Zacks Small-Cap Research

May 7, 2013
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inTEST Corporation (INTT-NASDAQ)

INTT: 14 Straight Profitable Quarters - OUTPERFORM

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.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	07/27/2010
Current Price (05/06/13)	$3.11
Target Price	**$7.00**

SUMMARY DATA

52-Week High	**$3.82**
52-Week Low	**$2.38**
One-Year Return (%)	**-17.90**
Beta	**1.29**
Average Daily Volume (sh)	**9,819**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$32**
Short Interest Ratio (days)	**0.98**
Institutional Ownership (%)	**39**
Insider Ownership (%)	**20**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**8.2**
Earnings Per Share (%)	**-29.6**
Dividend (%)	**N/A**
P/E using TTM EPS	**12.9**
P/E using 2013 Estimate	**10.7**
P/E using 2014 Estimate	**10.0**
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)
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	10.0 E	10.5 E	11.0 E	40.9 E
2014					45.0 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	$0.08 A	$0.70 A
2012	$0.07 A	$0.13 A	$0.06 A	$0.02 A	$0.28 A
2013	$0.03 A	$0.07 E	$0.09 E	$0.10 E	$0.29 E
2014					$0.31 E

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WHATS NEW

Over the last few years inTEST Corporation has been transforming itself through the strategic diversification of its Thermal products segment.

The idea of the transformation is that a diversification strategy outside of inTest's traditional semiconductor markets should help to mitigate the cyclicality tied to that industry and give 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.

In Short, traditional semiconductor markets are quite volatile. inTEST has been building this business to ensure their earnings are not. It worked!

For proof of what has taken place, look no further than the first quarter earnings release. While industry conditions remain challenging as a result of a number of capital equipment suppliers and semiconductor companies delaying certain capital expenditures, inTEST maintained profitability, generated cash, and continues to carry no debt.

Solid Quarter

On May 1, 2013, inTEST Corporation, reported financial results for its fiscal 2013 first quarter, ended March 31, 2013.

Revenues during the first quarter 2013 were $8.973 million, at the top end of management's guidance. This compares to revenues of $8.270 million for the three months ended December 31, 2012 and revenues of $10.731 million during the first quarter ended March 31, 2012.

In addition to sequential consolidated revenue growth, revenues in each of inTest's operating segments grew sequentially as well.

19 percent of first quarter 2013 net revenues were derived from non-semiconductor test compared to 15 percent of fourth quarter 2012 net revenues being derived from non-semiconductor test. Sequentially, first quarter non-semiconductor test net revenues increased 31 percent.

inTEST reported first quarter bookings were $7.7 million, down from fourth quarter 2012 bookings of $9.3 million and from first quarter 2012 bookings of $12.9 million.

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

Backlog at the end of the first quarter was $2.9 million, down from $4.2 million at the end of the fourth quarter.

Gross margin during the first quarter jumped to 45.8 percent compared to 42.4 percent from the fourth quarter fiscal 2012 and 42.8 percent for the three months ended March 31, 2012.

The increase in gross margin was driven by a more favorable absorption of fixed manufacturing cost in the

first quarter of 2013, which decreased from 20 percent of revenues in the fourth quarter to 16 percent of revenues in the first quarter.

inTEST reported first quarter 2013 net income of $292,000 compared to fourth quarter 2012 net income 201,000 and a net loss of $43,000 for the three months ended March 31,2012.

Based on a weighted average number of diluted shares outstanding of 10.366 million, diluted net income per share resulted in net income of $0.03 per share for the quarter. This compared to diluted net income per share of $0.02 on a weighted average number of diluted shares of 10.344 million during the three months, ended December 31, 2012 and a diluted net loss per share of $0.00 on a weighted average number of diluted shares of 10.205 million during the first quarter ended March 31, 2012.

inTEST's balance sheet remained solid during the first quarter with cash and equivalents of $15.384 million and working capital of $21.572 million. This compares to $15.576 million in cash and equivalents and working capital of $21.000 million for the period ended December 31, 2012.

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

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 last year.

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 past sales channel integration and Thermal product consolidation.

The Company 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 second quarter ending June 30, 2013 will be in the range of $9.5 million to $10.5 million and that net earnings will range from $0.05 to $0.09 per diluted share.

Similarly, management has been encouraged by the fact that it saw strengthening in the business early in the second quarter of 2013 and expects a recovery in the second half of 2013.

Likewise, inTEST has been profitable for the past 14 quarters, including a breakeven quarter in Q1 of 2012, and continues to generate cash which management expects to continue both trends through 2013.

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	3.55	7.80

Metric	inTEST	Industry Average
P/E TTM	12.9	18.10
P/E 2013 (E)	10.7	16.80
P/E 2014 (E)	10.0	13-15
P/S	0.77	3.00

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.

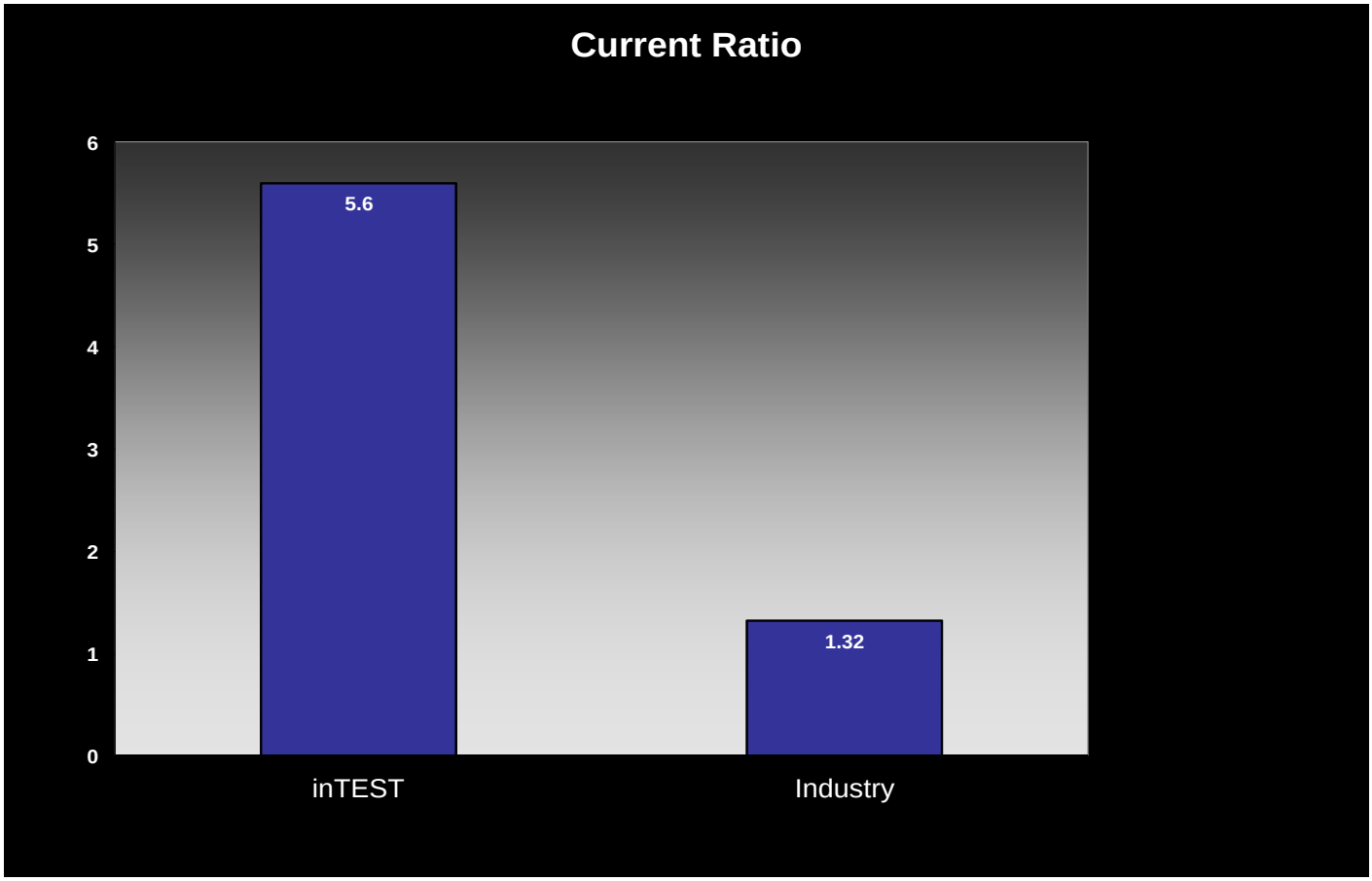
Weakness of the Model
As you add more layers to the model it is more sensitive to the assumptions you make. The growth may look more “lumpy” than we have it in the model.

Output
We used the following inputs:

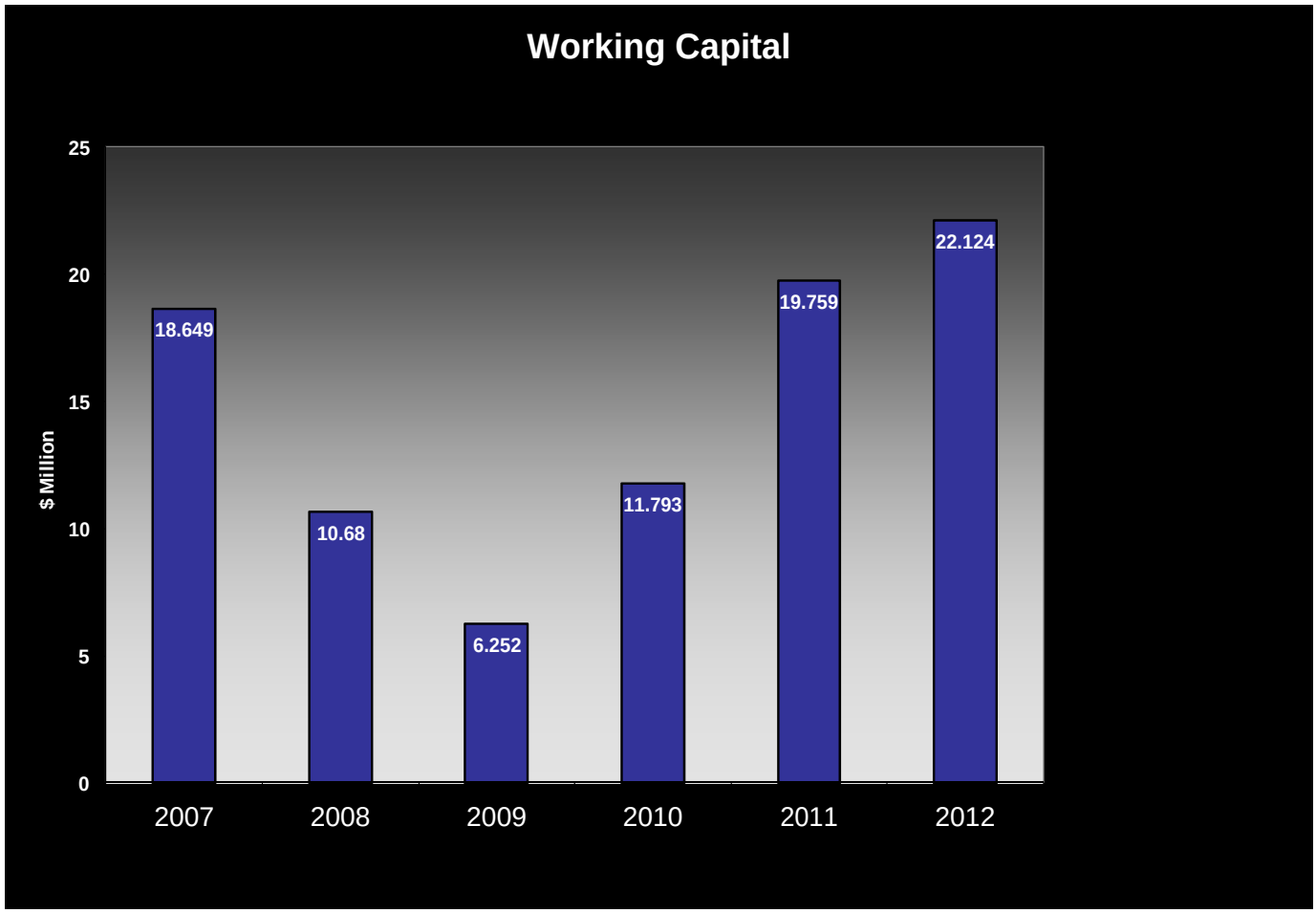
- A 5-year period with an earnings growth rate of 8.0% and a discount rate of 13.77%.

- 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 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)	Mar-12 Q1 12	Jun-12 Q2 12	Sep-12 Q3 12	Dec-12 Q4 12	Mar-13 Q1 13	Jun-13 Q2 13 E	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013 E
REVENUE											
Net Revenue	**10.73**	**13.58**	**10.80**	**8.27**	**8.97**	**10.00**	**23.5**	**46.2**	**47.3**	**43.4**	**40.97**
Sequential Growth		*27%*	*-20%*	*-23%*	*9%*	*11%*					
OPERATING EXPENSES											
Cost of Revenues	6.14	7.38	6.04	4.76	4.87	5.38	15.7	24.1	24.4	24.3	21.74
% of Revenue	*57.2%*	*54.4%*	*55.9%*	*57.6%*	*54.3%*	*53.8%*	*66.8%*	*52.1%*	*51.6%*	*56.1%*	*53.1%*
Gross Profit -	**4.6**	**6.2**	**4.8**	**3.5**	**4.1**	**4.6**	**7.8**	**22.1**	**22.9**	**19.1**	**19.2**
Proforma Gross Margin	*42.8%*	*45.6%*	*44.1%*	*42.4%*	*45.7%*	*46.3%*	*33.2%*	*47.9%*	*48.4%*	*43.9%*	*46.9%*
R&D + Engg	0.92	0.98	1.01	0.99	1.00	1.05	2.4	3.0	3.2	3.9	4.196
% of Revenue	*8.6%*	*7.2%*	*9.3%*	*11.9%*	*11.1%*	*10.5%*	*10.3%*	*6.6%*	*6.9%*	*9.0%*	*10.2%*
SG&A	3.40	3.22	2.77	2.43	2.75	2.65	9.8	11.8	12	11.81	11.15
% of Revenue	*31.7%*	*23.7%*	*25.6%*	*29.3%*	*30.6%*	*26.5%*	*41.6%*	*25.4%*	*25.5%*	*27.2%*	*27.2%*
GW Amort, Restructuring, other	*0.36*	-	-	-	-	-	-	-		-	-
% of Revenue											
Total Operating Expenses	4.68	4.20	3.77	3.41	3.74	3.70	12.2	14.8	15	16	15.34
% of Revenue	*43.6%*	*30.9%*	*34.9%*	*41.2%*	*41.7%*	*37.0%*	*51.9%*	*32.0%*	*32%*	*36%*	*37.4%*
Operating Income -	**-0.08**	**1.99**	**0.99**	**0.10**	**0.36**	**0.93**	**-4.4**	**7.4**	**7.6**	**3.36**	**3.89**
Operating Margin	*-0.8%*	*14.7%*	*9.2%*	*1.2%*	*4.1%*	*9.3%*	*-19%*	*16%*	*16%*	*8%*	*9.5%*
NON-OPERATING ITEMS											
Non operating Income/Expense	0.01	0.00	0.02	0.02	0.01	0.02	-0.5	0.1	0	0.1	0.03
% of Revenue	*0.12%*	*0.00%*	*0.21%*	*0.25%*	*0.07%*	*0.20%*	*-2.17%*	*0.11%*	*0.17%*	*0.13%*	*0.08%*
Tax Provision	0.0	0.7	0.3	-0.1	0.1	0.2	-0.050	0.148	-2.204	0.9	1.0
Effective Tax Rate											
Net Income -	**-0.04**	**1.33**	**0.66**	**0.20**	**0.29**	**0.71**	**-4.83**	**7.25**	**9.9**	**2.5**	**2.94**
Net Income Margin	*-0.4%*	*9.8%*	*6.1%*	*2.4%*	*3.3%*	*7.1%*	*-20.6%*	*15.7%*	*21%*	*6%*	*7.2%*
Adjustments (for one-time NR items)	**0.07**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**			**0.29**	**0.07**	**0.00**
EARNINGS PER SHARE											
EPS - Basic	$0.07	$0.13	$0.06	$0.02	$0.03	$0.07	-$0.42	$0.72	$0.70	$0.28	$0.29
EPS - Diluted	$0.07	$0.13	$0.06	$0.02	$0.03	$0.07	-$0.42	$0.72	$0.69	$0.28	$0.28

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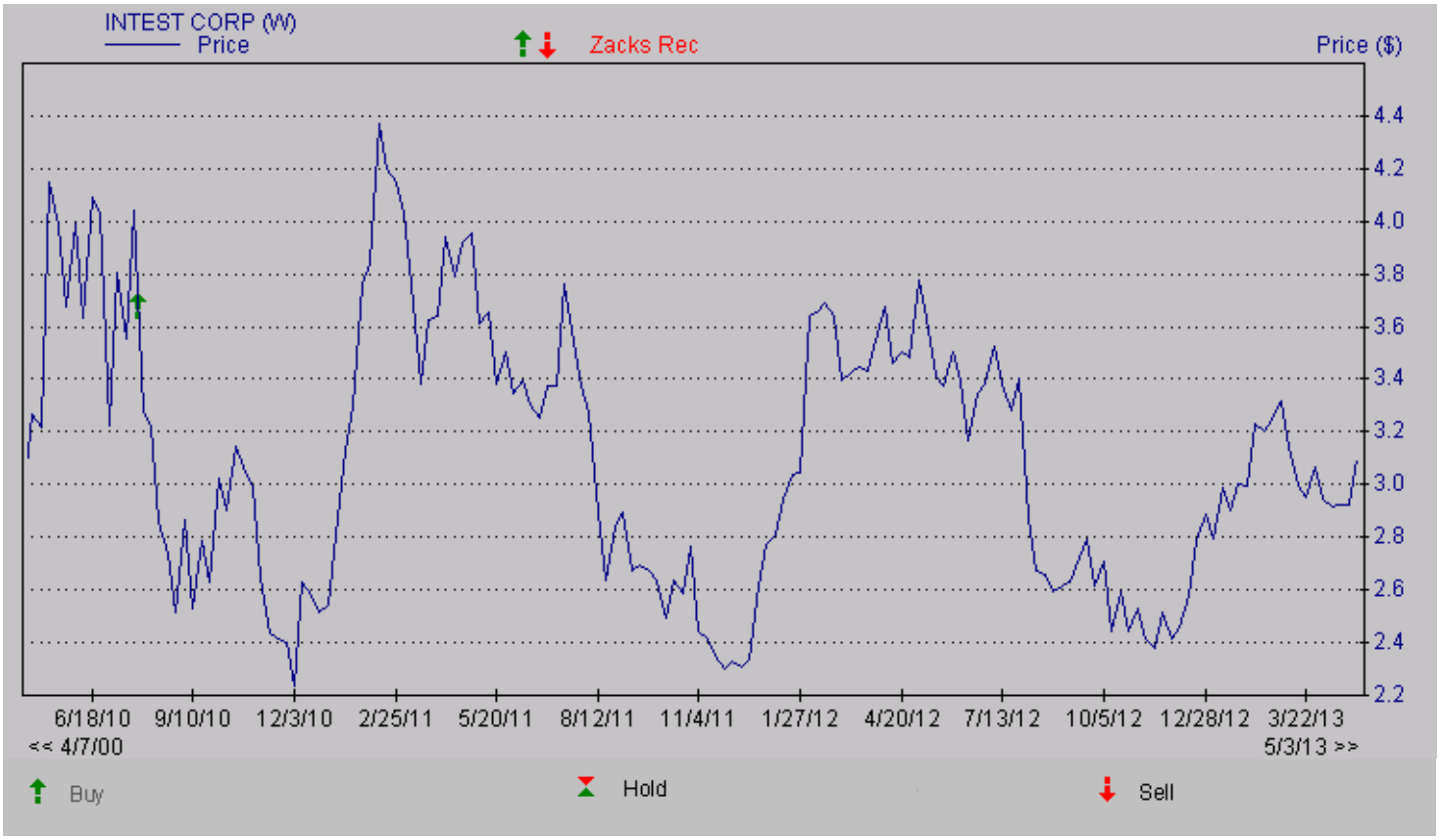
HISTORICAL ZACKS RECOMMENDATIONS



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