Zacks Small-Cap Research

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inTEST Corporation (INTT-NASDAQ)

INTT: inTEST is Worth More than 4 Bucks! - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	07/27/2010
Current Price (07/28/11)	$3.38
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). Non-semiconductor thermal testing remains a source of growth as well as diversification for inTEST.

On May 4, 2011 inTEST announced results for the first quarter of fiscal year 2011. Revenue and bookings saw strength, while margins trended down due to higher material costs associated with product mix. We expect margins to improve throughout 2011.

SUMMARY DATA

52-Week High	**$4.54**
52-Week Low	**$2.24**
One-Year Return (%)	**5.00**
Beta	**1.24**
Average Daily Volume (sh)	**73,824**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$39**
Short Interest Ratio (days)	**1.84**
Institutional Ownership (%)	**14**
Insider Ownership (%)	**22**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-14.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**4.6**
P/E using 2011 Estimate	**4.6**
P/E using 2012 Estimate	**3.9**
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	13.0 E	13.4 E	13.8 E	51.9 E
2012					55.0 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	$0.18 E	$0.21 E	$0.22 E	$0.74 E
2012					$0.86 E

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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.

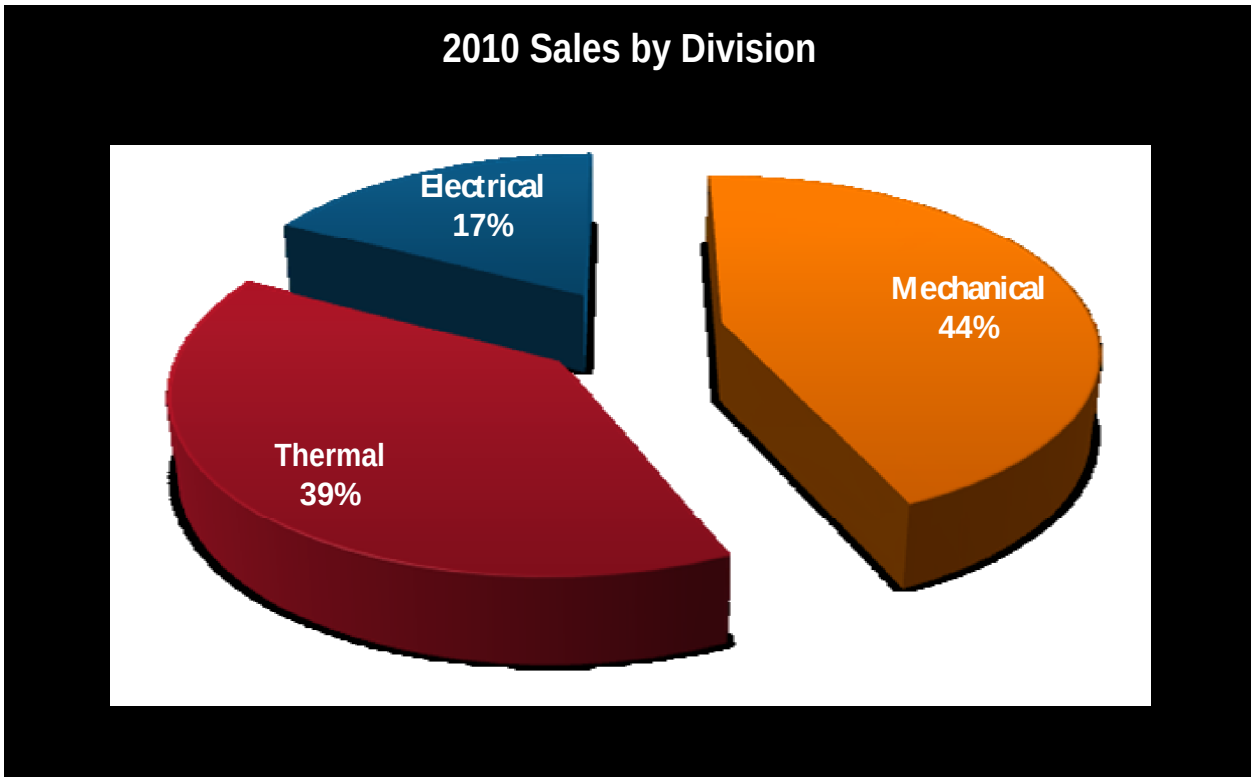
Bullish signs

- **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.**

Major Customers	Current Quarter	Outlook
Teradyne Inc.	Order Momentum strong after previously slow quarter	+25 million
LTX-Credence Corporation	strong quarter helped by 1 time payment	7-14% increase from last quarters top-line
Analog Devices	Strength across all segments	Industrial Customers look very solid
Cypress Semiconductor Corporation	Stronger than guidance + 3% sequential growth and +15% yoy	book to bill is above 1/ up 10-13%
Freescale Semiconductor	Strong quarter despite Japan Fab facility difficulty	sees continued improvement throughout 2011
Texas Instruments	Reported orders, resales and core business were strong	up 1-9% sequentially
Emerson Electric	Strength across all segments (+18%)	No quarterly outlook. Expect sales up 15-18% in 2011



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, because it takes debt into account - an item which other multiples like the P/E ratio 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 3.59x compared to 7.39x for the industry. **According to the enterprise multiple INTT appears undervalued compared to industry.**

$$\text{Enterprise Multiple} = \frac{\text{Enterprise Value}}{\text{EBITDA}}$$

Metric	inTEST	Industry Average
EV/EBITDA	3.59	7.39

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.)

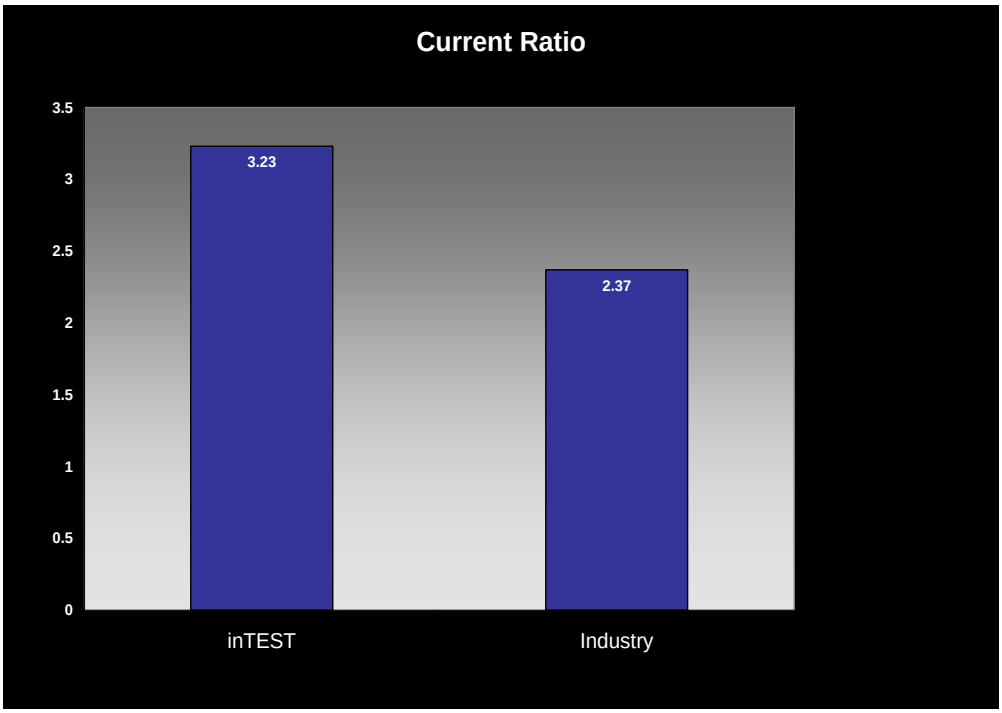
While not as popular as Price/Earnings or Price/BV, Price/Sales is not influenced by accounting decisions in depreciation, inventory and extraordinary charges. P/S multiples are much less volatile than P/E multiples. However if the problem with the firm lies in cost control the P/S ratio will not reflect this flaw.

The firm appears undervalued compared to the industry.

Metric	inTEST	Industry Average
P/E TTM	4.56	14.62
P/E 2011 (E)	4.56	14.13
P/E 2012 (E)	3.93	13-15
P/S	0.72	0.95

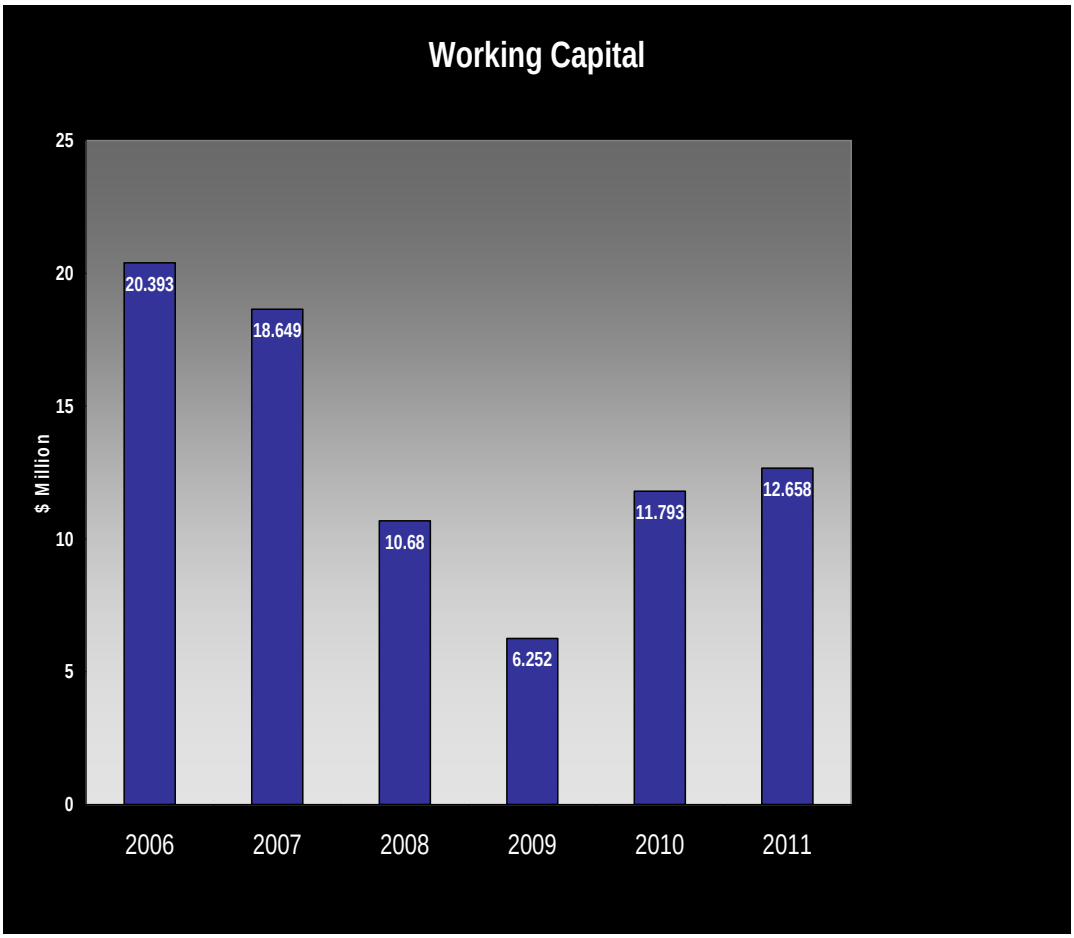
*source for background on valuation models: Investment Valuation, Aswath Damodaran

Our price target of $7.00 per share is the average of 9.2x our 2011 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.



RECENT NEWS

On May 4, 2011 inTEST announced results for the first quarter of fiscal year 2011 ending March 2011. Revenue for the period was $11.7 million rising 15.7% sequentially from $10.1 million and up 22.8% year-over-year.

Looking at results on a segment basis, first quarter net revenues for the Mechanical Products segment were $5.0 million, or 43% of net revenues, compared with revenues of $3.6 million, or 36% of net revenues a quarter ago. Thermal Products segment had net revenues of $5.4 million, or 46% of net revenues, compared with fourth quarter 2010 net revenues of $5.1 million, or 50% of net revenues. Electrical Products segment reported net revenues of $1.3 million, or 11% of net revenues, versus fourth quarter net revenues of $1.4 million, or 14% of net revenues.

Revenue	1Q 2011	4Q 2010
Mechanical Products	$5.0 Million	$3.6 Millior
Electrical Products	$1.3 Million	$1.4 million
Thermal Products	$5.4 Million	$5.1 Millior

Gross margin fell in the first quarter and was $5.1 million, or 44%, compared with fourth quarter 2010 gross margin of $4.8 million, or 47%, and $4.5 million or 48% in the year ago quarter. The decline in the gross margin was largely due to higher than expected material costs, which were the result of a less favorable product mix in both Thermal and Mechanical Products segments.

Mechanical products first quarter bookings were $5.6 million compared with bookings of $4.9 million in the 2010 fourth quarter. This was driven by strong manipulator bookings during the quarter. It is important for investors to realize that while the Manipulators do carry a lower margin they are a precursor for future business as their sales mean more testers are being built and shipped. The firm has also seen traction in the docking business which carries stronger margins. Over the past year inTEST has enhanced the line's lifting capability which will serve to increase the addressable market.

Electrical products segment, first quarter bookings ($1.7 million versus bookings of $1.5 million) reversed the quarterly trend of downward bookings throughout 2010 and was driven by a mixture of sales to multiple end users and to a specific OEM. Management reported this trend is continuing in the second quarter.

inTest saw strong bookings from the Thermal Solutions product group, largely driven by the sensor industry and military applications. Management reported there has been a strong proliferation of sensors, such as MEMS used in automotive applications (applications include air bag triggers and tire pressure sensors). Smart phones and I-Pad type devices are also a fast growing area of MEMS sensors.

Bookings	1Q 2011	4Q 201(
Mechanical Products	$5.6 Million	$4.9 Millior
Electrical Products	$1.7 Million	$1.5 million
Thermal Products	$5.8 Million	$5.3 Millior

Thermal products bookings specifically were $5.8 million, compared with fourth quarter bookings of $5.3 million. inTEST's goal is to grow the non-semiconductor business. Thermal products offer an effective way to expand inTEST's served available market by acquiring non-semiconductor business, opening the Company up to diverse new growth industries, including aerospace/defense, automotive, telecommunications and medical/pharmaceutical and making it less dependent on semiconductor capital spending swings. In the first quarter, the company began marketing all of the thermal products under the name "inTEST Thermal Solutions Corporation." The division specializes in meeting the most demanding applications by engineering unique thermal test solutions. Non-semi related bookings for the first quarter comprised 18% of overall bookings or $2.3 million.

First quarter net income was $1.3 million, or $0.12 per diluted share, compared with 2010 fourth quarter net income of $1.3 million, or $0.13 per diluted share. Total move costs included in first quarter results were $128,000 or $0.01 per diluted share. Zacks adds this back in.

Looking at the balance sheet, cash and cash equivalents at the end of the first quarter were $5.2 million versus $6.9 million in the fourth quarter of 2010. The decrease in cash during the first quarter was caused by several factors including the investments in improvements and equipment for two new facilities occupied during the first quarter, the payment of various accrued expenses and increases to inventory. Management expects cash to grow sequentially throughout 2011.

In conjunction with the first quarter results, inTEST filed a shelf registration statement which allows the company to raise capital of up to $30 million of common stock, preferred stock, warrants, debt securities or units. The amount inTEST is allowed to issue is a function of its public float, so $10 million is a more realistic number for the time being. The purpose of the filing is to provide the company flexibility for the strategic growth of the company through M&A activity.

The backlog at the end of the first quarter was $7.5 million, compared with $6.1 million at the end of the fourth quarter of 2010.

Management provided guidance for the second quarter of 2011. The firm expects net revenue will be in the range of $12.5 to $13.5 million and that net income will be in the range of $0.15 to $0.20 per diluted share. First quarter EPS guidance includes the impact of $75,000 of one-time costs associated with the preparation of the shelf registration.

PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Mar-10 Q1 10	Jun-10 Q2 10	Sep-10 Q3 10	Dec-10 Q4 10	Mar-11 Q1 11	Jun-11 Q2 11 E	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 E	FY 2012 E
REVENUE												
Net Revenue	**9.53**	**15.26**	**11.31**	**10.11**	**11.70**	**13.00**	**48.7**	**38.8**	**23.5**	**46.2**	**51.9**	**55.0**
Sequential Growth		*60%*	*-26%*	*-11%*	*16%*	*11%*						
OPERATING EXPENSES												
Cost of Revenues	4.99	7.89	5.85	5.32	6.61	7.00	29.9	25.0	15.7	24.1	28.0	28.3
% of Revenue	*52.4%*	*51.7%*	*51.8%*	*52.6%*	*56.5%*	*53.8%*	*61.4%*	*64.4%*	*66.8%*	*52.1%*	*53.9%*	*51.5%*
Gross Profit -	**4.5**	**7.4**	**5.5**	**4.8**	**5.1**	**6.0**	**18.8**	**13.8**	**7.8**	**22.1**	**23.9**	**26.7**
Proforma Gross Margin	*47.6%*	*48.3%*	*48.2%*	*47.4%*	*43.5%*	*46.2%*	*38.6%*	*35.6%*	*33.2%*	*47.9%*	*46.1%*	*48.5%*
R&D + Engg	0.70	0.79	0.77	0.79	0.81	0.84	5.5	5.1	2.4	3.0	3.5	4.0
% of Revenue	*7.4%*	*5.2%*	*6.8%*	*7.8%*	*6.9%*	*6.5%*	*11.3%*	*13.0%*	*10.3%*	*6.6%*	*6.7%*	*7.3%*
SG&A	2.71	3.41	3.00	2.64	3.02	3.25	16.7	15.9	9.8	11.8	13	14
% of Revenue	*28.4%*	*22.3%*	*26.5%*	*26.1%*	*25.8%*	*25.0%*	*34.4%*	*41.1%*	*41.6%*	*25.4%*	*24.6%*	*25.5%*
GW Amort, Restructuring, other	-							-	-	-		
% of Revenue												
Total Operating Expenses	3.41	4.19	3.77	3.42	3.83	4.09	22.2	21.0	12.2	14.8	16	18
% of Revenue	*35.8%*	*27.5%*	*33.3%*	*33.9%*	*32.7%*	*31.5%*	*45.7%*	*54.1%*	*51.9%*	*32.0%*	*31%*	*33%*
Operating Income -	**1.13**	**3.17**	**1.69**	**1.36**	**1.26**	**1.91**	**-3.5**	**-7.2**	**-4.4**	**7.4**	**7.7**	**8.7**
Operating Margin	*11.8%*	*20.8%*	*14.9%*	*13.5%*	*10.8%*	*14.7%*	*-7%*	*-19%*	*-19%*	*16%*	*15%*	*16%*
NON-OPERATING ITEMS												
Non operating Income/Expense	-0.01	-0.01	0.01	0.06	0.06	0.06	-3.0	-1.9	-0.5	0.1	0	0
% of Revenue	*-0.12%*	*-0.05%*	*0.07%*	*0.60%*	*0.48%*	*0.43%*	*-6.12%*	*-4.80%*	*-2.17%*	*0.11%*	*0.58%*	*0.27%*
Tax Provision	0.0	0.0	0.0	0.1	0.1	0.1	0.050	0.270	-0.050	0.148	0.400	0.020
Effective Tax Rate												
Net Income -	**1.11**	**3.16**	**1.68**	**1.29**	**1.26**	**1.89**	**-6.49**	**-9.33**	**-4.83**	**7.25**	**7.6**	**8.8**
Net Income Margin	*11.7%*	*20.7%*	*14.8%*	*12.8%*	*10.7%*	*14.5%*	*-13.3%*	*-24.1%*	*-20.6%*	*15.7%*	*15%*	*16%*
Adjustments					**0.01**							
EARNINGS PER SHARE												
EPS - Basic	$0.11	$0.32	$0.17	$0.13	$0.14	$0.19	$0.13	$0.15	-$0.42	$0.72	$0.75	$0.86
EPS - Diluted	$0.11	$0.31	$0.17	$0.13	$0.13	$0.18	$0.11	$0.14	-$0.42	$0.72	$0.74	$0.86

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