Zacks Small-Cap Research

March 15, 2012
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inTEST Corporation (INTT-NASDAQ)

INTT: Diversification Continues at inTEST - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/23/2012
Current Price (03/14/12)	$3.44
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	**$4.20**
52-Week Low	**$2.17**
One-Year Return (%)	**-0.29**
Beta	**1.32**
Average Daily Volume (sh)	**44,850**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$36**
Short Interest Ratio (days)	**0.51**
Institutional Ownership (%)	**15**
Insider Ownership (%)	**21**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-3.7**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**4.8**
P/E using 2012 Estimate	**4.6**
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)
2009	4.4 A	4.7 A	6.0 A	8.4 A	23.5 A
2010	9.5 A	15.3 A	11.3 A	10.1 A	46.2 A
2011	11.7 A	13.8 A	11.7 A	10.1 A	47.3 A
2012	9.7 E				53.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	-$0.28 A	-$0.17 A	-$0.03 A	$0.04 A	-$0.44 A
2010	$0.11 A	$0.31 A	$0.17 A	$0.13 A	$0.72 A
2011	$0.13 A	$0.26 A	$0.22 A	$0.08 A	$0.70 A
2012	$0.00 E				$0.74 E

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WHATS NEW

Solid Quarter as Diversification Continues at inTEST

On March 7, 2012, inTest Corporation, reported financial results for its fiscal 2011 fourth quarter and full year, ended December 31, 2011. Company revenues during the fourth quarter remained steady at $10.081 million compared to revenues of $10.110 million for the three months ended December 31, 2010.

However, inTest reported that fourth quarter bookings were $8.1 million, down from its third quarter 2011 bookings of $10.5 million and year over year fourth quarter 2010 bookings of $11.7 million. Still, while bookings during the quarter were down, first quarter 2012 quarter-to-date bookings currently reflect an increase of $1.4 million or 18% over the Company's fourth quarter 2011 bookings.

Furthermore, the Company continues to leverage its thermal division and sigma systems acquisition, making significant progress in diversifying its end market penetration with non-semi related bookings jumping from 19 percent of consolidated bookings in 2010 to 29 percent in fiscal 2011 and 38 percent in the fourth quarter, ended December 31, 2011.

Although the fourth quarter net income of $769,000 marked inTest's ninth consecutive quarter of profitability, net income plunged year over year by $525,000 from $1.294 million for the three months ended December 31, 2010.

The drop in year over year net income was primarily due to an increase in general and administrative expenses offset by improved gross margin.General and administrative expenses increased $274,000 year over year to $1.619 million during the fourth quarter fiscal 2011. Still, gross margin increased by 90 basis points year over year from 47.4 percent to 48.3 percent for the three months ended December 31, 2011. Sequentially, gross margin fell from 53 percent during the third quarter as a result of a less favorable product mix in the mechanical product segment and electrical products segment.

Based on a weighted average number of diluted shares outstanding of 10.281 million, diluted net income per share resulted in $0.08 per share for the quarter. This compared to diluted net income per share of $0.13 on a weighted average number of diluted shares of 10.184 million during the three months, ended December 31, 2010.

For the full year ended December 31, 2011, year over year revenues improved by 2.3 percent or $1.062 million to $47.266 million from $46.204 million for fiscal 2010. It should be noted that revenues have steadily improved each year since 2007 and are now approaching pre-recession levels.

Net income for the year improved by $2.611 million or 36 percent year over year to $9.863 million for the fiscal year ended December 31, 2011. This compares to $7.252 million for fiscal 2010. The increase in net income was primarily due to improved gross margin as well as the effect of a reversal of valuation allowance against deferred tax assets.

During the twelve months, gross margin improved by 50 basis points year over year to 48.4 percent, its highest level since 2006. This compares to gross margin of 47.9 percent for the year ended December 31, 2010.

Similarly, 2011 net earnings reflect the effect of a reversal of $3.1 million of valuation allowance against deferred tax assets which resulted in an increase to diluted earnings per share of $0.30 for the year.

Based on a weighted average number of diluted shares outstanding of 10.286 million, diluted net income per share resulted in $0.96 per share for the year. This compared to diluted net income per share of $0.72 on a weighted average number of diluted shares of 10.142 million during the full year, ended December 31, 2010.

inTest's balance sheet continued to improve with cash and equivalents increasing sequentially by $1.893 million to $13.597 million and working capital improving sequentially by $1.141 million to $19.759 million for the period ended December 31, 2011. The increase in cash was due to strong cash collections during the fourth quarter. However, management predicts that cash and equivalents will decrease in the first quarter of fiscal 2012 due to the recent acquisition of Thermonics, Inc., but will then begin increasing sequentially starting in the second quarter of fiscal 2012.

Stockholder's equity improved sequentially by nearly 3 percent or $758,000 to $26.199 million.

The Company remains focused on growth through acquisitions as well as increasing its footprint in the non-semi space. Over the past few years inTest has been attempting to transform itself through the strategic diversification of its Thermal Products segment, which remains the Company's strongest segment, driven by mobility and opportunities in the telecom market.

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.

Moving forward; the Company expects non-semiconductor related products to play an even greater role in the Company's growth strategy and success.

Additionally, management reported that it anticipates net revenue for its first quarter ended March 31, 2012 will be in the range of $9.5 million to $10.5 million and that net loss will be in the range of $(0.03) to $(0.07) per diluted share. Guidance for the first quarter reflects the weak semiconductor market as well as costs related with the closing of the Thermonics acquisition.

Still, management believes that the recent softness from semiconductor customers has improved substantially over the past few weeks and that this trend will continue.

Furthermore, inTest's management is confident in its long term growth prospects as a result of the improving semiconductor dealings as well as its continued expansion of non-semiconductor businesses.

Likewise, the Company further believes that the diversification of its served markets via its thermal group, improved efficiency and reduced operating costs attributable to its relocation of facilities are all strengths it can leverage moving forward.

INVESTMENT THESIS

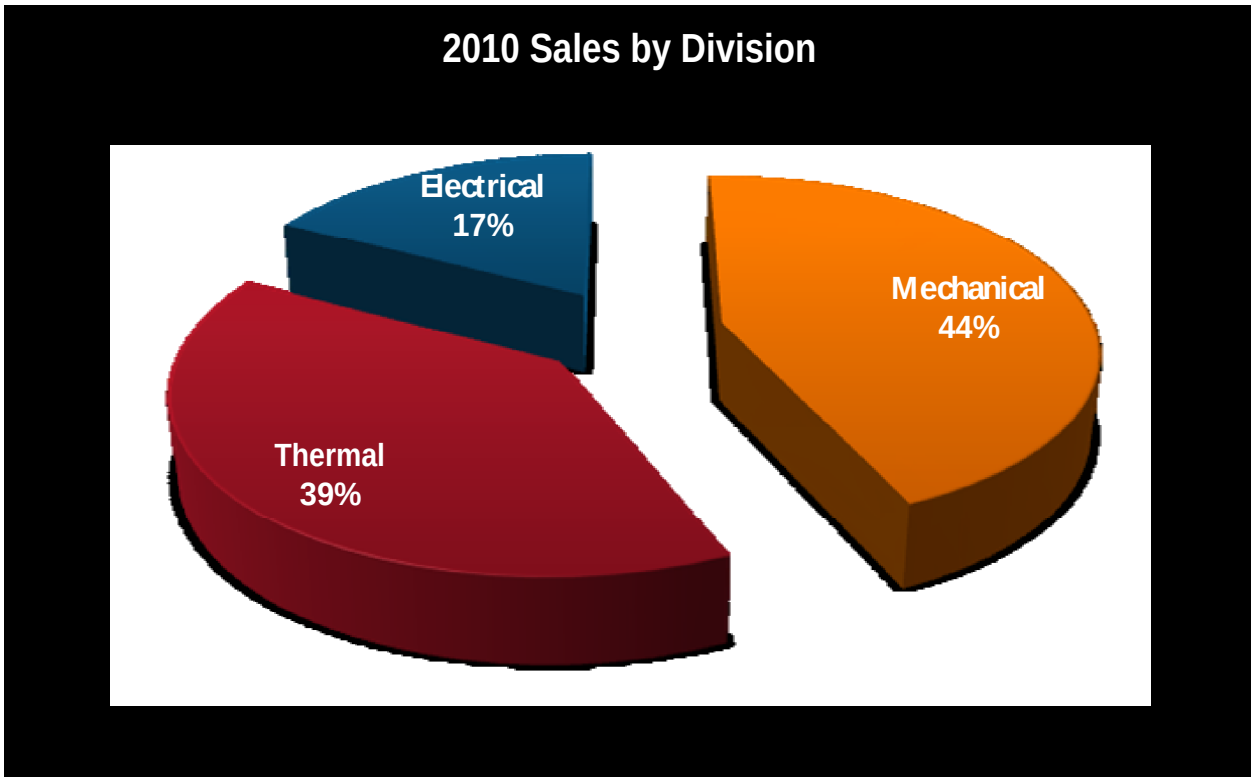
inTEST Corporation is a designer, manufacturer and marketer of mechanical, thermal and electrical products that are used by semiconductor manufacturers in conjunction with automatic test equipment, (ATE), in the testing of integrated circuits, (ICs). Beyond its blue chip portfolio of semiconductor manufacturers, 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.**
- **Semiconductor market outlook is solid, not on par with 2010, yet still expect growth**
- **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.**



The firm has 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. 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. We value the firm using several metrics

Enterprise Multiple

The enterprise multiple looks at a firm as a potential acquirer would. The ratio takes debt into account, which is an item which other multiples do not include. Enterprise value is calculated as market cap plus debt, minority interest and preferred shares, minus total cash and cash equivalents. The Firm's Enterprise multiple is 2.66x compared to 11.47x for the industry. **According to the enterprise multiple INTT appears undervalued compared to industry.**

Metric	inTEST	Industry Average
EV/EBITDA	2.66	11.47

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.
- The free cash flow to equity is the correct measure of expected cash flows to stockholders. (rather than dividends)

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 6% and a discount rate of 13.05%.

With these inputs we arrive at a target price of $7.23.

According to the model, the firm appears undervalued.

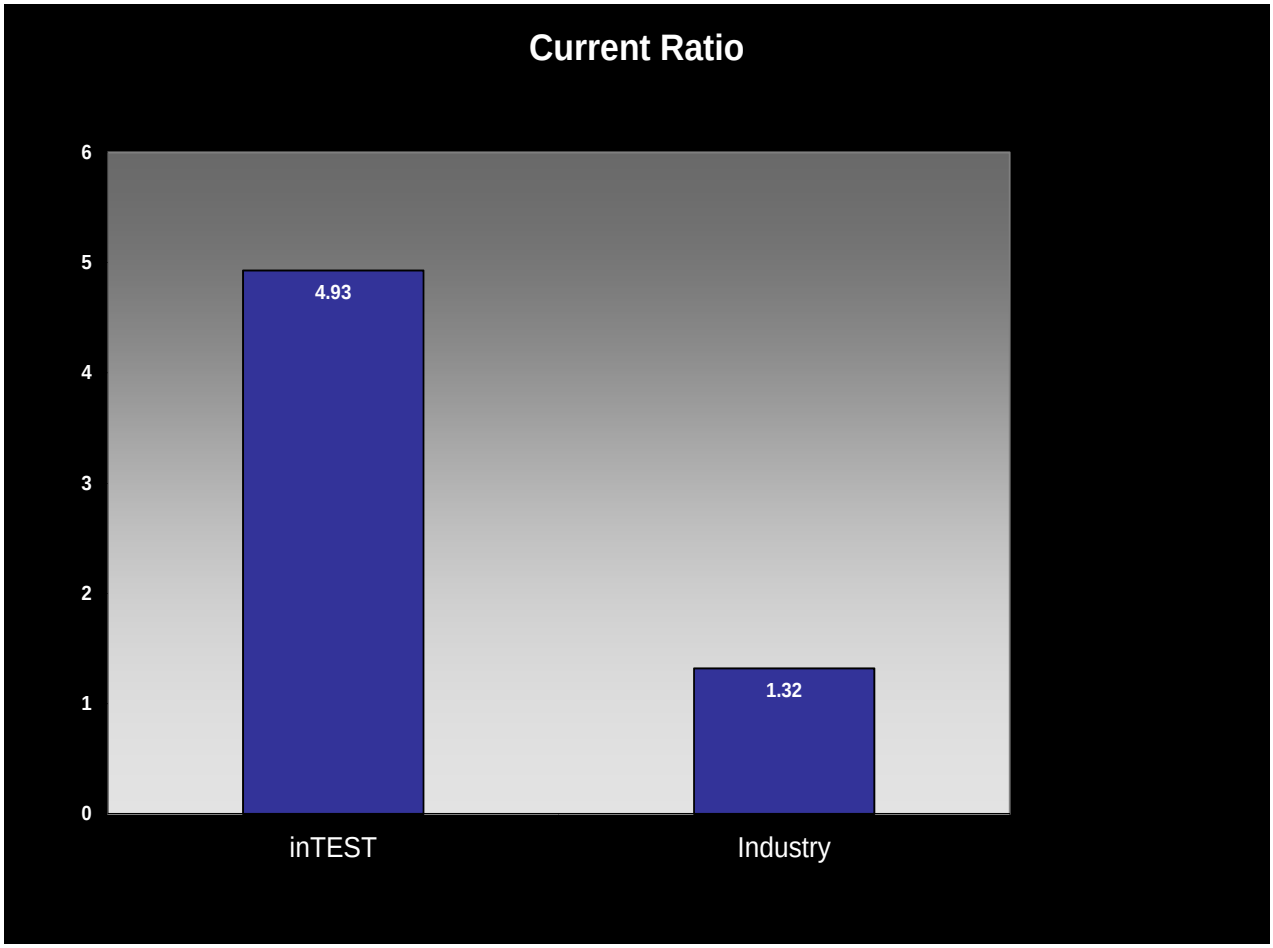
Price to Earnings Multiples/ Price to Sales Multiples
Due to its simplicity the Price/Earnings ratio is easily the most widely used metric in all of finance. The first strength of the model is that it is intuitive. It is simply the price paid for current earnings. It can also act as a proxy for other firm characteristics such as risk and growth. There is a downside to the P/E ratio in that it has the potential to reflect investor's mood rather than the fundamentals of the firm. It also eliminates assumptions about risk, growth, and retention ratio (something discounted cash flow models account for.)
While not as popular as Price/Earnings or Price/BV, Price/Sales is not influenced by accounting decisions in depreciation, inventory and extraordinary charges. P/S multiples are much less volatile than P/E multiples. However if the problem with the firm lies in cost control the P/S ratio will not reflect this flaw.

The firm appears undervalued compared to the industry.

Metric	inTEST	Industry Average
P/E TTM	4.91	14.07
P/E 2012 (E)	4.65	11.85
P/E 2013 (E)	4.30	13-15
P/S	0.76	1.31

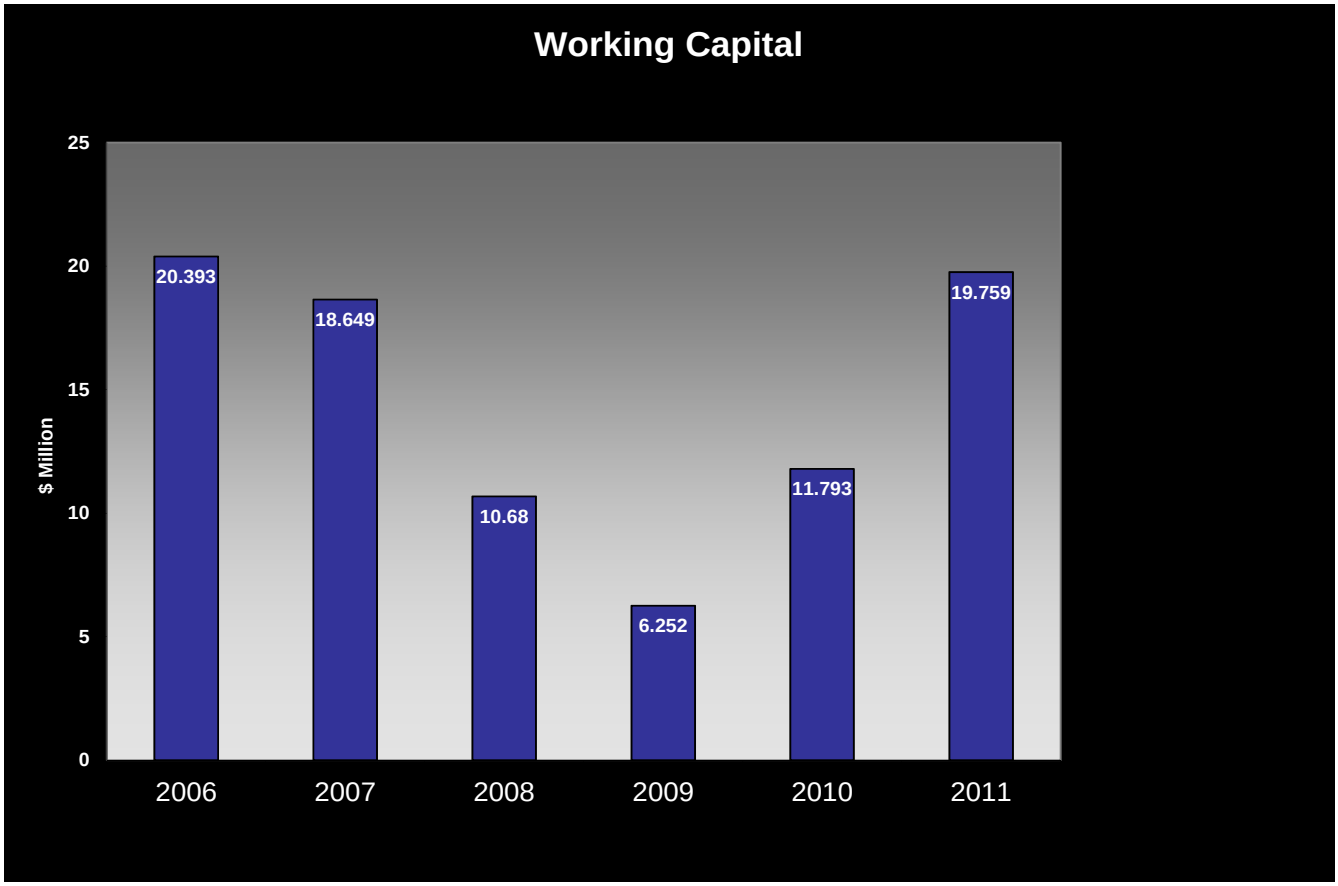
*source for background and General information on valuation models: Investment Valuation, Aswath Damodaran

Our price target of $7.00 per share is the average of 9.2x our 2012 EPS estimate and our two stage model. We would add shares at these levels.



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.


Working Capital
$ Million
25
20
15
10
5
0
20.393
18.649
10.68
6.252
11.793
19.759
2006
2007
2008
2009
2010
2011

PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Dec-10 Q4 10	Mar-11 Q1 11	Jun-11 Q2 11	Sep-11 Q3 11	Dec-11 Q4 11	Mar-12 Q1 12 E	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012 E
REVENUE												
Net Revenue	**10.11**	**11.70**	**13.80**	**11.68**	**10.08**	**9.70**	**48.7**	**38.8**	**23.5**	**46.2**	**47.3**	**53.0**
Sequential Growth		*16%*	*18%*	*-15%*	*-14%*	*-4%*						
OPERATING EXPENSES												
Cost of Revenues	5.32	6.61	7.00	5.55	5.21	5.72	29.9	25.0	15.7	24.1	24.4	28.0
% of Revenue	*52.6%*	*56.5%*	*50.7%*	*47.5%*	*51.7%*	*59.0%*	*61.4%*	*64.4%*	*66.8%*	*52.1%*	*51.6%*	*52.8%*
Gross Profit -	**4.8**	**5.1**	**6.8**	**6.1**	**4.9**	**4.0**	**18.8**	**13.8**	**7.8**	**22.1**	**22.9**	**25.0**
Proforma Gross Margin	*47.4%*	*43.5%*	*49.3%*	*52.5%*	*48.3%*	*41.0%*	*38.6%*	*35.6%*	*33.2%*	*47.9%*	*48.4%*	*47.2%*
R&D + Engg	0.79	0.81	0.82	0.81	0.80	0.83	5.5	5.1	2.4	3.0	3.2	3.3
% of Revenue	*7.8%*	*6.9%*	*6.0%*	*6.9%*	*7.9%*	*8.6%*	*11.3%*	*13.0%*	*10.3%*	*6.6%*	*6.9%*	*6.2%*
SG&A	2.64	3.02	3.25	2.91	2.89	3.50	16.7	15.9	9.8	11.8	12	13
% of Revenue	*26.1%*	*25.8%*	*23.6%*	*24.9%*	*28.7%*	*36.1%*	*34.4%*	*41.1%*	*41.6%*	*25.4%*	*25.5%*	*23.6%*
GW Amort, Restructuring, other						*0.30*		-	-	-		
% of Revenue												
Total Operating Expenses	3.42	3.83	4.08	3.72	3.69	4.63	22.2	21.0	12.2	14.8	15	16
% of Revenue	*33.9%*	*32.7%*	*29.5%*	*31.8%*	*36.6%*	*47.7%*	*45.7%*	*54.1%*	*51.9%*	*32.0%*	*32%*	*30%*
Operating Income -	**1.36**	**1.26**	**2.72**	**2.42**	**1.18**	**-0.65**	**-3.5**	**-7.2**	**-4.4**	**7.4**	**7.6**	**9.2**
Operating Margin	*13.5%*	*10.8%*	*19.7%*	*20.7%*	*11.7%*	*-6.7%*	*-7%*	*-19%*	*-19%*	*16%*	*16%*	*17%*
NON-OPERATING ITEMS												
Non operating Income/Expense	0.06	0.06	0.01	0.01	0.01	0.00	-3.0	-1.9	-0.5	0.1	0	0
% of Revenue	*0.60%*	*0.48%*	*0.07%*	*0.04%*	*0.10%*	*0.00%*	*-6.12%*	*-4.80%*	*-2.17%*	*0.11%*	*0.17%*	*0.38%*
Tax Provision	0.1	0.1	0.1	-2.8	0.4	-0.2	0.050	0.270	-0.050	0.148	-2.204	2.4
Effective Tax Rate												
Net Income -	**1.29**	**1.26**	**2.66**	**5.18**	**0.77**	**-0.49**	**-6.49**	**-9.33**	**-4.83**	**7.25**	**9.9**	**7.1**
Net Income Margin	*12.8%*	*10.7%*	*19.2%*	*44.4%*	*7.6%*	*-5.0%*	*-13.3%*	*-24.1%*	*-20.6%*	*15.7%*	*21%*	*13%*
Adjustments (for one-time NR items)		**0.01**		**0.28**		**0.05**					**0.29**	**0.05**
EARNINGS PER SHARE												
EPS - Basic	$0.13	$0.14	$0.26	$0.22	$0.08	$0.00	$0.13	$0.15	-$0.42	$0.72	$0.70	$0.74
EPS - Diluted	$0.13	$0.13	$0.26	$0.22	$0.08	$0.00	$0.11	$0.14	-$0.42	$0.72	$0.69	$0.74

Ken Nagy, CFA Zacks Investment Research 3/9/2012

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