Zacks Small-Cap Research

August 5, 2013
Ken Nagy, CFA

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

inTEST Corporation (INTT-NASDAQ)

INTT: Expect a Stronger Second Half - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	07/27/2010
Current Price (08/02/13)	$4.03
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	**$4.06**
52-Week Low	**$2.38**
One-Year Return (%)	**39.93**
Beta	**1.38**
Average Daily Volume (sh)	**21,579**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$42**
Short Interest Ratio (days)	**1.20**
Institutional Ownership (%)	**24**
Insider Ownership (%)	**20**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**9.6**
Earnings Per Share (%)	**-32.3**
Dividend (%)	**N/A**
P/E using TTM EPS	**19.2**
P/E using 2013 Estimate	**12.2**
P/E using 2014 Estimate	**10.6**
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)
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	8.9 A	11.2 A	10.8 E	11.5 E	42.4 E
2014					49.5 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	$0.06 A	$0.66 A
2012	$0.07 A	$0.13 A	$0.06 A	$0.02 A	$0.28 A
2013	$0.03 A	$0.10 A	$0.09 E	$0.10 E	$0.32 E
2014					$0.38 E

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Expect a Stronger Second Half

On July 31, 2013, 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 2013 second quarter and six months, ended June 30, 2013.

Revenues during the second quarter 2013 were $11.218 million, above management's guidance range of $9.5 million to $10.5 million for the quarter. This compares to revenues of $8.973 million for the three months ended March 31, 2013 and revenues of $13.576 million during the second quarter ended June 30, 2012.

The increase in revenues was fueled by strong demand by a wide verity of customers in the semiconductor industry. While net revenues exceeded guidance and increased sequentially by 25 percent, non-semiconductor test revenue increased both in terms of absolute dollars and as a percent of revenue.

Metric	Q2 Performance	Comparison	Takeaway
Electrical Segment	Bookings $1.9 M Revenue $1.6 M	Bookings +153%QoQ. Revenue +29%QoQ.	New probe pin ring designs were completed and verified at Teradyne.
Mechanical Products Segment	Bookings $3.7 M Revenue $3.8 M	Bookings +66%QoQ, Revenue +112%QoQ.	Business ramps at major test house in Taiwan drove April business.
Thermal Segment	Bookings $5.4 M Revenue $5.8 M	Bookings +14%QoQ, Revenue flat QoQ.	Non-semi represents 22% of total revenue.
Cash	$16.0 Million	Compared to $15.4 million a quarter ago.	Growing cash in 2013.
Working Capital	$22.8 Million	Compared to $21.6 million a quarter ago.	Improving since 2009.
Management Outlook	$10.0 to $11.0 M Top- Line $0.06-$0.10 EPS	Company does not usually give outlooks beyond one quarter.	Second half orders and revenue to be stronger than the first half. This is rare.
Industry Outlook	Likely that Q1 was a trough period.	Industry sources point to growth.	Improving as year continues.

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.

22 percent of second quarter 2013 net revenues were derived from non-semiconductor test compared to 19

percent of first quarter 2013 net revenues being derived from non-semiconductor test. Sequentially, second quarter non-semiconductor test net revenues increased 30 percent.

inTest reported second quarter bookings were $11.0 million, compared to first quarter 2013 bookings of $7.7 million and from second quarter 2012 bookings of $11.8 million.

Similarly, 20 percent of the company's second quarter 2013 bookings were derived from non-semiconductor test compared to 16 percent from the first quarter.

Backlog at the end of the second quarter was $2.7 million, down slightly from $2.9 million at the end of the first quarter.

Gross margin during the second quarter jumped to 48.7 percent compared to 45.8 percent from the first quarter fiscal 2013 and 45.6 percent for the three months ended June 30, 2012.

Gross margin was fueled by an increase in net revenues which caused a more favorable absorption of fixed manufacturing costs in the second quarter of 2013, which decreased from 16 percent of revenues in the first quarter to 13 percent of revenues in the second quarter.

inTest reported second quarter 2013 net income of $1.003 million compared to first quarter 2013 net income of $292,000 and net income of $1.334 million for the three months ended June 30, 2012.

Based on a weighted average number of diluted shares outstanding of 10.394 million, diluted net income per share resulted in net income of $0.10 per share for the quarter. This compared to diluted net income per share of $0.03 on a weighted average number of diluted shares of 10.366 million during the three months, ended March 31, 2013 and diluted net income per share of $0.13 on a weighted average number of diluted shares of 10.360 million during the second quarter ended June 30, 2012.

inTest's balance sheet remained solid during the second quarter with cash and equivalents of $16.032 million, working capital of $22.789 million and no debt. This compares to $15.384 million in cash and equivalents and working capital of $21.572 million for the period ended March 31, 2013.

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

inTest has added 5 companies to its operations in the last 15 years which have bolstered its growth opportunities. Last 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 third quarter ending September 30, 2013 will be in the range of $10 million to $11 million and that net earnings will range from $0.06 to $0.10 per diluted share.

Management expects orders and net revenues in the second half of 2013 will be stronger than those of the first half, with a sequential increase in revenues in the fourth quarter.

Likewise, inTest has been profitable for the past 15 quarters, including a breakeven quarter in Q1 of 2012, and continues to generate cash and management expects to continue both trends through 2013.

INVESTMENT THESIS

- **Complexity in chips increasing. As chips get smaller and more complex testing is more important.**
- **Today Chip content is spread out over mobile phone, automobile, industrial goods rather than strictly corporate IT, as was the case 10 years ago.**
- **Non-semiconductor Thermal business has potential for growth as well as revenue diversification. This has protected the firm from loss for 15 quarters while Semi has turned down.**
- **Firm is subject to the cyclical nature of the semiconductor equipment industry. Until non-semiconductor is large enough to offset.**

Historically semiconductor firms (also called integrated device manufacturers or IDMs) manufactured chips in their own fabs (chip fabrication plants). By the 1990's as chips grew smaller and more complex it was a natural that 'fabless' outsourced manufacturing began to emerge. The science of building ICs continues to become increasingly complicated as the marketplace demands chips with higher component densities, smaller and more precise design geometries, less power consumption and the mixing of electronic technologies, all in a smaller package. This has driven the semiconductor manufacturing equipment sector to build more elaborate and expensive gear to fabricate the chips. Testing has become more valuable and important part of the process.

Typically, semiconductor companies test each device at two different stages during the manufacturing process to ensure its functional and electrical performance prior to shipment to the device user. These companies use semiconductor testing equipment to first test a device after it has been fabricated but before it has been packaged to eliminate non-functioning parts. Then, after the functioning devices are packaged, they are tested again to determine if they fully meet performance specifications. Testing is an important step in the manufacturing process because it allows devices to be fabricated at both maximum density and performance—a key to the competitiveness of semiconductor manufacturers.

Mechanical Products

The firm offers four lines of manipulator products as well as docking products. The manipulator has an estimated 20% market share while the docking products enjoy an estimated 40% share. Estimates of market share are tough to come by as many market participants are private.

The four lines of manipulator products are the in2, the M Series, the Aero Series and the Cobal Series. These free-standing universal manipulators can hold a variety of test heads and enable an operator to reposition a test head for alternate use with any one of several probers or handlers on a test floor. Certain members of the Aero family are also available as a lower-cost solution for dedicated prober-only or handler-only test cell applications. Price ranges from $10,000 to $60,000.

INTT's docking hardware products protect the delicate interface contacts and ensure proper repeatable and precise alignment between the test head's interface board and the prober's probing assembly or the

handler's test socket as they are brought together, or "docked." A simple cam action docks and locks the test head to the prober or handler, thus eliminating motion of the test head relative to the prober or handler. This minimizes deterioration of the interface boards, test sockets and probing assemblies which is caused by constant vibration during testing. Docking hardware products range in price from approximately $2,000 to $25,000.

Electrical Products
inTEST's electrical products division manufactures tester interfaces. Tester interfaces provide the electrical connections between the tester and the wafer prober or IC handler to carry the electrical signals between the tester and the probe card on the prober or the test socket on the handler. Tester interfaces run from $7,000 to $40,000 each.

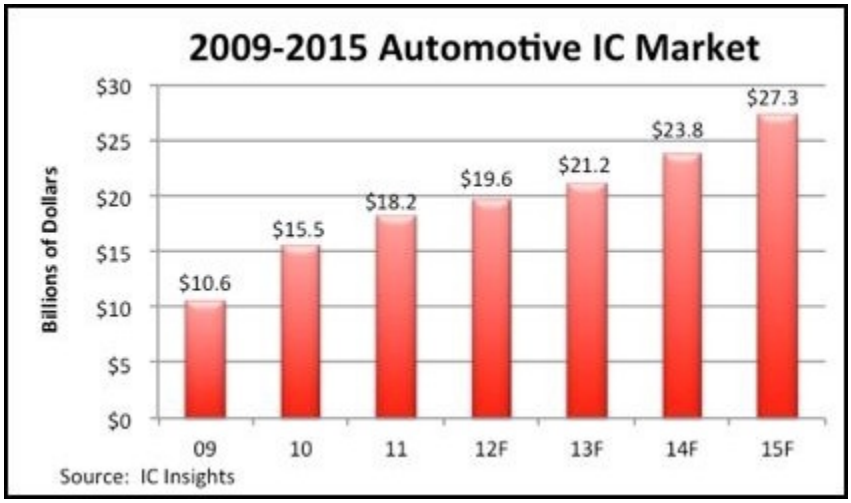
The Electrical division has emerged as a very profitable business. It is different because it based on long term sales and the product is very engineering intensive. So you work with the customer for several months before you ship the first product. Once you ship that product and if they're ramping, you get that business no matter what, because it's very difficult for another supplier to break in since he wasn't part of that development cycle. There tends to be an overall disconnect between the general economy of the semiconductor world and the way those sales go.

Thermal Products
INTT's Thermal Products are sold mainly to the environmental test market which encompasses a wide variety of industries including aerospace, automotive, communications, consumer electronics, defense, medical and semiconductor industries. The firm's thermal products allow a manufacturer to test semiconductor wafers and ICs, electronic components and assemblies, mechanical assemblies and electromechanical assemblies. Products range in price from approximately $10,000 to $90,000.

Chips are Everywhere
Today semiconductor chips are present in a variety of electronics and industrial goods. This was not the case just ten years ago. There has been a fundamental shift in the semiconductor industry from corporate IT to consumer demand.

As an example look at the chip content in Automobiles.

According to the EE Times and IC Insights, the average semiconductor content per vehicle was about $380 in 2012. This is 9% more than last year. During the time span from 2009 through 2015, the semiconductor content per vehicle will grow in lockstep with the market at a pace of 11% per year. IC Insights further believes that electronic controls will increasingly be found not only in the luxury car segment but also in the medium and compact class; the trickle-down effect of advanced technologies to lower price segments happens faster than estimated. **(http://www.automotive-eetimes.com/en/fuel-efficiency-drives-semiconductor-content-in-cars.html?cmp_id=7&news_id=222902391)**



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. This took a step back in 2012 with only $6.5 million coming from non-semi, but 2013 seems to be back in a growth mode. 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.

Traditional semiconductor markets are quite volatile. inTEST has been building this business to ensure their earnings are not. For 15 quarters (one breakeven) they have been profitable. While industry conditions remain challenging as a result of a number of capital equipment suppliers and semiconductor companies delaying certain capital expenditures, inTEST has maintained profitability, generated cash, and continues to carry no debt.

Breaking Down 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 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.

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.

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	4.7	7.3

Metric	inTEST	Industry Average
P/E TTM	19.2	18.9
P/E 2013 (E)	12.2	16.3
P/E 2014 (E)	10.6	13-15
P/S	1.1	1.5

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.

As the non-semiconductor business ramps up to 50% of total revenues and Semiconductor returns from a trough period 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. Of Course as you add more layers to the model it is more sensitive to the assumptions you make. The growth may also look more “lumpy” than in the model.

The firm does not have to grow the top-line at very high rates in order ramp its earnings. A look at the 2011 versus 2012 income statement confirms this. 2011 top-line revenue was $47.3 million. This produced diluted EPS of $0.96. Approximately $3.1 million of this was effect of a reversal of valuation allowance against deferred tax assets, so if that is removed we get a diluted EPS of $0.66. 2012

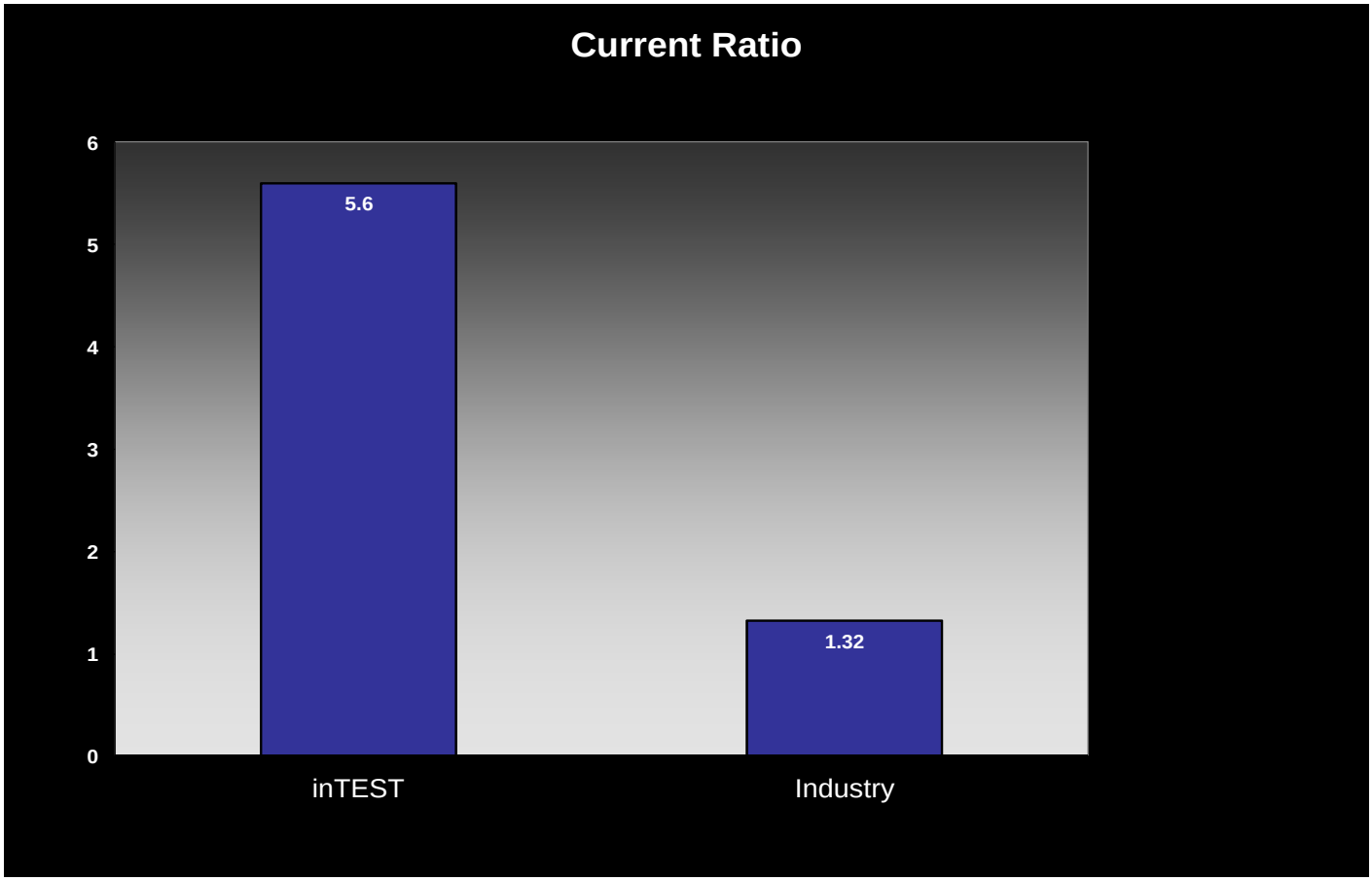
revenues were $43.4 million produced EPS of only $0.21. Diluted Shares are approximately 10.4 million and the float is 7.4 million shares.

We used the following inputs:

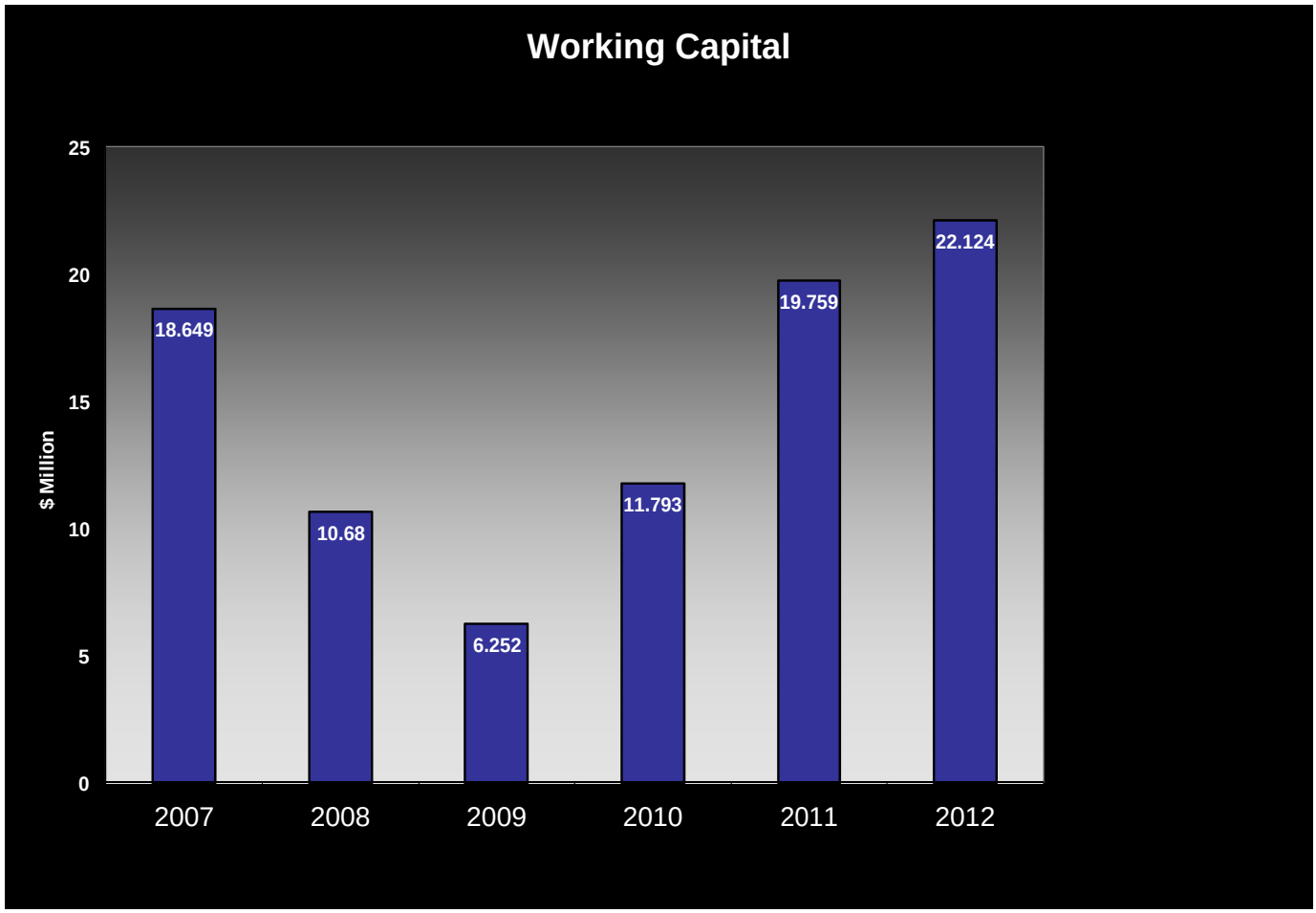
- A 5-year period with an earnings growth rate of 15.0% and a discount rate of 13.79%.
- A continuing period assumed to go on forever, with earnings growing at 5% and a discount rate of 12.75%.

Since inTEST has no long term debt we used the Capital Asset Pricing Model (CAPM) to find the discount rates. They are conservative (high) given the fact that the current beta is 1.66 and I assume the risk free rate will rise. The earnings growth rate may prove to be conservative assuming Semiconductor spending begins to show growth. Which is what order patterns are starting to show.

With these inputs we arrive at a target price of $6.25. Our price target of $7.00 per share is a blend the above valuation techniques 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.

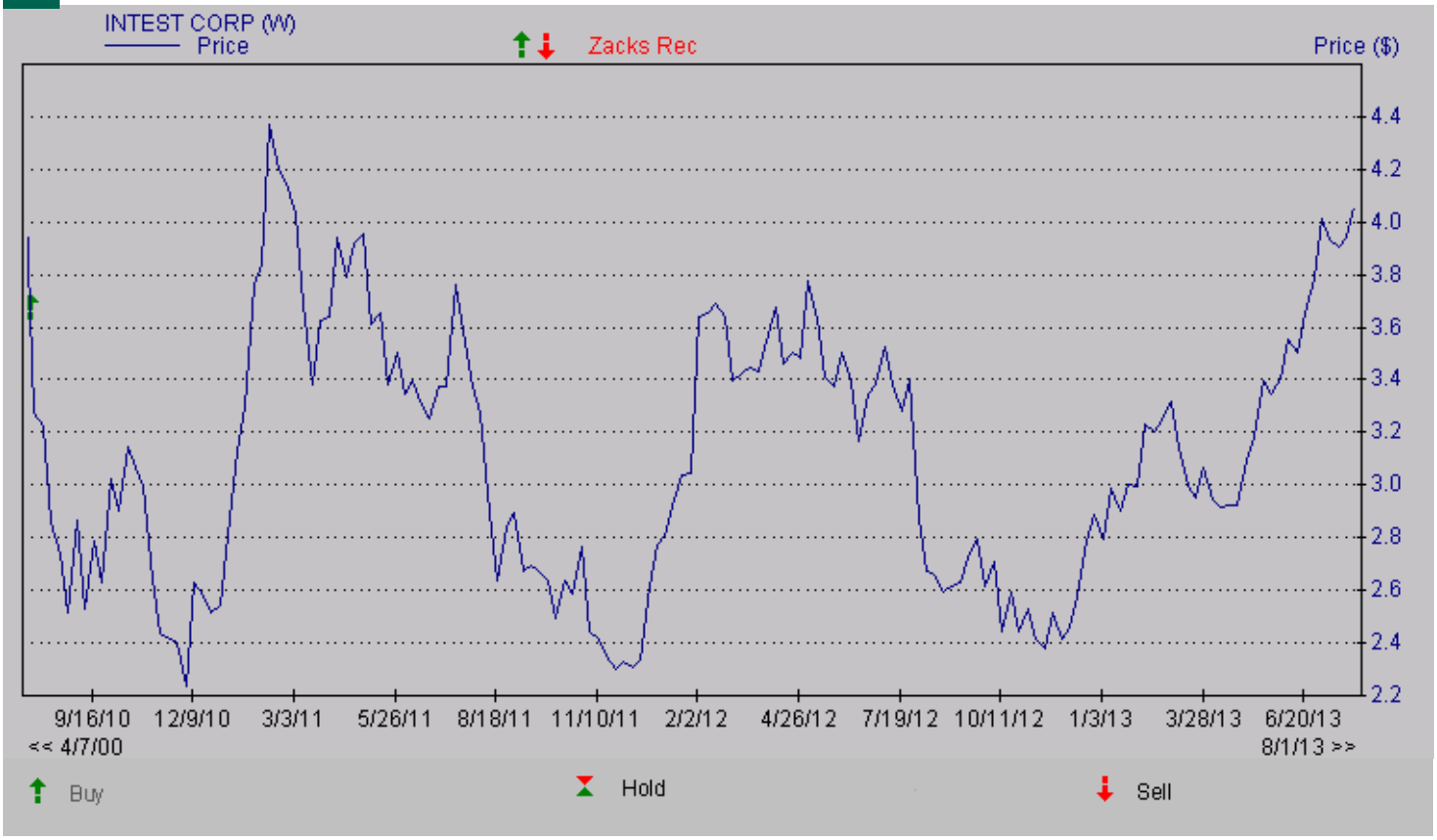

Working Capital
$ Million
25
20
15
10
5
0
18.649
10.68
6.252
11.793
19.759
22.124
2007
2008
2009
2010
2011
2012

PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Jun-12 Q2 12	Sep-12 Q3 12	Dec-12 Q4 12	Mar-13 Q1 13	Jun-13 Q2 13	Sep-13 Q3 13 E	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013 E
REVENUE											
Net Revenue	**13.58**	**10.80**	**8.27**	**8.97**	**11.22**	**10.75**	**23.5**	**46.2**	**47.3**	**43.4**	**42.44**
Sequential Growth		*-20%*	*-23%*	*9%*	*25%*	*-4%*					
OPERATING EXPENSES											
Cost of Revenues	7.38	6.04	4.76	4.87	5.75	5.60	15.7	24.1	24.4	24.3	22.22
% of Revenue	*54.4%*	*55.9%*	*57.6%*	*54.3%*	*51.3%*	*52.1%*	*66.8%*	*52.1%*	*51.6%*	*56.1%*	*52.4%*
Gross Profit -	**6.2**	**4.8**	**3.5**	**4.1**	**5.5**	**5.2**	**7.8**	**22.1**	**22.9**	**19.1**	**20.2**
Proforma Gross Margin	*45.6%*	*44.1%*	*42.4%*	*45.7%*	*48.7%*	*47.9%*	*33.2%*	*47.9%*	*48.4%*	*43.9%*	*47.6%*
R&D + Engg	0.98	1.01	0.99	1.00	0.93	0.98	2.4	3.0	3.2	3.9	4.051
% of Revenue	*7.2%*	*9.3%*	*11.9%*	*11.1%*	*8.2%*	*9.1%*	*10.3%*	*6.6%*	*6.9%*	*9.0%*	*9.5%*
SG&A	3.22	2.77	2.43	2.75	3.05	2.95	9.8	11.8	12	11.81	11.75
% of Revenue	*23.7%*	*25.6%*	*29.3%*	*30.6%*	*27.2%*	*27.4%*	*41.6%*	*25.4%*	*25.5%*	*27.2%*	*27.7%*
GW Amort, Restructuring, other	-	-	-	-	-	-	-	-		-	-
% of Revenue											
Total Operating Expenses	4.20	3.77	3.41	3.74	3.98	3.93	12.2	14.8	15	16	15.80
% of Revenue	*30.9%*	*34.9%*	*41.2%*	*41.7%*	*35.4%*	*36.6%*	*51.9%*	*32.0%*	*32%*	*36%*	*37.2%*
Operating Income -	**1.99**	**0.99**	**0.10**	**0.36**	**1.49**	**1.22**	**-4.4**	**7.4**	**7.6**	**3.36**	**4.42**
Operating Margin	*14.7%*	*9.2%*	*1.2%*	*4.1%*	*13.3%*	*11.3%*	*-19%*	*16%*	*16%*	*8%*	*10.4%*
NON-OPERATING ITEMS											
Non operating Income/Expense	0.00	0.02	0.02	0.01	0.00	0.00	-0.5	0.1	0	0.1	0.02
% of Revenue	*0.00%*	*0.21%*	*0.25%*	*0.07%*	*0.02%*	*0.02%*	*-2.17%*	*0.11%*	*0.17%*	*0.13%*	*0.04%*
Tax Provision	0.7	0.3	-0.1	0.1	0.5	0.3	-0.050	0.148	-2.204	0.9	1.1
Effective Tax Rate											
Net Income -	**1.33**	**0.66**	**0.20**	**0.29**	**1.01**	**0.92**	**-4.83**	**7.25**	**9.9**	**2.5**	**3.33**
Net Income Margin	*9.8%*	*6.1%*	*2.4%*	*3.3%*	*9.0%*	*8.5%*	*-20.6%*	*15.7%*	*21%*	*6%*	*7.8%*
Adjustments (for one-time NR items)	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**			**0.29**	**0.07**	**0.00**
EARNINGS PER SHARE											
EPS - Basic	$0.13	$0.06	$0.02	$0.03	$0.10	$0.09	-$0.42	$0.72	$0.66	$0.28	$0.32
EPS - Diluted	$0.13	$0.06	$0.02	$0.03	$0.10	$0.09	-$0.42	$0.72	$0.66	$0.28	$0.32

Ken Nagy, CFA Zacks Investment Research 8/3/2012

HISTORICAL ZACKS RECOMMENDATIONS



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