

INTEST CORP  
Form 10-Q  
August 12, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013 or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-22529

inTEST Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware

22-2370659

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

804 East Gate Drive, Suite 200  
Mt. Laurel, New Jersey 08054

(Address of principal executive offices, including zip code)

(856) 505-8800

(Registrant's Telephone Number, including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (SS 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer   
Non-accelerated filer

Accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
YES  NO

Number of shares of Common Stock, \$.01 par value, outstanding as of the close of business on July 31, 2013:

10,472,678

inTEST CORPORATION

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## PART 1. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

inTEST CORPORATION  
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

|   | June 30,<br>2013 | Dec. 31,<br>2012 |
|---|------------------|------------------|
|   | -----            | -----            |
| ASSETS:   |                  |                  |
| Current assets:   |                  |                  |
| Cash and cash equivalents   | \$16,032         | \$15,576         |
| Trade accounts receivable, net of allowance for<br>doubtful accounts of \$147 and \$147, respectively | 7,233            | 5,501            |
| Inventories   | 3,360            | 3,135            |
| Deferred tax assets   | 925              | 1,004            |
|   | (Unaudited)      |                  |

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|  |                 |                 |
|--|-----------------|-----------------|
| Prepaid expenses and other current assets  | 246             | 363             |
| Total current assets   | <u>27,796</u>   | <u>25,579</u>   |
| Property and equipment:  |                 |                 |
| Machinery and equipment  | 3,919           | 3,948           |
| Leasehold improvements   | <u>594</u>      | <u>591</u>      |
| Gross property and equipment   | 4,513           | 4,539           |
| Less: accumulated depreciation   | <u>(3,376)</u>  | <u>(3,289)</u>  |
| Net property and equipment   | <u>1,137</u>    | <u>1,250</u>    |
| Deferred tax assets  | 943             | 1,034           |
| Goodwill   | 1,706           | 1,706           |
| Intangible assets, net   | 1,962           | 2,194           |
| Restricted certificates of deposit   | 450             | 450             |
| Other assets   | <u>184</u>      | <u>186</u>      |
| Total assets   | <u>\$34,178</u> | <u>\$32,399</u> |
|  | =====           | =====           |
| LIABILITIES AND STOCKHOLDERS' EQUITY   |                 |                 |
| Current liabilities:   |                 |                 |
| Accounts payable   | \$ 1,328        | \$ 1,041        |
| Accrued wages and benefits   | 1,321           | 1,562           |
| Accrued sales commissions  | 542             | 348             |
| Accrued rent   | 558             | 529             |
| Accrued professional fees  | 386             | 385             |
| Deferred revenue and customer deposits   | 198             | 255             |
| Domestic and foreign income taxes payable  | 338             | 83              |
| Other current liabilities  | <u>336</u>      | <u>376</u>      |
| Total current liabilities  | <u>5,007</u>    | <u>4,579</u>    |
|  |                 |                 |
| Commitments and contingencies (Notes 9 and 11)   |                 |                 |
| Stockholders' equity:  |                 |                 |
| Preferred stock, \$0.01 par value; 5,000,000 shares authorized;<br>no shares issued or outstanding                     | -               | -               |
| Common stock, \$0.01 par value; 20,000,000 shares authorized;<br>10,505,755 and 10,453,255 shares issued, respectively | 105             | 105             |
| Additional paid-in capital   | 26,118          | 26,030          |
| Retained earnings  | 1,931           | 636             |
| Accumulated other comprehensive earnings   | 1,221           | 1,253           |
| Treasury stock, at cost; 33,077 and 33,077 shares, respectively  | <u>(204)</u>    | <u>(204)</u>    |
| Total stockholders' equity   | <u>29,171</u>   | <u>27,820</u>   |
| Total liabilities and stockholders' equity   | <u>\$34,178</u> | <u>\$32,399</u> |
|  | =====           | =====           |

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)  
(Unaudited)

| Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |
|--------------------------------|-------|------------------------------|-------|
| -----                          | ----- | -----                        | ----- |
| 2013                           | 2012  | 2013                         | 2012  |
| -----                          | ----- | -----                        | ----- |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Net revenues  | \$11,218   | \$13,576   | \$20,191   | \$24,307   |
| Cost of revenues  | 5,753      | 7,382      | 10,621     | 13,517     |
|   | -----      | -----      | -----      | -----      |
| Gross margin  | 5,465      | 6,194      | 9,570      | 10,790     |
|   | -----      | -----      | -----      | -----      |
| Operating expenses:   |            |            |            |            |
| Selling expense   | 1,528      | 1,555      | 2,717      | 2,961      |
| Engineering and product development expense                                       | 925        | 980        | 1,921      | 1,904      |
| General and administrative expense  | 1,523      | 1,665      | 3,079      | 3,656      |
| Restructuring and other charges   | -          | -          | -          | 359        |
|   | -----      | -----      | -----      | -----      |
| Total operating expenses  | 3,976      | 4,200      | 7,717      | 8,880      |
|   | -----      | -----      | -----      | -----      |
| Operating income  | 1,489      | 1,994      | 1,853      | 1,910      |
| Other income (expense)  | (2)        | -          | 4          | 13         |
|   | -----      | -----      | -----      | -----      |
| Earnings before income tax expense  | 1,487      | 1,994      | 1,857      | 1,923      |
| Income tax expense  | 484        | 660        | 562        | 632        |
|   | -----      | -----      | -----      | -----      |
| Net earnings  | \$ 1,003   | \$ 1,334   | \$ 1,295   | \$ 1,291   |
|   | =====      | =====      | =====      | =====      |
| Net earnings per common share - basic   | \$0.10     | \$0.13     | \$0.13     | \$0.13     |
| Weighted average common shares outstanding - basic                                | 10,371,716 | 10,273,812 | 10,349,695 | 10,239,463 |
| Net earnings per common share - diluted   | \$0.10     | \$0.13     | \$0.13     | \$0.13     |
| Weighted average common shares and common share equivalents outstanding - diluted | 10,394,094 | 10,359,657 | 10,380,279 | 10,342,014 |

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)  
(Unaudited)

|                    |                  |
|--------------------|------------------|
| Three Months Ended | Six Months Ended |
| June 30,           | June 30,         |
| -----              | -----            |

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|  | 2013     | 2012     | 2013     | 2012     |
|--|----------|----------|----------|----------|
|  | -----    | -----    | -----    | -----    |
| Net earnings                             | \$ 1,003 | \$ 1,334 | \$ 1,295 | \$ 1,291 |
| Foreign currency translation adjustments | 30       | (89)     | (32)     | (42)     |
|  | -----    | -----    | -----    | -----    |
| Comprehensive earnings                   | \$ 1,033 | \$ 1,245 | \$ 1,263 | \$ 1,249 |
|  | =====    | =====    | =====    | =====    |

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(In thousands, except share data)  
(Unaudited)

|   | Common Stock |        | Additional | Retained | Accumulated | Treasury | Total         |
|---|--------------|--------|------------|----------|-------------|----------|---------------|
|   | Shares       | Amount | Paid-In    | Earnings | Other       | Stock    | Stockholders' |
|   | -----        | -----  | -----      | -----    | -----       | -----    | -----         |
| Balance, January 1, 2013  | 10,453,255   | \$ 105 | \$26,030   | \$ 636   | \$1,253     | \$ (204) | \$27,820      |
| Net earnings  | -            | -      | -          | 1,295    | -           | -        | 1,295         |
| Other comprehensive loss  | -            | -      | -          | -        | (32)        | -        | (32)          |
| Amortization of deferred compensation related to restricted stock | -            | -      | 58         | -        | -           | -        | 58            |
| Issuance of non-vested shares of restricted stock                 | 42,500       | -      | -          | -        | -           | -        | -             |
| Stock options exercised   | 10,000       | -      | 30         | -        | -           | -        | 30            |
|   | -----        | -----  | -----      | -----    | -----       | -----    | -----         |
| Balance, June 30, 2013  | 10,505,755   | \$ 105 | \$26,118   | \$ 1,931 | \$1,221     | \$ (204) | \$29,171      |
|   | =====        | =====  | =====      | =====    | =====       | =====    | =====         |

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)  
(Unaudited)

|   | Six Months Ended<br>June 30, |          |
|---|------------------------------|----------|
|   | 2013                         | 2012     |
|   | -----                        | -----    |
| CASH FLOWS FROM OPERATING ACTIVITIES  |                              |          |
| Net earnings  | \$ 1,295                     | \$ 1,291 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                              |          |
| Depreciation and amortization   | 426                          | 471      |
| Provision for excess and obsolete inventory   | 197                          | 358      |
| Foreign exchange (gain) loss  | 14                           | (1)      |
| Amortization of deferred compensation related to restricted stock                   | 58                           | 61       |
| Profit sharing expense funded through the issuance of treasury stock                | -                            | 75       |
| Loss on sale of property and equipment  | 6                            | 10       |
| Proceeds from sale of demonstration equipment, net of gain                          | 3                            | 73       |
| Deferred income tax expense   | 170                          | 372      |
| Changes in assets and liabilities:  |                              |          |
| Trade accounts receivable   | (1,753)                      | (1,921)  |
| Inventories   | (423)                        | (42)     |
| Prepaid expenses and other current assets   | 116                          | 50       |
| Restricted certificates of deposit  | -                            | 50       |
| Other assets  | -                            | (17)     |
| Accounts payable  | 287                          | 1,010    |
| Accrued wages and benefits  | (238)                        | (373)    |
| Accrued sales commissions   | 194                          | (13)     |
| Accrued rent  | 29                           | 54       |
| Accrued professional fees   | 1                            | (66)     |
| Deferred revenue and customer deposits  | (56)                         | 107      |
| Domestic and foreign income taxes payable   | 255                          | 215      |
| Other current liabilities   | (40)                         | (57)     |
|   | -----                        | -----    |
| Net cash provided by operating activities   | 541                          | 1,707    |
|   | -----                        | -----    |
| CASH FLOWS FROM INVESTING ACTIVITIES  |                              |          |
| Acquisition of business   | -                            | (3,802)  |
| Purchase of property and equipment  | (95)                         | (129)    |
|   | -----                        | -----    |
| Net cash used in investing activities   | (95)                         | (3,931)  |
|   | -----                        | -----    |
| CASH FLOWS FROM FINANCING ACTIVITIES  |                              |          |
| Proceeds from stock options exercised   | 30                           | -        |
|   | -----                        | -----    |
| Net cash provided by financing activities   | 30                           | -        |
|   | -----                        | -----    |
| Effects of exchange rates on cash   | (20)                         | (34)     |
|   | -----                        | -----    |
| Net cash provided by (used in) all activities                                       | 456                          | (2,258)  |
| Cash and cash equivalents at beginning of period                                    | 15,576                       | 13,957   |
|   | -----                        | -----    |
| Cash and cash equivalents at end of period  | \$16,032                     | \$11,699 |
|   | =====                        | =====    |
| Cash payments for:  |                              |          |
| Domestic and foreign income taxes   | \$ 137                       | \$ 45    |
| Interest  | \$ -                         | \$ 8     |
| Details of acquisition:   |                              |          |
| Fair value of assets acquired   |                              | \$ 4,026 |
| Liabilities assumed   |                              | (274)    |
| Goodwill resulting from acquisition   |                              | 50       |

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|   |        |    |                            |
|---|--------|----|----------------------------|
| Net cash paid for acquisition   |        |    | -----<br>\$ 3,802<br>===== |
| SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES: |        |    |                            |
| Issuance of non-vested shares of restricted stock                     | \$ 124 | \$ | -                          |

See accompanying Notes to Consolidated Financial Statements.

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### inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except for share and per share data)

#### (1) NATURE OF OPERATIONS

We are an independent designer, manufacturer and marketer of thermal, mechanical and electrical products that are primarily used by semiconductor manufacturers in conjunction with automatic test equipment ("ATE") in the testing of integrated circuits ("ICs" or "semiconductors"). In addition, in recent years, we have begun marketing our thermal products in industries outside the ATE industry, such as the automotive, consumer electronics, defense/aerospace, energy and telecommunications industries.

The consolidated entity is comprised of inTEST Corporation (parent) and our wholly-owned subsidiaries. We have three reportable segments which are also our reporting units: Thermal Products, Mechanical Products and Electrical Products. We manufacture our products in the U.S. Marketing and support activities are conducted worldwide from our facilities in the U.S., Germany and Singapore. On January 16, 2012, Temptronic Corporation ("Temptronic"), a wholly-owned subsidiary of inTEST Corporation, acquired substantially all of the assets and certain liabilities of Thermonics, Inc. ("Thermonics"), a division of Test Enterprises, Inc. The acquisition of the Thermonics business broadens the product line of inTEST's Thermal Products segment. This acquisition is discussed further in Note 3.

The semiconductor industry in which we operate is characterized by rapid technological change, competitive pricing pressures and cyclical market patterns. This industry is subject to significant economic downturns at various times. Our financial results are affected by a wide variety of factors, including, but not limited to, general economic conditions worldwide and in the markets in which we operate, economic conditions specific to the semiconductor industry and the other industries we serve, our ability to safeguard patented technology and intellectual property in a rapidly evolving market, downward pricing pressures from customers, and our reliance on a relatively few number of customers for a significant portion of our sales. In addition, we are exposed to the risk of obsolescence of our inventory depending on the mix of future business and technological changes within the industry. As a result of these or other factors, we may experience significant period-to-period fluctuations in future operating results.

#### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### Basis of Presentation and Use of Estimates

The accompanying consolidated financial statements include our accounts and those of our wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated upon consolidation. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain of our accounts, including inventories, long-lived assets, goodwill, identifiable intangibles, deferred income tax valuation allowances and product warranty reserves, are particularly impacted by estimates.

In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the financial position, results of operations, and changes in cash flows for the interim periods presented. Certain footnote information has been condensed or omitted from these consolidated financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission on March 29, 2013 (the "2012 Form 10-K").

### **Reclassification**

Certain prior period amounts have been reclassified to be comparable with the current period's presentation.

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## inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except for share and per share data)

### **(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

#### **Inventories**

Inventories are valued on a first-in, first-out basis, not in excess of market value. Cash flows from the sale of inventories are recorded in operating cash flows. On a quarterly basis, we review our inventories and record excess and obsolete inventory charges based upon our established objective excess and obsolete inventory criteria. These criteria identify material that has not been used in a work order during the prior twelve months and the quantity of material on hand that is greater than the average annual usage of that material over the prior three years. In certain cases, additional excess and obsolete inventory charges are recorded based upon current industry conditions, anticipated product life cycles, new product introductions and expected future use of the inventory. The excess and obsolete inventory charges we record establish a new cost basis for the related inventories. We incurred excess and obsolete inventory charges of \$197 and \$358 for the six months ended June 30, 2013 and 2012, respectively.

#### **Goodwill, Intangible and Long-Lived Assets**

We account for goodwill and intangible assets in accordance with Accounting Standards Codification ("ASC") 350 (Intangibles- Goodwill and Other). Finite-lived intangible assets are amortized over their estimated useful economic life and are carried at cost less accumulated amortization. Goodwill is assessed for impairment at least annually in the fourth quarter, on a reporting unit basis, or more frequently when events and circumstances occur indicating that the recorded goodwill may be impaired. As a part of the goodwill impairment assessment, we have the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount. If we determine this is the case, we are required to perform a two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss, if any, to be recognized. The two-step test is discussed below. If we determine that it is more-likely-than-not that the fair value of the reporting unit is greater than its carrying amounts, the two-step goodwill

impairment test is not required.

If we determine it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a result of our qualitative assessment, we will perform a quantitative two-step goodwill impairment test. In the Step I test, the fair value of a reporting unit is computed and compared with its book value. If the book value of a reporting unit exceeds its fair value, a Step II test is performed in which the implied fair value of goodwill is compared with the carrying amount of goodwill. If the carrying amount of goodwill exceeds the implied fair value, an impairment loss is recorded in an amount equal to that excess. The two-step goodwill impairment assessment is based upon a combination of the income approach, which estimates the fair value of our reporting units based upon a discounted cash flow approach, and the market approach which estimates the fair value of our reporting units based upon comparable market multiples. This fair value is then reconciled to our market capitalization at year end with an appropriate control premium. The determination of the fair value of our reporting units requires management to make significant estimates and assumptions including the selection of appropriate peer group companies, control premiums, discount rate, terminal growth rates, forecasts of revenue and expense growth rates, changes in working capital, depreciation, amortization and capital expenditures. Changes in assumptions concerning future financial results or other underlying assumptions would have a significant impact on either the fair value of the reporting unit or the amount of the goodwill impairment charge.

Indefinite-lived intangible assets are assessed for impairment at least annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

Long-lived assets, which consist of finite-lived intangible assets and property and equipment, are assessed for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. Each impairment test is based on a comparison of the estimated undiscounted cash flows to the recorded value of the asset. If impairment is indicated, the asset is written down to its estimated fair value. The cash flow estimates used to determine the impairment, if any, contain management's best estimates using appropriate assumptions and projections at that time.

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)  
(In thousands, except for share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Continued)

**Stock-Based Compensation**

We account for stock-based compensation in accordance with ASC Topic 718 (Compensation - Stock Compensation) which requires that employee share-based equity awards be accounted for under the fair value method and requires the use of an option pricing model for estimating fair value of stock options granted, which is then amortized to expense over the service periods. See further disclosures related to our stock-based compensation plan in Note 10.

**Subsequent Events**

We have made an assessment of our operations and determined that there were no material subsequent events requiring adjustment to, or disclosure in, our consolidated financial statements for the six months ended June 30, 2013.

**Revenue Recognition**

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We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectability is reasonably assured. Sales of our products are made through our sales employees, third-party sales representatives and distributors. There are no differences in revenue recognition policies based on the sales channel. We do not provide our customers with rights of return or exchanges. Revenue is generally recognized upon product shipment. Our customers' purchase orders do not typically contain any customer-specific acceptance criteria, other than that the product performs within the agreed upon specifications. We test all products manufactured as part of our quality assurance process to determine that they comply with specifications prior to shipment to a customer. To the extent that any customer purchase order contains customer-specific acceptance criteria, revenue recognition is deferred until customer acceptance.

With respect to sales tax collected from customers and remitted to governmental authorities, we use a net presentation in our consolidated statement of operations. As a result, there are no amounts included in either our net revenues or cost of revenues related to sales tax.

### Product Warranties

We generally provide product warranties and record estimated warranty expense at the time of sale based upon historical claims experience. Warranty expense is included in selling expense in the consolidated financial statements.

### Restructuring and Other Charges

We recognize a liability for restructuring charges at fair value only when the liability is incurred. The three main components of our restructuring plans have been related to workforce reductions, the consolidation of excess facilities and asset impairments. Workforce-related charges are accrued when it is determined that a liability has been incurred, which is generally after individuals have been notified of their termination dates and expected severance benefits. Plans to consolidate excess facilities result in charges for lease termination fees and future commitments to pay lease charges, net of estimated future sub-lease income. We recognize these charges when we have vacated the premises. In addition, as a result of plans to consolidate excess facilities, we may incur other associated costs such as charges to relocate inventory, equipment or personnel. We recognize charges for other associated costs when these costs are incurred, which is generally when the goods or services have been provided to us. Assets that may be impaired consist of property, plant and equipment and identifiable intangible assets. Asset impairment charges are based on an estimate of the amounts and timing of future cash flows related to the expected future remaining use and ultimate sale or disposal of the asset.

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## inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)  
(In thousands, except for share and per share data)

### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Continued)

#### Income Taxes

The asset and liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for operating loss and tax credit carryforwards and for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted

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tax rates expected to apply to taxable income in the periods in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

### Net Earnings (Loss) Per Common Share

Net earnings (loss) per common share - basic is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding during each period. Net earnings (loss) per common share - diluted is computed by dividing net earnings (loss) by the weighted average number of common shares and common share equivalents outstanding during each period. Common share equivalents represent stock options and unvested shares of restricted stock and are calculated using the treasury stock method. Common share equivalents are excluded from the calculation if their effect is anti-dilutive.

The table below sets forth, for the periods indicated, a reconciliation of weighted average common shares outstanding - basic to weighted average common shares and common share equivalents outstanding - diluted and the average number of potentially dilutive securities that were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive:

|   | Three Months Ended<br>June 30, |                   | Six Months Ended<br>June 30, |                   |
|---|--------------------------------|-------------------|------------------------------|-------------------|
|   | 2013                           | 2012              | 2013                         | 2012              |
| Weighted average common shares outstanding - basic                                | 10,371,716                     | 10,273,812        | 10,349,695                   | 10,239,463        |
| Potentially dilutive securities:  |                                |                   |                              |                   |
| Employee stock options and unvested shares of restricted stock                    | 22,378                         | 85,845            | 30,584                       | 102,551           |
| Weighted average common shares and common share equivalents outstanding - diluted | <u>10,394,094</u>              | <u>10,359,657</u> | <u>10,380,279</u>            | <u>10,342,014</u> |
| <br>Average number of potentially dilutive securities excluded from calculation   | <br>18,462                     | <br>31,962        | <br>28,605                   | <br>38,811        |

### Effect of Recently Adopted Amendments to Authoritative Accounting Guidance

In July 2012, the FASB issued amendments to existing guidance on the assessment of impairment for indefinite-lived intangible assets other than goodwill. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. However, an entity can choose to adopt this guidance early even if its annual test date is before the issuance of the final standard, provided that the entity has not yet issued its financial statements for the most recent annual or interim period. We adopted these amendments on January 1, 2013. The adoption of these amendments did not have a material impact on our consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except for share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Continued)

In February 2013, the FASB issued amendments to existing guidance on the accounting for accumulated other comprehensive income. The amendments require entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. The amendments are effective for annual and interim periods beginning after December 15, 2012. We adopted these amendments on January 1, 2013. The adoption of these amendments did not have a material impact on our consolidated financial statements.

(3) ACQUISITION

On January 16, 2012, Temprotronic acquired substantially all of the assets and certain liabilities of Thermonics pursuant to the Asset Purchase Agreement dated December 9, 2011. Thermonics is engaged in the business of designing, manufacturing, selling and distributing temperature forcing systems used in the testing of various products under temperature controlled situations. The acquisition of the Thermonics business broadened the product line of inTEST's Thermal Products segment.

The purchase price for the assets was approximately \$3,802 in cash, plus the assumption of specified liabilities, including trade payables and certain customer contract obligations. In connection with this acquisition, we also signed a separate one year lease for the facility occupied by Thermonics in Sunnyvale, California. This facility is owned by certain shareholders of the seller. We ceased operations at this facility in February 2012 and relocated the Thermonics product line to our facility in Mansfield, Massachusetts where our Temprotronic operations are located. During 2012, we recorded a restructuring charge of \$313 related to this action. See Note 5 for further detail regarding this charge.

Total acquisition costs incurred to complete this transaction were \$485. The portion of these costs that was incurred in 2011 was \$148. Acquisition costs are expensed as incurred and included in general and administrative expense.

The Thermonics acquisition was accounted for as a purchase business combination and, accordingly, the results of Thermonics have been included in our consolidated results of operations from the date of acquisition. The allocation of the total purchase price of Thermonics net tangible and identifiable intangible assets was based on their estimated fair values as of the acquisition date. The tangible assets acquired include accounts receivable, inventory, and property and equipment. Liabilities assumed include trade payables, certain customer contract obligations and accrued

payments under a non-compete/non-solicitation agreement with a former employee of Thermonics. Identifiable intangible assets acquired include customer relationships, customer backlog, the Thermonics trade name, patented technology, and a non-compete/non-solicitation agreement with a former employee of Thermonics. The excess of the purchase price over the identifiable intangible and net tangible assets in the amount of \$50 was allocated to goodwill and is deductible for tax purposes. Goodwill is attributed to the synergies that are expected to result from the operations of the combined businesses. The determination of fair value reflects the assistance of third-party valuation specialists, as well as our own estimates and assumptions.

The following represents the allocation of the purchase price:

|   |                |
|---|----------------|
|   | \$ 50          |
| Goodwill  |                |
|   | 1,728          |
| Identifiable intangible assets                    |                |
| Tangible assets acquired and liabilities assumed: |                |
|   | 1,161          |
| Trade accounts receivable                         |                |
|   | 874            |
| Inventories                                       |                |
|   | 263            |
| Property and equipment                            |                |
|   | (77)           |
| Accounts payable                                  |                |
|   | (48)           |
| Accrued non-compete/non-solicitation payments     |                |
|   | (82)           |
| Accrued sales commissions                         |                |
|   | <u>(67)</u>    |
| Accrued warranty                                  |                |
|   | )              |
|   | <u>\$3,802</u> |
| Total purchase price                              |                |

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)  
(In thousands, except for share and per share data)

**(3) ACQUISITION** (Continued)

We estimated the fair value of identifiable intangible assets acquired using a combination of the income, cost and market approaches. The following table provides further information about the finite-lived intangible assets acquired in connection with the acquisition of Thermonics as of the acquisition date:

|  | <u>Fair<br/>Value</u> | Weighted<br>Average<br>Estimated<br><u>Useful<br/>Life</u> |
|--|-----------------------|--|
|  |                       | (in<br>months)   |
| Customer relationships                 | \$1,110               | 72   |
| Customer backlog                       | 70                    | 3  |
| Thermonics trade name                  | 140                   | 48   |
| Patented technology                    | 360                   | 132  |
| Non-compete/non-solicitation agreement | <u>48</u>             | 18   |
| Total intangible assets                | <u>\$1,728</u>        | 78.3   |

For the period from January 16, 2012 to June 30, 2012, Thermonics contributed \$2,044 of net revenues. We do not track net income within our Thermal Products segment by product line. As a result, the net income for Thermonics for the period from January 16, 2012 to June 30, 2012 is not available.

#### **(4) GOODWILL AND INTANGIBLE ASSETS**

Goodwill and intangible assets on our balance sheets are the result of our acquisitions of Sigma Systems Corp. ("Sigma") in October 2008 and Thermonics in January 2012. The acquisition of Thermonics is discussed further in Note 3.

##### **Goodwill**

All of our goodwill is allocated to our Thermal Products segment. There was no change in the amount of the carrying value of goodwill for the six months ended June 30, 2013.

##### **Intangible Assets**

The following tables provide further detail about our intangible assets as of June 30, 2013 and December 31, 2012:

|       | <u>June 30, 2013</u> |
|-------|----------------------|
| Gross | Net                  |

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|   | <u>Carrying<br/>Amount</u> | <u>Accumulated<br/>Amortization</u> | <u>Carrying<br/>Amount</u> |
|---|----------------------------|-------------------------------------|----------------------------|
| Finite-lived intangible assets:           |                            |                                     |                            |
| Customer relationships                    | \$1,480                    | \$ 581                              | \$ 899                     |
| Patented technology                       | 590                        | 276                                 | 314                        |
| Software                                  | 270                        | 128                                 | 142                        |
| Trade name                                | 140                        | 51                                  | 89                         |
| Customer backlog                          | 70                         | 70                                  | -                          |
| Non-compete/non-solicitation<br>agreement | <u>48</u>                  | <u>40</u>                           | <u>8</u>                   |
| Total finite-lived intangible assets      | 2,598                      | 1,146                               | 1,452                      |
| Indefinite-lived intangible assets:       |                            |                                     |                            |
| Sigma trademark                           | <u>510</u>                 | <u>-</u>                            | <u>510</u>                 |
| Total intangible assets                   | <u>\$3,108</u>             | <u>\$1,146</u>                      | <u>\$1,962</u>             |

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**inTEST CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)  
(In thousands, except for share and per share data)

(4) GOODWILL AND INTANGIBLE ASSETS

(Continued)

|                                 | <u>December 31, 2012</u>             |                                     |                                    |
|---------------------------------|--------------------------------------|-------------------------------------|------------------------------------|
|                                 | <u>Gross<br/>Carrying<br/>Amount</u> | <u>Accumulated<br/>Amortization</u> | <u>Net<br/>Carrying<br/>Amount</u> |
| Finite-lived intangible assets: |                                      |                                     |                                    |
|                                 | \$1,480                              | \$ 439                              | \$1,041                            |

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|  |                |               |                |
|--|----------------|---------------|----------------|
| Customer relationships                 | 590            | 233           | 357            |
| Patented technology                    | 270            | 115           | 155            |
| Software                               | 140            | 33            | 107            |
| Trade name                             | 70             | 70            | -              |
| Customer backlog                       | <u>48</u>      | <u>24</u>     | <u>24</u>      |
| Non-compete/non-solicitation agreement | 2,598          | 914           | 1,684          |
| Total finite-lived intangible assets   |                |               |                |
| Indefinite-lived intangible assets:    |                |               |                |
| Sigma trademark                        | <u>510</u>     | <u>-</u>      | <u>510</u>     |
| Total intangible assets                | <u>\$3,108</u> | <u>\$ 914</u> | <u>\$2,194</u> |

We generally amortize our finite-lived intangible assets over their estimated useful lives on a straightline basis, unless an alternate amortization method can be reliably determined. Any such alternate amortization method would be based on the pattern in which the economic benefits of the intangible asset are expected to be consumed. None of our intangible assets have any residual value. The following table provides further information about the estimated useful lives of our finite-lived intangible assets as of June 30, 2013:

|  | Estimated<br><u>Useful</u><br><u>Life</u> | Remaining<br>Estimated<br>Useful Life<br>at<br><u>June 30,</u><br><u>2013</u> |
|--|---|---|
|  | ----- (in months) -----                   |   |
| Finite-lived intangible assets resulting from the acquisition of Sigma:      |   |   |
| Customer relationships   | 72  | 15  |
| Software   | 120                                       | 63  |
| Patented technology  | 60  | 3   |
| Finite-lived intangible assets resulting from the acquisition of Thermonics: |   |   |

|  |     |       |
|--|-----|-------|
| Customer relationships                 | 72  | 54.5  |
|  | 3   | -     |
| Customer backlog                       |     |       |
|  | 48  | 30.5  |
| Trade name                             |     |       |
|  | 132 | 114.5 |
| Patented technology                    |     |       |
|  | 18  | 3     |
| Non-compete/non-solicitation agreement |     |       |

The following table sets forth changes in the amount of the carrying value of intangible assets for the six months ended June 30, 2013:

|                           |                |
|---------------------------|----------------|
|                           | \$2,194        |
| Balance - January 1, 2013 |                |
|                           | <u>(232)</u>   |
| Amortization              |                |
|                           | )              |
|                           | <u>\$1,962</u> |
| Balance - June 30, 2013   |                |

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)  
(In thousands, except for share and per share data)

(4) GOODWILL AND INTANGIBLE ASSETS

(Continued)

Total amortization expense for the six months ended June 30, 2013 and 2012 was \$232 and \$263, respectively. The following table sets forth the estimated annual amortization expense for our finite-lived intangible assets for each of the next five years:

|      |       |
|------|-------|
|      | \$446 |
| 2013 |       |
|      | \$355 |

|      |       |
|------|-------|
| 2014 | \$289 |
| 2015 | \$229 |
| 2016 | \$212 |
| 2017 |       |

(5)

**RESTRUCTURING AND OTHER CHARGES**

In connection with the acquisition of Thermonics, as discussed further in Note 3, we signed a separate one year lease for the facility in Sunnyvale, California occupied by Thermonics at the time of the acquisition. This facility was owned by certain shareholders of the seller. We ceased operations at this facility in February 2012 and relocated the Thermonics product line to our facility in Mansfield, Massachusetts where our Temptronic operations are located. During the first quarter of 2012, we incurred approximately \$359 of facility closure costs related to this action. These costs included lease termination fees of approximately \$220 and other costs associated with this consolidation of facilities, including the cost to relocate inventory and equipment, of approximately \$139. During the fourth quarter of 2012 we received a refund of \$46 of lease termination fees paid in the first quarter due to the sale of the leased facility. Accrued restructuring and other charges are included in Other Current Liabilities on our balance sheet.

Changes in our liability for restructuring and other charges for the six months ended June 30, 2012 are summarized as follows:

|  |                                  |
|--|----------------------------------|
|  | <u>Thermonics<br/>Relocation</u> |
|  | \$ -                             |
| Balance - January 1, 2012                          |                                  |
|  | 359                              |
| Accruals for facility closure costs                |                                  |
|  | <u>(359)</u>                     |
| Cash payments related to facility<br>closure costs |                                  |
|  | )                                |
|  | <u>\$ -</u>                      |
| Balance - June 30, 2012                            |                                  |

**(6) MAJOR CUSTOMERS**

During the six months ended June 30, 2013 and 2012, Texas Instruments Incorporated accounted for 11% and 19%, respectively, of our consolidated net revenues. While all three of our operating segments sold products to this customer, these revenues were primarily generated by our Mechanical Products and our Electrical Products segments. During the six months ended June 30, 2012, Teradyne, Inc. accounted for 14% of our consolidated net revenues. While both our Mechanical Products and our Electrical Products segments sold products to this customer, these revenues were primarily generated by our Electrical Products segment. No other customers accounted for 10% or more of our consolidated net revenues during the six months ended June 30, 2013 and 2012.

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)  
(In thousands, except for share and per share data)

(7)

**INVENTORIES**

Inventories held at June 30, 2013 and December 31, 2012 were comprised of the following:

|                               | June 30,       | Dec. 31,       |
|-------------------------------|----------------|----------------|
|                               | <i>2013</i>    | <i>2012</i>    |
| Raw materials                 | \$2,641        | \$2,157        |
| Work in process               | 325            | 454            |
| Inventory consigned to others | 104            | 105            |
| Finished goods                | <u>290</u>     | <u>419</u>     |
|                               | <u>\$3,360</u> | <u>\$3,135</u> |

**(8) DEBT**Letters of Credit

We have issued letters of credit as the security deposits for certain of our domestic leases. These letters of credit are secured by pledged certificates of deposit which are classified as Restricted Certificates of Deposit on our balance sheet. The terms of our leases require us to renew these letters of credit at least 30 days prior to their expiration dates for successive terms of not less than one year until lease expiration. Our outstanding letters of credit at June 30, 2013 and December 31, 2012 consisted of the following:

| L/C | Lease | <u>Letters of Credit<br/>Amount Outstanding</u> |
|-----|-------|---|
|-----|-------|---|

| <u>Facility</u> | <u>Original L/C<br/>Issue Date</u> | <u>Expiration<br/>Date</u> | <u>Expiration<br/>Date</u> | <u>June 30,<br/>2013</u> | <u>Dec. 31,<br/>2012</u> |
|-----------------|------------------------------------|----------------------------|----------------------------|--------------------------|--------------------------|
| Mt. Laurel, NJ  | 3/29/2010                          | 3/31/2014                  | 4/30/2021                  | \$250<br><u>200</u>      | \$250<br><u>200</u>      |
| Mansfield, MA   | 10/27/2010                         | 11/08/2013                 | 8/23/2021                  | <u>\$450</u>             | <u>\$450</u>             |

**(9) GUARANTEES**Product Warranties

Warranty expense for the six months ended June 30, 2013 and 2012 was \$60 and \$55, respectively. Accrued warranty costs are included in Other Current Liabilities on our balance sheet. The following table sets forth the changes in the liability for product warranties for the six months ended June 30, 2013:

|                                      |              |
|--------------------------------------|--------------|
| Balance - January 1, 2013            | \$197        |
| Payments made under product warranty | (55)         |
| Accruals for product warranty        | <u>60</u>    |
| Balance - June 30, 2013              | <u>\$202</u> |

**(10) STOCK-BASED COMPENSATION**

As of June 30, 2013, we had outstanding stock options and unvested restricted stock awards granted under stock-based employee compensation plans that are described more fully in Note 15 to the consolidated financial statements in our 2012 Form 10-K.

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)  
(In thousands, except for share and per share data)

**(10) STOCK-BASED COMPENSATION** (Continued)

As of June 30, 2013, total compensation expense to be recognized in future periods was \$172. The weighted average period over which this expense is expected to be recognized is 2.0 years. All of this expense is related to nonvested shares of restricted stock.

Restricted Stock Awards

We record compensation expense for restricted stock awards (nonvested shares) based on the quoted market price of our stock at the grant date and amortize the expense over the vesting period. Restricted stock awards generally vest over four years. The following table shows the allocation of the compensation expense we recorded during the three and six months ended June 30, 2013 and 2012, respectively, related to nonvested shares:

|  | Three Months<br>Ended<br><u>June 30,</u> |             | Six Months<br>Ended <u>June</u><br><u>30,</u> |             |
|--|--|-------------|---|-------------|
|  | <u>2013</u>                              | <u>2012</u> | <u>2013</u>                                   | <u>2012</u> |
| Cost of revenues                               | \$ 2                                     | \$ 2        | \$ 3  | \$ 4        |
| Selling expense                                | 2  | 2           | 4   | 4           |
| Engineering and product development<br>expense | 8  | 6           | 14  | 12          |
| General and administrative expense             | <u>19</u>                                | <u>24</u>   | <u>37</u>                                     | <u>41</u>   |
|  | <u>\$31</u>                              | <u>\$34</u> | <u>\$58</u>                                   | <u>\$61</u> |

There was no compensation expense capitalized in the three or six months ended June 30, 2013 or 2012.

The following table summarizes the activity related to nonvested shares for the six months ended June 30, 2013:

|   | Number<br>of Shares | Weighted<br>Average<br>Grant<br>Date<br>Fair Value |
|---|---------------------|--|
| Nonvested shares outstanding, January 1, 2013 | 108,750             | \$1.63   |
| Granted                                       | 42,500              | 2.92   |
|   | (53,750)            | 1.61   |

|   |               |      |
|---|---------------|------|
| Vested                                      |               |      |
| Forfeited                                   | —             | -    |
| Nonvested shares outstanding, June 30, 2013 | <u>97,500</u> | 1.60 |

Stock Options

The following table summarizes the stock option activity for the six months ended June 30, 2013:

|  | <u>Number<br/>of Shares</u> | <u>Weighted<br/>Average<br/>Exercise<br/>Price</u> |
|--|-----------------------------|--|
| Options outstanding, January 1, 2013 (219,000 exercisable) | 219,000                     | \$3.17   |
| Granted  | -                           | -  |
| Exercised  | (10,000)                    | 3.04   |
| Forfeited/Expired  | <u>(189,000)</u>            | 3.04   |
| Options outstanding, June 30, 2013 (20,000 exercisable)    | <u>20,000</u>               | 4.46   |

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inTEST CORPORATION  
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(Unaudited)  
(In thousands, except for share and per share data)

(11)

## EMPLOYEE BENEFIT PLANS

We have a defined contribution 401(k) plan for our employees who work in the U.S. (the "inTEST 401(k) Plan"). All permanent employees of inTEST Corporation, Temptronic (effective January 1, 2013) and inTEST Silicon Valley Corporation who are at least 18 years of age are eligible to participate in the plan. We match employee contributions dollar for dollar up to 10% of the employee's annual compensation, with a maximum limit of \$5. Employer contributions vest ratably over four years. Matching contributions are discretionary.

Temptronic adopted a defined contribution 401(k) plan for its domestic employees in 1988, that was merged into the inTEST 401(k) Plan effective September 1, 2002. Prior to January 1, 2013, the inTEST 401(k) Plan retained the matching provisions of the prior Temptronic plan for all Temptronic employees, which included discretionary employer matching contributions of \$0.50 on the dollar up to 6% of the employees' annual compensation, with a maximum limit of \$3. When the plans were merged, the eligibility and vesting provisions of the prior Temptronic plan were conformed to those for inTEST Corporation and inTEST Silicon Valley Corporation employees.

Prior to January 1, 2013, in addition to the employer matching contributions for which Temptronic employees were eligible, Temptronic employees participating in the inTEST 401(k) plan were also eligible to receive profit sharing contributions which are more fully described in Note 16 to our 2012 Form 10-K. During the third quarter of 2012, our Board of Directors approved an amendment to the inTEST 401(k) Plan. The amendment terminated the profit sharing contributions for Temptronic employees effective December 31, 2012. In addition, the amendment conformed the employer matching provisions for the Temptronic employees with those currently in place for inTEST Corporation and inTEST Silicon Valley employees effective January 1, 2013.

## (12) SEGMENT INFORMATION

We have three reportable segments, which are also our reporting units: Thermal Products, Mechanical Products and Electrical Products.

The Thermal Products segment includes the operations of Temptronic, Thermonics (which we acquired in January 2012 as discussed further in Note 3), Sigma, inTEST Thermal Solutions GmbH (formerly Temptronic GmbH) (Germany), and inTEST Pte, Limited (Singapore). Sales of this segment consist primarily of temperature management systems which we design, manufacture and market under our Temptronic, Thermonics and Sigma Systems product lines. In addition, this segment provides post warranty service and support.

The Mechanical Products segment includes the operations of our Mt. Laurel, New Jersey manufacturing facility. Sales of our Mechanical Products segment consist primarily of manipulator and docking hardware products, which we design, manufacture and market. In addition, this segment provides post warranty service and support for various ATE equipment.

The Electrical Products segment includes the operations of inTEST Silicon Valley Corporation. Sales of this segment consist primarily of tester interface products which we design, manufacture and market.

We operate our business worldwide, and all three segments sell their products both domestically and internationally. All three segments sell to semiconductor manufacturers, third-party test and assembly houses and ATE manufacturers. Our Thermal Products segment also sells into a variety of industries outside of the semiconductor industry, including the automotive, consumer electronics, defense/aerospace, energy and telecommunications industries. Intercompany pricing between segments is either a multiple of cost for component parts or list price for finished goods.

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## (12) SEGMENT INFORMATION

(Continued)

|  | <u>Three Months<br/>Ended<br/>June 30,</u> |                 | <u>Six Months Ended<br/>June 30,</u> |                 |
|--|--|-----------------|--------------------------------------|-----------------|
|  | <u>2013</u>                                | <u>2012</u>     | <u>2013</u>                          | <u>2012</u>     |
| Net revenues from unaffiliated customers:            |  |                 |                                      |                 |
| Thermal Products                                     | \$ 5,772                                   | \$ 6,503        | \$11,670                             | \$12,614        |
| Mechanical Products                                  | 3,812                                      | 3,086           | 5,608                                | 5,600           |
| Electrical Products                                  | 1,648                                      | 3,987           | 2,930                                | 6,103           |
|  | <u>(14)</u>                                | <u>-</u>        | <u>(17)</u>                          | <u>(10)</u>     |
| Intersegment sales                                   | )  | )               | )                                    | )               |
|  | <u>\$11,218</u>                            | <u>\$13,576</u> | <u>\$20,191</u>                      | <u>\$24,307</u> |
| Intersegment sales:                                  |  |                 |                                      |                 |
| Thermal Products                                     | \$ -                                       | \$ -            | \$ -                                 | \$ -            |
| Mechanical Products                                  | 14   | -               | 17                                   | 10              |
| Electrical Products                                  | <u>-</u>                                   | <u>-</u>        | <u>-</u>                             | <u>-</u>        |
|  | <u>\$ 14</u>                               | <u>\$ -</u>     | <u>\$ 17</u>                         | <u>\$ 10</u>    |
| Earnings (loss) before income tax expense (benefit): |  |                 |                                      |                 |
| Thermal Products                                     | \$1,078                                    | \$1,055         | \$2,236                              | \$1,372         |

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|                      |                |                |                |                |
|----------------------|----------------|----------------|----------------|----------------|
|                      | 290            | (380)          | (396)          | (932)          |
| Mechanical Products  | 207            | 1,374          | 199            | 1,739          |
| Electrical Products  | <u>(88)</u>    | <u>(55)</u>    | <u>(182)</u>   | <u>(256)</u>   |
| Corporate            | )              | )              | )              | )              |
|                      | <u>\$1,487</u> | <u>\$1,994</u> | <u>\$1,857</u> | <u>\$1,923</u> |
| Net earnings (loss): | \$ 727         | \$ 706         | \$1,641        | \$ 896         |
| Thermal Products     | 196            | (254)          | (346)          | (585)          |
| Mechanical Products  | 140            | 919            | 134            | 1,138          |
| Electrical Products  | <u>(59)</u>    | <u>(37)</u>    | <u>(133)</u>   | <u>(158)</u>   |
| Corporate            | )              | )              | )              | )              |
|                      | <u>\$1,003</u> | <u>\$1,334</u> | <u>\$1,295</u> | <u>\$1,291</u> |

|                      |  |                 |                 |
|----------------------|--|-----------------|-----------------|
|                      |  | June 30,        | Dec. 31,        |
| Identifiable assets: |  | <u>2013</u>     | <u>2012</u>     |
|                      |  | \$22,800        | \$20,849        |
| Thermal Products     |  | 7,237           | 7,737           |
| Mechanical Products  |  | <u>4,141</u>    | <u>3,813</u>    |
| Electrical Products  |  | <u>\$34,178</u> | <u>\$32,399</u> |

The following table provides information about our geographic areas of operation. Net revenues from unaffiliated customers are based on the location to which the goods are shipped.

|                   |                  |
|-------------------|------------------|
| Three Months      | Six Months Ended |
| Ended <u>June</u> | <u>June 30,</u>  |
| <u>30,</u>        |                  |

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|   | <u>2013</u>     | <u>2012</u>     | <u>2013</u>     | <u>2012</u>     |
|---|-----------------|-----------------|-----------------|-----------------|
| Net revenues from unaffiliated customers: |                 |                 |                 |                 |
| U.S.                                      | \$ 3,504        | \$ 3,733        | \$ 6,718        | \$ 7,929        |
|   | <u>7,714</u>    | <u>9,843</u>    | <u>13,473</u>   | <u>16,378</u>   |
| Foreign                                   | <u>\$11,218</u> | <u>\$13,576</u> | <u>\$20,191</u> | <u>\$24,307</u> |

|                         | June 30, Dec. 31, |                |
|-------------------------|-------------------|----------------|
|                         | <u>2013</u>       | <u>2012</u>    |
| Property and equipment: |                   |                |
| U.S.                    | \$ 841            | \$ 899         |
|                         | <u>296</u>        | <u>351</u>     |
| Foreign                 | <u>\$1,137</u>    | <u>\$1,250</u> |

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

Risk Factors and Forward-Looking Statements

In addition to historical information, this discussion and analysis contains statements relating to possible future events and results that are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements can often be identified by the use of forward-looking terminology such as "believes," "expects," "intends," "may," "will," "should" or "anticipates" or similar terminology. See Part I, Item 1 - "Business - Cautionary Statement Regarding Forward-Looking Statements" in our 2012 Form 10-K for examples of statements made in this report which may be "forward-looking statements." These statements involve risks and uncertainties and are based on various assumptions. Although we believe that our expectations are based on reasonable assumptions, investors and prospective investors are cautioned that such statements are only projections, and there cannot be any assurance that these events or results will occur.

Information about the primary risks and uncertainties that could cause our actual future results to differ materially from our historic results or the results described in the forward-looking statements made in this report or presented elsewhere by Management from time to time are included in Part I, Item 1A - "Risk Factors" in our 2012 Form 10-K. Material changes to such risk factors may be reported in subsequent Quarterly Reports on Form 10-Q in Part II, Item 1A. There have been no such changes from the risk factors set forth in our 2012 Form 10-K.

Overview

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This MD&A should be read in conjunction with the accompanying consolidated financial statements.

Our business and results of operations are substantially dependent upon the demand for ATE by semiconductor manufacturers and companies that specialize in the testing of ICs. Demand for ATE is driven by semiconductor manufacturers that are opening new, or expanding existing, semiconductor fabrication facilities or upgrading existing equipment, which in turn is dependent upon the current and anticipated market demand for semiconductors and products incorporating semiconductors. In the past, the semiconductor industry has been highly cyclical with recurring periods of oversupply, which often have a severe impact on the semiconductor industry's demand for ATE, including the products we manufacture. This can cause wide fluctuations in both our orders and net revenues and, depending on our ability to react quickly to these shifts in demand, can significantly impact our results of operations. These industry cycles are difficult to predict and in recent years have become more volatile and, in certain cases, shorter in duration. Because the industry cycles are generally characterized by sequential periods of growth or declines in orders and net revenues during each cycle, year over year comparisons of operating results may not always be as meaningful as comparisons of periods at similar points in either up or down cycles. In addition, during both downward and upward cycles in our industry, in any given quarter, the trend in both our orders and net revenues can be erratic. This can occur, for example, when orders are canceled or currently scheduled delivery dates are accelerated or postponed by a significant customer or when customer forecasts and general business conditions fluctuate during a quarter.

We believe that purchases of most of our products are typically made from semiconductor manufacturers' capital expenditure budgets. Certain portions of our business, however, are generally less dependent upon the capital expenditure budgets of the end users. For example, purchases of certain related ATE interface products, such as sockets and interface boards, which must be replaced periodically, are typically made from the end users' operating budgets. In addition, purchases of certain of our products, such as docking hardware, for the purpose of upgrading or improving the utilization, performance and efficiency of existing ATE, tend to be counter cyclical to sales of new ATE. Moreover, we believe a portion of our sales of thermal products results from the increasing need for temperature testing of circuit boards and specialized components that do not have the design or quantity to be tested in an electronic device handler. In addition, we market our Thermostream temperature management systems in industries outside the semiconductor test industry, such as the automotive, consumer electronics, defense/aerospace, energy and telecommunications industries. We believe that these industries usually are less cyclical than the ATE industry.

While the majority of our orders and net revenues are derived from the ATE market, our operating results do not always follow the overall trend in the ATE market in any given period. We believe that these anomalies may be driven by a variety of changes within the ATE market, including, for example, changing product requirements, longer time periods between new product offerings by OEMs and changes in customer buying patterns. In particular, demand for our mechanical and electrical products, which are sold exclusively within the ATE industry, and our operating margins in these product segments have been affected by shifts in the competitive landscape, including (i) customers placing heightened emphasis on shorter lead times (which places increased demands on our available engineering and production capacity increasing unit costs) and ordering in

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## **Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.** (Continued)

smaller quantities (which prevents us from acquiring component materials in larger volumes at lower cost and increasing unit costs), (ii) the practice of OEM manufacturers to specify other suppliers as primary vendors, with less frequent opportunities to compete for such designations, (iii) the role of third-party test and assembly houses in the ATE market and their requirement of products with a greater range of use at the lowest cost, (iv) customer supply line management groups demanding lower prices and spreading purchases across multiple vendors, and (v) certain competitors aggressively reducing their products' sales prices (causing us to either reduce our products' sales price to be successful in obtaining the sale or causing loss of the sale). These shifts in market practices have had, and may continue to have, varying levels of impact on our operating results and are difficult to quantify or predict from period to period. Management has taken, and will continue to take, such actions it deems appropriate to adjust our strategies, products and operations to counter such shifts in market practices as they become evident.

### Net Revenues and Orders

The following table sets forth, for the periods indicated, a breakdown of the net revenues from unaffiliated

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customers both by product segment and geographic area (based on the location to which the goods are shipped).

|  | (in 000's)         |                 |                |                  |                 |
|--|--------------------|-----------------|----------------|------------------|-----------------|
|  | Three Months Ended |                 |                | Six Months Ended |                 |
|  | June 30.           |                 | March          | June 30.         |                 |
|  | 2013               | 2012            | 31,<br>2013    | 2013             | 2012            |
| Net revenues from unaffiliated customers:                                |                    |                 |                |                  |                 |
| Thermal Products   | \$ 5,772           | \$ 6,503        | \$5,898        | \$11,670         | \$12,614        |
| Mechanical Products  | 3,812              | 3,086           | 1,796          | 5,608            | 5,600           |
| Electrical Products  | 1,648              | 3,987           | 1,282          | 2,930            | 6,103           |
|  | <u>(14</u>         | <u>-</u>        | <u>(3</u>      | <u>(17</u>       | <u>(10</u>      |
| Intersegment sales   | )                  | )               | )              | )                | )               |
|  | <u>\$11,218</u>    | <u>\$13,576</u> | <u>\$8,973</u> | <u>\$20,191</u>  | <u>\$24,307</u> |
| Intersegment sales:  |                    |                 |                |                  |                 |
| Thermal Products   | \$ -               | \$ -            | \$ -           | \$ -             | \$ -            |
| Mechanical Products  | 14                 | -               | 3              | 17               | 10              |
| Electrical Products  | <u>-</u>           | <u>-</u>        | <u>-</u>       | <u>-</u>         | <u>-</u>        |
|  | <u>\$14</u>        | <u>\$ -</u>     | <u>\$ 3</u>    | <u>\$17</u>      | <u>\$10</u>     |
| Net revenues from unaffiliated customers<br>(net of intersegment sales): |                    |                 |                |                  |                 |
| Thermal Products   | \$ 5,772           | \$ 6,503        | \$5,898        | \$11,670         | \$12,614        |
| Mechanical Products  | 3,798              | 3,086           | 1,793          | 5,591            | 5,590           |
| Electrical Products  | <u>1,648</u>       | <u>3,987</u>    | <u>1,282</u>   | <u>2,930</u>     | <u>6,103</u>    |
|  | <u>\$11,218</u>    | <u>\$13,576</u> | <u>\$8,973</u> | <u>\$20,191</u>  | <u>\$24,307</u> |

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|   |                 |                 |                |                 |                 |
|---|-----------------|-----------------|----------------|-----------------|-----------------|
| Net revenues from unaffiliated customers: |                 |                 |                |                 |                 |
|   | \$ 3,504        | \$ 3,733        | \$3,214        | \$ 6,718        | \$ 7,929        |
| U.S.                                      |                 |                 |                |                 |                 |
|   | <u>7,714</u>    | <u>9,843</u>    | <u>5,759</u>   | <u>13,473</u>   | <u>16,378</u>   |
| Foreign                                   |                 |                 |                |                 |                 |
|   | <u>\$11,218</u> | <u>\$13,576</u> | <u>\$8,973</u> | <u>\$20,191</u> | <u>\$24,307</u> |

Our consolidated net revenues for the quarter ended June 30, 2013 decreased \$2.4 million or 17% as compared to the same period in 2012. For the quarter ended June 30, 2013, net revenues (net of intersegment sales) of our Thermal and Electrical Products segments decreased \$731,000 or 11% and \$2.3 million or 59%, respectively, as compared to the same period in 2012, while the net revenues (net of intersegment sales) of our Mechanical Products segment increased \$712,000 or 23% as compared to the same period in 2012. Our consolidated net revenues for the quarter ended June 30, 2013 increased \$2.2 million or 25% as compared to the quarter ended March 31, 2013. Net revenues (net of intersegment sales) of our Mechanical and Electrical Products segments increased \$2.0 million or 112% and \$366,000 or 29%, respectively, for the second quarter of 2013 as compared to the first quarter of 2013, while the net revenues (net of intersegment sales) of our Thermal Products segment decreased \$126,000 or 2% during this time period. Net revenues from customers in various industries outside of the ATE industry and those net revenues as a percentage of our total consolidated net revenues were \$2.5 million or 22%, respectively, for the quarter ended June 30, 2013, compared to \$1.9 million or 22%, respectively, for the quarter ended March 31, 2013, and \$2.2 million or 17%, respectively, for the quarter ended June 30, 2012.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

. (Continued)

We believe the decline in the level of net revenues of our Thermal Products segment in the second quarter of 2013 as compared to the same period in 2012 as well as to the first quarter of 2013 primarily reflects reduced levels of demand within the ATE industry. This segment has historically lagged our other two product segments in regard to experiencing the impact of both increases and decreases in the levels of demand within the ATE industry. This trend has continued in the most recent downturn in the ATE industry. While our Mechanical and Electrical Products segments began to be affected by a decline in demand within the ATE industry in the second quarter of 2011, our Thermal Products segment did not begin to experience a significant impact from this decline in demand until the fourth quarter of 2011. Moreover, our Thermal Products segment has not yet begun to experience an increase in demand within the ATE industry although both our Mechanical and Electrical Products segments have experienced increased levels of demand in the most recent quarter.

We believe the increased level of net revenues experienced by both our Mechanical and Electrical Products segments during the second quarter of 2013 as compared to the first quarter of 2013 reflects increased demand within the ATE industry. Our Mechanical Products segment also recorded an increase in net revenues in the second quarter of 2013 as compared to the same period in 2012, reflecting the impact of this increased level of

demand. However, for our Electrical Products segment, net revenues for the second quarter of 2013 decreased as compared to the same period in 2012. We attribute this decrease to the fact that during the second quarter of 2012, our Electrical Products segment experienced an unusually high level of demand from one particular OEM customer which offset the decline in demand within the ATE industry during that quarter.

Total orders for the quarter ended June 30, 2013 were \$11.0 million compared to \$7.7 million for the quarter ended March 31, 2013 and \$11.8 million for the quarter ended June 30, 2012. For the quarter ended June 30, 2013, orders for our Thermal, Mechanical and Electrical Products segments were \$5.4 million, \$3.7 million and \$1.9 million, respectively, compared to \$4.7 million, \$2.2 million and \$759,000 for the quarter ended March 31, 2013, respectively, and \$6.4 million, \$2.3 million and \$3.1 million for the quarter ended June 30, 2012, respectively. Orders from customers in various industries outside of the ATE industry and those orders as a percentage of our total consolidated orders were \$2.2 million or 20%, respectively, for the quarter ended June 30, 2013, compared to \$1.4 million or 18%, respectively, for the quarter ended March 31, 2013, and \$1.4 million or 12%, respectively, for the quarter ended June 30, 2012. We cannot be certain what the level of our orders or net revenues will be in any future period for any of our product segments.

### Backlog

At June 30, 2013, our backlog of unfilled orders for all products was approximately \$2.7 million compared with approximately \$2.9 million at March 31, 2013 and \$5.2 million at June 30, 2012. Our backlog includes customer orders which we have accepted, substantially all of which we expect to deliver in 2013. While backlog is calculated on the basis of firm purchase orders, a customer may cancel an order or accelerate or postpone currently scheduled delivery dates. Our backlog may be affected by the tendency of customers to rely on short lead times available from suppliers, including us, in periods of depressed demand. In periods of increased demand, there is a tendency towards longer lead times that has the effect of increasing backlog. As a result, our backlog at a particular date is not necessarily indicative of sales for any future period.

### Product/Customer Mix

Our three product segments each have multiple products that we design, manufacture and sell to our customers. The gross margin on each product we offer is affected by a number of factors including the amount of intellectual property (such as patents) utilized in the product, the number of units ordered by the customer at one time, and the amount of inTEST designed and fabricated material included in our product compared with the amount of third-party designed and fabricated material included in our product. The weight of each of these factors, as well as the current market conditions, determines the ultimate sales price we can obtain for our products and the resulting gross margin.

The mix of products we sell in any period is ultimately determined by our customers' needs. Therefore, the mix of products sold in any given period can change significantly from the prior period. As a result, our consolidated gross margin can be significantly impacted in any given period by a change in the mix of products sold in that period.

We sell most of our products to semiconductor manufacturers and third-party test and assembly houses (end user sales) and to ATE manufacturers (OEM sales) who ultimately resell our equipment with theirs to semiconductor manufacturers. Our Thermal Products segment also sells into a variety of other industries including the automotive, consumer electronics, defense/aerospace, energy and telecommunications industries. The mix of customers during any given period will affect our gross margin due to differing sales discounts and commissions. For the six months ended June 30, 2013 and 2012, our OEM sales as a percentage of net revenues were 10% and 16%, respectively.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.** (Continued)

OEM sales generally have a lower gross margin than end user sales, as OEM sales historically have had a more significant discount. Our current net operating margins on most OEM sales, however, are only slightly less than margins on end user sales because of the payment of third party sales commissions on most end user sales. We have also continued to experience demands from our OEM customers' supply line managers to reduce our sales prices to them. If we cannot further reduce our manufacturing and operating costs, these pricing pressures will continue to reduce our gross and operating margins.

**Results of Operations**

The results of operations for our three product segments are generally affected by the same factors. Separate discussions and analyses for each product segment would be repetitive and obscure any unique factors that affected the results of operations of our different product segments. The discussion and analysis that follows, therefore, is presented on a consolidated basis and includes discussion of factors unique to each product segment where significant to an understanding of that segment.

The following table sets forth, for the periods indicated, the principal items included in the Consolidated Statements of Operations as a percentage of total net revenues.

|   | <u>Percentage of Net Revenues</u> |             |                              |             |
|---|-----------------------------------|-------------|------------------------------|-------------|
|   | <u>Quarters Ended June</u>        |             | <u>Six Months Ended June</u> |             |
|   | <u>30,</u>                        | <u>30,</u>  | <u>30,</u>                   | <u>30,</u>  |
|   | <u>2013</u>                       | <u>2012</u> | <u>2013</u>                  | <u>2012</u> |
| Net revenues                                | 100.0%                            | 100.0%      | 100.0%                       | 100.0%      |
| Cost of revenues                            | <u>51.3</u>                       | <u>54.4</u> | <u>52.6</u>                  | <u>55.6</u> |
| Gross margin                                | <u>48.7</u>                       | <u>45.6</u> | <u>47.4</u>                  | <u>44.4</u> |
| Selling expense                             | 13.6                              | 11.4        | 13.5                         | 12.2        |
| Engineering and product development expense | 8.2                               | 7.2         | 9.5                          | 7.8         |
| General and administrative expense          | 13.6                              | 12.3        | 15.2                         | 15.0        |
| Restructuring and other charges             | <u>0.0</u>                        | <u>0.0</u>  | <u>0.0</u>                   | <u>1.5</u>  |
| Operating income                            | 13.3                              | 14.7        | 9.2                          | 7.9         |

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|                                    |            |            |            |            |
|------------------------------------|------------|------------|------------|------------|
| Other income (expense)             | <u>0.0</u> | <u>0.0</u> | <u>0.0</u> | <u>0.0</u> |
|                                    | 13.3       | 14.7       | 9.2        | 7.9        |
| Earnings before income tax expense |            |            |            |            |
|                                    | <u>4.4</u> | <u>4.9</u> | <u>2.8</u> | <u>2.6</u> |
| Income tax expense                 |            |            |            |            |
|                                    | <u>8.9</u> | <u>9.8</u> | <u>6.4</u> | <u>5.3</u> |
| Net earnings                       |            |            |            |            |
|                                    | %          | %          | %          | %          |

Quarter Ended June 30, 2013 Compared to Quarter Ended June 30, 2012

*Net Revenues.* Net revenues were \$11.2 million for the quarter ended June 30, 2013 compared to \$13.6 million for the same period in 2012, a decrease of \$2.4 million or 17%. We believe the decrease in our net revenues during the second quarter of 2013 primarily reflects the factors previously discussed in the Overview.

During the quarter ended June 30, 2013, our net revenues from customers in the U.S. decreased 6% and our net revenues from foreign customers decreased 22%, respectively, as compared to the same period in 2012. The impact of changes in foreign currency exchange rates on the decrease in net revenues from foreign customers was less than 1%.

*Gross Margin.* Gross margin was 49% for the quarter ended June 30, 2013 compared to 46% for the same period in 2012. The improvement in the gross margin was primarily the result of a reduction in our component material costs as a percentage of net revenues, which decreased from 38% of net revenues in the second quarter of 2012 to 36% of net revenues in the second quarter of 2013. We attribute the decrease to changes in customer and product mix. In addition, the improvement in gross margin reflects a lower level of charges for obsolete and excess inventory in the second quarter of 2013 as compared to the same period in 2012. The reduction in these charges primarily reflects fewer items falling into our standard objective criteria. Finally, although our fixed operating costs were relatively unchanged as a percentage of net revenues, in absolute dollar terms these costs declined \$345,000 in the second quarter of 2013 as compared to the same period in 2012. This decrease primarily reflects reduced staff in the manufacturing operations of our Thermal Products segment. During the second quarter of 2012, we had higher staffing levels as a result of the integration of the Thermonics acquisition.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.** (Continued)

Selling Expense.

Selling expense was \$1.5 million for the quarter ended June 30, 2013 compared to \$1.6 million for the same period in 2012, a decrease of \$27,000 or 2%. The decrease primarily reflects lower levels of advertising, trade show and travel expenses which were partially offset by an increase in salary and benefits expense as a result of increases in our sales

staff in our Thermal Products segment.

*Engineering and Product Development Expense.* Engineering and product development expense was \$925,000 for the quarter ended June 30, 2013 compared to \$980,000 for the same period in 2012, a decrease of \$55,000 or 6%. The decrease primarily reflects reduced spending on materials used in product development projects, as well as third party product development consultants.

*General and Administrative Expense.* General and administrative expense was \$1.5 million for the quarter ended June 30, 2013 compared to \$1.7 million for the same period in 2012, a decrease of \$142,000 or 9%. The decrease primarily reflects reduced levels of profit-based bonus accruals reflecting the lower level of earnings in the second quarter of 2013 as compared to the same period in 2012.

*Income Tax Expense.* For the quarter ended June 30, 2013, we recorded income tax expense of \$484,000 compared to income tax expense of \$660,000 for the same period in 2012. Our effective tax rate was relatively unchanged at 33% for each of the quarters ended June 30, 2013 and 2012, respectively. On a quarterly basis, we record income tax expense or benefit based on the expected annualized effective tax rate for the various taxing jurisdictions in which we operate our businesses.

*Six Months Ended June 30, 2013 Compared to Six Months Ended June 30, 2012*

*Net Revenues.* Net revenues were \$20.2 million for the six months ended June 30, 2013 compared to \$24.3 million for the same period in 2012, a decrease of \$4.1 million or 17%. We believe the decrease in our net revenues during the first six months of 2013 primarily reflects the factors previously discussed in the Overview.

During the six months ended June 30, 2013, our net revenues from customers in the U.S. decreased 15% and our net revenues from foreign customers decreased 18%, respectively, as compared to the same period in 2012. The impact of changes in foreign currency exchange rates on the decrease in net revenues from foreign customers was less than 1%.

*Gross Margin.* Gross margin was 47% for the six months ended June 30, 2013 compared to 44% for the same period in 2012. The improvement in the gross margin was primarily the result of a reduction in our component material costs as a percentage of net revenues, which decreased from 37% of net revenues for the first six months of 2012 to 35% of net revenues for the same period in 2013. We attribute the decrease to changes in customer and product mix. In addition, our fixed operating costs declined from 15% of net revenues for the first six months of 2012 to 14% of net revenues for the same period in 2013. In absolute dollar terms these costs declined \$709,000. This decrease primarily reflects reduced headcount in our Thermal Products segment. Finally, the improvement in gross margin reflects a lower level of charges for obsolete and excess inventory in the first six months of 2013 as compared to the same period in 2012. The reduction in these charges primarily reflects fewer items falling into our standard objective criteria.

*Selling Expense.* Selling expense was \$2.7 million for the six months ended June 30, 2013 compared to \$3.0 million for the same period in 2012, a decrease of \$244,000 or 8%. The decrease primarily reflects lower levels of commission expense reflecting the lower net revenue levels in the first six months of 2013 as compared to the same period in 2012.

*Engineering and Product Development Expense.* Engineering and product development expense was relatively unchanged at \$1.9 million for each of the six months ended June 30, 2013 and 2012, respectively. Increases in spending on matters related to our intellectual property were offset by reductions in the use of third party consultants.

*General and Administrative Expense.* General and administrative expense was \$3.1 million for the six months ended June 30, 2013 compared to \$3.7 million for the same period in 2012, a decrease of \$577,000 or 16%. During the first six months of 2012, we recorded \$337,000 in costs associated with the acquisition of Thermonics and \$55,000 in costs

related to the relocation of our Electrical Products segment's operation in California. There were no similar costs recorded in the first six months of 2013. To a lesser extent, the decrease also reflects lower levels of professional fees and a reduction in salary and benefits expense.

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### **Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. (Continued)**

#### **Restructuring and Other Charges.**

Restructuring and other charges were \$359,000 for the first six months of 2012. There were no similar charges for the first six months of 2013. The restructuring and other charges recorded during the first six months of 2012 represent facility closure costs related to the closure of the Sunnyvale, California facility occupied by Thermonics at the time of our acquisition of this operation.

*Income Tax Expense.* For the six months ended June 30, 2013, we recorded income tax expense of \$562,000 compared to income tax expense of \$632,000 for the same period in 2012. Our effective tax rate was 30% for the first six months of 2013 compared to 33% for the same period in 2012. On a quarterly basis, we record income tax expense or benefit based on the expected annualized effective tax rate for the various taxing jurisdictions in which we operate our businesses. The reduction in our effective tax rate in the first six months of 2013 as compared to the same period in 2012 primarily reflects the recording of the effect of the reinstatement of certain domestic research and development tax credits; this change was enacted in January 2013.

#### **Liquidity and Capital Resources**

Net cash provided by operations for the six months ended June 30, 2013 was \$541,000 compared to \$1.7 million for the same period in 2012. During the first six months of 2013, we recorded net earnings of \$1.3 million. However, the positive impact on cash of our net earnings was offset by an increase of \$1.8 million in accounts receivable and \$423,000 in inventories. These increases reflect increased business activity, particularly during the second quarter of 2013 as compared to the fourth quarter of 2012. These increases were partially offset by a \$287,000 increase in accounts payable during the first six months of 2013, also reflecting the increased business activity as compared to the fourth quarter of 2012. During the first six months of 2013, domestic and foreign income taxes payable increased \$255,000 reflecting the accrual of income tax due on our earnings and accrued wages and benefits decreased \$238,000 reflecting the payout of profit related bonuses accrued on the prior year's results. During the first six months of 2013, we recorded \$426,000 of non-cash charges for depreciation and amortization.

We have no significant commitments for capital expenditures for the balance of 2013, however, depending upon changes in market demand, we may make such purchases as we deem necessary and appropriate.

As of June 30, 2013, we had cash and cash equivalents of \$16.0 million. We currently expect our cash and cash equivalents and projected future cash flow to be sufficient to support our short term working capital requirements. We do not currently have any credit facilities under which we can borrow to help fund our working capital or other requirements. We cannot be certain that, if needed, we would be able to obtain any credit facilities or under what terms such credit facilities would be available.

#### **New or Recently Adopted Accounting Standards**

See the Notes to the consolidated financial statements for information concerning the implementation and impact of new or recently adopted accounting standards.

### **Critical Accounting Policies**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to inventories, long-lived assets, goodwill, identifiable intangibles, deferred income tax valuation allowances and product warranty reserves. We base our estimates on historical experience and on appropriate and customary assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Some of these accounting estimates and assumptions are particularly sensitive because of their significance to our consolidated financial statements and because of the possibility that future events affecting them may differ markedly from what had been assumed when the financial statements were prepared. As of June 30, 2013, there have been no significant changes to the accounting policies that we have deemed critical. These policies are more fully described in our 2012 Form 10-K.

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## **Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. (Continued)**

### **Off -Balance Sheet Arrangements**

There were no off-balance sheet arrangements during the three months ended June 30, 2013 that have or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our interests.

## **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

This disclosure is not required for a smaller reporting company.

## **Item 4. CONTROLS AND PROCEDURES**

CEO and CFO Certifications. Included with this Quarterly Report as Exhibits 31.1 and 31.2 are two certifications, one by each of our Chief Executive Officer and our Chief Financial Officer (the "Section 302 Certifications"). This Item 4 contains information concerning the evaluations of our disclosure controls and procedures that are referred to in the Section 302 Certifications. This information should be read in conjunction with the Section 302 Certifications for a more complete understanding of the topics addressed therein.

**Evaluation of Our Disclosure Controls and Procedures.** The SEC requires that as of the end of the quarter covered by this Report, our CEO and CFO must evaluate the effectiveness of the design and operation of our disclosure controls and procedures and report on the effectiveness of the design and operation of our disclosure controls and procedures.

"Disclosure controls and procedures" mean the controls and other procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 (the "Exchange Act"), such as this Report, is recorded, processed, summarized and reported within the time periods specified in the rules and forms promulgated by the SEC. Disclosure controls and procedures are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

**Limitations on the Effectiveness of Controls.** Our management, including the CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, as opposed to absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within an entity have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a system of controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, our management has designed the disclosure controls and procedures to provide reasonable assurance that the objectives of the control system were met.

**CEO/CFO Conclusions about the Effectiveness of the Disclosure Controls and Procedures.** As required by Rule 13a-15(b), inTEST management, including our CEO and CFO, conducted an evaluation as of the end of the period covered by this Report, of the effectiveness of our disclosure controls and procedures. Based on that evaluation, our CEO and CFO concluded that, as of the end of the period covered by this Report, our disclosure controls and procedures were effective at the reasonable assurance level.

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inTEST CORPORATION

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time we may be a party to legal proceedings occurring in the ordinary course of business. We are not currently involved in any material legal proceedings.

Item 1A. Risk Factors

Information regarding the primary risks and uncertainties that could materially and adversely affect our future performance or could cause actual results to differ materially from those expressed or implied in our forward-looking statements, appears in Part I, Item 1A -- "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2012.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None

Item 6. Exhibits

A list of the Exhibits which are required by Item 601 of Regulation S-K and filed with this Report is set forth in the Index to Exhibits immediately following the signature page, which Index to Exhibits is incorporated herein by reference.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

inTEST Corporation

Date: August 12, 2013      /s/ Robert E. Matthiessen  
Robert E. Matthiessen  
*President and Chief Executive Officer*

Date: August 12, 2013      /s/ Hugh T. Regan, Jr.  
Hugh T. Regan, Jr.  
*Secretary, Treasurer and Chief Financial Officer*

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Index to Exhibits

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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