

INTEST CORP
Form 10-Q
August 13, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014 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 1-36117

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.

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Number of shares of Common Stock, \$.01 par value, outstanding as of the close of business on July 31, 2014:

10,562,678

inTEST CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

inTEST CORPORATION
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

| | June 30, 2014 | Dec. 31, 2013 |
|---|------------------|------------------|
| | ----- | ----- |
| ASSETS: | | |
| Current assets: | | |
| Cash and cash equivalents | \$19,616 | \$19,018 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$147 and \$147, respectively | 7,744 | 5,748 |
| Inventories | 3,873 | 3,243 |
| Deferred tax assets | 717 | 701 |
| Prepaid expenses and other current assets | <u>261</u> | <u>371</u> |

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| | | |
|------------------------------------|-----------------|-----------------|
| Total current assets | <u>32,211</u> | <u>29,081</u> |
| Property and equipment: | | |
| Machinery and equipment | 4,318 | 4,190 |
| Leasehold improvements | <u>594</u> | <u>594</u> |
| Gross property and equipment | 4,912 | 4,784 |
| Less: accumulated depreciation | <u>(3,582)</u> | <u>(3,530)</u> |
| Net property and equipment | <u>1,330</u> | <u>1,254</u> |
| Deferred tax assets | 924 | 1,030 |
| Goodwill | 1,706 | 1,706 |
| Intangible assets, net | 1,563 | 1,748 |
| Restricted certificates of deposit | 450 | 450 |
| Other assets | <u>211</u> | <u>212</u> |
| Total assets | <u>\$38,395</u> | <u>\$35,481</u> |
| | ===== | ===== |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | |
|---|--------------|--------------|
| Current liabilities: | | |
| Accounts payable | \$ 1,713 | \$ 1,064 |
| Accrued wages and benefits | 1,443 | 1,635 |
| Accrued rent | 593 | 577 |
| Accrued professional fees | 329 | 367 |
| Accrued sales commissions | 432 | 305 |
| Domestic and foreign income taxes payable | 617 | 83 |
| Other current liabilities | <u>413</u> | <u>301</u> |
| Total current liabilities | <u>5,540</u> | <u>4,332</u> |

Commitments and contingencies

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; 10,595,755 and 10,590,755 shares issued | 106 | 106 |
| Additional paid-in capital | 26,261 | 26,187 |
| Retained earnings | 5,356 | 3,713 |
| Accumulated other comprehensive earnings | 1,336 | 1,347 |
| Treasury stock, at cost; 33,077 and 33,077 shares, respectively | <u>(204)</u> | <u>(204)</u> |
| Total stockholders' equity | <u>32,855</u> | <u>31,149</u> |
| Total liabilities and stockholders' equity | <u>\$38,395</u> | <u>\$35,481</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 June 30, | | Six Months Ended June 30, | |
|--------------|--------------------------------|----------|------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| | ----- | ----- | ----- | ----- |
| Net revenues | \$12,343 | \$11,218 | \$21,140 | \$20,191 |

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| | | | | |
|---|------------|------------|------------|------------|
| Cost of revenues | 6,261 | 5,753 | 10,873 | 10,621 |
| | ----- | ----- | ----- | ----- |
| Gross margin | 6,082 | 5,465 | 10,267 | 9,570 |
| | ----- | ----- | ----- | ----- |
| Operating expenses: | | | | |
| Selling expense | 1,530 | 1,528 | 2,856 | 2,717 |
| Engineering and product development expense | 887 | 925 | 1,810 | 1,921 |
| General and administrative expense | 1,621 | 1,523 | 3,153 | 3,079 |
| | ----- | ----- | ----- | ----- |
| Total operating expenses | 4,038 | 3,976 | 7,819 | 7,717 |
| | ----- | ----- | ----- | ----- |
| Operating income | 2,044 | 1,489 | 2,448 | 1,853 |
| Other income (expense) | 10 | (2) | 17 | 4 |
| | ----- | ----- | ----- | ----- |
| Earnings before income tax expense | 2,054 | 1,487 | 2,465 | 1,857 |
| Income tax expense | 697 | 484 | 822 | 562 |
| | ----- | ----- | ----- | ----- |
| Net earnings | \$ 1,357 | \$ 1,003 | \$ 1,643 | \$ 1,295 |
| | ===== | ===== | ===== | ===== |
| Net earnings per common share - basic | \$0.13 | \$0.10 | \$0.16 | \$0.13 |
| Weighted average common shares outstanding - basic | 10,436,730 | 10,371,716 | 10,415,461 | 10,349,695 |
| Net earnings per common share - diluted | \$0.13 | \$0.10 | \$0.16 | \$0.13 |
| Weighted average common shares and common share equivalents outstanding - diluted | 10,456,183 | 10,394,094 | 10,452,567 | 10,380,279 |

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)
(Unaudited)

Three Months Ended Six Months Ended

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| | June 30, | | June 30, | |
|--|----------|----------|----------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Net earnings | \$ 1,357 | \$ 1,003 | \$ 1,643 | \$ 1,295 |
| Foreign currency translation adjustments | (15) | 30 | (11) | (32) |
| Comprehensive earnings | \$ 1,342 | \$ 1,033 | \$ 1,632 | \$ 1,263 |

See accompanying Notes to Consolidated Financial Statements.

inTEST CORPORATION
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(In thousands, except share data)
(Unaudited)

| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Earnings | Treasury Stock | Total Stockholders' Equity |
|---|--------------|--------|----------------------------------|----------------------|---|-------------------|----------------------------------|
| | Shares | Amount | | | | | |
| Balance, January 1, 2014 | 10,590,755 | \$ 106 | \$26,187 | \$3,713 | \$1,347 | \$ (204) | \$31,149 |
| Net earnings | - | - | - | 1,643 | - | - | 1,643 |
| Other comprehensive earnings | - | - | - | - | (11) | - | (11) |
| Amortization of deferred compensation related to restricted stock | - | - | 74 | - | - | - | 74 |
| Forfeiture of non-vested shares of restricted stock | (5,000) | - | - | - | - | - | - |
| Issuance of non-vested shares of restricted stock | 10,000 | - | - | - | - | - | - |
| Balance, June 30, 2014 | 10,595,755 | \$ 106 | \$26,261 | \$5,356 | \$1,336 | \$ (204) | \$32,855 |

See accompanying Notes to Consolidated Financial Statements.

inTEST CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)
(Unaudited)

| | Six Months Ended June 30, | |
|---|------------------------------|----------|
| | 2014 | 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net earnings | \$ 1,643 | \$ 1,295 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 438 | 426 |
| Provision for excess and obsolete inventory | 138 | 197 |
| Foreign exchange loss | 1 | 14 |
| Amortization of deferred compensation related to restricted stock | 74 | 58 |
| Loss on sale of property and equipment | 20 | 6 |
| Proceeds from sale of demonstration equipment, net of gain | 65 | 3 |
| Deferred income tax expense | 90 | 170 |
| Changes in assets and liabilities: | | |
| Trade accounts receivable | (1,999) | (1,753) |
| Inventories | (768) | (423) |
| Prepaid expenses and other current assets | 110 | 116 |
| Other assets | (1) | - |
| Accounts payable | 649 | 287 |
| Accrued wages and benefits | (191) | (238) |
| Accrued rent | 16 | 29 |
| Accrued professional fees | (38) | 1 |
| Accrued sales commissions | 127 | 194 |
| Domestic and foreign income taxes payable | 534 | 255 |
| Other current liabilities | 112 | (96) |
| Net cash provided by operating activities | 1,020 | 541 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of property and equipment | (424) | (95) |
| Proceeds from sale of property and equipment | 8 | - |
| Net cash used in investing activities | (416) | (95) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from stock options exercised | - | 30 |
| Net cash provided by financing activities | - | 30 |
| Effects of exchange rates on cash | (6) | (20) |
| Net cash provided by all activities | 598 | 456 |
| Cash and cash equivalents at beginning of period | 19,018 | 15,576 |
| Cash and cash equivalents at end of period | \$19,616 | \$16,032 |
| Cash payments for: | | |
| Domestic and foreign income taxes | \$ 199 | \$ 137 |
| Interest | \$ - | \$ - |

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SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

| | | |
|---|---------|--------|
| Issuance of non-vested shares of restricted stock | \$ 41 | \$ 124 |
| Forfeiture 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 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 markets outside the ATE market, such as the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets.

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.

The semiconductor market in which we operate is characterized by rapid technological change, competitive pricing pressures and cyclical market patterns. This market 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 market and the other markets we serve, our ability to safeguard patented technology and intellectual property in a rapidly evolving market, downward pricing pressures from customers, and our reliance on a relatively few number of customers for a significant portion of our sales. In addition, we are exposed to the risk of obsolescence of our inventory depending on the mix of future business and technological changes within the markets that we serve. 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 tax assets and liabilities including related 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, 2013 filed with the Securities and Exchange Commission on March 27, 2014 (the "2013 Form 10-K").

Reclassification

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

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventories

Inventories are valued at cost on a first-in, first-out basis, not in excess of market value. Cash flows from the sale of inventories are recorded in operating cash flows. On a quarterly basis, we review our inventories and record excess and obsolete inventory charges based upon our established objective excess and obsolete inventory criteria. These criteria identify material that has not been used in a work order during the prior twelve months and the quantity of material on hand that is greater than the average annual usage of that material over the prior three years. In certain cases, additional excess and obsolete inventory charges are recorded based upon current market conditions, anticipated product life cycles, new product introductions and expected future use of the inventory. The excess and obsolete inventory charges we record establish a new cost basis for the related inventories. We incurred excess and obsolete inventory charges of \$138 and \$197 for the six months ended June 30, 2014 and 2013, respectively.

Goodwill, Intangible and Long-Lived Assets

We account for goodwill and intangible assets in accordance with Accounting Standards Codification ("ASC") Topic 350 (Intangibles - Goodwill and Other). Finite-lived intangible assets are amortized over their estimated useful economic life and are carried at cost less accumulated amortization. Goodwill is assessed for impairment at least annually in the fourth quarter, on a reporting unit basis, or more frequently when events and circumstances occur indicating that the recorded goodwill may be impaired. As a part of the goodwill impairment

assessment, we have the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount. If we determine this is the case, we are required to perform a two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized. The two-step test is discussed below. If we determine that it is more-likely-than-not that the fair value of the reporting unit is greater than its carrying amounts, the two-step goodwill impairment test is not required.

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

Indefinite-lived intangible assets are assessed for impairment at least annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. As a part of the impairment assessment, we have the option to perform a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. If, as a result of our qualitative assessment, we determine that it is more-likely-than-not that the fair value of the indefinite-lived intangible asset is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The quantitative impairment test consists of a comparison of the fair value of the intangible asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Continued)

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 7.

Subsequent Events

We have made an assessment of our operations and determined that there were no material subsequent events requiring adjustment to, or disclosure in, our consolidated financial statements for the six months ended June 30, 2014.

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 collection of the related receivable 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.

In addition, in our Thermal and Mechanical Products segments, we lease certain of our equipment to customers under non-cancellable operating leases. These leases generally have an initial term of six months. We recognize revenue for these leases on a straight-line basis over the term of the lease.

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.

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 share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)Net Earnings Per Common Share

Net earnings per common share - basic is computed by dividing net earnings by the weighted average number of common shares outstanding during each period. Net earnings per common share - diluted is computed by dividing net earnings 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:

| | <u>Three Months Ended</u> <u>June 30,</u> | | <u>Six Months Ended</u> <u>June 30,</u> | |
|---|--|-------------------|--|-------------------|
| | <u>2014</u> | <u>2013</u> | <u>2014</u> | <u>2013</u> |
| Weighted average common shares outstanding - basic | 10,436,730 | 10,371,716 | 10,415,461 | 10,349,695 |
| Potentially dilutive securities: | | | | |
| Employee stock options and unvested shares of restricted stock | <u>19,453</u> | <u>22,378</u> | <u>37,106</u> | <u>30,584</u> |
| Weighted average common shares and common share equivalents outstanding - diluted | <u>10,456,183</u> | <u>10,394,094</u> | <u>10,452,567</u> | <u>10,380,279</u> |
| Average number of potentially dilutive securities excluded from calculation | 94,807 | 18,462 | 96,037 | 28,605 |

Effect of Recently Issued Amendments to Authoritative Accounting Guidance

In May 2014, the FASB issued new guidance on the recognition of revenue from contracts with customers. This guidance is presented in ASC Topic 606 (Revenue from Contracts with Customers). This new guidance will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. Companies can use either the retrospective or cumulative effect transition method. This new guidance is effective for

us on January 1, 2017. Early application is not permitted. We have not yet selected a transition method and we are still evaluating the effect that this guidance will have on our consolidated financial statements and related disclosures.

(3) 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, Inc. ("Thermonics"), a division of Test Enterprises, Inc. in January 2012.

Goodwill

All of our goodwill is allocated to our Thermal Products segment. There was no change in the amount of the carrying value of goodwill for the six months ended June 30, 2014.

Intangible Assets

The following tables provide further detail about our intangible assets as of June 30, 2014 and December 31, 2013:

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(3) GOODWILL AND INTANGIBLE ASSETS (Continued)

| | <u>June 30, 2014</u> | | |
|---------------------------------|---|---|---|
| | <u>Gross</u> Carrying <u>Amount</u> | <u>Accumulated</u> <u>Amortization</u> | <u>Net</u> Carrying <u>Amount</u> |
| Finite-lived intangible assets: | | | |
| Customer relationships | \$1,480 | \$ 860 | \$ 620 |
| Patented technology | 590 | 326 | 264 |
| Software | 270 | 155 | 115 |
| Trade name | 140 | 86 | 54 |
| | 70 | 70 | - |

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| | | | |
|--|----------------|----------------|----------------|
| Customer backlog | <u>48</u> | <u>48</u> | <u>-</u> |
| Non-compete/non-solicitation agreement | | | |
| | <u>2,598</u> | <u>1,545</u> | <u>1,053</u> |
| Total finite-lived intangible assets | | | |
| Indefinite-lived intangible assets: | | | |
| Sigma trademark | <u>510</u> | <u>-</u> | <u>510</u> |
| | | | |
| Total intangible assets | <u>\$3,108</u> | <u>\$1,545</u> | <u>\$1,563</u> |

December 31, 2013

| | <u>Gross Carrying Amount</u> | <u>Accumulated Amortization</u> | <u>Net Carrying Amount</u> |
|--|------------------------------|---------------------------------|----------------------------|
| Finite-lived intangible assets: | | | |
| Customer relationships | \$1,480 | \$ 725 | \$ 755 |
| Patented technology | 590 | 307 | 283 |
| Software | 270 | 142 | 128 |
| Trade name | 140 | 68 | 72 |
| Customer backlog | 70 | 70 | - |
| | <u>48</u> | <u>48</u> | <u>-</u> |
| Non-compete/non-solicitation agreement | | | |
| | <u>2,598</u> | <u>1,360</u> | <u>1,238</u> |
| Total finite-lived intangible assets | | | |
| Indefinite-lived intangible assets: | | | |
| Sigma trademark | <u>510</u> | <u>-</u> | <u>510</u> |
| | | | |
| Total intangible assets | <u>\$3,108</u> | <u>\$1,360</u> | <u>\$1,748</u> |

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. None of our intangible assets have any residual value.

The following table sets forth changes in the amount of the carrying value of intangible assets for the six months ended June 30, 2014:

| | |
|---------------------------|----------------|
| | \$1,748 |
| Balance - January 1, 2014 | |
| | <u>(185)</u> |
| Amortization | |
| |) |
| | <u>\$1,563</u> |
| Balance - June 30, 2014 | |

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(3) GOODWILL AND INTANGIBLE ASSETS (Continued)

Total amortization expense for the six months ended June 30, 2014 and 2013 was \$185 and \$232, respectively. The following table sets forth the estimated annual amortization expense for our finite-lived intangible assets for each of the next five years:

| | |
|------------------|-------|
| | \$170 |
| 2014 (remainder) | |
| | \$289 |
| 2015 | |
| | \$229 |
| 2016 | |
| | \$212 |
| 2017 | |
| | \$ 65 |
| 2018 | |

(4) MAJOR CUSTOMERS

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During the six months ended June 30, 2014 and 2013, Texas Instruments Incorporated accounted for 13% and 11%, respectively, of our consolidated net revenues. While all three of our operating segments sold products to this customer, these revenues were primarily generated by our Mechanical Products and our Electrical Products segments. During the six months ended June 30, 2014, Hakuto Co., Ltd., one of our distributors, accounted for 11% of our consolidated net revenues. These revenues were generated by our Thermal Products segment. No other customers accounted for 10% or more of our consolidated net revenues during the six months ended June 30, 2014 and 2013.

(5) INVENTORIES

Inventories held at June 30, 2014 and December 31, 2013 were comprised of the following:

| | June 30, | Dec. 31, |
|-------------------------------|----------------|----------------|
| | <i>2014</i> | <i>2013</i> |
| Raw materials | \$2,876 | \$2,753 |
| Work in process | 371 | 222 |
| Inventory consigned to others | 86 | 94 |
| Finished goods | <u>540</u> | <u>174</u> |
| | <u>\$3,873</u> | <u>\$3,243</u> |

(6) DEBT

Letters of Credit

We have issued letters of credit as the security deposits for certain of our domestic leases. These letters of credit are secured by pledged certificates of deposit which are classified as Restricted Certificates of Deposit on our balance sheet. The terms of our leases require us to renew these letters of credit at least 30 days prior to their expiration dates for successive terms of not less than one year until lease expiration. Our outstanding letters of credit at June 30, 2014 and December 31, 2013 consisted of the following:

| | L/C | Lease | Letters of Credit | |
|----------------------------|--------------------|--------------------|-------------------------|-------------------------|
| | | | <u>Amount</u> | |
| | | | <u>Outstanding</u> | |
| Original L/C Issue Date | Expiration Date | Expiration Date | June 30, <i>2014</i> | Dec. 31, <i>2013</i> |
| 3/29/2010 | 3/31/2015 | 4/30/2021 | \$250 | \$250 |

| | | | | | |
|----------------|------------|------------|-----------|--------------|--------------|
| Mt. Laurel, NJ | 10/27/2010 | 11/08/2014 | 8/23/2021 | <u>200</u> | <u>200</u> |
| Mansfield, MA | | | | <u>\$450</u> | <u>\$450</u> |

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except share and per share data)

(7) STOCK-BASED COMPENSATION

As of June 30, 2014, we had unvested restricted stock awards granted under stock-based employee compensation plans that are described more fully in Note 14 to the consolidated financial statements in our 2013 Form 10-K.

In addition, at our annual meeting on June 25, 2014, our stockholders approved the inTEST Corporation 2014 Stock Plan (the "2014 Stock Plan"). The 2014 Stock Plan permits the granting of stock options, restricted stock, stock appreciation rights or restricted stock units for up to 500,000 shares of our common stock to directors, officers, other key employees and consultants.

As of June 30, 2014, total compensation expense to be recognized in future periods was \$386. The weighted average period over which this expense is expected to be recognized is 3.2 years.

Restricted Stock Awards

We record compensation expense for restricted stock awards (nonvested shares) based on the quoted market price of our stock at the grant date and amortize the expense over the vesting period. Restricted stock awards generally vest over four years. The following table shows the allocation of the compensation expense we recorded during the three and six months ended June 30, 2014 and 2013, respectively, related to nonvested shares:

| | Three Months Ended <u>June 30,</u> | | Six Months Ended <u>June 30,</u> | |
|-------------------------|--|-------------|-------------------------------------|-------------|
| | <u>2014</u> | <u>2013</u> | <u>2014</u> | <u>2013</u> |
| Cost of revenues | \$ 3 | \$ 2 | \$ 6 | \$ 3 |
| Selling expense | 1 | 2 | 4 | 4 |
| Engineering and product | 5 | 8 | 11 | 14 |

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| | | | | |
|------------------------------------|--------------|--------------|--------------|--------------|
| development expense | <u>24</u> | <u>19</u> | <u>53</u> | <u>37</u> |
| General and administrative expense | <u>\$ 33</u> | <u>\$ 31</u> | <u>\$ 74</u> | <u>\$ 58</u> |

There was no compensation expense capitalized in the six months ended June 30, 2014 or 2013.

The following table summarizes the activity related to nonvested shares for the six months ended June 30, 2014:

| | <u>Number of Shares</u> | <u>Weighted Average Grant Date Fair Value</u> |
|---|-------------------------|---|
| Nonvested shares outstanding, January 1, 2014 | 180,000 | \$2.69 |
| Granted | 10,000 | 4.14 |
| Vested | (63,125) | 1.78 |
| Forfeited | <u>(5,000)</u> | 3.97 |
| |) | |
| Nonvested shares outstanding, June 30, 2014 | <u>121,875</u> | 3.01 |

Stock Options

The following table summarizes the stock option activity for the six months ended June 30, 2014:

| | <u>Number of Shares</u> | <u>Weighted Average Exercise Price</u> |
|---|-------------------------|--|
| Options outstanding, January 1, 2014 (10,000 exercisable) | 10,000 | \$ 5.66 |
| Granted | - | - |
| Exercised | - | - |

| | | |
|------------------------------------|----------------|------|
| Forfeited/Expired | <u>(10,000</u> | 5.66 |
| |) | |
| | _____ | - |
| Options outstanding, June 30, 2014 | | |

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(8) EMPLOYEE BENEFIT PLANS

We have a defined contribution 401(k) plan for our employees who work in the U.S. (the "inTEST 401(k) Plan"). All permanent employees of inTEST Corporation, Temptronic Corporation and inTEST Silicon Valley Corporation who are at least 18 years of age are eligible to participate in the plan. We match employee contributions dollar for dollar up to 10% of the employee's annual compensation, with a maximum limit of \$5. Employer contributions vest ratably over four years. Matching contributions are discretionary. For the six months ended June 30, 2014 and 2013, we recorded \$229 and \$223 of expense for matching contributions, respectively.

(9) SEGMENT INFORMATION

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

The Thermal Products segment includes the operations of Temptronic, Thermonics, Sigma, inTEST Thermal Solutions 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 markets outside of the semiconductor market, including the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. Intercompany pricing between segments is either a multiple of cost for component parts or list price for finished goods.

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| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | June 30, | | June 30, | |
| | <u>2014</u> | <u>2013</u> | <u>2014</u> | <u>2013</u> |
| Net revenues from unaffiliated customers: | | | | |
| Thermal Products | \$ 6,116 | \$5,772 | \$11,359 | \$11,670 |
| Mechanical Products | 4,137 | 3,798 | 6,184 | 5,591 |
| Electrical Products | <u>2,090</u> | <u>1,648</u> | <u>3,597</u> | <u>2,930</u> |
| | | | | |
| | <u>\$12,343</u> | <u>\$11,218</u> | <u>\$21,140</u> | <u>\$20,191</u> |
| | | | | |
| Earnings (loss) before income tax expense (benefit): | | | | |
| Thermal Products | \$1,207 | \$1,078 | \$2,018 | \$2,236 |
| Mechanical Products | 637 | 290 | 354 | (396) |
| Electrical Products | 400 | 207 | 405 | 199 |
| Corporate | <u>(190)</u> | <u>(88)</u> | <u>(312)</u> | <u>(182)</u> |
| | | | | |
| | <u>\$2,054</u> | <u>\$1,487</u> | <u>\$2,465</u> | <u>\$1,857</u> |
| | | | | |
| Net earnings (loss): | | | | |
| Thermal Products | \$ 797 | \$ 727 | \$1,361 | \$1,641 |
| Mechanical Products | 421 | 196 | 224 | (346) |
| Electrical Products | 264 | 140 | 268 | 134 |
| Corporate | <u>(125)</u> | <u>(59)</u> | <u>(210)</u> | <u>(133)</u> |
| | | | | |
| | <u>\$1,357</u> | <u>\$1,003</u> | <u>\$1,643</u> | <u>\$1,295</u> |

inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(9) SEGMENT INFORMATION

(Continued)

| | June 30, | Dec. 31, |
|----------------------|-----------------|-----------------|
| | <u>2014</u> | <u>2013</u> |
| Identifiable assets: | | |
| Thermal Products | \$25,410 | \$23,934 |
| Mechanical Products | 7,866 | 7,093 |
| Electrical Products | <u>5,119</u> | <u>4,454</u> |
| | <u>\$38,395</u> | <u>\$35,481</u> |

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

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | <u>June 30,</u> | | <u>June 30,</u> | |
| | <u>2014</u> | <u>2013</u> | <u>2014</u> | <u>2013</u> |
| Net revenues from unaffiliated customers: | | | | |
| U.S. | \$ 3,723 | \$ 3,504 | \$ 6,872 | \$ 6,718 |
| Foreign | <u>8,620</u> | <u>7,714</u> | <u>14,268</u> | <u>13,473</u> |
| | <u>\$12,343</u> | <u>\$11,218</u> | <u>\$21,140</u> | <u>\$20,191</u> |

| | June 30, | Dec. 31, |
|--------------------|----------------|----------------|
| | <u>2014</u> | 2013 |
| Long-lived assets: | | |
| U.S. | \$ 693 | \$ 700 |
| | <u>637</u> | <u>554</u> |
| Foreign | <u>\$1.330</u> | <u>\$1.254</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 2013 Form 10-K for examples of statements made in this report which may be "forward-looking statements." These statements involve risks and uncertainties and are based on various assumptions. Although we believe that our expectations are based on reasonable assumptions, investors and prospective investors are cautioned that such statements are only projections, and there cannot be any assurance that these events or results will occur.

Information about the primary risks and uncertainties that could cause our actual future results to differ materially from our historic results or the

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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 2013 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 2013 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.

ATE market cycles are difficult to predict and in recent years have become more volatile and, in certain cases, shorter in duration. Because the market 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 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.

As part of our diversification strategy to reduce the impact of ATE market volatility on our business operations, we market our Thermostream temperature management systems in markets outside the ATE market, such as the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. We believe that these markets usually are less cyclical than the ATE market. However, because we are a recent market entrant in these markets, we have not yet developed meaningful market shares in these non-ATE markets. Consequently, we are continuing to evaluate customer buying patterns or market trends in these non-ATE markets. In addition, our orders or net revenues in any given period in these markets do not necessarily reflect the overall trends in these non-ATE markets due to our limited market shares. The level of our orders and net revenues from these non-ATE markets has varied in the past, and we expect will vary significantly in the future, as we work to build our presence in these markets and establish new markets for our products.

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inTEST CORPORATION

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

(Continued)

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 market, 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 smaller quantities (which prevents us from acquiring component materials in larger volumes at lower cost and increasing unit costs), (ii) the practice of OEM manufacturers to specify other suppliers as primary vendors, with less frequent opportunities to compete for such designations, (iii) the role of third-party

test and assembly houses in the ATE market and their requirement of products with a greater range of use at the lowest cost, (iv) customer supply chain management groups demanding lower prices and spreading purchases across multiple vendors, and (v) certain competitors aggressively reducing their products' sales prices (causing us to either reduce our products' sales price to be successful in obtaining the sale or causing loss of the sale).

In addition, in recent periods we have seen instances where demand for ATE is not consistent for each of our product segments or for any given product within a particular product segment. This inconsistency in demand for ATE can be driven by a number of factors, but in most cases we have found the primary reason is unique customer-specific changes in demand for certain products driven by the needs of their customers or markets served. These shifts in market practices and customer-specific needs have had, and may continue to have, varying levels of impact on our operating results and are difficult to quantify or predict from period to period. Management has taken, and will continue to take, such actions it deems appropriate to adjust our strategies, products and operations to counter such shifts in market practices as they become evident.

Orders and Backlog

The following table sets forth, for the periods indicated, a breakdown of the orders received from unaffiliated customers both by product segment and market.

| | Three Months Ended | | Change | | Three Months Ended | | Change | |
|-------------------------------------|-----------------------|-----------------|----------------|-----|--------------------------|----------------|--------|--|
| | June 30. | | | | March 31. | | | |
| | 2014 | 2013 | \$ | % | 2014 | \$ | % | |
| Orders from unaffiliated customers: | | | | | | | | |
| | \$ 6,094 | \$ 5,366 | \$ 728 | 14% | | \$ 450 | 8% | |
| Thermal Products | | | | | \$ 5,644 | | | |
| | 4,178 | 3,687 | 491 | 13% | | 1,214 | 41% | |
| Mechanical Products | | | | | 2,964 | | | |
| | <u>2,366</u> | <u>1,919</u> | <u>447</u> | 23% | <u>1,553</u> | <u>813</u> | 52% | |
| Electrical Products | | | | | | | | |
| | <u>\$12,638</u> | <u>\$10,972</u> | <u>\$1,666</u> | 15% | <u>\$10,161</u> | <u>\$2,477</u> | 24% | |
| ATE market | | | | | | | | |
| | \$ 9,040 | \$ 8,347 | \$ 693 | 8% | | \$ 821 | 10% | |
| | <u>3,598</u> | <u>2,625</u> | <u>973</u> | 37% | <u>1,942</u> | <u>1,656</u> | 85% | |
| Non-ATE market | | | | | | | | |
| | <u>\$12,638</u> | <u>\$10,972</u> | <u>\$1,666</u> | 15% | <u>\$10,161</u> | <u>\$2,477</u> | 24% | |

| | Six | | Change | |
|-------------------------------------|-----------------|-----------------|----------------|----------|
| | Months Ended | | | |
| | <u>June 30,</u> | | <u>\$</u> | <u>%</u> |
| | <u>2014</u> | <u>2013</u> | | |
| Orders from unaffiliated customers: | | | | |
| | \$11,738 | \$10,090 | \$1,648 | 16% |
| Thermal Products | | | | |
| | 7,142 | 5,912 | 1,230 | 21% |
| Mechanical Products | | | | |
| | <u>3,919</u> | <u>2,678</u> | <u>1,241</u> | 46% |
| Electrical Products | | | | |
| | <u>\$22,799</u> | <u>\$18,680</u> | <u>\$4,119</u> | 22% |
| | | | | |
| | \$17,259 | \$14,530 | \$2,729 | 19% |
| ATE market | | | | |
| | <u>5,540</u> | <u>4,150</u> | <u>1,390</u> | 33% |
| Non-ATE market | | | | |
| | <u>\$22,799</u> | <u>\$18,680</u> | <u>\$4,119</u> | 22% |

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inTEST CORPORATION

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

Total consolidated orders for the quarter ended June 30, 2014 were \$12.6 million compared to \$11.0 million for the same period in 2013 and \$10.2 million for the quarter ended March 31, 2014. The increase in consolidated orders primarily reflects continued penetration into non-ATE markets by our Thermal Products segment, as well as improved demand in the ATE market for our Mechanical and Electrical Products segments. We believe the improved ATE market demand we have seen in both our Mechanical and Electrical Products segments reflects the overall improvement in demand being experienced by the broader ATE market, which had been in a period of reduced demand during 2012 and 2013.

Our Thermal Products segment experienced declines in demand from the ATE market during the second quarter of 2014 as compared to both the prior quarter and the comparable prior period. We believe the reduced ATE market demand experienced by our Thermal Products segment reflects a number of factors including instances where there was reduced demand due to customer-specific needs or events that drove higher than expected demand in prior periods that did not continue into the current period or where certain of our customers had made large purchases of ATE within the past year that have not yet been utilized to a level high enough to justify additional purchases of ATE.

Orders from customers in various markets outside of the ATE market for the quarter ended June 30, 2014,

grew by 37% as compared to the same period in 2013, reflecting increased demand from certain customers in the telecommunications and other non-ATE markets. As a percent of our total consolidated orders, non-ATE markets orders increased to 28% of consolidated orders in the second quarter of 2014 as compared to 24% in the second quarter of 2013 and 19% in the first quarter of 2014.

At June 30, 2014, our backlog of unfilled orders for all products was approximately \$4.8 million compared with approximately \$2.7 million at June 30, 2013 and \$4.5 million at March 31, 2014. Our backlog includes customer orders which we have accepted, substantially all of which we expect to deliver in 2014. 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.

Net Revenues

The following table sets forth, for the periods indicated, a breakdown of the net revenues from unaffiliated customers both by product segment and market.

| | Three Months Ended <u>June 30,</u> | | <u>Change</u> | | Three Months Ended <u>March 31,</u> | | <u>Change</u> | |
|---|--|-----------------|----------------|----------|--|----------------|---------------|--|
| | <u>2014</u> | <u>2013</u> | <u>\$</u> | <u>%</u> | <u>2014</u> | <u>\$</u> | <u>%</u> | |
| Net revenues from unaffiliated customers: | | | | | | | | |
| Thermal Products | \$ 6,116 | \$ 5,772 | \$ 344 | 6% | \$ 873 | 17% | | |
| Mechanical Products | 4,137 | 3,798 | 339 | 9% | 2,090 | 102% | | |
| Electrical Products | <u>2,090</u> | <u>1,648</u> | <u>442</u> | 27% | <u>1,507</u> | <u>583</u> | 39% | |
| ATE market | \$ 9,482 | \$ 8,394 | \$ 1,088 | 13% | \$ 1,875 | 25% | | |
| Non-ATE market | <u>2,861</u> | <u>2,824</u> | <u>37</u> | 1% | <u>1,190</u> | <u>1,671</u> | 140% | |
| | <u>\$12,343</u> | <u>\$11,218</u> | <u>\$1,125</u> | 10% | <u>\$8,797</u> | <u>\$3,546</u> | 40% | |

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inTEST CORPORATION

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

| | Six Months Ended | | Change | |
|---|---------------------|-----------------|---------------|----------|
| | <u>June 30,</u> | | | |
| | <u>2014</u> | <u>2013</u> | <u>\$</u> | <u>%</u> |
| Net revenues from unaffiliated customers: | | | | |
| | \$11,359 | \$11,670 | \$ (311) | (3)% |
| Thermal Products | | | | |
| | 6,184 | 5,591 | 593 | 11 % |
| Mechanical Products | | | | |
| | <u>3,597</u> | <u>2,930</u> | <u>667</u> | 23 % |
| Electrical Products | | | | |
| | <u>\$21,140</u> | <u>\$20,191</u> | <u>\$ 949</u> | 5 % |
| ATE market | \$17,089 | \$15,204 | \$1,885 | 12 % |
| | <u>4,051</u> | <u>4,987</u> | <u>(936)</u> | (19)% |
| Non-ATE market | | |) | |
| | <u>\$21,140</u> | <u>\$20,191</u> | <u>\$ 949</u> | 5 % |

Our consolidated net revenues for the quarter ended June 30, 2014 increased \$1.1 million as compared to the same period in 2013. For the quarter ended June 30, 2014, the net revenues of our Thermal, Mechanical and Electrical Products segments increased \$344,000, \$339,000 and \$442,000, respectively, as compared to the same period in 2013. The increases reflect the aforementioned increase in demand experienced during the second quarter of 2014 from the ATE market. Net revenues from customers outside the ATE market for the quarter ended June 30, 2014 were relatively flat as compared to the same period in 2013.

Our consolidated net revenues for the quarter ended June 30, 2014 increased \$3.5 million as compared to the

quarter ended March 31, 2014. The net revenues of our Thermal, Mechanical and Electrical Products segments increased \$873,000, \$2.1 million and \$583,000, respectively, for the second quarter of 2014 as compared to the first quarter of 2014. Net revenues from customers outside the ATE market for the quarter ended June 30, 2014 increased \$1.7 million as compared to the first quarter of 2014. The increases reflect the aforementioned increase in demand experienced during the second quarter of 2014 as compared to the first quarter of 2014 from both the ATE and non-ATE markets.

Product/Customer Mix

Our three product segments each have multiple products that we design, manufacture and market to our customers. Due to a number of factors, our products have varying levels of 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 markets including the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. The mix of customers during any given period will affect our gross margin due to differing sales discounts and commissions. For the six months ended June 30, 2014 and 2013, our OEM sales as a percentage of net revenues were 11% and 10%, 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 negatively affect our gross and operating margins.

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

Results of Operations

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

Quarter Ended June 30, 2014 Compared to Quarter Ended June 30, 2013

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Net Revenues. Net revenues were \$12.3 million for the quarter ended June 30, 2014 compared to \$11.2 million for the same period in 2013, an increase of \$1.1 million or 10%. We believe the increase in our net revenues during the second quarter of 2014 primarily reflects the factors previously discussed in the Overview.

Gross Margin. Our consolidated gross margin was 49% in each of the quarters ended June 30, 2014 and 2013, respectively. There was a slight improvement in our material costs as a percentage of net revenues, reflecting changes in product and customer mix. This improvement was offset by higher fixed operating costs for our Thermal Products segment, primarily reflecting increased facility related costs.

Selling Expense. Selling expense was \$1.5 million in each of the quarters ended June 30, 2014 and 2013, respectively. Higher salaries and benefits expense, as a result of an increase in headcount in our Thermal and Electrical Products segments, was offset by a reduction in the level of accruals for product warranties in our Thermal Products segment.

Engineering and Product Development Expense. Engineering and product development expense was \$887,000 for the quarter ended June 30, 2014 compared to \$925,000 for the same period in 2013, a decrease of \$38,000 or 4%. The decrease in engineering and product development expense primarily reflects decreased spending on third party consultants, material used in new product development and matters related to our intellectual property. These decreases were partially offset by an increase in salaries and benefits expense, primarily reflecting an increase in headcount in our Thermal and Electrical Products segments.

General and Administrative Expense. General and administrative expense was \$1.6 million for the quarter ended June 30, 2014 compared to \$1.5 million for the same period in 2013, an increase of \$98,000 or 6%. The increase primarily reflects higher accruals for profit-based bonuses and an increase in the use of third-party professionals who assist us with certain of our strategic initiatives.

Income Tax Expense. For the quarter ended June 30, 2014, we recorded income tax expense of \$697,000 compared to \$484,000 for the same period in 2013. Our effective tax rate for the quarter ended June 30, 2014 was 34% compared to 33% for the same period in 2013. On a quarterly basis, we record income tax expense or benefit based on the expected annualized effective tax rate for the various taxing jurisdictions in which we operate our businesses.

Six Months Ended June 30, 2014 Compared to Six Months Ended June 30, 2013

Net Revenues. Net revenues were \$21.1 million for the six months ended June 30, 2014 compared to \$20.2 million for the same period in 2013, an increase of \$949,000 or 5%. For the six months ended June 30, 2014, the net revenues of our Thermal Products segment decreased \$311,000 while the net revenues of our Mechanical and Electrical Products segments increased \$593,000 and \$667,000, respectively, as compared to the same period in 2013. Net revenues from customers outside the ATE market for the six months ended June 30, 2014 decreased \$936,000 as compared to the same period in 2013. We believe the decrease in the net revenues of our Thermal Products segment during the first half of 2014 reflects reduced demand from our customers outside the ATE market, primarily during the first quarter of 2014. We believe the increases in the net revenues of our Mechanical and Electrical Products segments during the first six months of 2014 primarily reflect increased demand from our customers in the ATE market as previously discussed in the Overview.

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

Gross Margin.

Our consolidated gross margin was 49% for the six months ended June 30, 2014 compared to 47% for the same period in 2013. The improvement in our gross margin reflects a reduction in both our material costs and our fixed operating costs as a percentage of net revenues. Our material costs declined from 35% of net revenues for the six months ended June 30, 2013 to 34% for the same period in 2014, reflecting changes in product and customer mix. Although our fixed operating costs increased \$33,000 in absolute dollar terms, they were more fully absorbed by the higher net revenue levels in 2014 and, as a result, these costs declined from 15% of net revenues for the six months ended June 30, 2013 to 14% for the same period in 2014. The \$33,000 increase in our fixed operating costs primarily reflects an increase in facility related costs for our Thermal Products segment which was partially offset by lower levels of depreciation and a reduction in salaries and benefits expense, reflecting headcount reductions in our Thermal Products segment.

Selling Expense. Selling expense was \$2.9 million for the six months ended June 30, 2014 compared to \$2.7 million for the same period in 2013 an increase of \$139,000 or 5%. The increase primarily reflects higher salaries and benefits expense as a result of an increase in headcount in our Thermal and Electrical Products segments which was partially offset by a reduction in accruals for product warranties and lower commission expense in our Thermal and Electrical Products segments.

Engineering and Product Development Expense. Engineering and product development expense was \$1.8 million for the six months ended June 30, 2014 compared to \$1.9 million for the same period in 2013 a decrease of \$111,000 or 6%. The decrease in engineering and product development expense primarily reflects decreased spending on matters related to our intellectual property and third party consultants. These decreases were partially offset by an increase in salaries and benefits expense, primarily reflecting an increase in headcount in our Thermal and Electrical Products segments.

General and Administrative Expense. General and administrative expense was \$3.2 million for the six months ended June 30, 2014 compared to \$3.1 million for the same period in 2013 an increase of \$74,000 or 2%. The increase primarily reflects an increase in the use of third-party professionals which was partially offset by a reduction in amortization expense related to our intangible assets.

Income Tax Expense. For the six months ended June 30, 2014, we recorded income tax expense of \$822,000 compared to \$562,000 for the same period in 2013. Our effective tax rate for the six months ended June 30, 2014 was 33% compared to 30% for the same period in 2013. On a quarterly basis, we record income tax expense or benefit based on the expected annualized effective tax rate for the various taxing jurisdictions in which we operate our businesses. The increase in our effective tax rate in the first six months of 2014 as compared to the same period in 2013 primarily reflects the recording of the effect of the reinstatement of certain domestic research and development tax credits for both 2013 and 2012, which was enacted in January 2013. There was no similar item to record in 2014.

Liquidity and Capital Resources

As discussed more fully in the Overview, 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. The cyclical and volatile nature of demand for ATE makes estimates of future revenues, results of operations and net cash flows difficult.

Our primary historical source of liquidity and capital resources has been cash flow generated by our operations and we manage our businesses to maximize operating cash flows as our primary source of liquidity. We use cash to fund growth in our operating assets, for new product research and development and for acquisitions.

Liquidity

Our cash and cash equivalents and working capital were as follows:

| | <u>June</u> <u>30, 2014</u> | <u>Dec. 31,</u> <u>2013</u> |
|---------------------------|--------------------------------|--------------------------------|
| Cash and cash equivalents | \$19,616 | \$19,018 |
| Working capital | \$26,671 | \$24,749 |

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

As of June 30, 2014, \$3.0 million of our cash and cash equivalents was held by our foreign subsidiaries. When these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. taxes if we repatriate certain of these funds. Our current intent is to indefinitely reinvest these funds in our foreign

operations.

We currently expect our cash and cash equivalents and projected future cash flow to be sufficient to support our short term working capital requirements. We do not currently have any credit facilities under which we can borrow to help fund our working capital or other requirements.

Cash Flows

Operating Activities. Net cash provided by operations for the six months ended June 30, 2014 was \$1.0 million. During the six months ended June 30, 2014, we recorded net earnings of \$1.6 million, which included non-cash charges of \$438,000 for depreciation and amortization. During the six months ended June 30, 2014, accounts receivable, inventories and accounts payable increased \$2.0 million, \$768,000 and \$649,000, respectively, compared to the levels at the end of 2013. These increases primarily reflect increased business activity during the first six months of 2014 as compared to the fourth quarter of 2013. During the six months ended June 30, 2014, domestic and foreign income taxes payable increased \$534,000 compared to the level at December 31, 2013 reflecting the accrual of taxes due on our income in 2014.

Investing Activities. During the six months ended June 30, 2014 purchases of property and equipment were \$424,000 which primarily represent additions to leased systems in our Thermal and Mechanical Products segments. We have no significant commitments for capital expenditures for the balance of 2014, however, depending upon changes in market demand or manufacturing and sales strategies, we may make such purchases or investments as we deem necessary and appropriate.

Financing Activities. During the six months ended June 30, 2014 there were no cash flows from financing activities.

New or Recently Adopted Accounting Standards

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

Critical Accounting Policies

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to inventories, long-lived assets, goodwill, identifiable intangibles, deferred income tax valuation allowances and product warranty reserves. We base our estimates on historical experience and on appropriate and customary assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Some of these accounting estimates and assumptions are particularly sensitive because of their significance to our consolidated financial statements and because of the possibility that future events affecting them may differ markedly from what had been assumed when the financial statements were prepared. As of June 30, 2014, there have been no significant changes to the accounting policies that we have deemed critical. These policies are more fully described in our 2013 Form 10-K.

Off -Balance Sheet Arrangements

There were no off-balance sheet arrangements during the six months ended June 30, 2014 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.

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Item 4. CONTROLS AND PROCEDURES

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

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

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

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

design will succeed in achieving its stated goals under all potential future conditions; over time, a system of controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, our management has designed the disclosure controls and procedures to provide reasonable assurance that the objectives of the control system were met.

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

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.

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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, 2013.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None

Item 6. Exhibits

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

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Signatures

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

inTEST Corporation

Date: August 13, 2014

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

Date: August 13, 2014

/s/ Hugh T. Regan, Jr.

Hugh T. Regan, Jr.

Secretary, Treasurer and Chief Financial Officer

Index to Exhibits

- 3.2* ByLaws of inTEST Corporation, as amended on June 23, 2014: Previously filed as Exhibit 3.2 of the Company's Form 8-K on June 25, 2014 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.