Zacks Small-Cap Research

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inTEST Corporation (INTT-NASDAQ)

INTT: Non Semiconductor contributes to Profits
- OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/23/2012
Current Price (11/02/12)	$2.53
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	**$2.17**
One-Year Return (%)	**3.27**
Beta	**1.33**
Average Daily Volume (sh)	**15,287**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$26**
Short Interest Ratio (days)	**0.33**
Institutional Ownership (%)	**24**
Insider Ownership (%)	**20**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**4.6**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**7.4**
P/E using 2012 Estimate	**9.0**
P/E using 2013 Estimate	**4.4**
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)
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	10.7 A	13.6 A	10.8 A	9.0 E	44.1 E
2013					52.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
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	$0.07 A	$0.13 A	$0.06 A	$0.02 E	$0.28 E
2013					$0.57 E

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WHATS NEW

Non Semiconductor Business contributes to profitability at inTEST
On October 31, 2012, inTest Corporation, an independent designer, manufacturer and marketer of semiconductor automatic test equipment interface solutions and temperature management products, reported financial results for its fiscal 2012 third quarter and nine months, ended September 30, 2012.

Revenues during the third quarter of 2012 were $10.799 million compared to revenues of $13.576 million for the three months ended June 30, 2012 and revenues of $11.681 million during the third quarter ended September 30, 2011.

Ten percent of third quarter 2012 net revenues were derived from non-semiconductor test compared to 14 percent of second quarter 2012 net revenues being derived from non-semiconductor test.

Over the last few years inTest has been transforming itself through the strategic diversification of its Thermal products segment. 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 further reported that third quarter bookings were $8.7 million, down from its second quarter 2012 bookings of $11.8 million and from third quarter 2011 bookings of $10.5 million.

Still, 17 percent of the Company's third quarter 2012 bookings were derived from non-semiconductor test which was solidly above the 10 percent from the second quarter 2012 and which was the Company's highest percentage recorded this year.

Gross margin during the third quarter fell to 44.1 percent compared to 45.6 percent from the second quarter fiscal 2012 and 52.5 percent for the three months ended September 30, 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 third quarter of 2012 which increased to 15% of revenues in the third quarter from 13% of revenues in the second quarter.

However, while inTest's fixed manufacturing cost increased as a percentage of revenue quarter over quarter, they actually declined in absolute dollar terms.by $200,000, primarily as a result of reductions in temporary staffing levels in its thermal products segment.

inTest reported second quarter 2012 net income of $664,000 compared to a second quarter 2012 net income of $1.334 and net income of $5.182 million for the three months ended September 30,2011.

Contributing to the profitability was the Company's non-semi component growing by 7% quarter over quarter.

The year over year drop in net income was primarily due to lower gross margin as well as third quarter 2011 net earnings including a $2.9 million reversal of valuation allowance against the Company's deferred tax assets.

Based on a weighted average number of diluted shares outstanding of 10.360 million, diluted net income per share resulted in net income of $0.06 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 10.360 million during the three

months, ended June 30, 2012 and diluted net income per share of $0.50 on a weighted average number of diluted shares of 10.297 million during the third quarter ended September 30, 2011.

inTest's balance sheet continued to improve during the third quarter with cash and equivalents of $14.700 million, working capital of $20.959 million and no debt. This compares to $11.699 million in cash and equivalents and working capital of $19.958 million for the period ended June 30, 2012.

The Company's cash balance now exceeds the level of December 31, 2011, prior to inTest's closing on the acquisition of Thermonics in January 2012. Management currently expects this strong cash generation to continue with cash and cash equivalents increasing sequentially at December 31, 2012.

While industry conditions became increasingly challenging throughout the third quarter as a result of a number of capital equipment suppliers and semiconductor companies delaying certain capital expenditures, inTEST remained profitable and delivered third quarter financial results that exceeded its guidance for both revenue and earnings per share.

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.

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 recently concluded sales channel integration and Thermal product consolidation.

Likewise, 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.

Management reported that it anticipates that net revenues for the fourth quarter ending December 31, 2012 is expected to be in the range of $8.5 to $9.5 million and that net earnings are projected to be in the range from a net loss of $(0.02) per diluted share to net income of $0.04 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	2.40	7.80

Metric	inTEST	Industry Average
P/E TTM	7.44	18.10
P/E 2012 (E)	9.04	16.80
P/E 2013 (E)	4.44	13-15
P/S	0.60	4.00

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

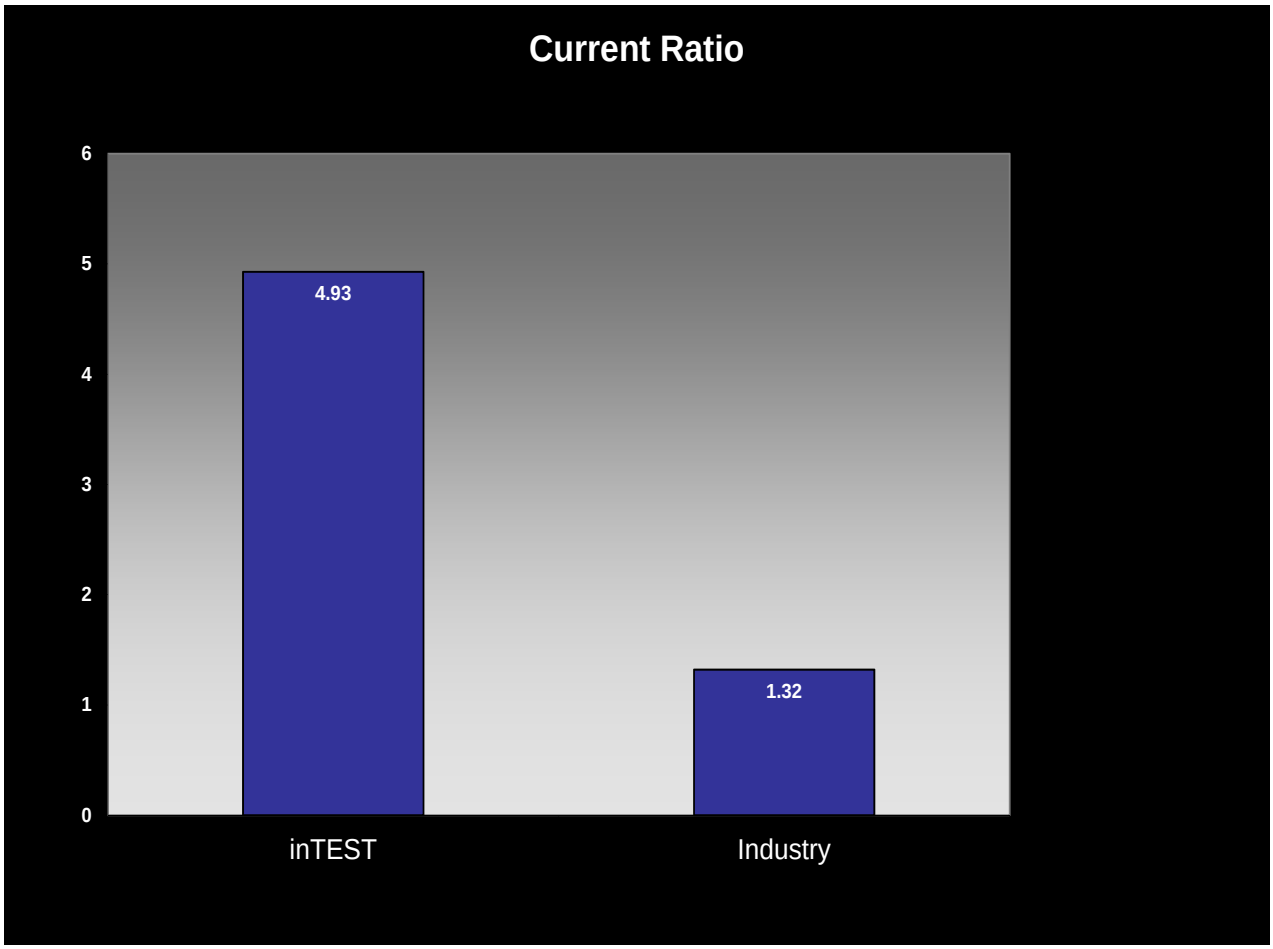
As you add more layers to the model it is more sensitive to the assumptions you make. The growth may look more "lumpy" than we have it in the model.

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%.

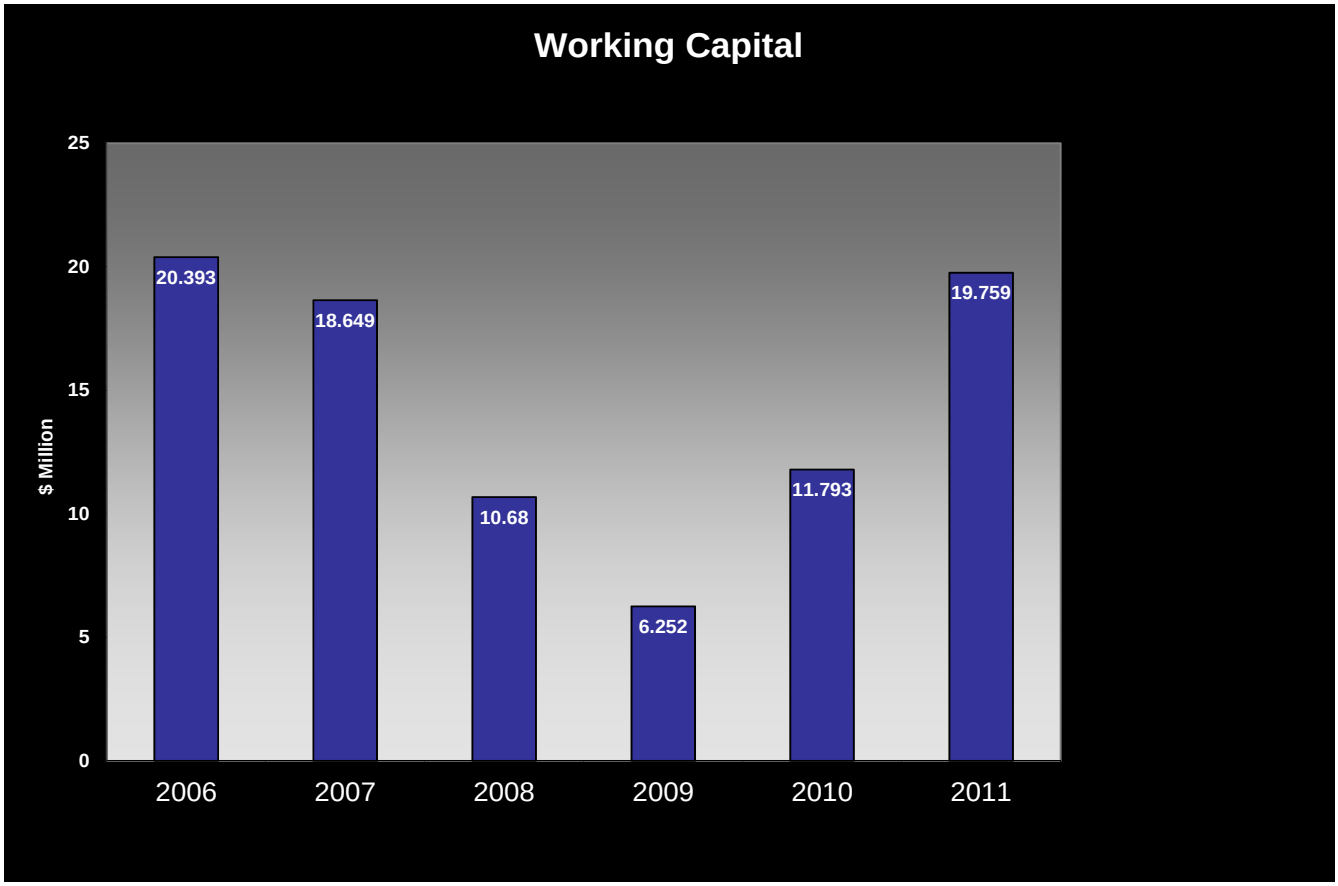
With these inputs we arrive at a target price of $7.23. Our price target of $7.00 per share is the average of 11.8x our 2013 EPS estimate and our two stage model. We would add shares at these levels.



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)	Sep-11 Q3 11	Dec-11 Q4 11	Mar-12 Q1 12	Jun-12 Q2 12	Sep-12 Q3 12	Dec-12 Q4 12 E	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012 E	FY 2013 E
REVENUE												
Net Revenue	**11.68**	**10.08**	**10.73**	**13.58**	**10.80**	**9.00**	**38.8**	**23.5**	**46.2**	**47.3**	**44.1**	**52.0**
Sequential Growth		*-14%*	*6%*	*27%*	*-20%*	*-17%*						
OPERATING EXPENSES												
Cost of Revenues	5.55	5.21	6.14	7.38	6.04	5.00	25.0	15.7	24.1	24.4	24.6	27.5
% of Revenue	*47.5%*	*51.7%*	*57.2%*	*54.4%*	*55.9%*	*55.6%*	*64.4%*	*66.8%*	*52.1%*	*51.6%*	*55.7%*	*52.9%*
Gross Profit -	**6.1**	**4.9**	**4.6**	**6.2**	**4.8**	**4.0**	**13.8**	**7.8**	**22.1**	**22.9**	**19.6**	**24.5**
Proforma Gross Margin	*52.5%*	*48.3%*	*42.8%*	*45.6%*	*44.1%*	*44.4%*	*35.6%*	*33.2%*	*47.9%*	*48.4%*	*44.3%*	*47.1%*
R&D + Engg	0.81	0.80	0.92	0.98	1.01	0.90	5.1	2.4	3.0	3.2	3.8	3.9
% of Revenue	*6.9%*	*7.9%*	*8.6%*	*7.2%*	*9.3%*	*10.0%*	*13.0%*	*10.3%*	*6.6%*	*6.9%*	*8.6%*	*7.5%*
SG&A	2.91	2.89	3.40	3.22	2.77	2.80	15.9	9.8	11.8	12	12.18	13.00
% of Revenue	*24.9%*	*28.7%*	*31.7%*	*23.7%*	*25.6%*	*31.1%*	*41.1%*	*41.6%*	*25.4%*	*25.5%*	*27.6%*	*25.0%*
GW Amort, Restructuring, other			*0.36*	-	-	-	-	-	-		*0.360*	
% of Revenue												
Total Operating Expenses	3.72	3.69	4.68	4.20	3.77	3.70	21.0	12.2	14.8	15	16	17
% of Revenue	*31.8%*	*36.6%*	*43.6%*	*30.9%*	*34.9%*	*41.1%*	*54.1%*	*51.9%*	*32.0%*	*32%*	*37%*	*33%*
Operating Income -	**2.42**	**1.18**	**-0.08**	**1.99**	**0.99**	**0.30**	**-7.2**	**-4.4**	**7.4**	**7.6**	**3.20**	**7.6**
Operating Margin	*20.7%*	*11.7%*	*-0.8%*	*14.7%*	*9.2%*	*3.3%*	*-19%*	*-19%*	*16%*	*16%*	*7%*	*15%*
NON-OPERATING ITEMS												
Non operating Income/Expense	0.01	0.01	0.01	0.00	0.02	0.02	-1.9	-0.5	0.1	0	0.1	0.2
% of Revenue	*0.04%*	*0.10%*	*0.12%*	*0.00%*	*0.21%*	*0.26%*	*-4.80%*	*-2.17%*	*0.11%*	*0.17%*	*0.13%*	*0.29%*
Tax Provision	-2.8	0.4	0.0	0.7	0.3	0.1	0.270	-0.050	0.148	-2.204	1.1	1.9
Effective Tax Rate												
Net Income -	**5.18**	**0.77**	**-0.04**	**1.33**	**0.66**	**0.24**	**-9.33**	**-4.83**	**7.25**	**9.9**	**2.2**	**5.8**
Net Income Margin	*44.4%*	*7.6%*	*-0.4%*	*9.8%*	*6.1%*	*2.7%*	*-24.1%*	*-20.6%*	*15.7%*	*21%*	*5%*	*11%*
Adjustments (for one-time NR ite	**0.28**		**0.07**	**0.00**	**0.00**	**0.00**				**0.29**	**0.07**	**0.00**
EARNINGS PER SHARE												
EPS - Basic	$0.22	$0.08	$0.07	$0.13	$0.06	$0.02	$0.15	-$0.42	$0.72	$0.70	$0.28	$0.57
EPS - Diluted	$0.22	$0.08	$0.07	$0.13	$0.06	$0.02	$0.14	-$0.42	$0.72	$0.69	$0.28	$0.57

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