Zacks Small-Cap Research

August 5, 2011
Ken Nagy, CFA

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

inTEST Corporation (INTT-NASDAQ)

INTT: Thermal Continues to Grow - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	07/27/2010
Current Price (08/04/11)	$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	**$4.54**
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	**4.9**
P/E using 2011 Estimate	**4.7**
P/E using 2012 Estimate	**4.0**
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	12.5 E	13.0 E	51.0 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	$0.26 A	$0.16 E	$0.18 E	$0.73 E
2012					$0.86 E

© Copyright 2011, Zacks Investment Research. All Rights Reserved.

WHATS NEW

On August 3, 2011 inTEST Corp., reported financial results for its fiscal 2011 second quarter, ended June 30, 2011.

A solid second quarter resulted in bookings, net revenues and net earnings all improving on a sequential basis. The healthy sequential results were driven by a continued strong thermal group which the Company has strategically diversified to address growth markets in both the semiconductor and non-semiconductor areas, which include the aerospace, automotive, defense, medical pharmaceutical and telecommunications areas.

InTEST's second quarter revenues increased 18 percent sequentially to $13.8 million, compared to first quarter revenues of $11.704 million for the three months ended March 31, 2011. Second quarter revenues decreased nearly 10 percent year over year, with revenue dropping $1.460 million from $15.260 million for the three months ended June 30, 2010, which was a pull in quarter. Year over year comparisons are difficult given the second quarter of 2010 was a significant pull in quarter after the downturn of 2009.

The Company's second quarter net income increased sequentially by over 100 percent or $1.398 million from net earnings of $1.257 million for the first quarter, ended March 31, 2011. Net income for the quarter came in weaker year over year, falling $433,000 to $2.655 million. This compares to net income of $3.168 million for the second quarter of 2010.

Gross margin was solid, increasing both sequentially and year over year. Gross margin for the three months ended June 30, 2011 was 49 percent compared to 44 percent for the first quarter, ended March 31, 2011 and 48 percent year over year.

The sequential improvement in gross margin was primarily due to a decrease in fixed manufacturing costs. This decrease, in turn, was driven by a reduction in run expense due to the relocation of inTEST's mechanical and thermal operations during the first quarter of 2011, and a reduction in unapplied labor in the Company's thermal segment.

Company bookings for the second quarter increased, marking inTest's third quarter of consecutive bookings growth. Booking for the second quarter grew $0.4 million or 3 percent in the second quarter to $13.5 million as compared with first quarter bookings of $13.1 million.

Correspondingly, in the second quarter, the Company's non-semiconductor related bookings grew to 28% from 18% in the first quarter. This increase further diversifies inTEST's product mix by somewhat offsetting any softening of the semiconductor industry order rate.

Looking forward, the Company is confident that its long-term growth prospects remain positive and that 2011 total revenue and earnings per share will exceed that of 2010.Likewise, management provided guidance for the Company's third quarter, ended September 30, 2011. Revenues for the three months are expected to be between $12 million and $13 million, or an approximately 10.6 percent year over year increase from 2010 revenues at the midpoint of the range. Net earnings for the quarter ended September 30, 2011 is anticipated to be between $0.13 and $0.18 per diluted

share, which would represent an 8.8 percent year over year decrease from the Company's 2010 net income per diluted share at the midpoint of the range.

Still, it should be noted that inTEST anticipates third quarter 2011 material costs, as a percentage of revenue, to increase by approximately 100 basis points. This increase in costs is expected as a result of a change in the anticipated product mix in the Company's thermal products segment. Furthermore, guidance for the third quarter 2011 precedes any effect to a possible reversal of deferred tax asset valuation allowances.

INVESTMENT THESIS

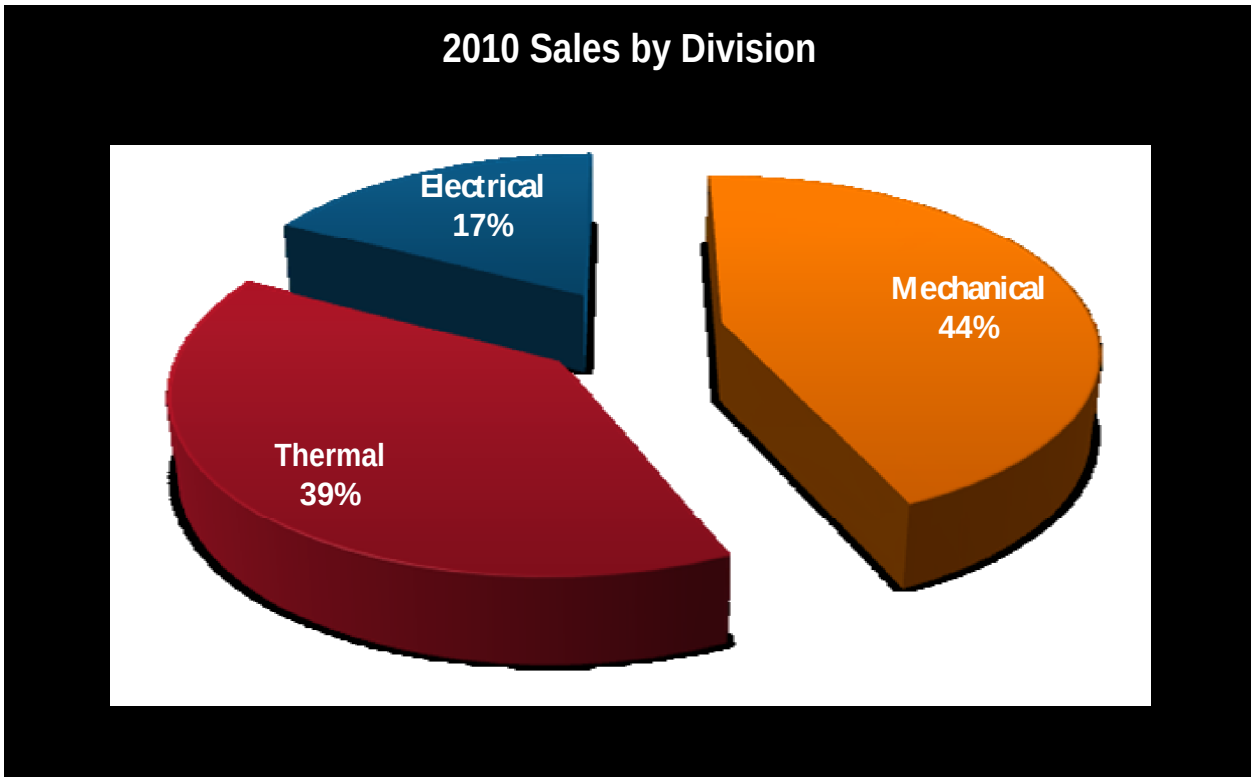
inTEST Corporation is a designer, manufacturer and marketer of mechanical, thermal and electrical products that are used by semiconductor manufacturers in conjunction with automatic test equipment, (ATE), in the testing of integrated circuits, (ICs). Beyond its blue chip portfolio of semiconductor manufacturers, 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, 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.)

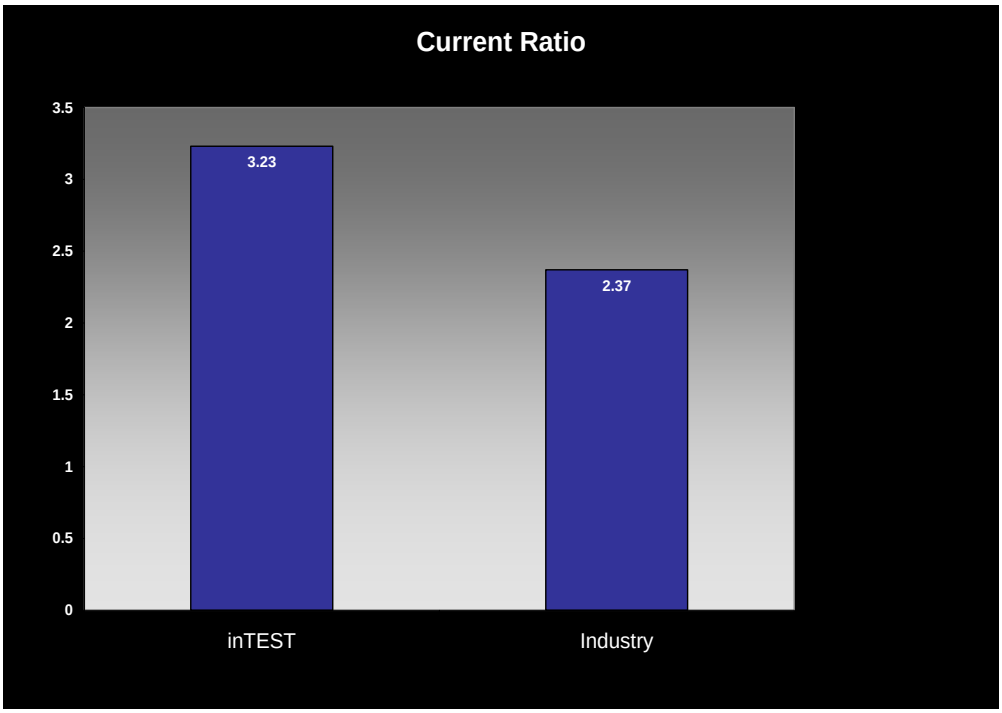
While not as popular as Price/Earnings or Price/BV, Price/Sales is not influenced by accounting decisions in depreciation, inventory and extraordinary charges. P/S multiples are much less volatile than P/E multiples. However if the problem with the firm lies in cost control the P/S ratio will not reflect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

The firm appears undervalued compared to the industry.

Metric	inTEST	Industry Average
P/E TTM	4.98	14.62
P/E 2011 (E)	4.71	14.13
P/E 2012 (E)	4.00	13-15
P/S	0.72	0.95

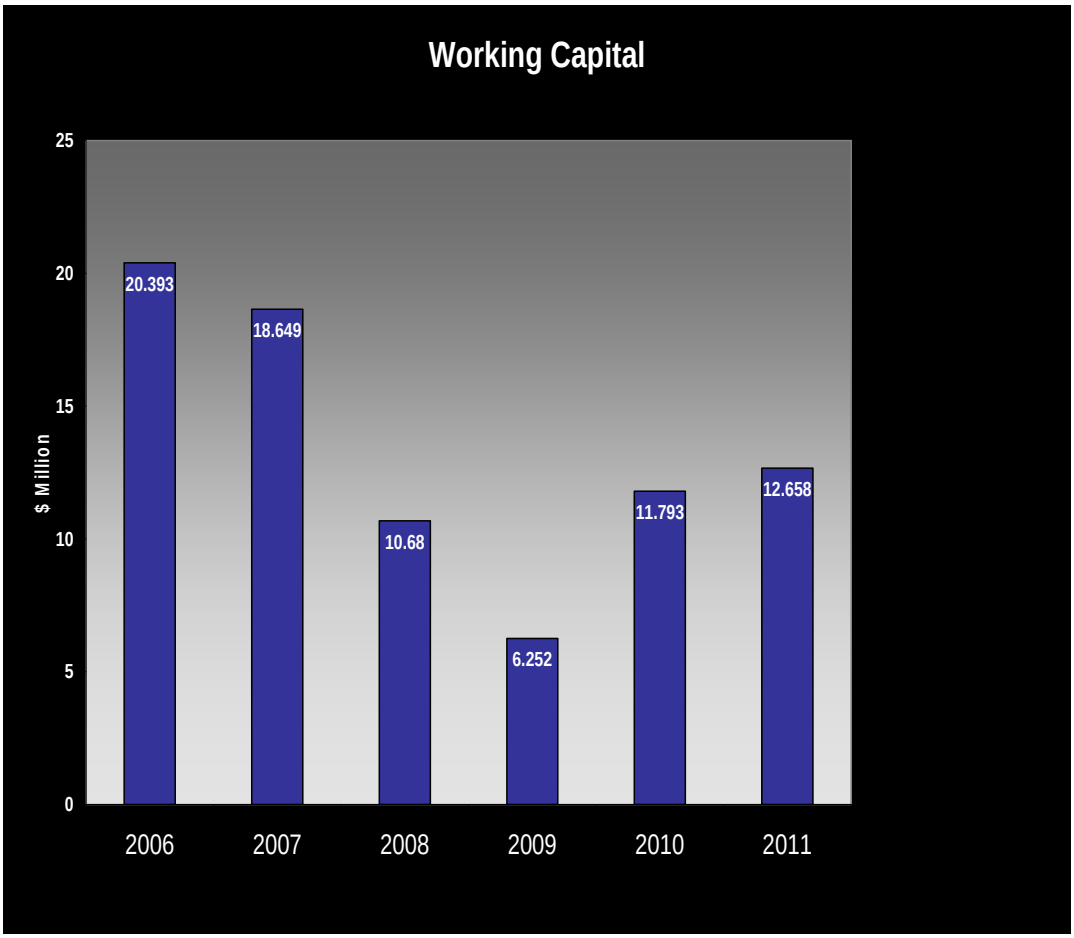
*source for background on valuation models: Investment Valuation, Aswath Damodaran

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.


Working Capital
$ Million
25
20
15
10
5
0
20.393
18.649
10.68
6.252
11.793
12.658
2006
2007
2008
2009
2010
2011

PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Jun-10 Q2 10	Sep-10 Q3 10	Dec-10 Q4 10	Mar-11 Q1 11	Jun-11 Q2 11	Sep-11 Q3 11 E	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 E	FY 2012 E
REVENUE												
Net Revenue	**15.26**	**11.31**	**10.11**	**11.70**	**13.80**	**12.50**	**48.7**	**38.8**	**23.5**	**46.2**	**51.0**	**55.0**
Sequential Growth		*-26%*	*-11%*	*16%*	*18%*	*-9%*						
OPERATING EXPENSES												
Cost of Revenues	7.89	5.85	5.32	6.61	7.00	6.75	29.9	25.0	15.7	24.1	27.2	28.3
% of Revenue	*51.7%*	*51.8%*	*52.6%*	*56.5%*	*50.7%*	*54.0%*	*61.4%*	*64.4%*	*66.8%*	*52.1%*	*53.4%*	*51.5%*
Gross Profit -	**7.4**	**5.5**	**4.8**	**5.1**	**6.8**	**5.8**	**18.8**	**13.8**	**7.8**	**22.1**	**23.8**	**26.7**
Proforma Gross Margin	*48.3%*	*48.2%*	*47.4%*	*43.5%*	*49.3%*	*46.0%*	*38.6%*	*35.6%*	*33.2%*	*47.9%*	*46.6%*	*48.5%*
R&D + Engg	0.79	0.77	0.79	0.81	0.82	0.82	5.5	5.1	2.4	3.0	3.4	4.0
% of Revenue	*5.2%*	*6.8%*	*7.8%*	*6.9%*	*6.0%*	*6.6%*	*11.3%*	*13.0%*	*10.3%*	*6.6%*	*6.6%*	*7.3%*
SG&A	3.41	3.00	2.64	3.02	3.25	3.20	16.7	15.9	9.8	11.8	13	14
% of Revenue	*22.3%*	*26.5%*	*26.1%*	*25.8%*	*23.6%*	*25.6%*	*34.4%*	*41.1%*	*41.6%*	*25.4%*	*25.0%*	*25.5%*
GW Amort, Restructuring, other								-	-	-		
% of Revenue												
Total Operating Expenses	4.19	3.77	3.42	3.83	4.08	4.02	22.2	21.0	12.2	14.8	16	18
% of Revenue	*27.5%*	*33.3%*	*33.9%*	*32.7%*	*29.5%*	*32.2%*	*45.7%*	*54.1%*	*51.9%*	*32.0%*	*32%*	*33%*
Operating Income -	**3.17**	**1.69**	**1.36**	**1.26**	**2.72**	**1.73**	**-3.5**	**-7.2**	**-4.4**	**7.4**	**7.7**	**8.7**
Operating Margin	*20.8%*	*14.9%*	*13.5%*	*10.8%*	*19.7%*	*13.8%*	*-7%*	*-19%*	*-19%*	*16%*	*15%*	*16%*
NON-OPERATING ITEMS												
Non operating Income/Expense	-0.01	0.01	0.06	0.06	0.01	0.01	-3.0	-1.9	-0.5	0.1	0	0
% of Revenue	*-0.05%*	*0.07%*	*0.60%*	*0.48%*	*0.07%*	*0.08%*	*-6.12%*	*-4.80%*	*-2.17%*	*0.11%*	*0.59%*	*0.27%*
Tax Provision	0.0	0.0	0.1	0.1	0.1	0.1	0.050	0.270	-0.050	0.148	0.400	0.020
Effective Tax Rate												
Net Income -	**3.16**	**1.68**	**1.29**	**1.26**	**2.66**	**1.66**	**-6.49**	**-9.33**	**-4.83**	**7.25**	**7.6**	**8.8**
Net Income Margin	*20.7%*	*14.8%*	*12.8%*	*10.7%*	*19.2%*	*13.3%*	*-13.3%*	*-24.1%*	*-20.6%*	*15.7%*	*15%*	*16%*
Adjustments				**0.01**								
EARNINGS PER SHARE												
EPS - Basic	$0.32	$0.17	$0.13	$0.14	$0.26	$0.16	$0.13	$0.15	-$0.42	$0.72	$0.75	$0.86
EPS - Diluted	$0.31	$0.17	$0.13	$0.13	$0.26	$0.16	$0.11	$0.14	-$0.42	$0.72	$0.74	$0.86

Ken Nagy, CFA Zacks Investment Research 8/4/2011

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 1033 companies covered: Buy/Outperform- 14.1%, Hold/Neutral- 78.3%, Sell/Underperform – 6.3%. Data is as of midnight on the business day immediately prior to this publication.