

INTEST CORP  
Form 10-Q  
November 14, 2012

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 September 30, 2012 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 October 31, 2012:

10,425,178

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)

	Sept. 30, 2012	Dec. 31, 2011
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents	\$14,700	\$13,957
Trade accounts receivable, net of allowance for doubtful accounts of \$147 and \$195, respectively	6,892	6,189
Inventories	3,843	3,896
Deferred tax assets	438	453

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Prepaid expenses and other current assets	<u>373</u>	<u>302</u>
Total current assets	<u>26,246</u>	<u>24,797</u>
Property and equipment:		
Machinery and equipment	3,844	3,585
Leasehold improvements	<u>576</u>	<u>514</u>
Gross property and equipment	4,420	4,099
Less: accumulated depreciation	<u>(3,174)</u>	<u>(2,965)</u>
Net property and equipment	<u>1,246</u>	<u>1,134</u>
Deferred tax assets	1,555	2,028
Goodwill	1,706	1,656
Intangible assets, net	2,300	942
Restricted certificates of deposit	450	500
Other assets	<u>165</u>	<u>180</u>
Total assets	<u>\$33,668</u>	<u>\$31,237</u>
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,488	\$ 1,031
Accrued wages and benefits	1,538	1,795
Accrued sales commissions	524	493
Accrued rent	508	407
Accrued professional fees	407	451
Customer deposits	186	425
Other current liabilities	<u>636</u>	<u>436</u>
Total current liabilities	<u>5,287</u>	<u>5,038</u>
	=====	=====
Commitments and contingencies (Notes 10 and 12)		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 5,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock, \$0.01 par value; 20,000,000 shares authorized; 10,463,255 shares issued	105	105
Additional paid-in capital	26,010	26,035
Retained earnings (accumulated deficit)	1,269	(686)
Accumulated other comprehensive earnings	1,201	1,217
Treasury stock, at cost; 33,077 and 76,328 shares, respectively	<u>(204)</u>	<u>(472)</u>
Total stockholders' equity	<u>28,381</u>	<u>26,199</u>
Total liabilities and stockholders' equity	<u>\$33,668</u>	<u>\$31,237</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 Sept. 30,		Nine Months Ended Sept. 30,	
	2012	2011	2012	2011
Net revenues	\$10,799	\$11,681	\$35,106	\$37,185

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Cost of revenues	6,037	5,548	19,554	19,161
	-----	-----	-----	-----
Gross margin	4,762	6,133	15,552	18,024
	-----	-----	-----	-----
Operating expenses:				
Selling expense	1,322	1,461	4,283	4,433
Engineering and product development expense	1,006	809	2,910	2,444
General and administrative expense	1,445	1,448	5,101	4,748
Restructuring and other charges	-	-	359	-
	-----	-----	-----	-----
Total operating expenses	3,773	3,718	12,653	11,625
	-----	-----	-----	-----
Operating income	989	2,415	2,899	6,399
	-----	-----	-----	-----
Other income (expense):				
Interest income	1	2	3	8
Interest expense	-	(1)	-	(3)
Other income	22	4	33	66
	-----	-----	-----	-----
Total other income	23	5	36	71
	-----	-----	-----	-----
Earnings before income tax expense (benefit)	1,012	2,420	2,935	6,470
Income tax expense (benefit)	348	(2,762)	980	(2,624)
	-----	-----	-----	-----
Net earnings	\$ 664	\$ 5,182	\$ 1,955	\$ 9,094
	=====	=====	=====	=====
Net earnings per common share - basic	\$0.06	\$0.51	\$0.19	\$0.90
Weighted average common shares outstanding - basic	10,302,417	10,182,795	10,260,601	10,132,807
Net earnings per common share - diluted	\$0.06	\$0.50	\$0.19	\$0.88
Weighted average common shares and common share equivalents outstanding - diluted	10,360,377	10,297,284	10,348,180	10,287,055

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)  
(Unaudited)

Three Months Ended	Nine Months Ended
Sept. 30,	Sept. 30,
-----	-----

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	2012	2011	2012	2011
	-----	-----	-----	-----
Net earnings	\$ 664	\$ 5,182	\$ 1,955	\$ 9,094
Foreign currency translation adjustments	26	(143)	(16)	(56)
	-----	-----	-----	-----
Comprehensive earnings	\$ 690	\$ 5,039	\$ 1,939	\$ 9,038
	=====	=====	=====	=====

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 Capital	Earnings (Accumulated Deficit)	Other Comprehensive Earnings	Stock	Stockholders' Equity
	-----	-----	-----	-----	-----	-----	-----
Balance, January 1, 2012	10,463,255	\$ 105	\$26,035	\$ (686)	\$1,217	\$ (472)	\$26,199
Net earnings	-	-	-	1,955	-	-	1,955
Other comprehensive loss	-	-	-	-	(16)	-	(16)
Amortization of deferred compensation related to restricted stock	-	-	93	-	-	-	93
Issuance of 43,251 shares to satisfy profit sharing liability	-	-	(118)	-	-	268	150
	-----	-----	-----	-----	-----	-----	-----
Balance, Sept. 30, 2012	10,463,255	\$ 105	\$26,010	\$ 1,269	\$1,201	\$ (204)	\$28,381
	=====	=====	=====	=====	=====	=====	=====

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)  
(Unaudited)

	Nine Months Ended Sept. 30,	
	2012	2011
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	\$ 1,955	\$ 9,094
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	696	304
Foreign exchange gain	(10)	(10)
Amortization of deferred compensation related to restricted stock	93	119
Profit sharing expense funded through the issuance of treasury stock	150	150
(Gain) loss on sale of property and equipment	5	(40)
Proceeds from sale of demonstration equipment, net of gain	86	107
Deferred income tax expense (benefit)	489	(2,905)
Changes in assets and liabilities:		
Trade accounts receivable	465	(601)
Inventories	926	(1,186)
Prepaid expenses and other current assets	(71)	60
Restricted certificates of deposit	50	200
Other assets	14	28
Accounts payable	380	62
Accrued wages and benefits	(255)	(63)
Accrued sales commissions	(50)	31
Accrued rent	101	320
Accrued professional fees	(44)	1
Customer deposits	(239)	341
Other current liabilities	85	(164)
Deferred rent	-	(39)
	-----	-----
Net cash provided by operating activities	4,826	5,809
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of business	(3,802)	-
Purchase of property and equipment	(283)	(685)
Proceeds from sale of property and equipment	13	40
	-----	-----
Net cash used in investing activities	(4,072)	(645)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from stock options exercised	-	30
	-----	-----
Net cash provided by financing activities	-	30
	-----	-----
Effects of exchange rates on cash	(11)	(25)
	-----	-----
Net cash provided by all activities	743	5,169
Cash and cash equivalents at beginning of period	13,957	6,895
	-----	-----
Cash and cash equivalents at end of period	\$14,700	\$12,064
	=====	=====
Cash payments for:		
Domestic and foreign income taxes	\$ 283	\$ 171
Interest	\$ 8	\$ 1
	-----	-----
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	\$ 3,802
	=====
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:	
Forfeitures of non-vested shares of restricted stock	\$ - \$ (20)

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 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, 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, 2011 filed with the Securities and Exchange Commission on March 30, 2012 (the "2011 Form 10-K").

#### **Reclassification**

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

#### **Inventories**

Inventory is valued at standard cost, which approximates actual cost computed on a first-in, first-out basis, not in excess of market value. Cash flows from the sale of inventory 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,

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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)**

anticipated product life cycles, new product introductions and expected future use of the inventory. The charges for excess and obsolete inventory we record establish a new cost basis for the related inventory. We incurred excess and obsolete inventory charges of \$522 and \$278 for the nine months ended September 30, 2012 and 2011, 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. In September 2011, the Financial Accounting Standards Board ("FASB") issued new guidance which provides an entity with 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 an entity determines this is the case, it is required to perform a two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized. The two-step test is discussed below. If an entity determines 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. This new guidance was effective for fiscal

years beginning after December 15, 2011. We adopted this guidance as of January 1, 2012. The adoption of this guidance did not have a material impact on our consolidated financial statements.

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.

### **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.

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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)**

**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 quarter ended September 30, 2012.

**Revenue Recognition**

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 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.

**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 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.

inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

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

For the nine months ended September 30, 2012 and 2011, we recorded income tax expense of \$980 and an income tax benefit of \$2,624, 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. During the past several years, due to our history of operating losses in both our domestic and certain of our foreign operations, we had recorded a full valuation allowance against the deferred tax assets of these operations, including net operating loss carryforwards, where we believed it was more likely than not that we would not have sufficient taxable income to utilize these assets before they expire. During the second half of 2011, we reversed \$3,110 of the valuation allowance which had been recorded against the deferred tax assets of these operations. The reversal of this amount of the valuation allowance was based on our current assessment that it is now more likely than not that we will be able to fully utilize these assets in the near future. Some of the key factors we considered in making our assessment included our profitability in both 2011 and 2010 and our level of certainty with regard to our forecasts of near term future profitability for the operations to which these assets relate.

**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		Nine Months Ended	
	<u>Sept. 30,</u>		<u>Sept. 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Weighted average common shares outstanding - basic	10,302,417	10,182,795	10,260,601	10,132,807
Potentially dilutive securities:				
Employee stock options and unvested shares of restricted stock	<u>57,960</u>	<u>114,489</u>	<u>87,579</u>	<u>154,248</u>
	<u>10,360,377</u>	<u>10,297,284</u>	<u>10,348,180</u>	<u>10,287,055</u>

Weighted average common shares and common share  
equivalents outstanding - diluted

Average number of potentially dilutive securities excluded from calculation	229,675	114,280	42,720	79,633
---	---------	---------	--------	--------

Effect of Recently Issued 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 of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The amendment is 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 do not expect the adoption of this amendment to have a material impact on our consolidated financial statements.

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

**(3) ACQUISITION**

On January 16, 2012, Temptronic 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 broadens 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 the seller. We ceased operations at this facility in February 2012 and

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relocated the Thermonics product line to our facility in Mansfield, Massachusetts where our Temptronic operations are located. We recorded a restructuring charge in the first quarter of 2012 of \$359 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	

We estimated the fair value of identifiable intangible assets acquired using a combination of the income, cost and market approaches. We generally amortize our finite-lived intangible assets over their estimated useful lives on a straight-line 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. 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:

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(3) ACQUISITION

(Continued)

	<u>Fair Value</u>	<u>Weighted Average Estimated Useful Life</u>
		(in 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 September 30, 2012, Thermonics contributed \$3,467 of net revenues. We do not track net income within our Thermal Products segment by product line. As a result, the net income

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for Thermonics for the period from January 16, 2012 to September 30, 2012 is not available.

The following unaudited pro forma information gives effect to the acquisition of Thermonics as if the acquisition occurred on January 1, 2011. These proforma summaries do not reflect any operating efficiencies or costs savings that may be achieved by the combined businesses. These proforma summaries are presented for informational purposes only and are not necessarily indicative of what the actual results of operations would have been had the acquisition taken place as of that date, nor are they indicative of future consolidated results of operations:

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Net revenues	\$10,799	\$13,223	\$35,322	\$41,268
Net earnings	658	5,417	2,537	8,093
Diluted earnings per share	\$0.06	\$0.53	\$0.25	\$0.79

The proforma results for 2011 shown above include non-recurring charges of \$337 which represent transaction costs related to the Thermonics acquisition and \$359 which represent facility closure costs related to the relocation of Thermonics' operations.

(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. Changes in the amount of the carrying value of goodwill for the nine months ended September 30, 2012 are as follows:

	<u>Sigma</u>	<u>Thermonics</u>	<u>Total</u>
Balance - January 1, 2012	\$1,656	\$ -	\$1,656
Acquisition of Thermonics	<u>-</u>	<u>50</u>	<u>50</u>
Balance - September 30, 2012	<u>\$1,656</u>	<u>\$ 50</u>	<u>\$1,706</u>

**Intangible Assets**

The following table provides further detail about our intangible assets as of September 30, 2012 and December 31, 2011:

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

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

	<u>Sept. 30, 2012</u>		
	Gross Carrying <u>Amount</u>	Accumulated <u>Amortization</u>	Net Carrying <u>Amount</u>
Finite-lived intangible assets:			
Customer relationships	\$1,480	\$ 377	\$1,103
Patented technology	590	212	378
Software	270	108	162
Trade name	140	25	115
Customer backlog	70	70	-
Non-compete/non-solicitation agreement	<u>48</u>	<u>16</u>	<u>32</u>
Total finite-lived intangible assets	<u>2,598</u>	<u>808</u>	<u>1,790</u>
Indefinite-lived intangible assets:			
Sigma trademark	<u>510</u>	<u>-</u>	<u>510</u>
Total intangible assets	<u>\$3,108</u>	<u>\$ 808</u>	<u>\$2,300</u>

December 31, 2011

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	Gross Carrying <u>Amount</u>	Accumulated <u>Amortization</u>	Net Carrying <u>Amount</u>
Finite-lived intangible assets:			
Customer relationships	\$ 370	\$ 200	\$ 170
Patented technology	230	150	80
Software	<u>270</u>	<u>88</u>	<u>182</u>
Total finite-lived intangible assets	<u>870</u>	<u>438</u>	<u>432</u>
Indefinite-lived intangible assets:			
Sigma trademark	<u>510</u>	—	<u>510</u>
Total intangible assets	<u>\$1,380</u>	<u>\$ 438</u>	<u>\$ 942</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 September 30, 2012:

	Estimated <u>Useful</u> <u>Life</u>	Remaining Estimated Useful Life at <u>Sept. 30,</u> <u>2012</u>
	---- (in months) ----	
Finite-lived intangible assets resulting from the acquisition of Sigma:		
Customer relationships	72	24
Software	120	72
Patented technology	60	12

Finite-lived intangible assets resulting from the acquisition of  
Thermonics:

	72	63.5
Customer relationships		
	3	-
Customer backlog		
	48	39.5
Trade name		
	132	123.5
Patented technology		
	18	12
Non-compete/non-solicitation agreement		

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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)**

The following table sets forth changes in the amount of the carrying value of finite-lived intangible assets for the nine months ended September 30, 2012:

	\$ 432
Balance - January 1, 2012	
	1,728
Acquisition of Thermonics	
	<u>(370)</u>
Amortization	
	)
	<u>\$1,790</u>
Balance - September 30, 2012	

Total amortization expense for the nine months ended September 30, 2012 and 2011 was \$370 and \$101, respectively. Total estimated amortization expense for 2012 is \$476. 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	

2016	\$229
2017	\$212

(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 is owned by 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. 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 nine months ended September 30, 2012 are summarized as follows:

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

**(6) MAJOR CUSTOMERS**

During the nine months ended September 30, 2012 and 2011, Texas Instruments Incorporated accounted for 16% and 12%, 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 nine months ended September 30, 2012, Teradyne, Inc. accounted for 13% 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 customer accounted for 10% or more of our consolidated net revenues during the nine months ended September 30, 2012 and 2011.

(Unaudited)

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

**(7) INVENTORIES**

Inventories held at September 30, 2012 and December 31, 2011 were comprised of the following:

	Sept. 30,	Dec. 31,
	<i>2012</i>	<i>2011</i>
Raw materials	\$2,916	\$2,784
Work in process	370	351
Inventory consigned to others	96	201
Finished goods	<u>461</u>	<u>560</u>
	<u>\$3,843</u>	<u>\$3,896</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 September 30, 2012 and December 31, 2011 consisted of the following:

<u>Facility</u>	<u>Original L/C Issue Date</u>	<u>L/C Expiration Date</u>	<u>Lease Expiration Date</u>	<u>Letters of Credit Amount Outstanding</u>	
				<u>Sept. 30, 2012</u>	<u>Dec. 31, 2011</u>
Mt. Laurel, NJ	3/29/2010	4/01/2013	4/30/2021	\$250	\$250
Mansfield, MA	10/27/2010	11/07/2012	8/23/2021	200	200
	9/13/2004	6/30/2012	4/30/2012	<u>-</u>	<u>50</u>

San Jose, CA

\$450      \$500

(9)

**GUARANTEES**Product Warranties

Warranty expense for the nine months ended September 30, 2012 and 2011 was \$68 and \$90, respectively. The following table sets forth the changes in the liability for product warranties for the nine months ended September 30, 2012:

Balance - January 1, 2012	\$214
Acquisition of Thermonics	67
Payments made under product warranty	(124)
Accruals for product warranty	<u>68</u>
Balance - September 30, 2012	<u>\$225</u>

The liability for product warranties is included in Other Current Liabilities on our balance sheet.

**(10) STOCK-BASED COMPENSATION**

As of September 30, 2012, 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 2011 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)**

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As of September 30, 2012, total compensation expense to be recognized in future periods was \$139. The weighted average period over which this expense is expected to be recognized is 1.4 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 nine months ended September 30, 2012 and 2011, respectively, related to nonvested shares:

	Three Months Ended <u>Sept. 30,</u>		Nine Months Ended <u>Sept.</u> <u>30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Cost of revenues	\$ 1	\$ 3	\$ 5	\$ 9
Selling expense	3	3	7	13
Engineering and product development expense	7	8	19	34
General and administrative expense	<u>21</u>	<u>18</u>	<u>62</u>	<u>63</u>
	<u>\$32</u>	<u>\$32</u>	<u>\$93</u>	<u>\$119</u>

There was no compensation expense capitalized in the three or nine months ended September 30, 2012 or 2011.

The following table summarizes the activity related to nonvested shares for the nine months ended September 30, 2012:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested shares outstanding, January 1, 2012	195,000	\$1.62
Granted	-	-
Vested	(76,250)	1.62
Forfeited	<u>-</u>	-

	<u>118,750</u>	1.61
Nonvested shares outstanding, September 30, 2012		

Stock Options

The following table summarizes the stock option activity for the nine months ended September 30, 2012:

	Number of Shares	Weighted Average <u>Exercise</u> <u>Price</u>
Options outstanding, January 1, 2012 (249,000 exercisable)	249,000	\$3.28
Granted	-	-
Exercised	-	-
Forfeited/Expired	<u>(30,000)</u>	4.11
	)	
Options outstanding, September 30, 2012 (219,000 exercisable)	<u>219,000</u>	3.17

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(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 and inTEST Silicon Valley Corp 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 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. The inTEST 401(k) Plan retains the matching provisions of the prior Temptronic plan for all Temptronic employees. Temptronic matches employee contributions \$0.50 on the dollar up to 6% of the employees' annual compensation, with a maximum limit of \$3. Matching contributions are discretionary. The eligibility and vesting provisions of the prior Temptronic plan have been conformed to those for inTEST Corporation and inTEST Silicon Valley Corporation employees.

In addition to the employer matching for which Temptronic employees are eligible, upon the termination of the Temptronic Equity Participation Plan ("EPP"), we also acknowledged that it was our intention to contribute \$3,000 in the aggregate to the inTEST 401(k) Plan as a form of profit sharing (not to exceed \$300 per year) for the benefit of Temptronic employees. The amount of these contributions approximates the amount that we had been committed to contribute to the EPP as of its termination date. All such profit sharing contributions are at the discretion of management, and will be allocated to employees annually in the same manner in which the shares held by the EPP had been allocated. The vesting provisions for these contributions are the same as those of the inTEST 401(k) Plan. Accruals for profit sharing contributions totaling \$225 were made during the each of the nine months ended September 30, 2012 and 2011, respectively. Through September 30, 2012, we had made a total of \$2,078 in profit sharing contributions. We have historically funded these contributions through the use of treasury shares during the quarter subsequent to the quarter in which we record the profit sharing liability, although management has the discretion to use cash to fund these contributions. Our current intention is to use cash to fund these contributions when our stock price is below \$3.00 per share.

During the third quarter of 2012, our Board of Directors approved an amendment to the inTEST 401(k) Plan. The amendment will terminate the profit sharing contributions for Temptronic employees effective December 31, 2012. In addition, the amendment will conform the employer matching provisions of the Plan for the Temptronic employees with those currently in place for inTEST Corporation and inTEST Silicon Valley employees.

## (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 Corporation, Thermonics (which we acquired in January 2012 as discussed further in Note 3), Sigma Systems Corp., 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 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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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(12) SEGMENT INFORMATION

(Continued)

	Three Months Ended <u>Sept.</u> <u>30,</u>	2011	Nine Months Ended <u>Sept. 30,</u>	2011
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Net revenues from unaffiliated customers:				
Thermal Products	\$ 6,037	\$ 7,572	\$18,651	\$19,593
Mechanical Products	2,677	3,172	8,277	13,299
Electrical Products	2,086	941	8,189	4,327
	<u>(1</u>	<u>(4</u>	<u>(11</u>	<u>(34</u>
Intersegment sales	)	)	)	)
	<u>\$10,799</u>	<u>\$11,681</u>	<u>\$35,106</u>	<u>\$37,185</u>
Intersegment sales:				
Thermal Products	\$ -	\$ -	\$ -	\$ -
Mechanical Products	-	3	10	7
	<u>1</u>	<u>1</u>	<u>1</u>	<u>27</u>
Electrical Products	<u>\$ 1</u>	<u>\$ 4</u>	<u>\$ 11</u>	<u>\$ 34</u>

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Earnings (loss) before income tax expense (benefit):	\$ 895	\$2,346	\$2,267	\$4,939
Thermal Products	(324)	218	(1,256)	1,330
Mechanical Products	376	(65)	2,115	615
Electrical Products	<u>65</u>	<u>(79)</u>	<u>(191)</u>	<u>(414)</u>
Corporate	)	)	)	)
	<u>\$1,012</u>	<u>\$2,420</u>	<u>\$2,935</u>	<u>\$6,470</u>
Net earnings (loss):	\$ 587	\$5,024	\$1,510	\$6,942
Thermal Products	(213)	466	(837)	1,869
Mechanical Products	247	(138)	1,409	865
Electrical Products	<u>43</u>	<u>(170)</u>	<u>(127)</u>	<u>(582)</u>
Corporate	)	)	)	)
	<u>\$ 664</u>	<u>\$5,182</u>	<u>\$1,955</u>	<u>\$9,094</u>

		Sept. 30,	Dec. 31,
Identifiable assets:		<u>2012</u>	<u>2011</u>
		\$21,950	\$20,030
Thermal Products		6,344	8,240
Mechanical Products		<u>5,374</u>	<u>2,967</u>
Electrical Products		<u>\$33,668</u>	<u>\$31,237</u>

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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 Ended		Nine Months Ended	
	Sept. 30,	Sept. 30,	Sept. 30,	Sept. 30,
	2012	2011	2012	2011
Net revenues from unaffiliated customers:				
U.S.	\$ 4,123	\$ 4,797	\$12,052	\$13,820
	<u>6,676</u>	<u>6,884</u>	<u>23,054</u>	<u>23,365</u>
Foreign	<u>\$10,799</u>	<u>\$11,681</u>	<u>\$35,106</u>	<u>\$37,185</u>

	Sept. 30, Dec. 31,	
	2012	2011
Long-lived assets:		
U.S.	\$ 995	\$ 836
	<u>251</u>	<u>298</u>
Foreign	<u>\$1,246</u>	<u>\$1,134</u>

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inTEST CORPORATION

**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 Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission on March 30, 2012 (the "2011 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

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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 2011 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 2011 Form 10-K.

### Overview

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 semiconductor test, such as the automotive, consumer electronics, defense/aerospace 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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### inTEST CORPORATION

#### 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, and (iv) customer supply line management groups demanding lower prices and spreading purchases across multiple vendors. These shifts in market practices have had, and may continue to have, varying levels of

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

	<u>(in 000's)</u>				
	<u>Three Months Ended</u>		<u>Nine Months Ended</u>		
	<u>Sept. 30,</u>	<u>June 30,</u>	<u>Sept. 30,</u>		
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2012</u>	<u>2011</u>
Net revenues from unaffiliated customers:					
Thermal Products	\$ 6,037	\$ 7,572	\$ 6,503	\$18,651	\$19,593
Mechanical Products	2,677	3,172	3,086	8,277	13,299
Electrical Products	2,086	941	3,987	8,189	4,327
	<u>—</u> (1	<u>—</u> (4	<u>—</u> -	<u>—</u> (11	<u>—</u> (34
Intersegment sales	)	)	)	)	)
	<u>\$10,799</u>	<u>\$11,681</u>	<u>\$13,576</u>	<u>\$35,106</u>	<u>\$37,185</u>
Intersegment sales:					
Thermal Products	\$ -	\$ -	\$ -	\$ -	\$ -
Mechanical Products	-	3	-	10	7
Electrical Products	<u>1</u>	<u>1</u>	<u>-</u>	<u>1</u>	<u>27</u>
	<u>\$ 1</u>	<u>\$ 4</u>	<u>\$ -</u>	<u>\$11</u>	<u>\$34</u>
Net revenues from unaffiliated customers (net of intersegment sales):					
Thermal Products	\$ 6,037	\$ 7,572	\$ 6,503	\$18,651	\$19,593
Mechanical Products	2,677	3,169	3,086	8,267	13,292

	<u>2,085</u>	<u>940</u>	<u>3,987</u>	<u>8,188</u>	<u>4,300</u>
Electrical Products	<u>\$10,799</u>	<u>\$11,681</u>	<u>\$13,576</u>	<u>\$35,106</u>	<u>\$37,185</u>
Net revenues from unaffiliated customers:					
U.S.	\$ 4,123	\$ 4,797	\$ 3,733	\$12,052	\$13,820
	<u>6,676</u>	<u>6,884</u>	<u>9,843</u>	<u>23,054</u>	<u>23,365</u>
Foreign	<u>\$10,799</u>	<u>\$11,681</u>	<u>\$13,576</u>	<u>\$35,106</u>	<u>\$37,185</u>

Our consolidated net revenues for the quarter ended September 30, 2012 decreased \$882,000 or 8% as compared to the same period in 2011. For the quarter ended September 30, 2012, net revenues (net of intersegment sales) of our Thermal and Mechanical Products segments decreased \$1.5 million or 20% and \$492,000 or 16%, respectively, while the net revenues (net of intersegment sales) of our Electrical Products segment increased \$1.1 million or 122% as compared to the same period in 2011. During the quarter ended September 30, 2012, the net revenues of our Thermal Products segment included \$1.4 million of net revenues attributable to Thermonics, Inc. ("Thermonics"), which we acquired on January 16, 2012 as discussed further under "Acquisition" below. Adjusted to eliminate the impact of the net revenues attributable to Thermonics, the net revenues (net of intersegment sales) of our Thermal Products segment for the third quarter of 2012 would have decreased \$2.9 million or 39% as compared to the same period in 2011. 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 \$1.1 million or 10%, respectively, for the quarter ended September 30, 2012, compared to \$1.8 million or 14%, respectively, for the quarter ended June 30, 2012, and \$3.6 million or 31%, respectively, for the quarter ended September 30, 2011. Adjusted to eliminate the impact of the net revenues attributable to Thermonics, the 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 \$1.1 million or 12%, respectively, for the quarter ended September 30, 2012 and \$1.8 million or 15%, 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)

During the first nine months of 2012, the level of demand experienced by our Thermal and Mechanical Products segments was less than that experienced during the same period in 2011. We believe the decline in the level of net revenues of our Thermal Products segment (when adjusted to eliminate the impact of the acquisition of Thermonics) reflects in part that this segment, which 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, is now being impacted by the decline in demand in the ATE industry which we began to see impacting our Mechanical Products segment during the second quarter of 2011. In addition, our Thermal Products segment sells to industries outside of the ATE industry. This diversification has, in the past, helped to balance the impact of changing levels of demand in the ATE industry. However, in the first nine months of 2012, we have experienced weakened levels of demand in certain of these industries as well, which contributed to the overall level of decrease experienced by this product segment in the first nine months of 2012 as compared to the same period in 2011.

We believe the decrease in the level of net revenues in our Mechanical Products segment reflects reduced demand within the ATE industry, which we had begun to see reflected in the level of our orders for this segment during the second quarter of 2011. This decline in demand was partially offset by increased demand during the first quarter of 2012 from one particular major customer that recently completed an acquisition and, as a result, has had higher than typical demand for certain of our equipment as a part of the process of integrating their post-acquisition operations. This same major customer also purchases products from our Electrical Products segment and we believe this also is responsible for a portion of the increase in the net revenues of our Electrical Products segment during the first nine months of 2012 as compared to the same period in 2011. We also attribute the increase in the net revenues of our Electrical Products segment to a significant increase in demand from one particular major OEM customer. However, the level of demand from this OEM customer weakened significantly during the third quarter of 2012 which we expect will result in a decline in the net revenues of our Electrical Products segment in the fourth quarter of 2012 as compared to the third quarter of 2012.

Total orders for the quarter ended September 30, 2012 were \$8.7 million compared to \$11.8 million for the quarter ended June 30, 2012 and \$10.5 million for the quarter ended September 30, 2011. Orders for the third quarter of 2012 include \$1.2 million attributable to Thermonics. For the quarter ended September 30, 2012, orders for our Thermal, Mechanical and Electrical Products segments were \$5.7 million, \$1.7 million and \$1.3 million, respectively, compared to \$6.4 million, \$2.3 million and \$3.1 million for the quarter ended June 30, 2012, respectively, and \$7.4 million, \$2.3 million and \$827,000 for the quarter ended September 30, 2011, respectively. Orders from customers in various industries outside of the ATE industry and those orders as a percentage of our total consolidated orders were \$1.5 million or 17%, respectively, for the quarter ended September 30, 2012, compared to \$1.2 million or 10%, respectively, for the quarter ended June 30, 2012, and \$4.3 million or 41%, respectively, for the quarter ended September 30, 2011. 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 September 30, 2012, our backlog of unfilled orders for all products was approximately \$3.2 million compared with approximately \$5.2 million at June 30, 2012 and \$6.1 million at September 30, 2011. Our backlog at September 30, 2012 included approximately \$545,000 that was attributable to Thermonics compared with approximately \$744,000 at June 30, 2012. Our backlog includes customer orders which we have accepted, substantially all of which we expect to deliver in 2012. 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.

#### Acquisition

On January 16, 2012, Temptronic Corporation acquired substantially all of the assets and certain liabilities of Thermonics, a division of Test Enterprises, Inc., 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 broadens the product line of inTEST's Thermal Products segment. The purchase price for the assets was approximately \$3.8 million in cash, plus the assumption of specified liabilities. For further discussion of the acquisition, see Note 3 to our consolidated financial statements.

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

(Continued)

#### 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 patented technology) utilized in the product, the number of units ordered by the customer at one time, or 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 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 nine months ended September 30, 2012 and 2011, our OEM sales as a percentage of net revenues were 16% and 13%, respectively.

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

All of our products are used by semiconductor manufacturers in conjunction with ATE in the testing of ICs. In addition, some of the products manufactured by our Thermal Products segment are used in industries outside of the semiconductor industry, including the automotive, consumer electronics, defense/aerospace and telecommunications industries. The results of operations for each product segment 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

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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 Sept. 30,</u>		<u>Nine Months Ended Sept.</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
	100.0%	100.0%	100.0%	100.0%
Net revenues				
Cost of revenues	<u>55.9</u>	<u>47.5</u>	<u>55.7</u>	<u>51.5</u>
Gross margin	<u>44.1</u>	<u>52.5</u>	<u>44.3</u>	<u>48.5</u>
Selling expense	12.2	12.5	12.2	11.9
Engineering and product development expense	9.3	6.9	8.3	6.6
General and administrative expense	13.4	12.4	14.5	12.8
Restructuring and other charges	<u>0.0</u>	<u>0.0</u>	<u>1.0</u>	<u>0.0</u>
Operating income	9.2	20.7	8.3	17.2
Other income	<u>0.2</u>	<u>0.0</u>	<u>0.1</u>	<u>0.2</u>
Earnings before income tax expense (benefit)	9.4	20.7	8.4	17.4
Income tax expense (benefit)	<u>3.2</u>	<u>(23.6)</u>	<u>2.8</u>	<u>(7.1)</u>
Net earnings	<u>6.2</u>	<u>44.3</u>	<u>5.6</u>	<u>24.5</u>
	%	%	%	%

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

(Continued)

Quarter Ended September 30, 2012 Compared to Quarter Ended September 30, 2011

*Net Revenues.* Net revenues were \$10.8 million for the quarter ended September 30, 2012 compared to \$11.7 million for the same period in 2011, a decrease of \$882,000 or 8%. Net revenues (net of intersegment sales) of our Thermal and Mechanical Products segments decreased \$1.5 million or 20% and \$492,000 or 16%, respectively, while the net revenues (net of intersegment sales) of our Electrical Products segment increased \$1.1 million or 122% as compared to the same period in 2011. During the quarter ended September 30, 2012, the net revenues of our Thermal Products segment included \$1.4 million of net revenues attributable to Thermonics. We believe the decrease in our consolidated net revenues during the third quarter of 2012 primarily reflects the factors previously discussed in the Overview.

During the quarter ended September 30, 2012, our net revenues from customers in the U.S. decreased 14% while our net revenues from foreign customers decreased 3%, respectively, as compared to the same period in 2011. 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 44% for the third quarter of 2012 compared to 53% for the same period in 2011. The decrease in gross margin was largely the result of an increase in our component material costs as a percentage of net revenues. Total component material costs represented 37% of net revenues for the third quarter of 2012 as compared to 31% for the same quarter in 2011. The increase in component material costs reflects changes in product and customer mix, primarily in our Mechanical and Electrical Products segments. For our Mechanical Products segment, a greater percentage of this segment's total net revenues for the third quarter of 2012 were generated by sales of our manipulator products and certain other distributor products which have lower margins than our docking hardware products. For our Electrical Products segment, a greater percentage of this segment's total net revenues for the third quarter of 2012 were generated by sales to OEM customers where our margins are typically lower than for similar sales to End User customers. To a lesser extent, the decrease in gross margin is also the result of an increase in our charges for excess and obsolete inventory, which increased \$83,000 in absolute dollar terms during the third quarter of 2012 as compared to the same period in 2011. This increase indicates that more inventory items are falling into our standard excess and obsolete criteria in 2012, largely as a result of the continued reduced levels of demand in the ATE industry. For the quarter ended September 30, 2012, our fixed operating costs were relatively unchanged at \$1.6 million. As a percentage of net revenues, these costs increased slightly from 14% of net revenues for the third quarter of 2011 to 15% of net revenues for the third quarter of 2012, reflecting that these costs were not as fully absorbed by the lower net revenue levels in the third quarter of 2012.

*Selling Expense.* Selling expense was \$1.3 million for the third quarter of 2012 compared to \$1.5 million for the same period in 2011, a decrease of \$139,000 or 10%. The decrease primarily represents lower levels of commissions in our Thermal and Mechanical Products segments as a result of the lower net revenue levels in the third quarter of 2012 as compared to the third quarter of 2011.

*Engineering and Product Development Expense.* Engineering and product development expense was \$1.0 million for the third quarter of 2012 compared to \$809,000 for the same period in 2011, an increase of \$197,000 or 24%. The increase in engineering and product development expense reflects higher spending on materials used in new product development projects and, to a lesser extent, an increased use of third party consultants and the hiring of additional staff in our Thermal and Electrical Products segments.

*General and Administrative Expense.* General and administrative expense was relatively unchanged at \$1.4 million for both the third quarter of 2012 and the same period in 2011. Reductions in the level of accruals for profit based bonuses were offset by higher levels of intangible asset amortization as a result of the Thermonics acquisition, as well as increased professional fees.

*Other Income.* Other income was \$23,000 for the third quarter of 2012 compared to \$5,000 for the same period in 2011. The increase primarily represents higher levels of foreign currency transaction gains.

*Income Tax Expense.* For the quarter ended September 30, 2012, we recorded income tax expense of \$348,000 compared to an income tax benefit of \$2.8 million for the same period in 2011. 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. During the past several years, due to our history of operating losses in both our domestic and certain of our foreign operations, we had recorded a full valuation allowance against the deferred tax assets of these operations, including net operating loss carryforwards, where we believed it was more likely than not that we would not have sufficient taxable income to utilize these assets before they expire. During the third and fourth quarters of 2011, we reversed \$3.1 million of the valuation allowance which had been recorded against the deferred tax assets of these operations. The reversal of this amount of the valuation

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

(Continued)

allowance was based on our current assessment that it is now more likely than not that we will be able to fully utilize these assets in the near future. Some of the key factors we considered in making our assessment included our profitability in both 2011 and 2010 and our level of certainty with regard to our forecasts of near term future profitability for the operations to which these assets relate.

*Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011*

*Net Revenues.* Net revenues were \$35.1 million for the nine months ended September 30, 2012 compared to \$37.2 million for the same period in 2011, a decrease of \$2.1 million or 6%. Net revenues (net of intersegment sales) of our Thermal and Mechanical Products segments decreased \$942,000 or 5% and \$5.0 million or 38%, respectively, while the net revenues (net of intersegment sales) of our Electrical Products segment increased \$3.9 million or 90% as compared to the same period in 2011. During the nine months ended September 30, 2012, the net revenues of our Thermal Products segment included \$3.5 million of net revenues attributable to Thermonics. We believe the decrease in our consolidated net revenues during the first nine months of 2012 primarily reflects the factors previously discussed in the Overview.

During the nine months ended September 30, 2012, our net revenues from customers in the U.S. decreased 13% while our net revenues from foreign customers decreased 1% as compared to the same period in 2011. The impact of changes in foreign currency exchange rates on the change in net revenues from foreign customers was less than 1%.

*Gross Margin.* Gross margin was 44% for the first nine months of 2012 compared to 49% for the same period in 2011. The decrease in gross margin was partly the result of an increase in our component material costs as a percentage of net revenues. Total component material costs represented 37% of net revenues for the first nine months of 2012 as compared to 35% for the same period in 2011. The increase in component material costs primarily reflects changes in customer mix in our Electrical Products segments. During the first nine months of 2012, a greater percentage of this segment's total net revenues were generated by sales to OEM customers where our margins are typically lower than for similar sales to End User customers. To a lesser extent, the decrease in gross margin is also the result of an increase in our charges for excess and obsolete inventory and our fixed operating costs for the first nine months of 2012 as compared to the same period in 2011. Our charges for excess and obsolete inventory increased \$244,000 in absolute dollar terms during the first nine months of 2012 as compared to the same period in 2011. This increase indicates that more inventory items are falling into our standard excess and obsolete criteria in 2012, largely as a result of the continued reduced levels of demand in the ATE industry. For the nine months ended September 30, 2012, our fixed operating costs increased \$163,000 in absolute dollar terms as compared to the same period in 2011. This increase primarily reflects increased salaries and benefits expense representing increased levels of staff in our Thermal Products segment. In addition, we had higher levels of depreciation reflecting a higher fixed asset base at September 30, 2012 as compared to September 30, 2011. These increases were partially offset by decreases in facilities related costs such as rent and utilities, reflecting that we have now completed the relocation of all three of our domestic operations to smaller facilities.

*Selling Expense.* Selling expense was \$4.3 million for the first nine months of 2012 compared to \$4.4 million

for the same period in 2011, a decrease of \$150,000 or 3%. The decrease primarily represents lower levels of commissions in our Mechanical Products segment as a result of the lower net revenue levels in the first nine months of 2012 as compared to the same period in 2011. This decrease was partially offset by increases in advertising expense in our Mechanical and Electrical Products segments.

*Engineering and Product Development Expense.* Engineering and product development expense was \$2.9 million for the first nine months of 2012 compared to \$2.4 million for the same period in 2011, an increase of \$466,000 or 19%. The increase in engineering and product development expense reflects higher spending on materials used in new product development projects and an increase in the use of third party consultants, primarily in our Thermal Products segment, and the hiring of additional staff in our Thermal and Electrical Products segments.

*General and Administrative Expense.* General and administrative expense was \$5.1 million for the first nine months of 2012 compared to \$4.7 million for the same period in 2011, an increase of \$353,000 or 7%. During the first nine months of 2012, we recorded \$337,000 in costs associated with the acquisition of Thermonics which was completed on January 16, 2012; there were no similar costs recorded in the first nine months of 2011. In addition, amortization expense related to our intangible assets increased \$269,000 during the first nine months of 2012 as compared to the same period in 2011. This increase represents amortization of the intangible assets acquired as a part of the Thermonics transaction. These increases were partially offset by a decrease in accruals for profit-related bonuses in our Corporate, Mechanical Products and Thermal Products segments, reflecting the lower level of net earnings in the first nine months of 2012 as compared to the same period of 2011.

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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 nine months of 2012; there were no similar charges for the first nine months of 2011. The restructuring and other charges recorded during the first quarter 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.

*Other Income.* Other income was \$36,000 for the first nine months of 2012 compared to other income of \$71,000 for the same period in 2011. During the first nine months of 2011, we recorded a gain on sale of property and equipment; there was no similar gain recorded during the first nine months of 2012.

*Income Tax Expense.* For the nine months ended September 30, 2012, we recorded income tax expense of \$980,000 compared to an income tax benefit of \$2.6 million for the same period in 2011. 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. During the past several years, due to our history of operating losses in both our domestic and certain of our foreign operations, we had recorded a full valuation allowance against the deferred tax assets of these operations, including net operating loss carryforwards, where we believed it was more likely than not that we would not have sufficient taxable income to utilize these assets before they expire. During the third and fourth quarters of 2011, we reversed \$3.1 million of the valuation allowance which had been recorded against the deferred tax assets of these operations. The reversal of this amount of the valuation allowance was based on our current assessment that it is now more likely than not that we will be able to fully utilize these assets in the near future. Some of the key factors we considered in making our assessment included our profitability in both 2011 and 2010 and our level of certainty with regard to our forecasts of near term future profitability for the operations to which these assets relate.

**Liquidity and Capital Resources**

Net cash provided by operations for the nine months ended September 30, 2012 was \$4.8 million compared to \$5.8 million for the same period

in 2011. The decrease in net cash provided by operations reflects in part the lower level of net earnings in the first nine months of 2012 as compared to 2011. During the first nine months of 2012, we recorded deferred income tax expense of \$489,000. In contrast, as previously discussed, during the third quarter of 2011, we reversed \$2.9 million of the valuation allowance that had been recorded against our deferred tax assets in prior periods. Adjusted to eliminate the impact of the Thermonics acquisition, inventories decreased \$926,000 during the first nine months of 2012 compared to an increase of \$1.2 million during the same period in 2011, and accounts receivable decreased \$465,000 during the first nine months of 2012 compared to an increase of \$601,000 during the same period in 2011. These decreases primarily reflect the reduced business activity in our Thermal and Mechanical Products segments in 2012 as compared to 2011. Customer deposits decreased \$239,000 during the first nine months of 2012 compared to an increase of \$341,000 during the same time period in 2011. Depreciation and amortization was \$696,000 for the first nine months of 2012 compared to \$304,000 for the same period in 2011. The increase in 2012 as compared to 2011 primarily reflects higher levels of depreciation and amortization related to fixed assets and intangible assets acquired as a part of the Thermonics transaction completed in January 2012.

During the first nine months of 2012, we paid \$3.8 million to acquire Thermonics, as discussed further in the Overview and in Note 3 to our consolidated financial statements. We have no significant commitments for capital expenditures for the balance of 2012, however, depending upon changes in market demand, we may make such purchases as we deem necessary and appropriate.

As of September 30, 2012, we had cash and cash equivalents of \$14.7 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 available credit facilities under which we can borrow to help fund our working capital 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.

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

### **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 September 30, 2012, there have been no significant changes to the accounting policies that we have deemed critical. These policies are more fully described in our 2011 Form 10-K.

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

There were no off-balance sheet arrangements during the nine months ended September 30, 2012 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

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#### **Item 4. CONTROLS AND PROCEDURES (Continued)**

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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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, 2011.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

None

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: November 14,  
2012

/s/ Robert E. Matthiessen  
Robert E. Matthiessen  
*President and Chief Executive Officer*

Date: November 14,  
2012

/s/ Hugh T. Regan, Jr.  
Hugh T. Regan, Jr.  
*Secretary, Treasurer and Chief Financial Officer*

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Index to Exhibits

- 3.1\* Articles of Incorporation: Previously filed by the Company as an Exhibit to the Company's Registration Statement on Form S-1, File No. 333-26457, and incorporated herein by reference.
- 3.2\* ByLaws of inTEST Corporation, as amended on October 30, 2007: Previously filed as Exhibit 3.2 of the Company's Form 8-K on November 5, 2007 and incorporated herein by reference.
- 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.

\* Indicates document previously filed.