Zacks Small-Cap Research

March 12, 2013
Ken Nagy, CFA

www.zacks.com 111 North Canal Street, Chicago, IL 60606

inTEST Corporation (INTT-NASDAQ)

INTT: Thermal Transformation Continues - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	07/27/2010
Current Price (03/11/13)	$3.05
Target Price	**$7.00**

OUTLOOK

inTEST Corporation is a designer, manufacturer and marketer of mechanical, thermal and electrical products that are used by semiconductor manufacturers in conjunction with automatic test equipment, (ATE), in the testing of integrated circuits, (ICs). Beyond its blue chip portfolio of semiconductor manufacturers, the firm has diversified into non-semi thermal testing products. This has the effect of diversifying revenues and opens the company up to new markets. In the test equipment world change is good; be it the broad switch to mobile computing, the march to finer geometries, or the growth of electronic content in automobiles more chip content means more testing for inTEST.

SUMMARY DATA

52-Week High	**$3.82**
52-Week Low	**$2.38**
One-Year Return (%)	**-10.82**
Beta	**1.29**
Average Daily Volume (sh)	**10,086**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$32**
Short Interest Ratio (days)	**0.56**
Institutional Ownership (%)	**30**
Insider Ownership (%)	**20**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**6.5**
Earnings Per Share (%)	**-25.7**
Dividend (%)	**N/A**
P/E using TTM EPS	**10.9**
P/E using 2013 Estimate	**30.5**
P/E using 2014 Estimate	**10.2**
Zacks Rank	**3**

Risk Level	**Moderate**
Type of Stock	**Small-Blend**
Industry	**Semiconductor-IC**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	11.7 A	13.8 A	11.7 A	10.1 A	47.3 A
2012	10.7 A	13.6 A	10.8 A	8.3 A	43.4 A
2013	8.5 E	9.0 E	9.5 E	11.0 E	38.0 E
2014					45.0 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	$0.13 A	$0.26 A	$0.22 A	$0.08 A	$0.70 A
2012	$0.07 A	$0.13 A	$0.06 A	$0.02 A	$0.28 A
2013	$0.01 E	$0.02 E	$0.03 E	$0.04 E	$0.10 E
2014					$0.30 E

© Copyright 2013, Zacks Investment Research. All Rights Reserved.

WHATS NEW

Thermal Transformation Continues.

On March 6, 2013, inTest Corporation, reported financial results for its fiscal 2012 fourth quarter and full year, ended December 31, 2012.

Revenues during the fourth quarter 2012 were $8.270 million compared to revenues of $10.799 million for the three months ended September 30, 2012 and revenues of $10.081 million during the fourth quarter ended December 31, 2011.

15 percent of fourth quarter 2012 net revenues were derived from non-semiconductor test compared to 10 percent of third quarter 2012 net revenues being derived from non-semiconductor test. Sequentially, fourth quarter non-semiconductor test net revenues increased 16 percent.

Over the last few years inTest has been transforming itself through the strategic diversification of its Thermal products segment.

The diversification strategy outside of inTest's traditional semiconductor markets helps to mitigate the cyclicality that's so closely tied to that industry and affords the Company several exciting new opportunities with multiple new customers.

As a result the Company now addresses growth markets in both the semiconductor and non-semiconductor areas, which include automotive, consumer electronics, defense aerospace, telecommunications and most recently the nuclear market.

inTest reported fourth quarter bookings were $9.3 million, up from third quarter 2012 bookings of $8.7 million and from fourth quarter 2011 bookings of $8.1 million.

Similarly, 20 percent of the Company's third quarter 2012 bookings were derived from non-semiconductor test which was solidly above the 17 percent from the third quarter 2012 and the highest percentage recorded this year. Additionally, fourth quarter non-semiconductor test bookings increased 23 percent sequentially.

Backlog at the end of the fourth quarter was $4.2 million, up from $3.2 million at the end of the third quarter.

However, gross margin during the fourth quarter fell to 42.4 percent compared to 44.1 percent from the third quarter fiscal 2012 and 48.3 percent for the three months ended December 31, 2011.

The quarter over quarter reduction in gross margin was driven by a less favorable absorption of the Company's fixed manufacturing cost in the fourth quarter of 2012 which increased to 20% of revenues in the fourth quarter from 15% of revenues in the third quarter.

However, while inTest's fixed manufacturing cost increased as a percentage of revenue quarter over quarter, they were essentially flat sequentially at $1.6 million.

Similarly, the increase in fixed manufacturing costs as a percentage of net revenues in the fourth quarter was almost fully offset by a reduction in consolidated material costs, which declined from 37.0% in the third quarter to 32.4 percent in the fourth quarter. Additionally, all 3 of the Company's product segments

experienced decreases in their component material costs sequentially, with the Electrical Products segment experiencing the largest reduction, from 45.5 percent of net revenues in the third quarter, to 37.3 percent of net revenues in the fourth quarter.

inTest reported fourth quarter 2012 net income of $201,000 compared to third quarter 2012 net income of $664,000 and net income of $769,000 for the three months ended December 31,2011.

The year over year drop in net income was primarily due to lower revenues and margins.

Based on a weighted average number of diluted shares outstanding of 10.344 million, diluted net income per share resulted in net income of $0.02 per share for the quarter. This compared to diluted net income per share of $0.06 on a weighted average number of diluted shares of 10.360 million during the three months, ended September 30, 2012 and diluted net income per share of $0.08 on a weighted average number of diluted shares of 10.281 million during the fourth quarter ended December 31, 2011.

During the quarter, inTEST declared a special one-time cash dividend of $0.08 per share, which was paid on December 17, 2012 to stockholders of record at close of business on December 10, 2012. The special dividend was economically advantageous to stockholders due to the increase in 2013 tax rates, and was funded with $834,000 of available cash on hand.

Revenues for the full year fiscal 2012 were $43.376 million compared to revenues of $47.266 million for the twelve months ended December 31, 2011.

Full year 2012 revenue in the Electrical segment was up substantially by 79 percent over fiscal 2011. Likewise, during the fourth quarter, the segment developed a new wafer probe interface at the request of a major IDM which has been field-tested and approved. Consequently, orders should come in, starting in 2013.

Gross margin during the year dropped to 43.9 percent compared to 48.4 percent from fiscal 2011.

Net income for the twelve months ended December 31, 2012 was $2.156 million, marking the Company's third consecutive year of profitability. This compares to net income of $9.863 million for the full year ended December 31, 2011.

Fiscal 2012 net earnings consists of approximately $650,000 in non-recurring costs related to the acquisition of Thermonics including restructuring costs of $313,000 (related to facility closure costs) and acquisition related expenses of $337,000. Fiscal 2011 net earnings reflect a reversal of $3.1 million of valuation allowance against inTest's deferred tax assets. The impact of the reversal of the valuation allowance was an increase in the Company's diluted earnings per share of $0.30. Absent the reversal of the deferred tax valuation allowance, 2011 net earnings would have been $0.66 per diluted share.

Based on a weighted average number of diluted shares outstanding of 10.347 million, diluted net income per share resulted in net income of $0.21 per share for the full year ended December 31, 2012. This compared to diluted net income per share of $0.96 on a weighted average number of diluted shares of 10.286 million during the twelve months, ended December 31, 2011.

inTest's balance sheet continued to improve during the fourth quarter with cash and equivalents of $15.576 million, working capital of $21.000 million. This compares to $14.700 million in cash and equivalents and working capital of $20.959 million for the period ended September 30, 2012.

Furthermore, management currently expects this strong cash generation to continue with cash and cash equivalents increasing sequentially throughout 2013.

Accounts receivable at the end of the fourth quarter were $6.892 million which decreased $1.391 million quarter over quarter, primarily driven by lower levels of net revenues in the fourth quarter compared to

the third quarter, as well as a decrease in days sales outstanding which were 58 days at December 31, 2012 compared to 60.4 days at September 30, 2012.

Likewise, inventory declined by approximately $708,000 to $3.135 million at the end of December and capital expenditures during the fourth quarter were $148,000, compared to $154,000 in the third quarter.

While industry conditions were increasingly challenging throughout the year as a result of a number of capital equipment suppliers and semiconductor companies delaying certain capital expenditures, inTEST maintained profitability, generated cash and continue to carry no debt. .

Still, while the Company's long-term objective is to grow and evolve inTEST Corporation into a broad-based industrial test company as it executes on its differentiated product strategy, due to the softening economy, the Company strategically repositioned its sales force by integrating its sales channel and consolidating products in its Thermal division during the year.

Similarly, the Company continues to maintain fiscal discipline and cost controls and is benefitting from the restructuring activities that it undertook in the 2008 - 2009 timeframe, coupled with the past sales channel integration and Thermal product consolidation.

The Company has added 5 companies to our operations in the last 15 years which have bolstered its growth opportunities. This past year, inTest acquired Thermonics, which further enhanced its presence in the ATE industry, while at the same time, providing additional leverage into growth industries outside of the semi industry.

Management intends to continue to leverage the Thermal division and Sigma Systems acquisition and expects that on an overall basis, non-semiconductor related products will play an even greater role in the Company's success as it diversifies its end market penetration.

As a result, management is confident in its long-term growth prospects and believes inTEST is well positioned to capture new opportunities as industry conditions improve.

Correspondingly, management reported that it anticipates that net revenues for the first quarter ending March 31, 2013 will be in the range of $8.0 million to $9.0 million and that financial results will range from a net loss of $(0.02) per diluted share to net earnings of $0.03 per diluted share.

INVESTMENT THESIS

inTEST Corporation is a designer, manufacturer and marketer of mechanical, thermal and electrical products that are used by semiconductor manufacturers in conjunction with automatic test equipment, (ATE), in the testing of integrated circuits, (ICs). Beyond its blue chip portfolio of semiconductor manufacturers, the acquisition of Sigma has propelled the firm to diversify into non-semi thermal testing products. This has the effect of diversifying revenues and opens the company up to new markets. In the test equipment world change is good; be it the broad switch to mobile computing, the march to finer geometries, or the growth of electronic content in automobiles more chip content means more testing for inTEST.

Bullish signs

- **Complexity in chips increasing. As chips get smaller and more complex testing is more important.**
- **Chip content spread out over mobile phone, automobile, industrial goods rather than corporate IT.**
- **Non-semiconductor business has potential for growth as well as revenue diversification.**

Bearish Signs

- **More consumers in semiconductor than ever before. Pressure of macro economy weakness. (although many items price under $1,000.00)**
- **Firm is subject to the cyclical nature of the semiconductor equipment industry. Until non-semiconductor is large enough to offset.**

Focus on Thermal

The firm has built a diversified portfolio that includes non-semiconductor markets. This revenue should be a bit more inelastic and run on a different cyclical time frame than the semiconductor business. Non-semi revenue grew from 19% of total revenue ($9 Million) in 2010 to 29% of total revenue ($13 Million) in 2011. The firm's goal is to grow Non-Semi revenue to 50% of revenue. The potential for Non-Semi is enormous because it incorporates any market that uses thermal.

inTEST is benefiting from the increasing need for temperature testing of circuit boards and specialized components.

The firm competes mainly on two levels.

- Wafer Level
- Discrete product Level

Wafer level is a solid business for the firm but will never be a significant growth engine. Standards in this area are not stringent and in the past 10 years prober manufacturers have taken over. inTEST serves smaller OEM's in this area with its Thermochuck product which tests semiconductor wafers at high and low (-65 to +400 C) temperatures at the wafer probing station.

The Discrete product level is where inTEST will experience growth over the next several years. These products provide the ability to characterize and stress test a variety of materials over extreme and variable temperature conditions that can occur in actual use.

The focus of is on four main areas solving unique and challenging temperature problems.

- Sensor Technology
- Fiber Optics
- Communication
- Defense and Aerospace

inTEST solves unique and challenging temperature problems.
Many of the thermal businesses the firm competes with are large companies that have standard products. The only model out there that has been in industrial thermal test to date is one where a customer must modify its test. inTEST's business model is quite the opposite. The company asks the question "what do you have to do to test?", and builds the equipment to fit the product. This is a model that's not generally been used out there because most of the companies they compete with are very large. Being small and able to move quickly, allows inTEST to win these custom jobs.

New Acquisition in Thermal
In January 2012, Temptronic Corporation, a member of inTEST Corporation's Thermal Solutions Group, closed on the acquisition of Thermonics, Inc. With a purchase price for the assets of approximately $3.8 million in cash (which included net working capital of approximately $1.1 million),Thermonics is expected to further enhance inTEST's presence in the ATE industry as well as provide additional leverage into growth industries outside of the semiconductor industry. The integration of the acquisition is on track and management expects it to be accretive to operations beginning in the second quarter of 2012. Furthermore, management anticipates a 30 percent net contribution margin on incremental revenues which are expected to improve sequentially throughout 2012 eventually reaching as much as 35 to 36 percent over time.

Real World Solution
Real world solutions of Non-Semi applications range from problem solving in oil field environments to testing network infrastructure equipment from major telecom manufacturers. Here is a look at one.

Customer: Major manufacturer of industrial electronics
Application: Production test of pressure sensor systems for oil pipeline use.
Need: Each pressure system requires two separately controlled temperature environments. Also, specific throughput requirements.
Temp range: -100°C to +300°C

The Solution



- Center zone and each outer zone are independently controlled
- 4 DUTs are mounted in apertures between the center and an outer zone
- One side of DUT is stressed at hot temperatures while other side at cold
- Simulates real-world stress this DUT sees in the field

VALUATION

Looking at several metrics the stock is undervalued. According to the enterprise multiple, the P/S, and P/E INTT appears undervalued compared to industry.

Metric	inTEST	Industry Average
EV/EBITDA	3.99	7.80

Metric	inTEST	Industry Average
P/E TTM	10.9	18.10
P/E 2013 (E)	30.5	16.80
P/E 2014 (E)	10.2	13-15
P/S	0.72	3.00

Two Stage Free Cash Flow to Equity Model

FCFE = Net Income - Net Capital Expenditure - Change in Net Working Capital + New Debt - Debt Repayment

Assumptions

- The firm is expected to grow at a higher growth rate in the first period.
- The growth rate will drop at the end of the first period to the stable growth rate.

Rationale for using the Model

As the non-semiconductor business ramps up to 50% of total revenues we expect the firm to grow at a higher overall rate than the industry. As These products mature and the firm faces more competition we expect the growth rate to level off.

Weakness of the Model

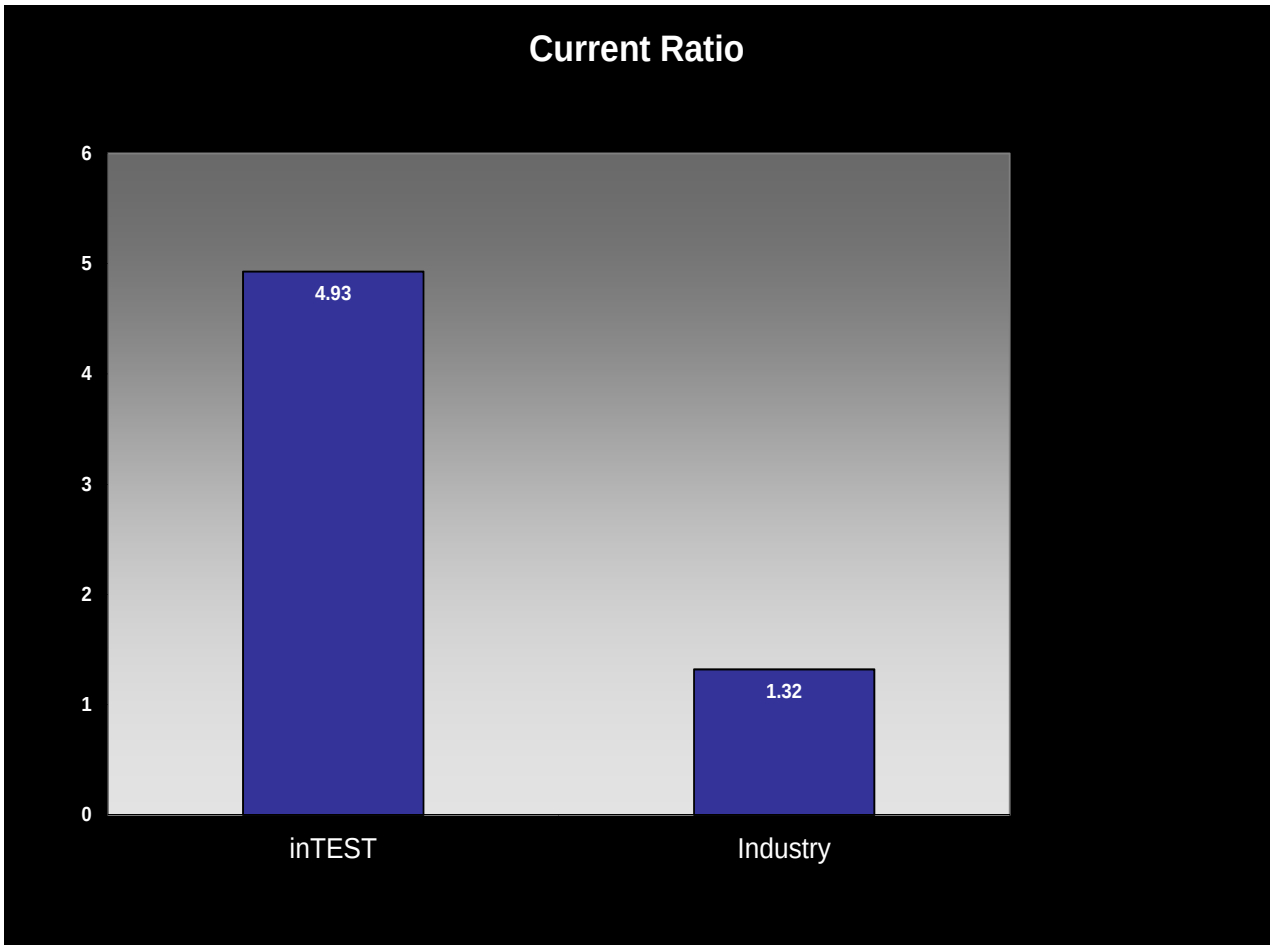
As you add more layers to the model it is more sensitive to the assumptions you make. The growth may look more “lumpy” than we have it in the model.

Output

We used the following inputs:

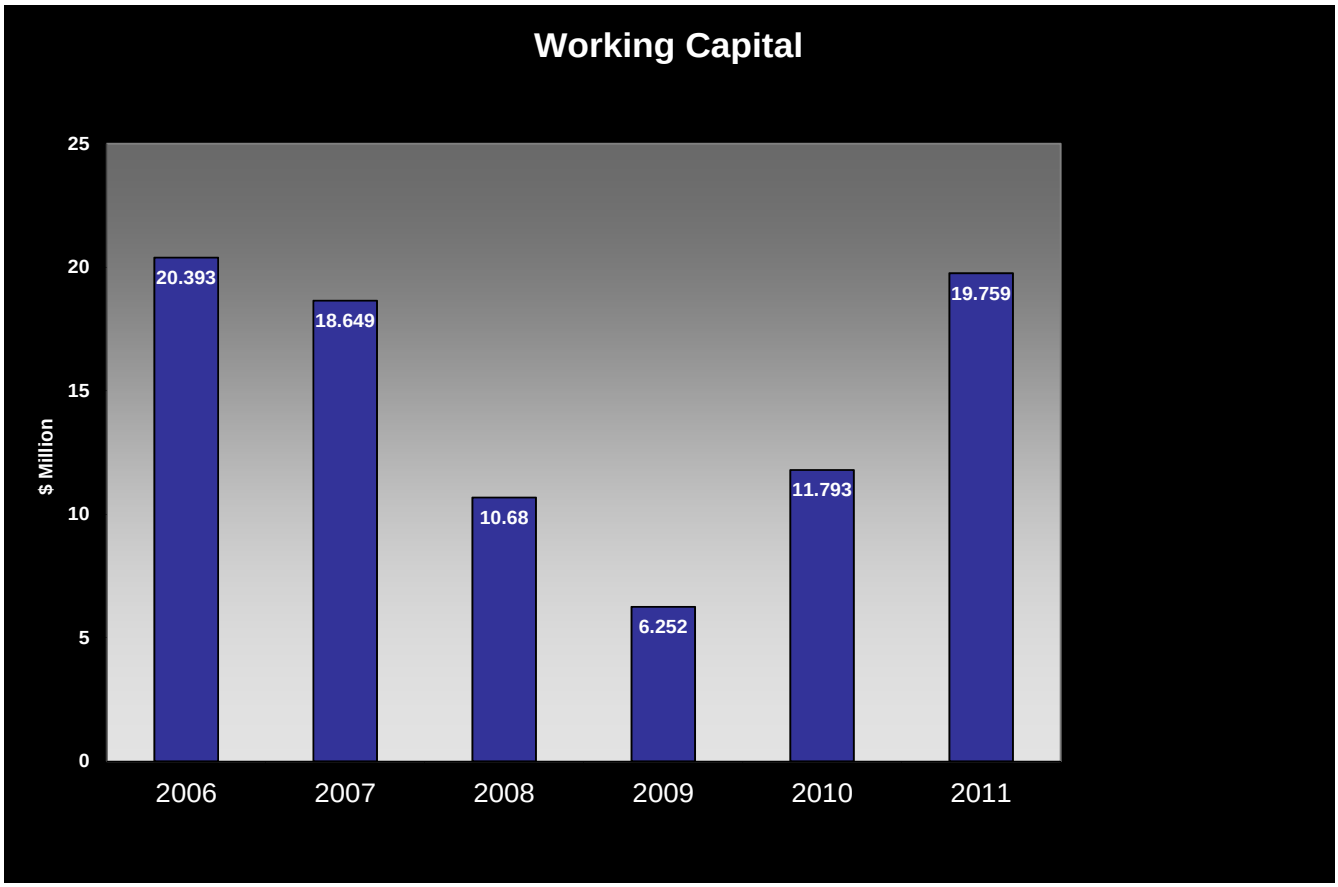
- A 5-year period with an earnings growth rate of 8.0% and a discount rate of 13.77%.
- A continuing period assumed to go on forever, with earnings growing at 5% and a discount rate of 13.05%.

With these inputs we arrive at a target price of $7.23. Our price target of $7.00 per share is the average of 11.8x our 2013 EPS estimate and our two stage model. We would add shares at these levels.


Current Ratio
6
5
4
3
2
1
0
4.93
1.32
inTEST
Industry

Balance Sheet Analysis

The current ratio can give a sense of the efficiency of a company's operating cycle or its ability to turn its product into cash. Companies that have trouble getting paid on their receivables or have long inventory turnover can run into liquidity problems because they are unable to alleviate their obligations.
Because business operations differ in each industry, it is always more useful to compare companies within the same industry. inTEST current ratio is above the industry average and the firm has been building working capital since 2009.

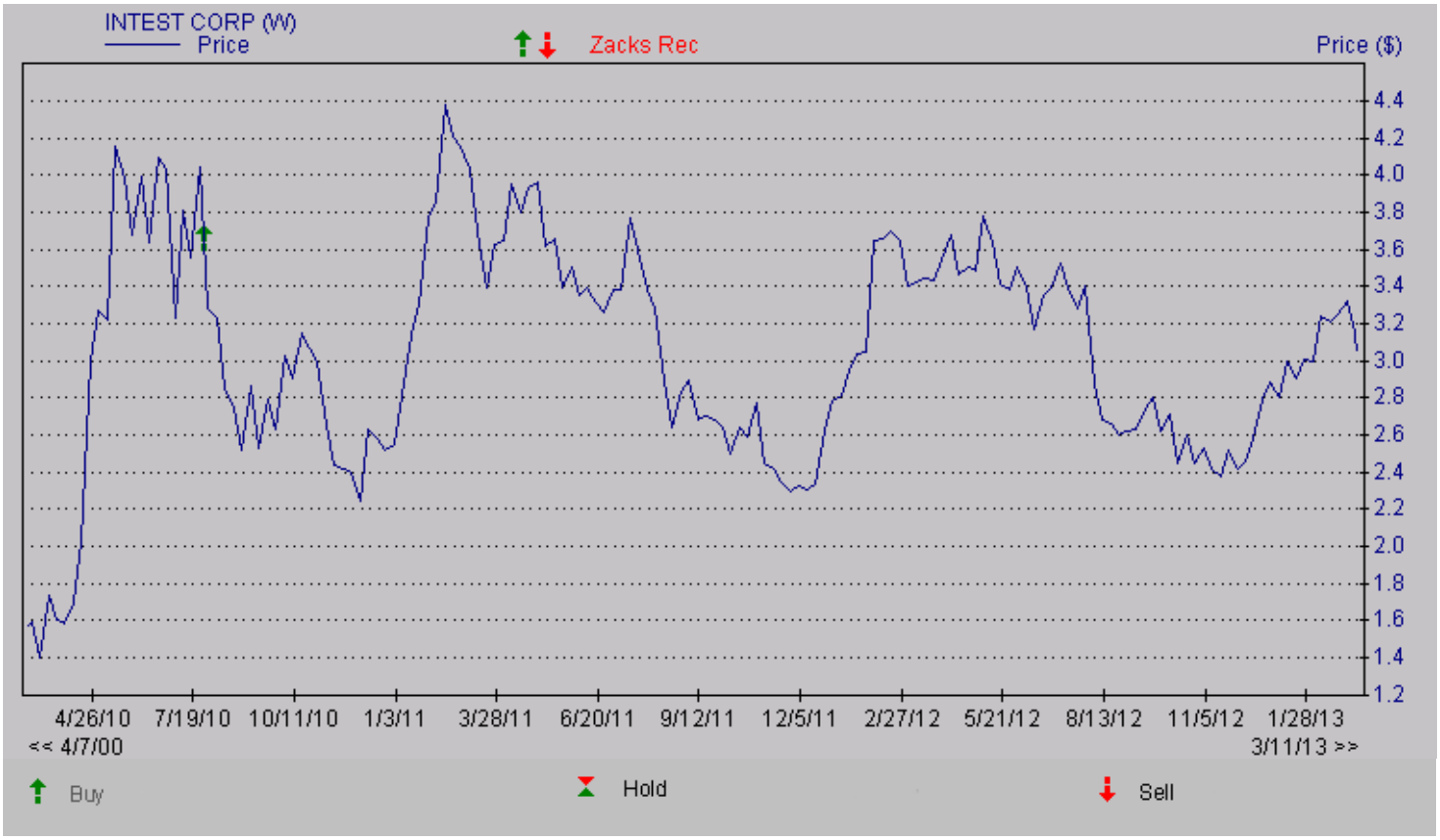


PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Dec-11 Q4 11	Mar-12 Q1 12	Jun-12 Q2 12	Sep-12 Q3 12	Dec-12 Q4 12	Mar-13 Q1 13 E	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013 E
REVENUE											
Net Revenue	**10.08**	**10.73**	**13.58**	**10.80**	**8.27**	**8.50**	**23.5**	**46.2**	**47.3**	**43.4**	**38.0**
Sequential Growth		*6%*	*27%*	*-20%*	*-23%*	*3%*					
OPERATING EXPENSES											
Cost of Revenues	5.21	6.14	7.38	6.04	4.76	4.95	15.7	24.1	24.4	24.3	21.8
% of Revenue	*51.7%*	*57.2%*	*54.4%*	*55.9%*	*57.6%*	*58.2%*	*66.8%*	*52.1%*	*51.6%*	*56.1%*	*57.2%*
Gross Profit -	**4.9**	**4.6**	**6.2**	**4.8**	**3.5**	**3.6**	**7.8**	**22.1**	**22.9**	**19.1**	**16.3**
Proforma Gross Margin	*48.3%*	*42.8%*	*45.6%*	*44.1%*	*42.4%*	*41.8%*	*33.2%*	*47.9%*	*48.4%*	*43.9%*	*42.8%*
R&D + Engg	0.80	0.92	0.98	1.01	0.99	0.95	2.4	3.0	3.2	3.9	3.9
% of Revenue	*7.9%*	*8.6%*	*7.2%*	*9.3%*	*11.9%*	*11.2%*	*10.3%*	*6.6%*	*6.9%*	*9.0%*	*10.3%*
SG&A	2.89	3.40	3.22	2.77	2.43	2.50	9.8	11.8	12	11.81	11.00
% of Revenue	*28.7%*	*31.7%*	*23.7%*	*25.6%*	*29.3%*	*29.4%*	*41.6%*	*25.4%*	*25.5%*	*27.2%*	*28.9%*
GW Amort, Restructuring, other		*0.36*	-	-	-	-	-	-		*0.359*	
% of Revenue											
Total Operating Expenses	3.69	4.68	4.20	3.77	3.41	3.45	12.2	14.8	15	16	15
% of Revenue	*36.6%*	*43.6%*	*30.9%*	*34.9%*	*41.2%*	*40.6%*	*51.9%*	*32.0%*	*32%*	*37%*	*39%*
Operating Income -	**1.18**	**-0.08**	**1.99**	**0.99**	**0.10**	**0.10**	**-4.4**	**7.4**	**7.6**	**3.00**	**1.4**
Operating Margin	*11.7%*	*-0.8%*	*14.7%*	*9.2%*	*1.2%*	*1.2%*	*-19%*	*16%*	*16%*	*7%*	*4%*
NON-OPERATING ITEMS											
Non operating Income/Expense	0.01	0.01	0.00	0.02	0.02	0.02	-0.5	0.1	0	0.1	0.1
% of Revenue	*0.10%*	*0.12%*	*0.00%*	*0.21%*	*0.25%*	*0.24%*	*-2.17%*	*0.11%*	*0.17%*	*0.13%*	*0.21%*
Tax Provision	0.4	0.0	0.7	0.3	-0.1	0.0	-0.050	0.148	-2.204	0.9	0.4
Effective Tax Rate											
Net Income -	**0.77**	**-0.04**	**1.33**	**0.66**	**0.20**	**0.09**	**-4.83**	**7.25**	**9.9**	**2.2**	**1.1**
Net Income Margin	*7.6%*	*-0.4%*	*9.8%*	*6.1%*	*2.4%*	*1.1%*	*-20.6%*	*15.7%*	*21%*	*5%*	*3%*
Adjustments (for one-time NR items)		**0.07**	**0.00**	**0.00**	**0.00**	**0.00**			**0.29**	**0.07**	**0.00**
EARNINGS PER SHARE											
EPS - Basic	$0.08	$0.07	$0.13	$0.06	$0.02	$0.01	-$0.42	$0.72	$0.70	$0.28	$0.11
EPS - Diluted	$0.08	$0.07	$0.13	$0.06	$0.02	$0.01	-$0.42	$0.72	$0.69	$0.28	$0.10

Ken Nagy, CFA Zacks Investment Research 3/12/2012

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

The following disclosures relate to relationships between Zacks Investment Research ("ZIR") and Zacks Small-Cap Research ("Zacks SCR") and the issuers covered by the Zacks SCR analysts in the Small-Cap Universe.

ZIR or Zacks SCR Analysts do not hold or trade securities in the issuers which they cover. Each analyst has full discretion on the rating and price target based on their own due diligence. Analysts are paid in part based on the overall profitability of Zacks SCR. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Zacks SCR for non-investment banking services. No part of analyst compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or blog.

ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Zacks SCR has never received compensation for investment banking services on the small-cap universe. Zacks SCR does not expect received compensation for investment banking services on the small-cap universe. Zacks SCR has received compensation for non-investment banking services on the small-cap universe, and expects to receive additional compensation for non-investment banking services on the small-cap universe, paid by issuers of securities covered by Zacks SCR. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, investment research, and investment management.

Additional information is available upon request. Zacks SCR reports are based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Because of individual objectives, the report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed by Zacks SCR Analysts are subject to change. Reports are not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. Zacks SCR uses the following rating system for the securities it covers. Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters. Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters. Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution of Zacks Ratings is as follows on the 1005 companies covered: Buy/Outperform- 15.6%, Hold/Neutral- 77.2%, Sell/Underperform – 6.8%. Data is as of midnight on the business day immediately prior to this publication.