

INTEST CORP  
Form 10-Q  
November 14, 2007

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, 2007 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)

7 Esterbrook Lane  
Cherry Hill, New Jersey 08003

(Address of principal executive offices, including zip code)

**(856) 424-6886**

(Registrant's Telephone Number, including Area Code)

Indicate by check X 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

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Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):  
Large accelerated filer  Accelerated filer  Non-accelerated filer

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 October 31, 2007:

9,527,206

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inTEST CORPORATION

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inTEST CORPORATION  
CONSOLIDATED BALANCE SHEETS

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

	Sept. 30, 2007	Dec. 31, 2006
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents	\$10,659	\$13,174
Trade accounts and notes receivable, net of allowance for doubtful accounts of \$116 and \$133, respectively	7,873	8,678
Inventories	6,149	6,193
Prepaid expenses and other current assets	<u>1,257</u>	<u>758</u>
Total current assets	<u>25,938</u>	<u>28,803</u>
Property and equipment:		
Machinery and equipment	7,622	7,976
Leasehold improvements	<u>3,379</u>	<u>3,256</u>
	11,001	11,232
Less: accumulated depreciation	<u>(8,156)</u>	<u>(7,904)</u>
Net property and equipment	<u>2,845</u>	<u>3,328</u>

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Other assets	754	700
Goodwill	2,784	2,629
Intangible assets, net	<u>281</u>	<u>299</u>
Total assets	<u>\$32,602</u>	<u>\$35,759</u>
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,858	\$ 3,145
Accrued wages and benefits	1,822	1,894
Accrued warranty	529	857
Accrued sales commissions	449	418
Other accrued expenses	953	1,000
Domestic and foreign income taxes payable	166	971
Capital lease obligations	7	7
Deferred rent	<u>118</u>	<u>118</u>
Total current liabilities	<u>6,902</u>	<u>8,410</u>
Capital lease obligations, net of current portion	10	16
Deferred rent, net of current portion	<u>422</u>	<u>511</u>
Total liabilities	<u>7,334</u>	<u>8,937</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; 9,666,505 and 9,510,755 shares issued, respectively	97	95
Additional paid-in capital	24,719	24,515
Retained earnings	355	2,914
Accumulated other comprehensive income	1,109	609
Treasury stock, at cost; 163,686 and 212,050 shares, respectively	<u>(1,012)</u>	<u>(1,311)</u>
Total stockholders' equity	<u>25,268</u>	<u>26,822</u>
Total liabilities and stockholders' equity	<u>\$32,602</u>	<u>\$35,759</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,	
	2007	2006	2007	2006
Net revenues	\$13,114	\$16,566	\$37,294	\$49,187
Cost of revenues	7,981	9,643	23,130	28,019
Gross margin	<u>5,133</u>	<u>6,923</u>	<u>14,164</u>	<u>21,168</u>
Operating expenses:				
Selling expense	2,121	2,232	6,578	6,954

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Engineering and product development expense	1,364	1,775	4,162	4,500
General and administrative expense	1,970	1,984	6,181	6,111
Total operating expenses	5,455	5,991	16,921	17,565
Operating income (loss)	(322)	932	(2,757)	3,603
Other income (expense):				
Interest income	89	98	306	226
Interest expense	-	(3)	(1)	(4)
Other	59	(10)	90	7
Total other income	148	85	395	229
Earnings (loss) before income taxes	(174)	1,017	(2,362)	3,832
Income tax expense	78	509	197	1,042
Net earnings (loss)	\$ (252)	\$ 508	\$ (2,559)	\$ 2,790
Net earnings (loss) per common share - basic	\$ (0.03)	\$0.06	\$ (0.28)	\$0.31
Weighted average common shares outstanding-basic	9,216,443	9,053,603	9,196,557	9,020,173
Net earnings (loss) per common share - diluted	\$ (0.03)	\$0.06	\$ (0.28)	\$0.31
Weighted average common and common share equivalents outstanding-diluted	9,216,443	9,264,809	9,196,557	9,152,747

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS (LOSS)

(In thousands)  
(Unaudited)

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2007	2006	2007	2006
Net earnings (loss)	\$ (252)	\$ 508	\$ (2,559)	\$ 2,790
Foreign currency translation adjustments	487	(115)	500	322

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Comprehensive earnings (loss)	\$ 235	\$ 393	\$ (2,059)	\$3,112
	=====	=====	=====	=====

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		Add'l	Retained	Accumulated	Treasury	Total
	Shares	Amount	Paid-In	Earnings	Other	Stock	Stockholders'
	-----	-----	Capital	-----	Earnings/(Loss)	-----	Equity
	-----	-----	-----	-----	-----	-----	-----
Balance, December 31, 2006	9,510,755	\$ 95	\$24,515	\$2,914	\$ 609	\$ (1,311)	\$26,822
Net loss	-	-	-	(2,559)	-	-	(2,559)
Other comprehensive income	-	-	-	-	500	-	500
Issuance of non-vested shares of restricted stock	162,000	2	(2)	-	-	-	-
Amortization of deferred compensation related to restricted stock	-	-	271	-	-	-	271
Options exercised	5,000	-	17	-	-	-	17
Forfeiture of non-vested shares of restricted stock	(11,250)	-	-	-	-	-	-
Issuance of 48,364 shares of treasury stock to satisfy profit sharing liability	-	-	(82)	-	-	299	217
	-----	-----	-----	-----	-----	-----	-----
Balance, September 30, 2007	9,666,505	\$ 97	\$24,719	\$ 355	\$1,109	\$ (1,012)	\$25,268
	=====	=====	=====	=====	=====	=====	=====

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)  
(Unaudited)

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	Nine Months Ended Sept. 30,	
	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net earnings (loss)	\$(2,559)	\$ 2,790
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,017	1,128
Foreign exchange loss	7	88
Amortization of deferred compensation related to restricted stock	271	243
Profit sharing expense funded through the issuance of treasury stock	217	225
Gain on sale of fixed assets	(36)	(11)
Proceeds from sale of demonstration equipment, net of gain	24	2
Changes in assets and liabilities:		
Trade accounts and notes receivable	897	(1,182)
Inventories	133	(516)
Prepaid expenses and other current assets	(468)	(361)
Other assets	(33)	(51)
Accounts payable	(319)	1,738
Accrued wages and benefits	(101)	535
Accrued warranty	(332)	5
Accrued sales commissions	27	57
Accrued restructuring and other charges	-	(79)
Other accrued expenses	(54)	3
Domestic and foreign income taxes payable	(817)	576
Deferred rent	(88)	(88)
Net cash provided by (used in) operating activities	(2,214)	5,102
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(521)	(551)
Proceeds from sale of property and equipment	66	38
Net cash used in investing activities	(455)	(513)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayment of capital lease obligations	(6)	(22)
Proceeds from stock options exercised	17	98
Net cash provided by financing activities	11	76
Effects of exchange rates on cash	143	100
Net cash provided by (used in) all activities	(2,515)	4,765
Cash and cash equivalents at beginning of period	13,174	7,295
Cash and cash equivalents at end of period	\$10,659	\$12,060
<b>SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Restricted stock awards granted	\$ 675	\$ -
Unvested restricted stock awards forfeited	\$ 42	\$ -
Cash payments for:		
Domestic and foreign income taxes	\$ 825	\$ 451
Interest	1	4

See accompanying Notes to Consolidated Financial Statements.

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 manipulator and docking hardware products, temperature management systems and tester interface products that are used by semiconductor manufacturers in conjunction with automatic test equipment ("ATE") in the testing of integrated circuits ("ICs" or "semiconductors").

The consolidated entity is comprised of inTEST Corporation (parent) and our wholly-owned subsidiaries. We manufacture our products in the U.S., Germany and Singapore. Marketing and support activities are conducted worldwide from our facilities in the U.S., the U.K., Germany, Japan and Singapore.

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 or in the markets in which we operate, economic conditions specific to the semiconductor industry, our ability to safeguard patents 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 have experienced significant period-to-period fluctuations in our operating results.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Use of Estimates

The accompanying unaudited 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 long-lived assets, goodwill, inventory, deferred income tax valuation allowances and product warranty reserves, are particularly affected 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, 2006 (our "2006 Form 10-K").

**Reclassification**

Certain prior period amounts have been reclassified to be comparable with the current period's presentation. In particular, prior to the first quarter of 2007, legal fees related to our patents and other intellectual property were included in general and administrative expense. Effective January 1, 2007, we include these fees as a component of engineering and product development expense. Prior periods have been reclassified accordingly.

**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, 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 \$593 and \$409 for the nine months ended September 30, 2007 and 2006, respectively.

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

## (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Continued)

**Goodwill and Intangibles**

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*, goodwill and other indefinite life intangible assets are subject to at least an annual assessment for impairment by applying a fair value based test.

Goodwill at both September 30, 2007 and December 31, 2006 relates to the manipulator/docking hardware segment. The following table sets forth changes in the amount of the carrying value of goodwill for the nine months ended September 30, 2007:

	\$2,629
Balance - Beginning of period	
	<u>155</u>
Impact of foreign currency translation	
	<u>\$2,784</u>

Balance - End of period

As of September 30, 2007 and December 31, 2006, definite life intangibles totaled \$281 and \$299, net of accumulated amortization of \$281 and \$221, respectively. These definite life intangibles are the result of our acquisition of Intestlogic and are being amortized using the straight-line method over the remaining estimated useful life of six years. These definite life intangible assets are technology based, include patented technology and are allocated to the manipulator/docking hardware segment. The following table sets forth changes in the amount of the carrying value of definite life intangibles for the nine months ended September 30, 2007:

	\$299
Balance - Beginning of period	
	(40)
Amortization	
	<u>22</u>
Impact of foreign currency translation	
	<u>\$281</u>
Balance - End of period	

Estimated annual amortization expense for each of the next five years is \$52.

### **Revenue Recognition**

We recognize revenue in accordance with Staff Accounting Bulletin No. 104 ("SAB 104"), *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 collectibility 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 sales agreements 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 sales agreements contain 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.

inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Continued)

**Restructuring and Other Charges**

We recognize a liability for restructuring costs 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 charges for consolidation of excess facilities when we have vacated the premises. 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. These estimates are derived using the guidance of SFAS No. 146, *Accounting for Exit or Disposal Activities*, and SFAS No. 144, *Accounting for the Impairment of Long Lived Assets*.

**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.

For the nine months ended September 30, 2007, we recorded income tax expense of \$197 compared to \$1,042 for the same period in 2006. 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. Due to our history of operating losses in both our domestic and certain of our foreign operations, we have recorded a full valuation allowance against the deferred tax assets of these operations, including net operating loss carryforwards, where we believe it is more likely than not that we will not have sufficient taxable income to utilize these assets before they expire. During the first nine months of 2007, the income tax expense recorded primarily represents income tax expense on the taxable income of our foreign operations where we do not have a history of operating losses and therefore do not have net operating loss carryforwards to offset income tax expense on those earnings. The reduction in our effective tax rate for the first nine months of 2007 compared to the same period in 2006 reflects that the losses of our domestic operations and certain of our

foreign operations represented a larger proportion of our total results for the first nine months of 2007 than in the comparable period in 2006.

**Net Earnings (Loss) Per Common Share**

Net earnings (loss) per common share is computed in accordance with SFAS No. 128, *Earnings Per Share*. Basic earnings (loss) per common share is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding during each period. Diluted earnings (loss) per common share 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 outstanding - diluted and the average number of potentially dilutive securities and their respective weighted average exercise prices that were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive:

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Continued)

	<u>Three Months Ended</u> <u>Sept. 30,</u>		<u>Nine Months Ended</u> <u>Sept. 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Weighted average common shares outstanding -- basic	9,216,443	9,053,603	9,196,557	9,020,173
Potentially dilutive securities:				
Employee stock options and unvested shares of restricted stock	<u>          -</u>	<u>211,206</u>	<u>          -</u>	<u>132,574</u>
Weighted average common shares outstanding -- diluted	<u>9,216,443</u>	<u>9,264,809</u>	<u>9,196,557</u>	<u>9,152,747</u>
	741,267	125,050	736,477	279,166

Average number of potentially dilutive securities excluded  
from calculation

\$3.87      \$6.08      \$3.97      \$3.37

Weighted average exercise price of excluded securities

### Recently Adopted Accounting Standards

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 ("SAB 108"), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB 108 requires registrants to quantify misstatements using both an income statement ("rollover") and balance sheet ("iron curtain") approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 was effective for fiscal years ending on or after November 15, 2006. The adoption of SAB 108 did not have a material impact on our consolidated financial position, results of operations or cash flows.

On January 1, 2007, we adopted FASB Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. FIN 48 provides guidance for the recognition and measurement of uncertain tax positions in an enterprise's financial statements. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would ultimately be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more-likely-than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is considered by itself and not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

In May 2007, the FASB issued FASB Staff Position ("FSP") FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48 (FSP FIN 48-1)*. FSP FIN 48-1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN 48-1 is effective retroactively to January 1, 2007. The implementation of this standard did not have a material impact on our consolidated financial position or results of operations.

Our policy is to record interest and penalties associated with unrecognized tax benefits as additional income taxes in the statement of income. As of January 1, 2007, we had no unrecognized tax benefits, and accordingly, we have not recognized any interest or penalties during the first nine months of 2007 related to unrecognized tax benefits.

We file U.S. income tax returns and multiple state and foreign income tax returns. With few exceptions, the U.S. and state income tax returns filed for the tax years ending on December 31, 2003 through December 31, 2006 are subject to examination by the relevant taxing authorities.

inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Continued)

On January 1, 2007, we adopted Emerging Issues Task Force on Issue No. 06-3 ("EITF 06-3"), *How Sales Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement*. EITF 06-3 requires a company to disclose its accounting policy (i.e. gross vs. net basis) relating to the presentation of taxes within the scope of EITF 06-3. Furthermore, for taxes reported on a gross basis, an enterprise should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented. The guidance was effective for all periods beginning after December 15, 2006. The adoption of EITF 06-3 did not have an impact on our consolidated financial position, results of operations or cash flows.

**New Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently in the process of assessing the impact the adoption of SFAS 157 will have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 permits companies to elect to measure certain financial instruments at fair value on an instrument-by-instrument basis, with changes in fair value recognized in earnings each reporting period. In addition, SFAS 159 establishes financial statement presentation and disclosure requirements for assets and liabilities reported at fair value under the election. SFAS 159 is effective as of the beginning of the first fiscal year beginning after November 15, 2007. We are currently in the process of assessing the impact the adoption of SFAS 159 will have on our financial statements.

(3)

**MAJOR CUSTOMERS**

Texas Instruments Inc. accounted for 18% and 22% of our consolidated net revenues for the nine months ended September 30, 2007 and 2006, respectively. While all three of our operating segments sold products to this customer, these revenues were primarily generated by our manipulator/docking hardware segment. During the nine months ended September 30, 2007 and 2006, no other customer accounted for 10% or more of our consolidated net revenues.

(4)

**INVENTORIES**

Inventories held at September 30, 2007 and December 31, 2006 were comprised of the following:

	Sept. 30,	Dec. 31,
	<i>2007</i>	<i>2006</i>
Raw materials	\$4,506	\$4,415
Work in process	495	497
Inventory consigned to others	457	357
Finished goods	<u>691</u>	<u>924</u>
	<u>\$6,149</u>	<u>\$6,193</u>

(5)

**LEASEHOLD IMPROVEMENTS AND DEFERRED RENT**

In accordance with FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*, we record tenant improvements made to our leased facilities based on the amount of the total cost to construct the improvements regardless of whether a portion of that cost was paid through an allowance provided by the facility's landlord. The amount of the allowance, if any, is recorded as deferred rent. We amortize deferred rent on a straight-line basis over the lease term and record the amortization as a reduction of rent expense. Amortization of deferred rent was \$88 for the nine months ended September 30 during both 2007 and 2006.

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(5)

**LEASEHOLD IMPROVEMENTS AND DEFERRED RENT (Continued)**

In addition, certain of our operating leases contain predetermined fixed escalations of minimum rentals during the original lease terms. For these leases, we recognize the related rental expense on a straight-line basis over the life of the lease and record the difference between the amounts charged to operations and amounts paid as accrued rent which is included in other accrued expenses on our balance sheet.

(6)

## GUARANTEES

### Product Warranties

Warranty expense (recovery) for the nine months ended September 30, 2007 and 2006 was \$(122) and \$361, respectively. During the nine months ended September 30, 2007, we recorded a reduction in our consolidated warranty accrual reflecting favorable claims experience.

The following table sets forth the changes in the liability for product warranties for the nine months ended September 30, 2007:

Balance - Beginning of period	\$857
Payments made under product warranty	(206)
Reduction in accrued warranty due to favorable claims experience	<u>(122)</u>
	)
Balance - End of period	<u>\$529</u>

### U.K. Lease Guarantee

In connection with the closure of our U.K. manufacturing operation, as more fully discussed in Notes 9 and 10 to the consolidated financial statements in our 2006 Form 10-K, we have entered into a sub-leasing arrangement for the facility which was occupied by this operation prior to its closure. As a condition of the sub-lease, the landlord of this facility has required that we guarantee the performance of the sub-lessee with respect to the lease payments. We have performed a credit analysis of the sub-lessee and believe that a default by them with regard to their obligations under the sub-lease agreement is remote. However, as of September 30, 2007, there was approximately \$366 of future payments that we would be obligated to make if the sub-lessee were to default and we were unable to enter into a new sub-lease agreement with another party. Our original lease on this facility extends through December 31, 2010. As of September 30, 2007 we have not recorded any amounts in our financial statements related to this guarantee.

(7) STOCK-BASED COMPENSATION

As of September 30, 2007, we have outstanding stock options and unvested restricted stock awards granted under a stock-based employee compensation plan (the "1997 Stock Plan") that is described more fully in Note 14 to our consolidated financial statements in our 2006 Form 10-K. No options or shares of restricted stock may be granted under this plan after March 31, 2007. In addition, at our annual meeting of stockholders held on June 13, 2007, our stockholders, upon the recommendation of our Board of Directors, approved the inTEST Corporation 2007 Stock Plan (the "2007 Stock Plan"). The 2007 Stock Plan permits the granting of stock options or restricted stock, for up to 500,000 shares of our common stock, to officers, other key employees and consultants. A description of the 2007 Stock Plan, including the full text of the 2007 Stock Plan, is contained in the proxy statement for our 2007 annual meeting of stockholders.

As of September 30, 2007, total compensation expense to be recognized in future periods was \$946. The weighted average period over which this expense is expected to be recognized is 2.6 years. All of this expense is related to nonvested shares of restricted stock.

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(7) STOCK-BASED COMPENSATION

(Continued)

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, 2007 and 2006, respectively, related to nonvested shares:

	Three Months Ended <u>September</u> <u>30,</u>		Nine Months Ended <u>September</u> <u>30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Cost of revenues	\$ 4	\$ 5	\$ 14	\$ 14
Selling expenses	7	3	13	9
	9	4	19	13

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Engineering and product development expense	<u>85</u>	<u>70</u>	<u>225</u>	<u>207</u>
General and administrative expenses	<u>\$105</u>	<u>\$82</u>	<u>\$271</u>	<u>\$243</u>

There was no compensation expense capitalized in either the three or nine months ended September 30, 2007 or 2006.

The following table summarizes the activity related to nonvested shares for the nine months ended September 30, 2007:

	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested shares outstanding, January 1, 2007	133,750	\$4.58
Granted	162,000	4.16
Vested	(1,250)	3.25
Forfeited	<u>(11,250)</u>	<u>3.76</u>
)		
Nonvested shares outstanding, September 30, 2007	<u>283,250</u>	<u>\$4.38</u>

Stock Options

The following table summarizes the stock option activity for the nine months ended September 30, 2007:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Options outstanding, January 1, 2007 (561,550 exercisable)	561,550	\$ 3.91
Granted	-	-
Exercised	(5,000)	3.35

Forfeited/Expired	<u>(81,250)</u>	5.97
	)	
	<u>475,300</u>	3.56
Options outstanding, September 30, 2007 (475,300 exercisable)		

(8)

**EMPLOYEE BENEFIT PLANS**

We have a defined contribution 401(k) plan (the "inTEST 401(k) Plan") for our employees who work in the U.S. As a part of this plan, we match a portion of employee contributions. This plan, including our employer matching contributions, is more fully discussed in Note 15 to the consolidated financial statements in our 2006 Form 10-K.

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(8)

**EMPLOYEE BENEFIT PLANS (Continued)**

In addition to the employer matching contributions for which employees of our Temptronic subsidiary are eligible, upon the termination of the Temptronic Equity Participation Plan ("EPP"), we 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 profit sharing 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 essentially the same manner in which the shares held by the EPP had been allocated. The vesting provisions for these contributions will be the same as those of the inTEST 401(k) Plan. Accruals for profit sharing contributions totaling \$228 and \$212 were made during the nine month periods ended September 30, 2007 and 2006, respectively. Through September 30, 2007, we had made a total of \$953 in profit sharing contributions. We typically fund these obligations through the use of treasury shares during the quarter subsequent to the quarter in which we record the profit sharing liability.

**(9) SEGMENT INFORMATION**

We have three reportable segments: Manipulator/Docking Hardware Products, Temperature Management Systems and Tester Interface Products. The Manipulator and Docking Hardware segment includes the operations of our Cherry Hill, New Jersey manufacturing facility as well as the operations of three of our foreign subsidiaries: inTEST KK (Japan), inTEST PTE, Limited (Singapore) and Intestlogic GmbH (Germany). Sales of this segment consist primarily of manipulator and docking hardware products which we design, manufacture and market, as well as certain other

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related products which we design and market, but which are manufactured by third parties. The Temperature Management segment includes the operations of Temptronic Corporation in Sharon, Massachusetts as well as Temptronic GmbH (Germany). Sales of this segment consist primarily of temperature management systems which we design, manufacture and market under our Temptronic product line. In addition, this segment provides after sale service and support, which is paid for by its customers. The Tester Interface 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 and ATE manufacturers. Intercompany pricing between segments is either a multiple of cost for component parts or a percentage discount from list price for finished goods.

	Three Months Ended _____ Sept. 30, _____		Nine Months Ended _____ Sept. 30, _____	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Net revenues from unaffiliated customers:				
Manipulator/Docking Hardware	\$ 6,537	\$ 9,657	\$17,187	\$28,515
Temperature Management	5,649	6,129	17,101	16,715
Tester Interface	1,503	1,533	4,802	6,095
	<u>(575)</u>	<u>(753)</u>	<u>(1,796)</u>	<u>(2,138)</u>
Intersegment sales	)	)	)	)
	<u>\$13,114</u>	<u>\$16,566</u>	<u>\$37,294</u>	<u>\$49,187</u>
Intersegment sales:				
Manipulator/Docking Hardware	\$ 3	\$ 1	\$ 7	\$ 4
Temperature Management	475	734	1,498	1,634
Tester Interface	<u>97</u>	<u>18</u>	<u>291</u>	<u>500</u>
	<u>\$575</u>	<u>\$753</u>	<u>\$1,796</u>	<u>\$2,138</u>
Earnings (loss) before income taxes:				
Manipulator/Docking Hardware	\$(155)	\$ 748	\$(2,391)	\$3,151
Temperature Management	318	807	1,302	1,213

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Tester Interface	(375)	(629)	(1,245)	(548)
	<u>38</u>	<u>91</u>	<u>(28)</u>	<u>16</u>
Corporate		)		
	<u>\$(174)</u>	<u>\$1,017</u>	<u>\$(2,362)</u>	<u>\$3,832</u>
	)	)		

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inTEST CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(9) SEGMENT INFORMATION

(Continued)

	Three Months Ended <u>Sept. 30,</u>		Nine Months Ended <u>Sept. 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Net earnings (loss):				
Manipulator/Docking Hardware	\$(194)	\$328	\$(2,450)	\$2,290
Temperature Management	279	554	1,164	883
Tester Interface	(375)	(465)	(1,245)	(399)
	<u>38</u>	<u>91</u>	<u>(28)</u>	<u>16</u>
Corporate		)		
	<u>\$(252)</u>	<u>\$508</u>	<u>\$(2,559)</u>	<u>\$2,790</u>
	)	)		

Sept. 30, Dec. 31,  
2007      2006

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Identifiable assets:		
	\$17,996	\$20,324
Manipulator/Docking Hardware	11,453	11,692
Temperature Management	<u>3,153</u>	<u>3,743</u>
Tester Interface	<u>\$32,602</u>	<u>\$35,759</u>

The following table provides information about our geographic areas of operation. Net revenues from unaffiliated customers are based on the location of the selling entity.

	Three Months Ended _____ Sept. 30, _____		Nine Months Ended _____ Sept. 30, _____	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Net revenues from unaffiliated customers:				
U.S.	\$ 9,584	\$11,109	\$28,092	\$33,359
Europe	2,112	1,342	4,614	4,807
	<u>1,418</u>	<u>4,115</u>	<u>4,588</u>	<u>11,021</u>
Asia-Pacific	<u>\$13,114</u>	<u>\$16,566</u>	<u>\$37,294</u>	<u>\$49,187</u>

	Sept. 30, _____	Dec. 31, _____
	<u>2007</u>	<u>2006</u>
Long-lived assets:		
U.S.	\$2,462	\$2,983
Europe	310	315
Asia-Pacific	<u>73</u>	<u>30</u>

\$2.845    \$3.328

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inTEST CORPORATION

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

Overview

As discussed more fully in our 2006 Form 10-K, 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. Because the industry cycles are generally characterized by sequential quarterly growth or declines in orders and net revenues throughout the 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, while the general trend over several quarters tends to be one of either growth or decline, 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 temperature management systems 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, in recent years we have begun to market our temperature

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management systems in industries outside semiconductor test, such as the automotive, aerospace, medical and telecommunications industries. We believe that these industries usually are less cyclical than the ATE industry.

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 of the selling entity).

	(in 000's)				
	<u>Three Months Ended</u>			<u>Nine Months Ended</u>	
	<u>Sept. 30,</u>	<u>June 30,</u>	<u>Sept. 30,</u>	<u>Sept. 30,</u>	<u>2006</u>
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2007</u>	<u>2006</u>
Net revenues from unaffiliated customers:					
Manipulator/Docking Hardware	\$ 6,537	\$ 9,657	\$ 4,693	\$17,187	\$28,515
Temperature Management	5,649	6,129	5,913	17,101	16,715
Tester Interface	1,503	1,533	1,966	4,802	6,095
	<u>(575)</u>	<u>(753)</u>	<u>(510)</u>	<u>(1,796)</u>	<u>(2,138)</u>
Intersegment sales	)            )            )            )            )				
	<u>\$13,114</u>	<u>\$16,566</u>	<u>\$12,062</u>	<u>\$37,294</u>	<u>\$49,187</u>
Intersegment sales:					
Manipulator/Docking Hardware	\$ 3	\$ 1	\$ -	\$ 7	\$ 4
Temperature Management	475	734	448	1,498	1,634
Tester Interface	<u>97</u>	<u>18</u>	<u>62</u>	<u>291</u>	<u>500</u>
	<u>\$575</u>	<u>\$753</u>	<u>\$510</u>	<u>\$1,796</u>	<u>\$2,138</u>
Net revenues from unaffiliated customers (net of intersegment sales):					
Manipulator/Docking Hardware	\$ 6,534	\$ 9,656	\$ 4,693	\$17,180	\$28,511
Temperature Management	5,174	5,395	5,465	15,603	15,081
	<u>1,406</u>	<u>1,515</u>	<u>1,904</u>	<u>4,511</u>	<u>5,595</u>

Tester Interface

\$13,114   \$16,566   \$12,062   \$37,294   \$49,187

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## inTEST CORPORATION

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

. (Continued)

	(in 000's)				
	Three Months Ended		Nine Months Ended		
	Sept. 30.	June 30.	Sept. 30.		
	Sept. 30.	June 30.	Sept. 30.	Sept. 30.	Sept. 30.
Net revenues from unaffiliated customers:					
U.S.	\$ 9,584	\$11,109	\$ 9,558	\$28,092	\$33,359
Europe	2,112	1,342	1,195	4,614	4,807
	<u>1,418</u>	<u>4,115</u>	<u>1,309</u>	<u>4,588</u>	<u>11,021</u>
Asia-Pacific	<u>\$13,114</u>	<u>\$16,566</u>	<u>\$12,062</u>	<u>\$37,294</u>	<u>\$49,187</u>

Consolidated net revenues for the third quarter of 2007 decreased \$3.5 million or 21% compared to the third quarter of 2006. Consolidated net revenues for the nine months ended September 30, 2007 decreased \$11.9 million or 24% from the level experienced for the same period in 2006. During 2006, the semiconductor industry in which we operate experienced higher levels of demand than have been present in 2007 thus far, with the peak of demand occurring during the second quarter of 2006. The increased demand during 2006 resulted in our quarterly net revenues increasing from \$13.7 million in the first quarter of 2006 to \$18.9 million in the second quarter of the year. Subsequent to the second quarter of 2006, our orders and, as a result, our quarterly net revenues began to decline resulting in total consolidated net revenues of \$16.6 million and \$13.2 million, respectively, for the third and fourth quarters of 2006.

Although our consolidated net revenues began to decline after the second quarter of 2006, they still remained higher during the balance of 2006 than the levels we have experienced to date in 2007. As we entered 2007, the then current industry consensus was that the reduced demand that had begun in late 2006 would last through the first half of 2007. It was expected that the second half of 2007 would be the period when demand would begin to increase. However, late in the third quarter of 2007, it became apparent that demand was remaining flat or weakening somewhat. This is reflected in the decline in our orders during the third quarter of 2007. Our total orders for the quarter ended September 30, 2007 declined to \$11.1 million compared to \$13.8

million for the second quarter of the 2007. We believe the trend we have seen in our orders reflects a similar trend being experienced by our customers as well as others within our industry.

Backlog

At September 30, 2007, our backlog of unfilled orders for all products was approximately \$5.1 million compared with approximately \$7.0 million at June 30, 2007 and \$5.8 million at September 30, 2006. Our backlog includes customer orders which we have accepted, substantially all of which we expect to deliver in 2007. 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.

Cost Containment and Organizational Changes

In response to the cyclical nature of the ATE market in which we operate, we took various actions (the "2004/2005 Restructuring") to restructure our operations during the prior downturn. The goal of the 2004/2005 Restructuring was to significantly reduce our fixed operating costs and position ourselves to more effectively meet the needs and expectations of the cyclical ATE market. The 2004/2005 Restructuring included organizational changes allowing us to eliminate certain central corporate staff, facility closures allowing us to eliminate excess manufacturing capacity and workforce reductions. Additional information regarding the various restructuring plans implemented as a part of the 2004/2005 Restructuring, including the costs incurred, is set forth in Note 10 to the consolidated financial statements in our 2006 Form 10-K.

As of December 31, 2006, all of the restructuring plans implemented as a part of the 2004/2005 Restructuring had been completed and, accordingly, there were no accruals remaining related to any of these plans. However, as a part of the sub-lease agreement for the facility which was occupied by our U.K. manufacturing operation prior to its closure, we remain obligated for the lease payments in the event the sub-lessee defaults. This guaranty obligation is more fully discussed in Note 6 above and in Notes 9 and 10 to the consolidated financial statements of our 2006 Form 10-K. Our U.K. operation was included in our Manipulator/Docking Hardware segment.

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inTEST CORPORATION

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

. (Continued)

In addition to the 2004/2005 Restructuring, in 2004, we implemented headcount reductions and salary and benefit adjustments as temporary cost-saving measures which we reinstated as warranted by increases in our sales levels and profitability during late 2005 and early 2006. This includes the restoration on April 1, 2006, of the salaries for certain staff in our manipulator/docking hardware product segment which had been reduced in late 2004. In addition, on July 1, 2006, we reinstated our employer 401(k) matching contribution and increased salaries for most of our domestic staff, the majority of whom had not had salary increases in two years. Total 401(k) employer match expense incurred during the first nine months of 2007 and for the year ended December 31, 2006 was \$335,000 and \$242,000, respectively.

As part of our continuing focus to determine methods to increase our profitability worldwide while operating in the cyclical ATE market, we continue to review and evaluate actions that could better match our operating costs against our anticipated future revenue and product demand.

Excess and Obsolete Inventory Charges

On a quarterly basis, we review our inventories and record charges for excess and obsolete inventory based upon our established objective excess and obsolete inventory criteria. These criteria identify material that has not been used in a work order during the prior twelve months and the quantity of material on hand that is greater than the average annual usage of that material over the prior three years. In certain cases, additional excess and obsolete inventory charges are recorded based upon current industry conditions, anticipated product life cycles, new product introductions and expected future use of the inventory. The excess and obsolete inventory charges we record establish a new cost basis for the related inventory. We incurred charges for excess and obsolete inventory of \$593,000 and \$409,000 for the nine months ended September 30, 2007 and 2006, respectively. The level of these charges was based upon a variety of factors, including changes in demand for our products and new product designs. See also the section entitled "Critical Accounting Policies."

Product Warranty Charges

We accrue product warranty charges quarterly, based upon our historical claims experience. In addition, from time to time, we accrue additional amounts based upon known product warranty issues, such as product retrofits. For the nine months ended September 30, 2007 and 2006, our product warranty charges (recovery) were \$(122,000) and \$361,000, or (0.3)% and 0.7% of net revenues, respectively. The downward trend in our product warranty charges has been driven by a number of factors including recent improvements in product quality as well as the fact that there were no introductions of new product families in 2006 and 2005 in our manipulator/docking hardware segment. The level of our product warranty charges both in absolute dollars and as a percentage of net revenues is affected by a number of factors including the cyclicity of demand in the ATE industry, the prototype nature of much of our business, the complex nature of many of our products, the introduction of new product families which typically have higher levels of warranty claims than existing product families, and, at our discretion, providing warranty repairs or replacements to customers after the contracted warranty period has expired in order to promote strong customer relations. See also "Critical Accounting Policies."

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 impacted by a number of factors, including the amount of intellectual property (such as patents) utilized in the product, the number of units ordered by the customer at one time, 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 our products to both semiconductor manufacturers (end user sales) and to ATE manufacturers (OEM

sales) who ultimately resell our equipment with theirs to semiconductor manufacturers. 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, 2007 and 2006, our OEM sales as a percentage of net revenues were 22% and 23%, respectively.

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## inTEST CORPORATION

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

(Continued)

The impact of an increase in OEM sales as a percentage of net revenues is generally a reduction in our gross margin, as OEM sales historically have had a more significant discount than end user sales. Our current net operating margins on most OEM sales for these product segments, 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 also expect to continue to experience demands from our OEM customers' supply line management groups to reduce our sales prices to them. This continued price pressure may have the ultimate effect of reducing our gross and operating margins if we cannot further reduce our manufacturing and operating costs.

#### 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. These statements involve risks and uncertainties and are based on various assumptions. Although we believe that our expectations are based on reasonable assumptions, investors and prospective investors are cautioned that such statements are only projections, and there cannot be any assurance that these events or results will occur.

Information about the primary risks and uncertainties that could cause our actual future results to differ materially from our historic results or the results described in the forward-looking statements made in this report or presented elsewhere by Management from time to time are included in Part I, Item 1A - "Risk Factors" of our 2006 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 2006 Form 10-K.

#### Results of Operations

All of our products are used by semiconductor manufacturers in conjunction with ATE in the testing of ICs. Consequently, 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 presented on a consolidated basis and includes discussion of factors unique to each

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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</u>			
	<u>Revenues</u>			
	<u>Quarters Ended Sept.</u>		<u>Nine Months Ended</u>	
	<u>30,</u>		<u>Sept. 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	<u>60.9</u>	<u>58.2</u>	<u>62.0</u>	<u>57.0</u>
Gross margin	<u>39.1</u>	<u>41.8</u>	<u>38.0</u>	<u>43.0</u>
Selling expense	16.2	13.5	17.6	14.1
Engineering and product development expense	10.4	10.7	11.2	9.2
General and administrative expense	<u>15.0</u>	<u>12.0</u>	<u>16.6</u>	<u>12.4</u>
Operating income (loss)	(2.5)	5.6	(7.4)	7.3
Other income	<u>1.2</u>	<u>0.5</u>	<u>1.1</u>	<u>0.5</u>
Earnings (loss) before income taxes	(1.3)	6.1	(6.3)	7.8
Income tax expense	<u>0.6</u>	<u>3.0</u>	<u>0.6</u>	<u>2.1</u>
Net earnings (loss)	<u>(1.9)</u>	<u>3.1</u>	<u>(6.9)</u>	<u>5.7</u>
	)%	%	)%	%

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

.(Continued)

### Quarter Ended September 30, 2007 Compared to Quarter Ended September 30, 2006

*Net Revenues.* Net revenues were \$13.1 million for the quarter ended September 30, 2007 compared to \$16.6 million for the same period in 2006, a decrease of \$3.5 million or 21%. The percentage decrease in the net revenues (net of intersegment sales) of our manipulator/docking hardware, temperature management and tester interface product segments were 32%, 4% and 7%, respectively. The larger percentage decrease in our manipulator/docking hardware product segment primarily reflects a decline in net revenues from the sale of certain third-party products distributed through our operation in Japan. During the quarter ended September 30, 2007, the net revenues of our Japanese operation were \$309,000 compared to \$2.5 million for the same period in 2006, a \$2.2 million or 88% decline. We were notified shortly after the end of the first quarter of 2007 that the company for which we distributed these products had been acquired and that we would no longer be distributing these products for them after the second quarter of 2007. We had previously anticipated declining sales from this operation during 2007 as we had expected that the customer who had been purchasing the majority of these products from us would no longer have the same level of demand. We are currently in the process of investigating potential distribution opportunities for other third-party products in this region, but we cannot be certain if and when such opportunities will be realized.

During the quarter ended September 30, 2007, our net revenues from customers in the U.S. and Asia decreased 14% and 66%, respectively, while our net revenues from customers in Europe increased 57% from the comparable prior period. Adjusted to eliminate the impact of changes in foreign currency exchange rates, the decrease in net revenues from customers in Asia would have been 67% and the increase from customers in Europe would have been 45%. The higher decrease in net revenues from customers in Asia primarily reflects the aforementioned decline in sales of third-party products by our operation in Japan. The increase from customers in Europe primarily reflects strong sales by our Intestlogic operation in Germany of some of our recently introduced manipulator designs.

*Gross Margin.* Gross margin was 39% for the third quarter of 2007 compared to 42% for the same period in 2006. The decrease in gross margin primarily reflects an increase in our fixed operating costs as a percentage of net revenues. Although the absolute dollar amount of these costs decreased \$189,000 compared to the third quarter of 2006, they were not as fully absorbed during the third quarter of 2007 due to the lower net revenue levels as compared to the same period in 2006. The \$189,000 decrease in fixed operating costs primarily reflects reduced salary and benefits expense as a result of reduced headcount during the third quarter of 2007 as compared to the same period in 2006. To a lesser extent both direct labor and charges for excess and obsolete inventory increased as a percentage of net revenues. Similar to our fixed operating costs, direct labor declined in absolute dollar terms during the third quarter of 2007 as compared to the same period in 2006 reflecting reduced headcount. However, as a result of the reduced revenue levels, these costs were not as fully absorbed in the third quarter of 2007 compared to the third quarter of 2006. Charges for excess and obsolete inventory increased both in absolute dollar terms and as a percentage of net revenues during the third quarter of 2007 compared to the same period in 2006. The increase in the absolute dollar amount of these charges reflects that, as demand remains at reduced levels, more of our inventory is meeting the criteria we use to evaluate whether items in our inventory are excess or obsolete. These increases were partially offset by a reduction in component material costs as a percentage of net revenues, reflecting changes in product and customer mix.

*Selling Expense.* Selling expense was \$2.1 million for the third quarter of 2007 compared to \$2.2 million for the comparable prior period, a decrease of \$111,000 or 5%. Lower levels of warranty charges and a reduction in travel costs were partially offset by increased salary and benefits expense and higher levels of commissions. Warranty charges declined primarily as a result of favorable claims experience, while our travel costs declined primarily as a result of the reduced level of business activity. The higher level of salary and benefits expense reflects increased headcount, while the increase in commissions reflects changes in customer mix. Both of these increases occurred primarily in our temperature management product segment.

*Engineering and Product Development Expense.* Engineering and product development expense was \$1.4 million for the third quarter of 2007 compared to \$1.8 million for the comparable prior period, a decrease of \$411,000 or 23%. The decrease is primarily a result of lower salary and benefits expense and a reduction in spending on research and development materials during the third quarter of 2007 compared to the third quarter of 2006. Salary and benefits expense declined as a result of headcount reductions, primarily in our tester interface product segment. Our spending on research and development materials declined reflecting that we had fewer new product development projects in the phase where spending on research and development materials is increased, primarily in our manipulator/docking hardware product segment.

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

(Continued)

General and Administrative Expense.

General and administrative expense was relatively unchanged at \$2.0 million for both the third quarter of 2007 and the same period in 2006. Decreases in accruals for profit-based bonuses were offset by higher recruiting expense and an increase in professional fees. The reduction in bonuses is a result of recording a net loss for the third quarter of 2007 compared to net earnings during the third quarter of 2006. The recruiting expense recorded during the third quarter of 2007 related to hiring a new managing director for our Intestlogic operation in Germany. There were no similar costs recorded during the third quarter of 2006. The increase in professional fees during the third quarter of 2007 as compared to the same period in 2006 is related to higher levels of spending on third-party consultants who have been assisting us in preparation for compliance with Section 404 of the Sarbanes-Oxley Act.

*Other Income.* Other income was \$148,000 for the third quarter of 2007 compared to \$85,000 for the comparable period in 2006, an increase of \$63,000. The increase primarily represents a reduction in foreign currency losses combined with gains on the sale of certain machine shop equipment by our operation in San Jose, California.

*Income Tax Expense.* For the quarter ended September 30, 2007, we recorded income tax expense of \$78,000 compared to income tax expense of \$509,000 for the same period in 2006. 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. Due to our history of operating losses in both our domestic and certain of our foreign operations, we have recorded a full valuation allowance against the deferred tax assets of these operations, including net operating loss carryforwards, where we believe it is more likely than not that we will not have sufficient taxable income to utilize these assets before they expire. During the third quarter of 2007, the income tax expense recorded primarily represents income tax expense on the taxable income of our foreign operations where we do not have a history of operating losses and therefore do not have net operating loss carryforwards to offset income tax expense on those earnings. The reduction in our effective tax rate for the third quarter of 2007 compared to the same period in 2006 reflects that the losses of our domestic operations and certain of our foreign operations represented a larger proportion of our total results for the third quarter of 2007 than in the comparable period in 2006.

*Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006*

*Net Revenues.* Net revenues were \$37.3 million for the nine months ended September 30, 2007 compared to \$49.2 million for the same period in 2006, a decrease of \$11.9 million or 24%. The percentage decrease in the net revenues (net of intersegment sales) of our manipulator/docking hardware and tester interface product segments were 40% and 20%, respectively, while the net revenues (net of intersegment sales) of our temperature management product segment increased 4% for the first nine months of 2007 as compared to the same period in 2006. As previously discussed, we believe the semiconductor industry continued to be in a period of weakened demand during the first nine months of 2007 compared to the same period in 2006. This reduction in demand has been more significant for our manipulator/docking hardware and tester interface product segments than for our temperature management product segment where we have continued to experience increased success in selling these products in markets which we believe to be less cyclical than the semiconductor test industry. In addition, in our manipulator/docking hardware product segment we saw a decline in demand for certain third-party products we distribute through our operation in Japan during 2007, as previously discussed. During the nine months ended September 30, 2007, the net revenues of our Japanese operation were \$1.4 million compared to \$5.4 million for the same period in 2006, a \$4.0 million or 74% decline.

During the nine months ended September 30, 2007, our net revenues from customers in the U.S., Europe and Asia decreased 16%, 4% and 58%, respectively. Adjusted to eliminate the impact of changes in foreign currency exchange rates, the decrease in net revenues from customers in Europe and Asia would have been 12% and 59%, respectively. The lower decrease from customers in Europe primarily reflects strong sales by our Intestlogic operation in Germany of some of our recently introduced manipulator designs. The higher decrease in net revenues from customers in Asia primarily reflects the aforementioned decline in sales of third-party products by our operation in Japan.

## inTEST CORPORATION

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

(Continued)

## Gross Margin

Gross margin was 38% for the first nine months of 2007 as compared to 43% for the same period in 2006. The decrease in gross margin primarily reflects an increase in our fixed operating costs as a percentage of net revenues. Although the absolute dollar amount of these costs decreased \$122,000 compared to the same period in 2006, they were not as fully absorbed during the first nine months of 2007 due to the lower net revenue levels as compared to the same period in 2006. The \$122,000 decrease in fixed operating costs was primarily driven by reductions in insurance premiums and lower levels of depreciation. The reduction in insurance premiums primarily reflects the reduction in the volume of business activity in the first nine months of 2007 as compared to the same period in 2006. The decrease in depreciation reflects a lower asset base as of September 30, 2007 compared to September 30, 2006. These decreases were partially offset by fixed labor and overhead costs at our machine shops in Cherry Hill and Silicon Valley which were not as fully absorbed due to lower volume at these operations during the first nine months of 2007 as compared to the same period in 2006.

*Selling Expense.* Selling expense was \$6.6 million for the first nine months of 2007 as compared to \$7.0 million for the same period in 2006, a decrease of \$376,000 or 5%. The decrease was primarily driven by lower levels of warranty charges, reflecting favorable claims experience, and, to a lesser extent, a reduction in fees paid to third parties for installation of our products at customer sites, primarily in Asia. These decreases were partially offset by an increase in salary and benefits expense reflecting increased headcount, primarily at our temperature management product segment.

*Engineering and Product Development Expense.* Engineering and product development expense was \$4.2 million for the first nine months of 2007 compared to \$4.5 million for the same period in 2006, a decrease of \$338,000 or 8%. During the first nine months of 2006 we received \$700,000 in reimbursement payments for engineering services under a contract with one of the customers of our tester interface product segment. This reimbursement offset \$379,000 of salary and benefits expense and expenditures for research and development materials incurred during the first nine months of 2006, as well as reimbursing \$321,000 of development costs incurred in periods prior to the negotiation of this reimbursement contract. The reduction in engineering and product development costs in the first nine months of 2007 as compared to the same period in 2006 (after excluding the reimbursement of prior period costs from 2006) is primarily a result of lower salary and benefits expense and a reduction in spending on research and development materials reflecting fewer staff and fewer new product development projects in the phase where spending on research and development materials is increased.

*General and Administrative Expense.* General and administrative expense was \$6.2 million for the first nine months of 2007 compared to \$6.1 million for the same period in 2006, an increase of \$70,000 or 1%. The increase was primarily driven by an increase in salary and benefits expense which reflects both a \$119,000 severance payment in 2007 to the former managing director of our Intestlogic operation as well as the restoration of certain salaries and benefits in the second and third quarters of 2006. This increase was partially offset by decreases in profit-based bonuses as a result of our loss for the first nine months of 2007. To a lesser extent, there was also a decrease in the level of professional fees in the first nine months of 2007 as compared to the same period in 2006. In the first nine months of 2006, we incurred higher levels of spending on third-party consultants who have been assisting us in preparation for compliance with Section 404 of the Sarbanes-Oxley Act.

*Other Income.* Other income was \$395,000 for the nine months ended September 30, 2007 compared to \$229,000 for the comparable period in 2006, an increase of \$166,000. The increase in other income was due to an increase in interest income as well as a reduction in foreign exchange losses. The increase in interest income reflects higher average cash balances as well as an increase in the rate of interest being earned during the first nine months of 2007 as compared to the same period in 2006.

*Income Tax Expense (Benefit).* For the nine months ended September 30, 2007, we recorded income tax expense of \$197,000 compared to \$1.0 million for the same period in 2006. 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. Due to our history of operating losses in both our domestic and certain of our foreign operations, we have recorded a full valuation allowance against the deferred tax assets of these operations, including net operating loss carryforwards, where we believe it is more likely than not that we will not have sufficient taxable income to utilize these assets before they expire. During the first nine months of 2007, the income tax expense recorded primarily represents income tax expense on the taxable income of our foreign operations where we do not have a history of operating losses and therefore do not have net operating loss

carryforwards to offset income tax expense on those earnings. The reduction in our effective tax rate for the first nine months of 2007 compared to the same period in 2006 reflects that the losses of our domestic operations and certain of our foreign operations represented a larger proportion of our total results for the first nine months of 2007 than in the comparable period in 2006.

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

(Continued)

**Liquidity and Capital Resources**

Net cash used in operations for the nine months ended September 30, 2007 was \$2.2 million compared to net cash provided by operations of \$5.1 million for the same period in 2006. The shift to cash used in operations for the first nine months of 2007 from cash provided by operations for the same period in 2006 was primarily the result of our \$2.6 million net loss in the first nine months of 2007 as compared to net earnings of \$2.8 million for the same period in 2006. During the nine months ended September 30, 2007 accounts receivable decreased \$897,000 primarily reflecting the lower net revenue levels experienced in the first nine months of 2007 as compared to the same period in 2006. Domestic and foreign income taxes payable decreased \$817,000 compared to the amount at December 31, 2006 due to the payment of income taxes on earnings in 2006 by certain of our foreign operations. During the nine months ended September 30, 2007, accrued warranty decreased \$332,000 compared to the level at December 31, 2006 reflecting favorable claims experience. Accounts payable decreased \$319,000 in the first nine months of 2007, also reflecting the reduced level of business activity.

Purchases of property and equipment were \$521,000 for the nine months ended September 30, 2007. These purchases primarily consisted of demonstration and quality assurance testing equipment for our facilities in Sharon, Massachusetts and San Jose, California and additional leasehold improvements for our facility in Cherry Hill, New Jersey. During the nine months ended September 30, 2007, we also purchased additional computer and other office equipment for our Intestlogic operation in Germany and a new vehicle for our Temptronic GmbH operation in Germany. During the nine months ended September 30, 2007, we received \$66,000 in proceeds from the sale of certain machine shop equipment by our operation in San Jose, California. We have no significant commitments for capital expenditures for the balance of 2007, however, depending upon changes in market demand, we may make such purchases as we deem necessary and appropriate.

Net cash provided by financing activities for the nine months ended September 30, 2007 was \$11,000, which represents \$17,000 of proceeds from the exercise of stock options and \$6,000 in payments made under capital lease obligations.

On October 2, 2007, we amended the lease for our Cherry Hill facility to reduce the square footage leased by approximately 42,000 square feet, which represented approximately 34% of the total facility square footage. The annual lease cost for this space was approximately \$264,000 for 2007 and under the terms of the original lease would have escalated annually through the end of the lease on August 31, 2010. The average annual cost savings through the end of the original lease term is approximately \$274,000.

We have a secured credit facility that provides for maximum borrowings of \$250,000. We have not utilized this facility to borrow any funds. Our usage consists of the issuance of letters of credit in the face amount of \$250,000. We pay a quarterly fee of 1.5% per annum on the total amount of the outstanding letters of credit. The terms of the loan agreement require that we maintain a minimum level of \$200,000 of domestic cash. This credit facility expires on September 30, 2008.

As of September 30, 2007 we had cash and cash equivalents of \$10.7 million. We believe our cash balances will be sufficient to satisfy our cash requirements for the foreseeable future. Should the current downturn be prolonged or, conversely, if we enter the next upturn earlier than we anticipate, or should the increases in our quarterly net revenues and bookings be more rapid than we expect, we may require additional debt or equity financing to meet working capital or capital expenditure needs. We cannot be certain that, if needed, we would be able to raise such additional financing or upon what terms such financing 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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## inTEST CORPORATION

### 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, 2007, there have been no significant changes to the accounting policies that we have deemed critical. These policies are more fully described in our 2006 Form 10-K.

#### **International Operations**

Net revenues generated by our foreign subsidiaries were 25% and 32% of consolidated net revenues for the nine months ended September 30, 2007 and 2006, respectively. We anticipate that net revenues generated by our foreign subsidiaries will continue to account for a significant portion of consolidated net revenues in the foreseeable future. The net revenues generated by our foreign subsidiaries will continue to be subject to certain risks that could have a material adverse effect on our business, financial condition or results of operations. Such risks are discussed in Part I, Item 1A-"Risk Factors" of our 2006 Form 10-K.

Net revenues denominated in foreign currencies were 16% and 21% of consolidated net revenues for the nine months ended September 30, 2007 and 2006, respectively. Although we seek to operate our business such that a significant portion of our product costs are denominated in the same currency as the associated sales, we may be adversely affected in the future due to our exposure to foreign operations. Moreover, net revenues denominated in currencies other than U.S. dollars expose us to currency fluctuations, which can adversely affect our business, financial condition or results of operations. Such risks are discussed in Part I, Item 1A - "Risk Factors" of our 2006 Form 10-K.

Item 3.

#### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

##### Foreign Currency Risk

We are subject to the risk of changes in foreign currency exchange rates due to our global operations. We manufacture and sell our products primarily in North America, Europe and Asia. As a result, our financial results could be significantly affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets in which we manufacture and sell our products. Our operating results are primarily exposed to changes in exchange rates between the U.S. dollar and the Euro, the Singapore dollar and/or the Japanese Yen.

As currency exchange rates change, translation of the statements of operations of our international businesses into U.S. dollars affects year-over-year comparability of operating results. We do not hedge operating translation risks because cash flows from international operations are generally reinvested locally. Changes in foreign currency exchange rates are generally reported as a component of stockholders' equity as all of our foreign subsidiaries report in their functional currencies. Total other comprehensive income was \$500,000 and \$322,000 for the nine months ended September 30, 2007 and 2006, respectively, due to changes in cumulative translation adjustments.

As of September 30, 2007 and December 31, 2006, our net current assets (defined as current assets less current liabilities) subject to foreign currency translation risk were \$4.4 million and \$5.1 million, respectively. The potential decrease in net current assets from a hypothetical 10% adverse change in quoted foreign currency exchange rates would be \$443,000 and \$508,000, respectively. The sensitivity analysis presented assumes a parallel shift in foreign currency exchange rates. Exchange rates rarely move in the same direction. This assumption may overstate the impact of changing exchange rates on individual assets and liabilities denominated in a foreign currency.

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#### inTEST CORPORATION

Item 3.

#### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK. (Continued)**

##### Interest Rate Risk

As of September 30, 2007, we had cash and cash equivalents of \$10.7 million. We generally place our investments in U.S. Treasury obligations or money market funds backed by such investments. We have not held and do not hold any derivatives related to our interest rate exposure. Due to the average maturity and conservative nature of our investment portfolio, a sudden change in interest rates would not have a material effect on the value of the portfolio. Management estimates that had the average yield of our investments decreased by 100 basis points, our interest income for the nine months ended September 30, 2007 would have decreased by less than \$88,000. This estimate assumes that the decrease occurred on the first day of 2007 and reduced the yield of each investment by 100 basis points. The impact on our future interest income of future changes in investment yields will depend largely on the gross amount of our cash, cash equivalents and short-term investments.

## Item 4. CONTROLS AND PROCEDURES

### CEO and CFO Certifications

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

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

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

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

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

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## 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, 2006. There have been no material changes from the risk factors as disclosed in that report.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Securities Holders

None

Item 5. Other Information

None

Item 6. 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.

10.1 Compensatory Arrangements of GM-Temperature Management Product Segment: Previously filed as Item 5.02 of the Company's Form 8-K on August 3, 2007, and incorporated herein by reference.

10.2 Third Amendment to Industrial Building Lease between inTEST Corporation and Brown Pelican LLC dated as of July 16, 2007: Previously filed as an Exhibit of the Company's Form 8-K on October 2, 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.

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Signatures

