenue increased 5.3% to \$345.4 million, while Sensors revenue decreased 9.5% to \$69.2 million.

Gross Profit

Gross profit in the Third Quarter of Fiscal 2013 was \$54.6 million, a decrease of \$9.1 million, or 14.3%, compared to \$63.7 million for the Third Quarter of Fiscal 2012. Gross profit as a percentage of revenue was 40.4%, a decrease of 4.5 percentage points from 44.9% for the Third Quarter of Fiscal 2012. This decrease reflects an unfavorable mix of lower margin products and services in Test. The gross profit rate was also negatively impacted by approximately 1 percentage point from continued investment in productivity and infrastructure initiatives in Test, 1 percentage point from higher warranty expense in Test, and 1 percentage point from lower engineering labor utilization in Test. These decreases were partially offset by a 1 percentage point favorable impact from lower variable compensation. The productivity and infrastructure initiatives that impact gross profit are focused on the building of a scalable enterprise and include investments in the Company's operating system and service delivery system. These investments will likely continue for the remainder of fiscal year 2013 and into fiscal year 2014.

Gross profit in the First Nine Fiscal Months of 2013 was \$165.1 million, a decrease of \$13.7 million, or 7.7%, compared to \$178.8 million for the First Nine Fiscal Months of 2012. Gross profit as a percentage of revenue was 39.8%, a decrease of 4.4 percentage points from 44.2% for the First Nine Fiscal Months of 2012. This decrease reflects an unfavorable mix, primarily resulting from a higher proportion of lower-margin custom development products in Test. The gross profit rate was also negatively impacted by approximately 1 percentage point from continued investment in productivity and infrastructure initiatives in Test, 1 percentage point from lower engineering labor utilization in Test, and 1 percentage point from higher warranty expense in Test.

Selling and Marketing Expense

Selling and marketing expense in the Third Quarter of Fiscal 2013 was \$20.3 million, an increase of \$0.7 million, or 3.6%, compared to \$19.6 million for the Third Quarter of Fiscal 2012. Selling and marketing expense in the First Nine Fiscal Months of 2013 was \$59.0 million, an increase of \$3.2 million, or 5.7%, compared to \$55.8 million for the First Nine Fiscal Months of 2012. Both increases were primarily driven by higher travel and other discretionary expenses to support current sales efforts, as well as higher compensation and benefits resulting from increased headcount, partially offset by lower variable compensation and sales commissions. Selling and marketing expense as a percentage of revenue for the Third Quarter of Fiscal 2013 was 15.0%, compared to 13.8% for the Third Quarter of Fiscal 2012. Selling and marketing expense as a percentage of revenue for the First Nine Fiscal Months of 2013 was 14.2%, compared to 13.8% for the First Nine Fiscal Months of 2012.

General and Administrative Expense

General and administrative expense in the Third Quarter of Fiscal 2013 was \$11.6 million, a decrease of \$1.4 million, or 10.8%, compared to \$13.0 million for the Third Quarter of Fiscal 2012. This decrease was primarily driven by a lower level of investment in strategic and compliance initiatives, lower variable compensation, and Chief Executive Officer (“CEO”) transition-related expenses recognized in the Third Quarter of Fiscal 2012, partially offset by higher compensation and benefits driven by increased headcount. General and administrative expense as a percentage of revenue was 8.6%, compared to 9.2% for the Third Quarter of Fiscal 2012.

General and administrative expense in the First Nine Fiscal Months of 2013 was \$37.1 million, a decrease of \$3.0 million, or 7.5%, compared to \$40.1 million for the First Nine Fiscal Months of 2012. This decrease is primarily driven by a lower level of investment in strategic and compliance initiatives, and CEO transition-related expenses recognized in the First Nine Fiscal Months of Fiscal 2012, partially offset by higher compensation and benefits driven by increased headcount, as well as senior management transition-related expenses in Sensors. General and administrative expense as a percentage of revenue was 8.9%, compared to 9.9% for the First Nine Fiscal Months of 2012.

Research and Development Expense

Research and development expense in the Third Quarter of Fiscal 2013 was \$6.3 million, an increase of \$1.2 million, or 23.5%, compared to \$5.1 million for the Third Quarter of Fiscal 2012. Research and development expense in the First Nine Fiscal Months of 2013 was \$16.9 million, an increase of \$0.8 million, or 5.0%, compared to \$16.1 million for the First Nine Fiscal Months of 2012. Both increases were primarily due to timing of planned expenditures in Test. Research and development expense as a percentage of revenue for the Third Quarter of Fiscal 2013 was 4.7%, compared to 3.6% for the Third Quarter of Fiscal 2012. Research and development expense as a percentage of revenue for the First Nine Fiscal Months of 2013 was 4.1%, compared to 4.0% for the First Nine Fiscal Months of 2012.

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U.S. Government Settlement Expense

In the fourth quarter of fiscal year 2012, the Company reached an agreement with the DOC and the USAO, settling for \$7.8 million the DOC and USAO's investigation into the Company's past disclosures on its government certifications and its government contracting compliance policies, general compliance record and practices in areas including export controls and government contracts. During the Third Quarter of Fiscal 2012, the Company accrued a loss contingency equal to the settlement amount. U.S. Government settlement expense as a percentage of revenue was 5.5% and 1.9% for the Third Quarter of Fiscal 2012 and First Nine Fiscal Months of 2012, respectively.

Income from Operations

Income from operations in the Third Quarter of Fiscal 2013 was \$16.4 million, a decrease of \$1.8 million, or 9.9%, compared to income from operations of \$18.2 million for the Third Quarter of Fiscal 2012. Income from operations in the First Nine Fiscal Months of 2013 was \$52.1 million, a decrease of \$6.9 million, or 11.7%, compared to income from operations of \$59.0 million for the First Nine Fiscal Months of 2012. Both decreases were driven by lower gross profit, partially offset by decreased operating expenses. Operating income as a percentage of revenue for the Third Quarter of Fiscal 2013 was 12.1%, compared to 12.8% for the Third Quarter of Fiscal 2012. Operating income as a percentage of revenue for the First Nine Fiscal Months of 2013 was 12.6%, compared to 14.6% for the First Nine Fiscal Months of 2012.

Interest (Expense) Income, net

Net interest expense in the Third Quarter of Fiscal 2013 was less than \$0.1 million, compared to \$0.2 million of net interest income in the Third Quarter of Fiscal 2012. Net interest income in the Third Quarter of Fiscal 2012 was driven by a \$0.3 million reduction in accrued interest associated with the Company's liability for uncertain tax positions.

Net interest expense in the First Nine Fiscal Months of 2013 was \$0.2 million, flat compared to the First Nine Fiscal Months of 2012.

Other Income (Expense), net

Other income (expense), net in the Third Quarter of Fiscal 2013 was \$0.4 million of net other income, an increase of \$0.3 million compared to \$0.1 million of net other income in the Third Quarter of Fiscal 2012. This increase was primarily due to \$0.1 million increased net gains on foreign currency transactions in the Third Quarter of Fiscal 2013 compared to \$0.2 million net losses on foreign currency transactions in the Third Quarter of Fiscal 2012.

Other income (expense), net in the First Nine Fiscal Months of 2013 was \$0.1 million of net other expense, a decrease of \$0.3 million compared to \$0.4 million of net other expense in the First Nine Fiscal Months of 2012. This decrease is primarily due to \$0.4 million higher royalty income in the First Nine Fiscal Months of 2013 associated with a Test product line that was sold by the Company in fiscal year 2012, partially offset by \$0.3 million increased net losses on foreign currency transactions driven by volatility in the value of the U.S. dollar against the Japanese Yen during the First Nine Fiscal Months of 2013.

Provision for Income Taxes

Provision for income taxes in the Third Quarter of Fiscal 2013 totaled \$5.3 million, a decrease of \$3.6 million, or 40.4%, compared to \$8.9 million for the Third Quarter of Fiscal 2012, primarily due to a lower effective tax rate as well as decreased income before income taxes. The effective tax rate for the Third Quarter of Fiscal 2013 was 31.2%, a decrease of 16.9 percentage points compared to a tax rate of 48.1% for the Third Quarter of Fiscal 2012. The effective tax rate for the Third Quarter of Fiscal 2012 was negatively impacted by approximately 15.6 percentage points due to the recognition of the previously mentioned \$7.8 million accrual related to the U.S. Government settlement which was nondeductible for income tax purposes.

Provision for income taxes in the First Nine Fiscal Months of 2013 totaled \$15.4 million, a decrease of \$6.7 million, or 30.3%, compared to \$22.1 million for the First Nine Fiscal Months of 2012, primarily due to a lower effective tax rate as well as decreased income before income taxes. The effective tax rate for the First Nine Fiscal Months of 2013 was 29.8%, a decrease of 8.1 percentage points compared to a tax rate of 37.9% for the First Nine Fiscal Months of 2012. The effective tax rate for the First Nine Fiscal Months of Fiscal 2012 was unfavorably impacted by approximately 4.9 percentage points due to the recognition of the previously mentioned \$7.8 million nondeductible accrual associated with the U.S. Government settlement. In addition, the effective tax rate for the First Nine Fiscal Months of 2013 was favorably impacted by approximately 2.0 percentage points due to the enactment of legislation in the Second Quarter of Fiscal 2013 that retroactively extended the United States R&D tax credit and provided a tax benefit of \$1.0 million for the retroactive period January 1, 2012 through September 29, 2012.

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Net income in the Third Quarter of Fiscal 2013 was \$11.5 million, an increase of \$1.9 million, or 19.8%, compared to \$9.6 million for the Third Quarter of Fiscal 2012. The increase was primarily driven by a decrease in the effective tax rate, partially offset by lower income from operations. Earnings per diluted share were \$0.72, an increase of \$0.13 per share, or 22.0%, compared to \$0.59 for the Third Quarter of Fiscal 2012. The previously mentioned \$7.8 million accrual recognized in the Third Quarter of Fiscal 2012 negatively impacted earnings per diluted share by \$0.48.

Net income in the First Nine Fiscal Months of 2013 was \$36.4 million, relatively flat compared to the First Nine Fiscal Months of 2012, as lower income from operations was partially offset by a decrease in the effective tax rate. Earnings per diluted share increased \$0.03 to \$2.29, compared to \$2.26 for the First Nine Fiscal Months of 2012. The previously mentioned \$7.8 million accrual recognized in the Third Quarter of Fiscal 2012 negatively impacted earnings per diluted share by \$0.48 in the prior year.

Segment Results**Test Segment**Orders and Backlog

The following is a comparison of Fiscal 2013 to Fiscal 2012 orders for Test, separately identifying the estimated impact of currency translation (in millions):

	Three Fiscal Months Ended	Estimated		Three Fiscal Months Ended	Nine Fiscal Months Ended	Estimated		Nine Fiscal Months Ended
	June 29, 2013	Business Change	Currency Translation	June 30, 2012	June 29, 2013	Business Change	Currency Translation	June 30, 2012
Orders	\$ 105.4	\$(17.7)	\$ (0.4)	\$ 123.5	\$ 335.8	\$(5.9)	\$ (2.5)	\$ 344.2

Orders

Orders in the Third Quarter of Fiscal 2013 totaled \$105.4 million, a decrease of \$18.1 million, or 14.7%, compared to orders of \$123.5 million for the Third Quarter of Fiscal 2012, primarily driven by variability in large orders as well as a 4.0% decline in base orders. Base orders decreased primarily due to weaker volume of materials orders in Europe

and the Americas. Third Quarter of Fiscal 2013 orders included one large Americas' order in the ground vehicles market totaling \$6 million for aerodynamic testing. Orders in the Third Quarter of Fiscal 2012 included two large orders: an \$11 million Asian structures order and a \$9 million European structures order. Currency translation unfavorably impacted orders by approximately \$0.4 million. Test accounted for 80.9% of total Company orders, compared to 83.5% for the Third Quarter of Fiscal 2012.

Orders in the First Nine Fiscal Months of 2013 totaled \$335.8 million, a decrease of \$8.4 million, or 2.4%, compared to orders of \$344.2 million for the First Nine Fiscal Months of 2012. First Nine Fiscal Months 2013 orders included two large European orders in the ground vehicles market totaling \$17 million, one of which was for a rolling road wind tunnel measurement system and the other was for a transmission test system, as well as two large Americas' orders totaling \$15 million, one of which was for a vehicle motion simulator in the structures market and the other for an aerodynamic test system in the ground vehicles market. First Nine Fiscal Months of 2012 orders included three large custom orders of approximately \$25 million, of which \$20 million was associated with the structures market and \$5 million was associated with the ground vehicles market. Geographically, the Americas' increased 4.8% and Europe was up 4.5%, driven by the previously mentioned large orders. Asia declined 11.4%, primarily due to the cyclical nature of Chinese seismic orders, as well as timing of wind energy orders, in the structures market. Currency translation unfavorably impacted orders by approximately \$2.5 million. Test accounted for 82.5% of total Company orders, compared to 82.3% for the First Nine Fiscal Months of 2012.

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Backlog of undelivered orders at the end of the quarter was \$266.6 million, a decrease of 2.0% compared to backlog of \$272.0 million at the end of the Third Quarter of Fiscal 2012. As previously mentioned, Third Quarter of Fiscal 2013 beginning backlog was negatively impacted by a custom order totaling approximately \$2.1 million that was cancelled during the First Quarter of Fiscal 2013.

Results of Operations

The following is a comparison of Fiscal 2013 to Fiscal 2012 results of operations for Test, separately identifying the estimated impact of currency translation (in millions):

	Three Fiscal Months Ended June 29, 2013	Estimated Business Change	Currency Translation	Three Fiscal Months Ended June 30, 2012	Nine Fiscal Months Ended June 29, 2013	Estimated Business Change	Currency Translation	Nine Fiscal Months Ended June 30, 2012
Revenue	\$ 110.4	\$(4.4)	\$ (1.5)	\$ 116.3	\$ 345.4	\$21.8	\$ (4.3)	\$ 327.9
Cost of sales	70.3	4.4	(1.2)	67.1	219.3	30.1	(3.4)	192.6
Gross profit	40.1	(8.8)	(0.3)	49.2	126.1	(8.3)	(0.9)	135.3
	36.3 %			42.2 %	36.5 %			41.3 %
Operating expenses:								
Selling and marketing	15.5	(0.1)	(0.1)	15.7	46.1	2.2	(0.4)	44.3
General administrative	8.9	(1.2)	0.1	10.0	27.9	(2.8)	0.2	30.5
Research and development	4.8	1.1	—	3.7	12.8	0.6	—	12.2
U.S. Government settlement	—	(6.1)	—	6.1	—	(6.1)	—	6.1
Total operating expenses	29.2	(6.3)	—	35.5	86.8	(6.1)	(0.2)	93.1
Income from operations	\$ 10.9	\$(2.5)	\$ (0.3)	\$ 13.7	\$ 39.3	\$(2.2)	\$ (0.7)	\$ 42.2

Revenue

Revenue in the Third Quarter of Fiscal 2013 was \$110.4 million, a decrease of \$5.9 million, or 5.1%, compared to revenue of \$116.3 million for the Third Quarter of Fiscal 2012. The decrease was primarily driven by lower beginning backlog, a decline in base orders, as well as an estimated \$1.5 million unfavorable impact of currency translation.

Revenue in the First Nine Fiscal Months of 2013 was \$345.4 million, an increase of \$17.5 million, or 5.3%, compared to revenue of \$327.9 million for the First Nine Fiscal Months of 2012. The increase was primarily driven by a strong execution on 5.2% higher beginning backlog, partially offset by an estimated \$4.3 million unfavorable impact of currency translation. The backlog conversion rate benefited from the implementation of operational process improvements.

Gross Profit

Gross profit in the Third Quarter of Fiscal 2013 was \$40.1 million, a decrease of \$9.1 million, or 18.5%, compared to \$49.2 million for the Third Quarter of Fiscal 2012. Gross profit as a percentage of revenue was 36.3%, a decrease of 5.9 percentage points from 42.2% for the Third Quarter of Fiscal 2012. Of the reduced gross profit rate, approximately 2 percentage points resulted from an unfavorable mix of lower-margin products and services, 2 percentage points resulted from increased warranty expense, 1 percentage point resulted from continued investment in productivity and infrastructure initiatives, and 1 percentage point resulted from lower engineering labor utilization caused primarily by increased innovation and training initiatives, and 1 percentage point resulted from decreased leverage on lower volume. These decreases were partially offset by a 1 percentage point favorable impact from lower variable compensation. As previously mentioned, the productivity and infrastructure initiatives that impact gross profit are focused on the building of a scalable enterprise and include investments in the Company's operating system and service delivery system. These investments will likely continue for the remainder of fiscal year 2013 and into fiscal year 2014.

Gross profit in the First Nine Fiscal Months of 2013 was \$126.1 million, a decrease of \$9.2 million, or 6.8%, compared to gross profit of \$135.3 million for the First Nine Fiscal Months of 2012. Gross profit as a percentage of revenue was 36.5%, a decrease of 4.8 percentage points from 41.3% for the First Nine Fiscal Months of 2012. Of the reduced gross profit rate, approximately 2 percentage points resulted from an unfavorable mix of lower-margin products and services, 1 percentage point resulted from continued investment in productivity and infrastructure initiatives, and 1 percentage point resulted from increased warranty expense, and 1 percentage point resulted from lower engineering labor utilization caused primarily by increased innovation and training initiatives during the current year.

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Selling and Marketing Expense

Selling and marketing expense in the Third Quarter of Fiscal 2013 was \$15.5 million, a decrease of \$0.2 million compared to \$15.7 million for the Third Quarter of Fiscal 2012. The decrease was driven by lower variable compensation and sales commissions as well as a \$0.1 million favorable impact of currency translation, partially offset by continued investment in sales expansion to drive future revenue growth, primarily comprised of higher compensation and benefits resulting from increased headcount. Selling and marketing expense as a percentage of revenue was 14.0% on lower volume, compared to 13.5% for the Third Quarter of Fiscal 2012.

Selling and marketing expense in the First Nine Fiscal Months of 2013 was \$46.1 million, an increase of \$1.8 million, or 4.1%, compared to \$44.3 million for the First Nine Fiscal Months of 2012. This increase was primarily driven by higher compensation and benefits resulting from increased headcount, as well as increased travel and other discretionary expenses to support selling efforts, partially offset by reduced bad debt expense, as well as lower sales commissions and variable compensation expense. Selling and marketing expense as a percentage of revenue was 13.3% on higher volume, compared to 13.5% for the First Nine Fiscal Months of 2012.

General and Administrative Expense

General and administrative expense in the Third Quarter of Fiscal 2013 was \$8.9 million, a decrease of \$1.1 million, or 11.0%, compared to \$10.0 million for the Third Quarter of Fiscal 2012. This decrease is primarily driven by a lower level of investment in strategic and compliance initiatives, CEO transition-related expenses recognized in the Third Quarter of Fiscal 2012, as well as lower variable compensation. General and administrative expense as a percentage of revenue was 8.1%, compared to 8.6% for the Third Quarter of Fiscal 2012.

General and administrative expense in the First Nine Fiscal Months of 2013 was \$27.9 million, a decrease of \$2.6 million, or 8.5%, compared to \$30.5 million for the First Nine Fiscal Months of 2012. This decrease is primarily driven by a relatively lower level of investment in strategic and compliance initiatives, CEO transition-related expenses recognized in the First Nine Fiscal Months of 2013, partially offset by higher compensation and benefits driven by increased headcount. General and administrative expense as a percentage of revenue was 8.1%, compared to 9.3% for the First Nine Fiscal Months of 2012.

Research and Development Expense

Research and development expense in the Third Quarter of Fiscal 2013 was \$4.8 million, an increase of \$1.1 million, or 29.7%, compared to \$3.7 million for the Third Quarter of Fiscal 2012. Research and development expense in the First Nine Fiscal Months of 2013 was \$12.8 million, an increase of \$0.6 million, or 4.9%, compared to the First Nine Fiscal Months of 2012. Both increases were driven by the timing of planned expenditures. Research and development expense as a percentage of revenue for the Third Quarter of Fiscal 2013 was 4.3%, compared to 3.2% for the Third Quarter of Fiscal 2012. Research and development expense as a percentage of revenue for the First Nine Fiscal Months of 2013 was 3.7%, flat compared to the First Nine Fiscal Months of 2012.

U.S. Government Settlement Expense

U.S. Government settlement expense for both the Third Quarter of Fiscal 2012 and the First Nine Fiscal Months of 2012 includes \$6.1 million of the \$7.8 million accrual related to the previously mentioned U.S. Government matter that was settled during the Fourth Quarter of Fiscal 2012. U.S. Government settlement expense as a percentage of revenue was 5.2% and 1.9% for the Third Quarter of Fiscal 2012 and the First Nine Fiscal Months of 2012, respectively.

Income from Operations

Income from operations in the Third Quarter of Fiscal 2013 was \$10.9 million, a decrease of \$2.8 million, or 20.4%, compared to \$13.7 million for the Third Quarter of Fiscal 2012. Income from operations in the First Nine Fiscal Months of 2013 was \$39.3 million, a decrease of \$2.9 million, or 6.9%, compared to \$42.2 million for the First Nine Fiscal Months of 2012. Both decreases were driven by lower gross profit, partially offset by decreased operating expenses. Operating income as a percentage of revenue for the Third Quarter of Fiscal 2013 was 9.9%, compared to 11.8% for the Third Quarter of Fiscal 2012. Operating income as a percentage of revenue for the First Nine Fiscal Months of 2013 was 11.4%, compared to 12.9% for the First Nine Fiscal Months of 2012.

Table of Contents**Sensors Segment**Orders and Backlog

The following is a comparison of Fiscal 2013 to Fiscal 2012 orders for Sensors, separately identifying the estimated impact of currency translation (in millions):

	Three Fiscal Months Ended	Estimated Business Currency Change	Translation	Three Fiscal Months Ended	Nine Fiscal Months Ended	Estimated Business Currency Change	Translation	Nine Fiscal Months Ended
	June 29, 2013			June 30, 2012	June 29, 2013			June 30, 2012
Orders	\$ 24.9	\$1.4	\$ (1.0)	\$ 24.5	\$ 71.4	\$(0.4)	\$ (2.4)	\$ 74.2

Orders

Orders in the Third Quarter of Fiscal 2013 totaled \$24.9 million, an increase of \$0.4 million, or 1.6%, including an estimated 4.1% unfavorable impact of currency translation, compared to orders of \$24.5 million for the Third Quarter of Fiscal 2012. During the quarter, the Company experienced improvement in overall demand for sensors. The mobile hydraulic market was up 10.8%. While a trend has not developed, the cyclical downturn in the overall hydraulic market appears to be turning. The industrial market was flat, as overall market improvement was offset by an unfavorable impact of currency translation. Sensors accounted for 19.1% of total Company orders, compared to 16.5% for the Third Quarter of Fiscal 2012.

Orders in the First Nine Fiscal Months of 2013 totaled \$71.4 million, a decrease of \$2.8 million, or 3.8%, including an estimated 3.2% unfavorable impact of currency translation, compared to orders of \$74.2 million for the First Nine Fiscal Months of 2012, primarily due to soft market conditions in Europe and Japan. The industrial market was down 3.1% and the mobile hydraulic market was down 7.9%. Sensors accounted for 17.5% of total Company orders, compared to 17.7% for the First Nine Fiscal Months of 2012.

Backlog

Backlog of undelivered orders at the end of the quarter was \$15.9 million, an increase of 9.7% compared to backlog of \$14.5 million at the end of the Third Quarter of Fiscal 2012.

Results of Operations

The following is a comparison of Fiscal 2013 to Fiscal 2012 results of operations for Sensors, separately identifying the estimated impact of currency translation (in millions):

	Three Fiscal Months Ended June 29, 2013	Estimated Business Change	Currency Translation	Three Fiscal Months Ended June 30, 2012	Nine Fiscal Months Ended June 29, 2013	Estimated Business Change	Currency Translation	Nine Fiscal Months Ended June 30, 2012
Revenue	\$ 24.7	\$0.2	\$ (0.9)	\$ 25.4	\$ 69.2	\$(5.2)	\$ (2.1)	\$ 76.5
Cost of sales	10.2	(0.4)	(0.3)	10.9	30.2	(2.0)	(0.8)	33.0
Gross profit	14.5	0.6	(0.6)	14.5	39.0	(3.2)	(1.3)	43.5
	58.7 %			57.2 %	56.4 %			56.9 %
Operating expenses:								
Selling and marketing	4.8	1.1	(0.2)	3.9	12.9	1.9	(0.5)	11.5
General administrative	2.7	(0.2)	(0.1)	3.0	9.2	(0.1)	(0.3)	9.6
Research and development	1.5	0.1	—	1.4	4.1	0.2	—	3.9
U.S. Government settlement	—	(1.7)	—	1.7	—	(1.7)	—	1.7
Total operating expenses	9.0	(0.7)	(0.3)	10.0	26.2	0.3	(0.8)	26.7
Income from operations	\$ 5.5	\$1.3	\$ (0.3)	\$ 4.5	\$ 12.8	\$(3.5)	\$ (0.5)	\$ 16.8

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Revenue

Revenue in the Third Quarter of Fiscal 2013 was \$24.7 million, a decrease of \$0.7 million, or 2.8%, compared to revenue of \$25.4 million for the Third Quarter of Fiscal 2012. This decrease was primarily driven by an estimated \$0.9 million unfavorable impact of currency translation.

Revenue in the First Nine Fiscal Months of 2013 was \$69.2 million, a decrease of \$7.3 million, or 9.5%, compared to revenue of \$76.5 million for the First Nine Fiscal Months of 2012. This decrease was primarily driven by a 20.8% lower beginning backlog, reduced order volume, and an estimated \$2.1 million unfavorable impact of currency translation.

Gross Profit

Gross profit in the Third Quarter of Fiscal 2013 was \$14.5 million, flat compared to the Third Quarter of Fiscal 2012. Gross profit as a percentage of revenue was 58.7%, an increase of 1.5 percentage points from 57.2% for the Third Quarter of Fiscal 2012, driven by relatively favorable product mix and improved productivity.

Gross profit in the First Nine Fiscal Months of 2013 was \$39.0 million, a decrease of \$4.5 million, or 10.3%, compared to gross profit of \$43.5 million for the First Nine Fiscal Months of 2012, driven by lower revenue volume. Gross profit as a percentage of revenue was 56.4%, a decrease of 0.5 percentage points from 56.9% for the First Nine Fiscal Months of 2012, driven by reduced leverage on lower volume.

Selling and Marketing Expense

Selling and marketing expense in the Third Quarter of Fiscal 2013 was \$4.8 million, an increase of \$0.9 million, or 23.1%, compared to \$3.9 million for the Third Quarter of Fiscal 2012. Selling and marketing expense in the First Nine Fiscal Months of 2013 was \$12.9 million, an increase of \$1.4 million, or 12.2%, compared to \$11.5 million for the First Nine Fiscal Months of 2012. Both increases were primarily due to higher compensation and benefits driven by increased headcount to support future sales growth, as well as increased discretionary expenses to support current sales efforts. Selling and marketing expense as a percentage of revenue for the Third Quarter of Fiscal 2013 was 19.4%, compared to 15.4% for the Third Quarter of Fiscal 2012. Selling and marketing expense as a percentage of revenue for the First Nine Fiscal Months of 2013 was 18.6%, compared to 15.0% for the First Nine Fiscal Months of 2012.

General and Administrative Expense

General and administrative expense in the Third Quarter of Fiscal 2013 was \$2.7 million, a decrease of \$0.3 million, or 10.0%, compared to \$3.0 million for the Third Quarter of Fiscal 2012. This decrease is primarily driven by a

relatively lower level of investment in strategic and compliance initiatives. General and administrative expense as a percentage of revenue was 10.9%, compared to 11.8% for the Third Quarter of Fiscal 2012.

General and administrative expense in the First Nine Fiscal Months of 2013 was \$9.2 million, a decrease of \$0.4 million, or 4.2%, compared to \$9.6 million for the First Nine Fiscal Months of 2012, as a relatively lower level of investment in strategic and compliance initiatives as well as a favorable impact of currency translation was partially offset by higher compensation and benefits driven by senior management transition-related expenses. General and administrative expense as a percentage of revenue was 13.3% on lower volume, compared to 12.5% for the First Nine Fiscal Months of 2012.

Research and Development Expense

Research and development expense in the Third Quarter of Fiscal 2013 was \$1.5 million, relatively flat compared to \$1.4 million for the Third Quarter of Fiscal 2012. Research and development expense in the First Nine Fiscal Months of 2013 was \$4.1 million, relatively flat compared to \$3.9 million for the First Nine Fiscal Months of 2012. Research and development expense as a percentage of revenue for the Third Quarter of Fiscal 2013 was 6.1%, compared to 5.5% for the Third Quarter of Fiscal 2012. Research and development expense as a percentage of revenue for the First Nine Fiscal Months of 2013 was 5.9%, compared to 5.1% for the First Nine Fiscal Months of 2012.

U.S. Government Settlement Expense

U.S. Government settlement expense for both the Third Quarter of Fiscal 2012 and the First Nine Fiscal Months of 2012 includes \$1.7 million of the \$7.8 million accrual related to the previously mentioned U.S. Government matter that was settled during the Fourth Quarter of Fiscal 2012. U.S. Government settlement expense as a percentage of revenue was 6.7% and 2.2% for the Third Quarter of Fiscal 2012 and First Nine Fiscal Months of 2012, respectively.

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Income from Operations

Income from operations in the Third Quarter of Fiscal 2013 was \$5.5 million, an increase of \$1.0 million, or 22.2%, compared to income from operations of \$4.5 million for the Third Quarter of Fiscal 2012. The increase was driven by lower operating expenses. Operating income as a percentage of revenue was 22.3%, compared to 17.7% for the Third Quarter of Fiscal 2012.

Income from operations in the First Nine Fiscal Months of 2013 was \$12.8 million, a decrease of \$4.0 million, or 23.8%, compared to income from operations of \$16.8 million for the First Nine Fiscal Months of 2012. The decrease was primarily due to lower gross profit, partially offset by lower operating expenses. Operating income as a percentage of revenue was 18.5%, compared to 22.0% for the First Nine Fiscal Months of 2012.

Capital Resources and Liquidity

The Company had cash and cash equivalents of \$53.6 million at the end of the Third Quarter of Fiscal 2013. Of this amount, \$3.1 million was located in North America, \$33.4 million in Europe, and \$17.1 million in Asia. Of the \$50.5 million of cash located outside of North America, approximately \$38.4 million is not available for use in the U.S. without the incurrence of U.S. federal and state income tax.

The North American balance was primarily invested in bank deposits. In Europe and Asia, the balances were primarily invested in money market funds and bank deposits. In accordance with its investment policy, the Company places cash equivalent investments with issuers who have high-quality investment credit ratings. In addition, the Company limits the amount of investment exposure it has with any particular issuer. The Company's investment objectives are to preserve principal, maintain liquidity, and achieve the best available return consistent with its primary objectives of safety and liquidity. At the end of the Third Quarter of Fiscal 2013, the Company held no short-term investments.

Total cash and cash equivalents decreased \$26.3 million in the First Nine Fiscal Months of 2013, primarily due to increased working capital requirements, investment in property and equipment, and dividend payments, partially offset by earnings. Total cash and cash equivalents increased \$41.4 million in the First Nine Fiscal Months of 2012, primarily due to earnings and proceeds from the exercise of stock options, partially offset by dividend payments and investment in property and equipment.

Cash flows from operating activities provided cash totaling \$1.9 million for the First Nine Fiscal Months of 2013, compared to cash provided of \$52.2 million for the First Nine Fiscal Months of 2012. Cash provided for the First Nine Fiscal Months of Fiscal 2013 was primarily from earnings, substantially offset by \$19.0 million increased accounts

and unbilled receivables resulting from general timing of billings and collections, \$11.7 million increased inventories to support future revenue, \$5.5 million decreased accounts payable resulting from general timing of purchases and payments, and \$11.9 million decreased advance payments received from customers driven by the mix and timing of orders.

Cash provided for the First Nine Fiscal Months of 2012 was primarily from earnings.

Cash flows from investing activities required the use of cash totaling \$23.2 million for the First Nine Fiscal Months of 2013, compared to the use of cash totaling \$11.7 million for the First Nine Fiscal Months of 2012, each of which reflects investment in property and equipment. The significant increase was driven by investments in various growth and productivity initiatives.

Cash flows from financing activities used cash totaling \$2.3 million for the First Nine Fiscal Months of 2013, compared to the cash provided totaling \$3.3 million for the First Nine Fiscal Months of 2012. The cash used for the First Nine Fiscal Months of 2013 was primarily due to cash dividend payments totaling \$14.4 million as well as the use of \$2.6 million to purchase approximately 45,500 shares of the Company's common stock, partially offset by \$9.7 million net proceeds received from short-term borrowings and \$4.3 million received in connection with stock option exercises. The cash provided for the First Nine Fiscal Months of 2012 was primarily due to \$14.6 million received in connection with stock option exercises, partially offset by payment of cash dividends of \$12.0 million.

Under the terms of its borrowing agreements, the Company has agreed to certain financial covenants. At the end of the Third Quarter of Fiscal 2013, the Company was in compliance with the financial terms and conditions of those agreements.

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Off-Balance Sheet Arrangements

As of June 29, 2013, the Company had no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Critical Accounting Policies

The Consolidated Financial Statements are prepared in accordance with GAAP, which require the Company to make estimates and assumptions in certain circumstances that affect amounts reported. In preparing these financial statements, management has made its best estimates and judgments of certain amounts, giving due consideration to materiality. The Company believes that of its significant accounting policies, the following are particularly important to the portrayal of the Company's results of operations and financial position, may require the application of a higher level of judgment by the Company's management and, as a result, are subject to an inherent degree of uncertainty. Further information is provided in Note 1 in the Condensed Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Revenue Recognition. The Company is required to comply with a variety of technical accounting requirements in order to achieve consistent and accurate revenue recognition. The most significant area of judgment and estimation is percentage of completion contract accounting. The Company develops cost estimates that include materials, component parts, labor and overhead costs. Detailed costs plans are developed for all aspects of the contracts during the bidding phase of the contract. Cost estimates are largely based on actual historical performance of similar projects combined with current knowledge of the projects in progress. Significant factors that impact the cost estimates include technical risk, inflationary cost of materials and labor, changes in scope and schedule, and internal and subcontractor performance. Actual costs incurred during the project phase are monitored and compared to the estimates on a monthly basis. Cost estimates are revised based on changes in circumstances. Anticipated losses on long-term contracts are recognized when such losses become evident.

Inventories. The Company maintains a material amount of inventory to support its engineering and manufacturing operations. This inventory is stated at the lower of cost or market. On a regular basis, the Company reviews its inventory and identifies that which is excess, slow moving, and obsolete by considering factors such as inventory levels, expected product life, and forecasted sales demand. Any identified excess, slow moving, and obsolete inventory is written down to its market value through a charge to income from operations. It is possible that additional inventory write-down charges may be required in the future if there is a significant decline in demand for the Company's products and the Company does not adjust its manufacturing production accordingly.

Impairment of Long-Lived Assets. The Company reviews the carrying value of long-lived assets or asset groups, such as property and equipment and intangibles subject to amortization, when events or changes in circumstances such as market value, asset utilization, physical change, legal factors, or other matters indicate that the carrying value may not be recoverable. When this review indicates the carrying value of an asset or asset group exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group, the Company recognizes an asset impairment charge against operations. The amount of the impairment charge recorded is the amount by which the carrying value of the impaired asset or asset group exceeds its fair value.

Goodwill. The Company tests goodwill at least annually for impairment. Goodwill is also tested for impairment as changes in circumstances occur indicating that the carrying value may not be recoverable. Goodwill impairment testing first requires a comparison of the fair value of each reporting unit to the carrying value. If the carrying value of the reporting unit exceeds fair value, goodwill is considered impaired.

The Company has three reporting units, two of which are assigned goodwill. At June 29, 2013, one reporting unit was assigned \$15.0 million of goodwill while another was assigned \$1.6 million. The fair value of a reporting unit is estimated using a discounted cash flow model that requires input of certain estimates and assumptions requiring management judgment, including projections of economic conditions and customer demand, revenue and margins, changes in competition, operating costs, and new product introductions. At the end of the prior fiscal year, the estimated fair value of the reporting unit assigned \$1.5 million of goodwill was substantially in excess of its carrying value, while the estimated fair value of the reporting unit assigned \$14.7 million of goodwill exceeded its carrying value by approximately 28 percent. While the Company believes the estimates and assumptions used in determining the fair value of its reporting units are reasonable, significant changes in estimates of future cash flows, such as those caused by unforeseen events or changes in market conditions, could materially impact the fair value of a reporting unit which could result in the recognition of a goodwill impairment charge.

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Software Development Costs. The Company incurs costs associated with the development of software to be sold, leased, or otherwise marketed. Software development costs are expensed as incurred until technological feasibility has been established, at which time future costs incurred are capitalized until the product is available for general release to the public. A certain amount of judgment and estimation is required to assess when technological feasibility is established, as well as the ongoing assessment of the recoverability of capitalized costs. In evaluating the recoverability of capitalized software costs, the Company compares expected product performance, utilizing forecasted revenue amounts, to the total costs incurred to date and estimates of additional costs to be incurred. If revised forecasted product revenue is less than, and/or revised forecasted costs are greater than, the previously forecasted amounts, the net realizable value may be lower than previously estimated, which could result in the recognition of an impairment charge in the period in which such a determination is made.

Warranty Obligations. The Company is subject to warranty obligations on sales of its products. The Company records general warranty provisions based on an estimated warranty expense percentage applied to current period revenue. The percentage applied reflects historical warranty claims experience over the preceding twelve-month period. Both the experience percentage and the warranty liability are evaluated on an ongoing basis for adequacy. A certain amount of judgment is required in determining appropriate reserve levels for anticipated warranty claims. While these reserve levels are based on historical warranty experience, they may not reflect the actual claims that will occur over the upcoming warranty period, and additional warranty reserves may be required.

Income Taxes. The Company records a tax provision for the anticipated tax consequences of the reported results of operations. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those deferred tax assets and liabilities are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized. The Company believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining net realizable value of its deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's financial condition and operating results.

Other Matters

The Company's dividend policy is to maintain a payout ratio that allows dividends to increase as earnings per share increases over time while sustaining dividends through economic cycles. The Company's dividend practice is to target, over time, a payout ratio of approximately 30% of net earnings per share.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements” regarding financial projections made pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995 that are subject to certain risks and uncertainties, as well as assumptions, that could cause actual results to differ materially from historical results and those presently anticipated or projected. Words such as “may,” “will,” “should,” “expects,” “intends,” “projects,” “believes,” “estimates,” “targets,” “anticipates,” and similar expressions are used to identify these forward-looking statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to, those factors described in Part I, Item 1A, “Risk Factors” of our 2012 Form 10-K. Such important factors include:

- The Company’s business operations may be affected by government contracting risks
- The Company’s business is significantly international in scope, which poses multiple risks including, but not limited to: currency value fluctuations; difficulty enforcing agreements and collecting receivables; import and export matters; higher danger of terrorist activity; difficulty in staffing; and compliance with laws
- Volatility in the global economy could adversely affect results

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- The Company's business is subject to strong competition
- The Company may not achieve its growth plans for the expansion of the business because the Company's long-term success depends on its ability to expand its business through new product development, mergers and acquisitions, geographic expansion, and service offerings, all of which are subject to inherent risks including, but not limited to: market demand; market acceptance of products; and the Company's ability to advance its technology
- The Company may experience difficulties obtaining the services of skilled employees
- The Company may fail to protect its intellectual property effectively, or may infringe upon the intellectual property of others
- The business could be adversely affected by product liability claims and commercial litigation
- The Company may experience difficulty obtaining materials or components for its products, or the cost of materials or components may increase
- Government regulation imposes significant costs and other constraints
- The backlog, sales, delivery and acceptance cycle for many of the Company's products is irregular and may not develop as anticipated
- The Company's customers are in cyclical industries and a downturn in those industries could adversely affect results
- Interest rate fluctuations could adversely affect results
- The Company may be required to recognize impairment charges for long-lived assets
- The Company will need to begin disclosing its use of "conflict minerals," which will impose costs on the Company and could raise reputational and other risks that could adversely affect results

The performance of the Company's business and its securities may be adversely affected by these factors and by other factors common to other businesses and investments, or to the general economy. Forward-looking statements are qualified by some or all of these risk factors. Therefore, you should consider these risks with caution and form your own critical and independent conclusions about the likely effect of these risks on our future performance.

Forward-looking statements speak only as of the date on which such statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events or circumstances. Readers should carefully review the disclosures and the risk factors described in this and other documents we file from time to time with the SEC, including our reports on Form 8-K to be filed by the Company in fiscal year 2013.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company's investment portfolio at June 29, 2013 included \$53.6 million of cash and cash equivalents. The cash equivalent portion of the Company's investment portfolio is invested in money market funds and bank deposits. A hypothetical 1.0 percentage point increase or decrease in market interest rates would have caused interest income to increase or decrease by \$0.5 million for the nine-fiscal month period ended June 29, 2013.

The Company is exposed to market risk from changes in foreign currency exchange rates and interest rates. The Company manages exposure to changes in foreign currency exchange rates through its regular operating and financing activities and through the use of foreign currency exchange contracts. These contracts are used to manage the Company's overall exposure to exchange rate fluctuations, as the gains and losses on these contracts are intended to offset gains and losses on the Company's assets, liabilities, and cash flows.

A hypothetical 10% appreciation or depreciation in foreign currencies against the U.S. dollar, assuming all other variables were held constant, would have resulted in an estimated increase or decrease of \$18.9 million in revenue for the nine-fiscal month period ended June 29, 2013.

At June 29, 2013, the Company's short-term borrowings outstanding consisted of \$10.0 million utilization of the revolving credit facility. This utilization of the credit facility involves interest payments calculated at a floating rate and, therefore, is impacted by the effect of increases or decreases in market interest rates. Because the Company anticipates the borrowing to be outstanding for only a short period of time, it has elected not to mitigate this risk. A hypothetical 1 percentage point increase or decrease in interest rates, assuming all other variables were held constant, would have resulted in an estimated increase or decrease of less than \$0.1 million in interest expense for the three-month period ended June 29, 2013.

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Item 4. Controls and Procedures

The Company's management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of June 29, 2013, the Company's disclosure controls and procedures were effective.

There were no changes that occurred during the fiscal quarter ended June 29, 2013 that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART II ----- OTHER INFORMATION

Item 1. Legal Proceedings

Investigative Matters

As previously reported by the Company with disclosures starting in March 2012, the Company investigated certain gift, travel, entertainment and other expenses incurred in connection with some of the Company's operations in the Asia Pacific region. The investigation focused on possible violations of Company policy, corresponding internal control issues and possible violations of applicable law, including the Foreign Corrupt Practices Act. Substantial investigative work has been completed and the Company has taken remedial actions, including changes to internal control procedures and removing certain persons formerly employed in its Korea office. The Company voluntarily disclosed this matter to the Department of Justice and the SEC. Additionally, the Company disclosed this matter to the U.S. Air Force pursuant to its Administrative Agreement with the U.S. Air Force. The Company presented the results of its investigation and its corrective actions to representatives of the Department of Justice and the SEC on January 16, 2013. The Company cannot predict the outcome of this matter at this time or whether it will have a material adverse impact on its business prospects, financial condition, operating results or cash flows.

Litigation

The Company is subject to various claims, legal actions, and complaints arising in the ordinary course of business. Management believes the final resolution of legal matters outstanding as of June 29, 2013 will not have a material adverse effect on the consolidated financial position or results of operations of the Company. The Company expenses legal costs as incurred.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Company Equity Securities:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
March 31, 2013 - May 4, 2013	—	\$ —	—	2,108,774
May 5, 2013 - June 1, 2013	127,582	\$ 54.87	127,582	1,981,192
June 2, 2013 - June 29, 2013	45,474	\$ 57.59	45,474	1,935,718
Total	173,056	\$ 55.58	173,056	

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The Company purchases its common stock to mitigate dilution related to new shares created by employee equity compensation such as stock option, restricted stock, restricted stock units, and employee stock purchase plan awards, as well as to return excess capital to shareholders.

During the fourth quarter of fiscal year 2012, the Company entered into an accelerated share purchase agreement with an unrelated third party investment bank. The Company made an initial \$35.0 million payment to the investment bank and immediately received an initial delivery of approximately 0.5 million shares of its common stock with a fair value of \$28.0 million as of the purchase date. The remaining \$7.0 million of the Company's initial payment to the investment bank was reported as a reduction in retained earnings.

During the third quarter of fiscal year 2013, the Company received approximately 0.1 million shares of its common stock from the bank pursuant to the settlement of the accelerated share purchase program. The amount of shares received at settlement was determined based on the volume weighted average price of the Company's stock during the purchase period. The delivered shares were retired by the Company upon receipt.

Also during the third quarter of fiscal year 2013, after the conclusion of the accelerated share purchase program, the Company entered into an agreement with an unrelated third party investment bank to purchase shares of its common stock on the open market within a specified range. This agreement was executed under a 2.0 million share purchase authorization approved and announced by the Company's Board of Directors on February 11, 2011. Authority over pricing and timing under the authorization has been delegated to management. The share purchase authorizations have no expiration date. There are approximately 1.9 million shares available for purchase under the existing authorizations.

Item 6. Exhibits

Exhibit

Number Description

- | | |
|------|---|
| 10.1 | Letter Agreement (with Annexes, Exhibit and ISDA) Regarding Accelerated Share Repurchase Program by and between the Company and J.P Morgan Securities, Inc., as agent for JPMorgan Chase Bank, National Association, London Branch, dated September 7, 2012 (filed herewith). |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith). |

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32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) (furnished herewith).

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) (furnished herewith).

101.INS **XBRL Instance Document (furnished herewith).

101.SCH **XBRL Taxonomy Extension Schema Document (furnished herewith).

101.CAL
** XBRL Taxonomy Extension Calculation Linkbase Document (furnished herewith).

101.DEF **XBRL Taxonomy Extension Definition Linkbase Document (furnished herewith).

101.LAB
** XBRL Taxonomy Extension Label Linkbase Document (furnished herewith).

101.PRE **XBRL Taxonomy Extension Presentation Linkbase Document (furnished herewith).

** XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SYSTEMS CORPORATION

Dated: August 5, 2013 /s/ SUSAN E. KNIGHT
Susan E. Knight
Senior Vice President and Chief Financial Officer *

* Executing as both the principal financial officer and a duly authorized officer of the Company.