Zacks Small-Cap Research

November 4, 2011
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inTEST Corporation (INTT-NASDAQ)

INTT: Wake up, This Stock is Under Valued!- OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	07/27/2010
Current Price (11/03/11)	$2.71
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	**$2.24**
One-Year Return (%)	**3.83**
Beta	**1.27**
Average Daily Volume (sh)	**22,518**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$28**
Short Interest Ratio (days)	**1.55**
Institutional Ownership (%)	**23**
Insider Ownership (%)	**21**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-9.9**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**3.6**
P/E using 2011 Estimate	**3.8**
P/E using 2012 Estimate	**3.6**
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)
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	11.7 A	9.8 E	46.9 E
2012					51.0 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	$0.22 A	$0.10 E	$0.71 E
2012					$0.76 E

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WHATS NEW

On November 2, 2011, inTest Corporation, reported financial results for its fiscal 2011 third quarter and nine months, ended September 30, 2011.

A solid third quarter by the Company resulted in quarterly revenues increasing by 3.3 percent or $376,000 year over year to $11.681 million, which compares to revenues of $11.305 million for the three months ended September 30, 2010.

inTest reported that third quarter bookings were $10.5 million, down from its second quarter 2011 bookings of $13.5 million but up year over year compared to its third quarter 2010 bookings of $9.8 million.

inTest's third quarter 2011 net income soared $3.504 million to $5.182 million from $1.678 million during the three months ended September 30, 2010. Still, third quarter net earnings per share would have resulted in $0.22 per diluted share absent the valuation allowance as the impact of the reversal of the valuation allowance increased diluted net earnings per share by $0.28 per diluted share.

The jump in year over year net income was primarily due to improved gross margin as well as a reversal of the valuation allowance against deferred tax assets resulting in an income tax benefit of $2.762 million in the third quarter of 2011 compared to an income tax expense of $16,000 for the comparable quarter of 2010.

Gross margin increased year over year from 48.2 percent to 52.5 percent for the three months ended September 30, 2011.The increase in gross margin was mainly due to a more favorable product mix in the Company's Mechanical Products segment.

Based on a weighted average number of diluted shares outstanding of 10.297 million, diluted net income per share resulted in $0.50 per share. This compared to diluted net income per share of $0.17 on a weighted average number of diluted shares of 10.195 million during the three months ended September 30, 2010.

inTest's balance sheet continued to improve with cash and equivalents increasing sequentially by $3.185 million to $12.064 million and working capital improving by $3.007 million to $18.618 million for the period ended September 30, 2011.

The increase in cash was due to strong cash collections during the third quarter and management predicts that cash will increase to between $14 to $15 million by December 31, 2011.

Similarly, total stockholder's equity improved sequentially by over 25 percent or $5.146 million to $25.441 million.

Additionally, management reported that it anticipates net revenue for its fourth quarter ended December 31, 2011 will be in the range of $9.5 million to $10.5 million and that net earnings will be in the range of $0.03 to $0.10 per diluted share.

The Company further believes that the diversification of its served markets via its thermal group, improved efficiency and reduced operating costs attributable to its relocation of facilities are all strengths it can leverage moving forward. Along the same lines the Company continues to expand upon its diversification strategy by leveraging its thermal division and Sigma Systems acquisition.

inTest believes it continues to make significant process in diversifying its end market penetration through its thermal products which offer an effective way to expand the Company's available markets by acquiring non semiconductor business in the aerospace, automotive, medical and telecommunications markets.

As a result of this diversification strategy, non-semi related bookings consisted of 18 percent of the Company's consolidated bookings at the beginning of the year which compares to third quarter non-semi bookings comprising of 41 percent of inTest's consolidated bookings.

The Company expects this trend to continue and predicts that non semiconductor related products will play an even greater role in company's success going forward.

INVESTMENT THESIS

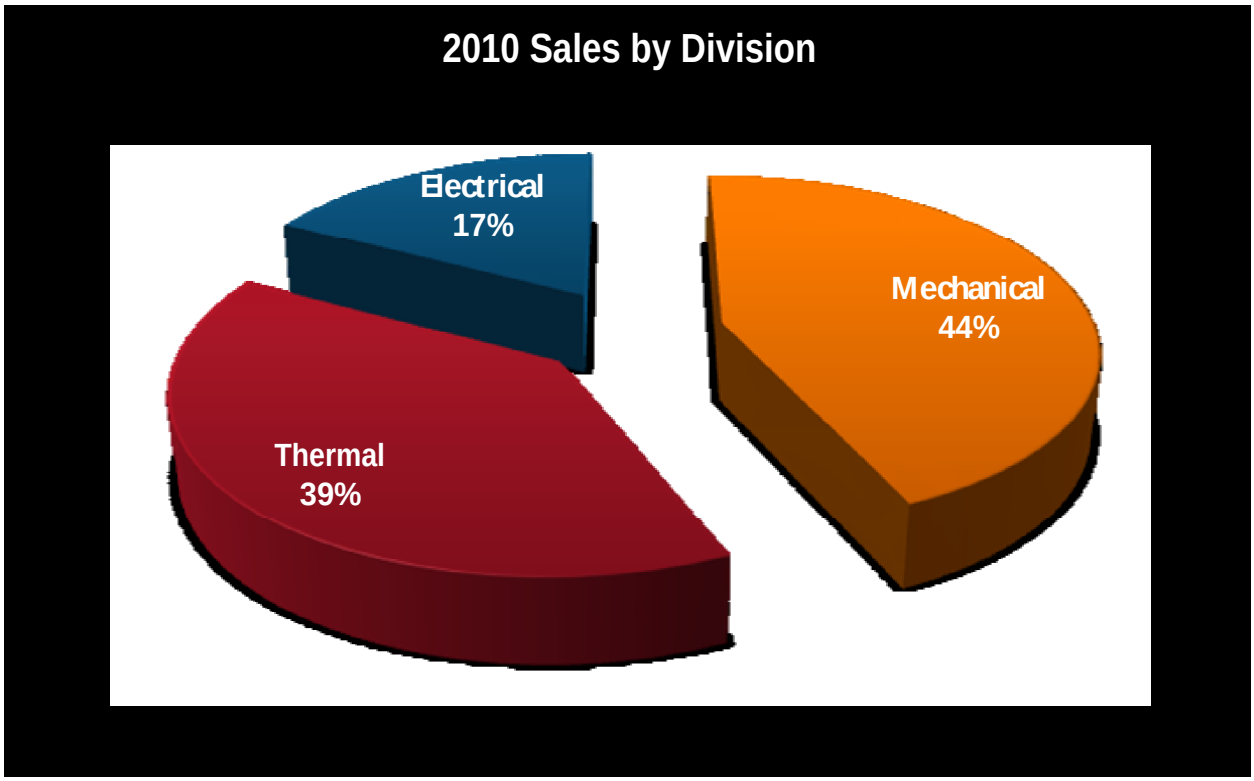
inTEST Corporation is a designer, manufacturer and marketer of mechanical, thermal and electrical products that are used by semiconductor manufacturers in conjunction with automatic test equipment, (ATE), in the testing of integrated circuits, (ICs). Beyond its blue chip portfolio of semiconductor manufacturers, 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. The ratio takes debt into account, which is an item which other multiples 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 2.54x compared to 4.79x for the industry. **According to the enterprise multiple INTT appears undervalued compared to industry.**

Metric	inTEST	Industry Average
EV/EBITDA	2.54	4.79

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.

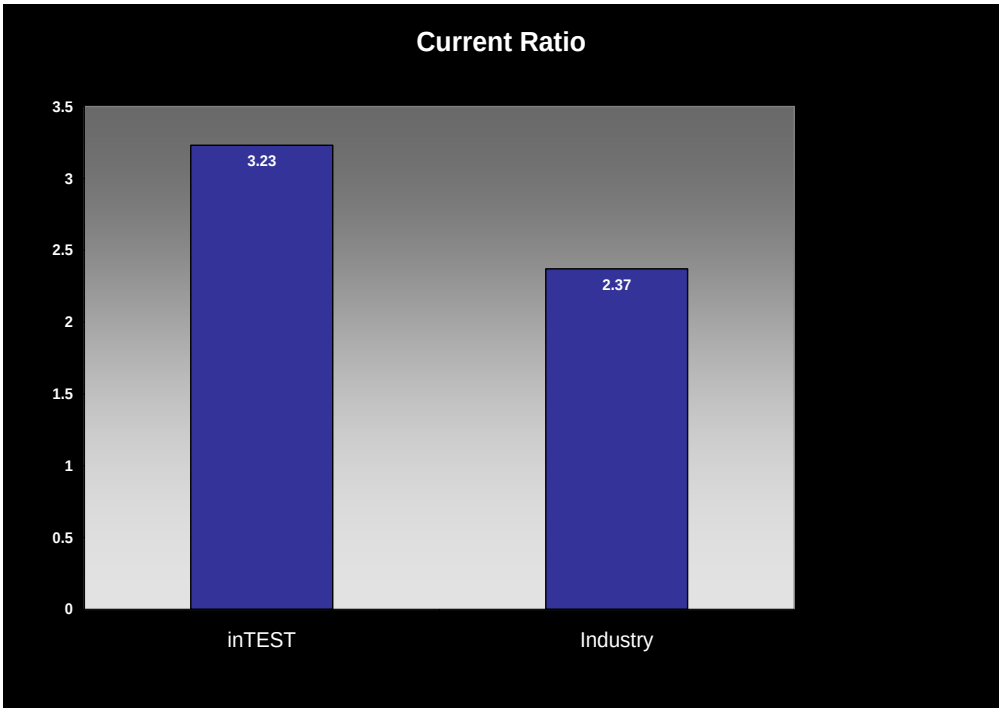
Price to Earnings Multiples/ Price to Sales Multiples
Due to its simplicity the Price/Earnings ratio is easily the most widely used metric in all of finance. The first strength of the model is that it is intuitive. It is simply the price paid for current earnings. It can also act as a proxy for other 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	3.56	14.07
P/E 2011 (E)	3.81	13.34
P/E 2012 (E)	3.56	13-15
P/S	0.61	0.95

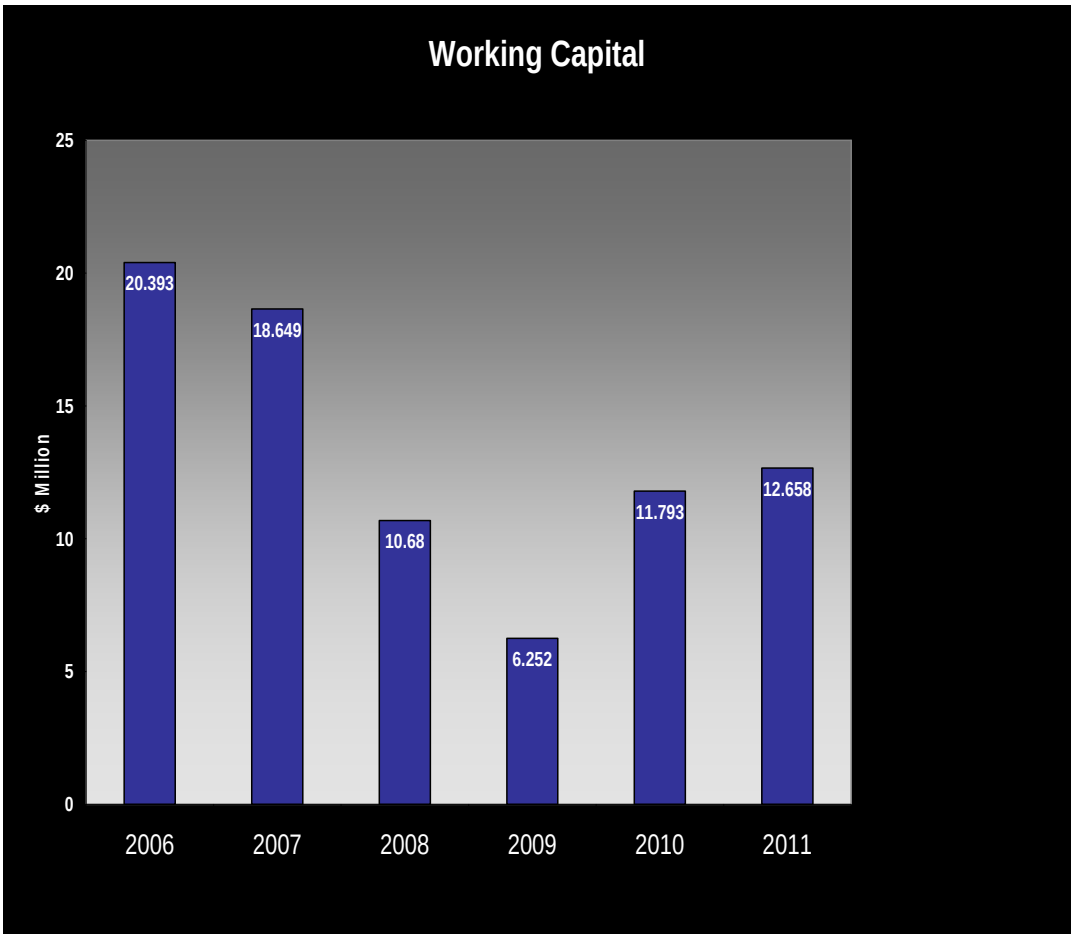
*source for background and General information on valuation models: Investment Valuation, Aswath Damodaran

Our price target of $7.00 per share is the average of 10.1x 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)	Sep-10 Q3 10	Dec-10 Q4 10	Mar-11 Q1 11	Jun-11 Q2 11	Sep-11 Q3 11	Dec-11 Q4 11 E	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 E	FY 2012 E
REVENUE												
Net Revenue	**11.31**	**10.11**	**11.70**	**13.80**	**11.68**	**9.75**	**48.7**	**38.8**	**23.5**	**46.2**	**46.9**	**51.0**
Sequential Growth		*-11%*	*16%*	*18%*	*-15%*	*-17%*						
OPERATING EXPENSES												
Cost of Revenues	5.85	5.32	6.61	7.00	5.55	5.00	29.9	25.0	15.7	24.1	24.2	25.3
% of Revenue	*51.8%*	*52.6%*	*56.5%*	*50.7%*	*47.5%*	*51.3%*	*61.4%*	*64.4%*	*66.8%*	*52.1%*	*51.5%*	*49.5%*
Gross Profit -	**5.5**	**4.8**	**5.1**	**6.8**	**6.1**	**4.8**	**18.8**	**13.8**	**7.8**	**22.1**	**22.8**	**25.8**
Proforma Gross Margin	*48.2%*	*47.4%*	*43.5%*	*49.3%*	*52.5%*	*48.7%*	*38.6%*	*35.6%*	*33.2%*	*47.9%*	*48.5%*	*50.5%*
R&D + Engg	0.77	0.79	0.81	0.82	0.81	0.80	5.5	5.1	2.4	3.0	3.2	3.6
% of Revenue	*6.8%*	*7.8%*	*6.9%*	*6.0%*	*6.9%*	*8.2%*	*11.3%*	*13.0%*	*10.3%*	*6.6%*	*6.9%*	*7.1%*
SG&A	3.00	2.64	3.02	3.25	2.91	2.90	16.7	15.9	9.8	11.8	12	13
% of Revenue	*26.5%*	*26.1%*	*25.8%*	*23.6%*	*24.9%*	*29.7%*	*34.4%*	*41.1%*	*41.6%*	*25.4%*	*25.7%*	*24.5%*
GW Amort, Restructuring, other								-	-	-		
% of Revenue												
Total Operating Expenses	3.77	3.42	3.83	4.08	3.72	3.70	22.2	21.0	12.2	14.8	15	16
% of Revenue	*33.3%*	*33.9%*	*32.7%*	*29.5%*	*31.8%*	*37.9%*	*45.7%*	*54.1%*	*51.9%*	*32.0%*	*33%*	*32%*
Operating Income -	**1.69**	**1.36**	**1.26**	**2.72**	**2.42**	**1.05**	**-3.5**	**-7.2**	**-4.4**	**7.4**	**7.4**	**9.7**
Operating Margin	*14.9%*	*13.5%*	*10.8%*	*19.7%*	*20.7%*	*10.8%*	*-7%*	*-19%*	*-19%*	*16%*	*16%*	*19%*
NON-OPERATING ITEMS												
Non operating Income/Expense	0.01	0.06	0.06	0.01	0.01	0.01	-3.0	-1.9	-0.5	0.1	0	0
% of Revenue	*0.07%*	*0.60%*	*0.48%*	*0.07%*	*0.04%*	*0.05%*	*-6.12%*	*-4.80%*	*-2.17%*	*0.11%*	*0.16%*	*0.29%*
Tax Provision	0.0	0.1	0.1	0.1	-2.8	0.0	0.050	0.270	-0.050	0.148	-2.614	2.000
Effective Tax Rate												
Net Income -	**1.68**	**1.29**	**1.26**	**2.66**	**5.18**	**1.05**	**-6.49**	**-9.33**	**-4.83**	**7.25**	**10.1**	**7.8**
Net Income Margin	*14.8%*	*12.8%*	*10.7%*	*19.2%*	*44.4%*	*10.7%*	*-13.3%*	*-24.1%*	*-20.6%*	*15.7%*	*22%*	*15%*
Adjustments			**0.01**		**0.28**						**0.29**	
EARNINGS PER SHARE												
EPS - Basic	$0.17	$0.13	$0.14	$0.26	$0.22	$0.10	$0.13	$0.15	-$0.42	$0.72	$0.72	$0.76
EPS - Diluted	$0.17	$0.13	$0.13	$0.26	$0.22	$0.10	$0.11	$0.14	-$0.42	$0.72	$0.71	$0.76

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HISTORICAL ZACKS RECOMMENDATIONS



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