Operator: Good day, and welcome to the inTEST Corporation Third Quarter 2022 Financial Results Conference Call. Please note today's event is being recorded.

I would now like to turn the conference over to Shawn Southard. Please go ahead.

Shawn Southard: Thank you. Good morning, everyone. We appreciate your time today and your interest in inTEST Corporation. Here with me are Nick Grant, our President and CEO, and Duncan Gilmour, our Chief Financial Officer and Treasurer.

You should have a copy of the Third Quarter 2022 Financial Results, which we released earlier this morning. If not, you can access the release, as well as the slides that will accompany our conversation, on our website at ir.Intest.com. After our formal presentation, we will be opening the line for Q&A.

If you'll turn to Slide 2 in the deck, I will review the Safe Harbor Statement. You should be aware that we may make some forward-looking statements during the formal discussions, as well as during the Q&A session. These statements apply to future events that are subject to risks and uncertainties, as well as other factors that could cause actual results to differ materially from what is stated here today. These risks and uncertainties and other factors are provided in the earnings release, as well as with other documents filed by the Company with the Securities and Exchange Commission. These documents can be found on our website or at sec.gov.

During today's call, we will also discuss some non-GAAP financial measures. We believe these will be useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliation of non-GAAP measures with comparable GAAP measures in the tables that accompany today's release and in the slides.

With that, please turn to Slide 3 and I will turn it over to Nick to begin. Nick?

Nick Grant: Thank you, Shawn, and good morning, everyone. Thanks for joining us for our third quarter 2022 earnings call.

We delivered another solid quarter that we believe demonstrates strong execution of our 5-Point Strategy as we focus on growing in our key target markets, delivering quality engineered solutions, and leveraging our expanding sales presence. The entire inTEST team has been working hard and staying focused and I want to thank everyone for their perseverance.

In our third quarter, revenue grew 46% year-over-year to another record level of $30.8 million. Organically, revenue grew at an impressive 23% year-over-year. We believe our strong results are indicative of the success of our 5-Point Strategy that directs our efforts in our markets as well as keeps us on track and well-focused. In fact, our focus is enabling us to make some excellent inroads as we increase our customer base, drive innovation, deepen relationships with existing customers and expand our geographic reach.

Demand remains strong for our innovative solutions in the front end of the semi market, specifically in silicon carbide crystal growth applications. Sales to this market more than doubled over the prior-year period. The significant growth in demand for our induction heating solutions used in silicon carbide crystal growth reflects the advantages of our technology in this application combined with the rapid expansion of silicon carbide as a more efficient and powerful semiconductor material.

We continue to make positive inroads in back-end semi as well with our test and thermal solutions. Back-end semi sales were up 17% versus a year ago and up 23% sequentially.

As a reminder, our test solutions in this space primarily serve analog and mixed signal semiconductor production where demand has remained elevated. Our exposure is minimal in the memory and microprocessor space, which some companies are reporting is currently at overcapacity.

We continue to make excellent inroads in the EV market, both with our organic and acquired businesses. Likewise, we have expanded our presence in defense and life sciences with our acquisitions and are benefitting from the strength in those markets.

Of note, we surpassed our previous backlog record with $47.9 million in backlog at quarter end.

With that, let me turn it over to Duncan to review the financials in more detail. Duncan, over to you.

Duncan Gilmour: Thank you, Nick.

Starting on Slide 4, revenue for the third quarter 2022 was $30.8 million, up 46%, or $9.6 million, versus the same period last year and at the top end of our guidance range of $29 to $31 million.

This revenue growth of $9.6 million comprised $4.8 million from the acquisitions made in the fourth quarter last year, and $4.8 million from legacy inTEST operations, representing 23% organic revenue growth. Both legacy operations and acquisitions contributed to growth in nearly all of our target markets.

Our acquisitions were the main contributor to growth in the security, auto/EV, life sciences, and defense markets. This broadening contribution is indicative of the Company's strategy to diversify and expand revenue with new customers and from new markets.

As Nick mentioned, we are also benefitting from secular trends in the segments of the semiconductor industry that we serve.

Supply chain and logistics challenges were similar to recent quarters and we estimate this impacted Q3 2022 revenue negatively by approximately $1 million.

Our teams continue to address these challenges admirably and have demonstrated great tenacity and ingenuity in order to continue to meet customer expectations.

Moving to Slide 5, gross margin of 45.2% in the quarter tightened from the prior-year and trailing periods, reflecting changes in product and channel mix. We also continue to manage through operational inefficiencies and material cost headwinds created by the ongoing supply chain challenges. The strengthening US dollar has also had an impact on margin.

We believe our current business mix will continue to deliver gross margins in the mid 40% range, which is consistent with our long-term plan to deliver 20% segment operating margins.

As you can see on Slide 6, our operating expenses were relatively consistent with our trailing second quarter. The $2.9 million increase over the prior-year period primarily reflects incorporating the acquisitions, which added approximately $2.4 million in incremental expenses. We have also made investments this year in sales, marketing, and engineering as we execute on our strategy to drive growth.

Pre-Tax intangible asset amortization was down $170,000 from the second quarter.

As a percent of revenue, operating expenses declined 220 basis points from the prior year period, demonstrating the operating leverage gained with higher sales volume.

Turning to Slide 7, you can see our bottom line and Adjusted EBITDA results. We had GAAP net earnings of $2.5 million, or $0.23 per diluted share, for the third quarter. On an adjusted basis, non-GAAP EPS was $0.28 per share compared with $0.25 per share in the second quarter. Adjusted EPS reflects adding back tax effected acquired intangible amortization.

On an after-tax basis, acquired intangible amortization amounted to $492,000 in the third quarter. We expect, after tax intangible amortization, for the fourth quarter to decline to $465,000.

The reported effective tax rate for the quarter was 16.9%. Our effective tax rate for the balance of the year is expected to be in the 16% to 17% range.

Adjusted EBITDA, which excludes stock-based compensation, was $4.5 million, a nice improvement over both the prior-year and trailing quarters.

Slide 8 shows our capital structure and cash flow. As we recently announced, during the quarter, we expanded our term loan facility by $25.5 million and ended the quarter with $30 million available under this facility. We also have $10 million available under our working capital revolver. We believe we are effectively leveraging the balance sheet to achieve our goals and have the financial flexibility to continue executing on our 5-Point Strategy for growth. Our current liquidity stands at approximately $52 million.

Our cash, cash equivalents and short-term investments at the end of the third quarter were $12.4 million. Currency impacted our cash balances with foreign currency exchange rates reducing cash by about a half million dollars. We have $1.1 million in restricted cash related to a pre-payment on a customer order. As we did in the prior two quarters, we repaid $1 million of debt, bringing it down to $17.2 million.

Even with our augmented line of credit, our objective is to maintain a total debt to Adjusted EBITDA ratio under 2.5x.

We generated $1.4 million in cash from operations in the quarter; although, for the nine-month period, we have used $3.7 million to support our growth, primarily in working capital requirements with inventory build and the timing of receipts.

Capital expenditures during the nine months were $1.0 million, up from about $600,000 in the first nine months of 2021. Given the timing of projects and purchases, we expect capex to be about $1.5 million for the year.

With that, if you will turn to Slide 9, I will now turn the call back over to Nick.

Nick Grant: Thanks, Duncan. Orders for the quarter were up 55% to $32.7 million over last year's third quarter as overall demand for our products and solutions remains strong. In fact, this is the fourth quarter in a row that we had a book-to-bill ratio over 1.

Year-over-year, demand was strong across nearly all of our end markets, especially in semi, defense, security and life sciences. Orders for the semi market were up 44% year-over-year to $19.2 million. Nearly half of the increase over last year was related to silicon carbide and other front-end applications. Back-end orders remained strong achieving 27% year-over-year growth. As I mentioned earlier, we are especially encouraged with the benefit of the secular trends in the particular segments of the semiconductor industry in which our technologies are applied.

Demand for our products from the defense and space industries has been strengthening where we have broadened our exposure to both of these industries with our acquisitions. Defense/aerospace orders were up 66% sequentially.

Security also had strength in the quarter and is a relatively new market that we gained through the acquisition of image and data capture technologies.

As to our record backlog, we expect to convert approximately 55% to sales in the fourth quarter, which represents about 80% of our expectations for the quarter. That leaves over $20 million of backlog that we expect to convert in 2023. Historically, only about 20% of our backlog extended beyond the current quarter. The longer-term backlog represents customers securing our production capacity in rapidly growing markets, such as silicon carbide crystal production.

Let's look at our fourth quarter expectations on Slide 10. We have been executing to plan and have a solid line of sight to year end at this point.

For the fourth quarter of 2022, we expect revenue to be in the range of $30 to $32 million. We expect gross margins for the quarter to be approximately 45% which is representative of our business mix as well as our expanding channels to market. Quarterly operating expenses are expected to run between $10.7 to $10.9 million. These estimated expenses include intangible asset amortization, which is expected to be approximately $560,000, pre-tax. We also expect interest expense to run approximately $190,000 for the quarter and our effective tax rate to be between 16% to 17% for the year.

Q4 GAAP EPS should be in the range of $0.20 to $0.25 per diluted share, while adjusted non-GAAP EPS is anticipated to be approximately $0.25 to $0.30 per diluted share. The difference between GAAP and non-GAAP is tax affected intangible asset amortization expense of approximately $465 thousand in the quarter.

Our fourth quarter guidance implies that our full year revenue will land near the high end of our original guidance for the year of $110 million to $115 million. Our team's strong execution of our strategy has positioned us to deliver these results, despite challenging supply chain headwinds and changing macroeconomic conditions.

Our guidance is based on our current views and assumes supply chain challenges remain unchanged from what we have been seeing and are subject to any strategic investments we may choose to make.

Slide 11 highlights our strategic goals for 2025 that we delineated at our Investor Day in late March.

Based on our 2022 revenue expectations, we will have doubled the size of the Company in the last 2 years and, by executing on our 5-Point Strategy, we believe we can achieve this again by 2025.

I should note that acquisitions are a part of our long-term strategy and we have an active pipeline of opportunities. Importantly, we have a strong balance sheet and expanded borrowing capacity that we believe will enable us to execute on our plan.

If you'll turn to Slide 12, given our expectations for topline growth, we believe we can drive earnings and cash generation. We believe our plan positions us to deliver adjusted EBITDA of approximately $30+ million by 2025 and improve earnings power to approximately $20+ million by 2025.

Let me sum up on slide 13. As I have noted, our 5-Point Strategy is delivering results. We have highly engineered solutions that enable our customers to improve productivity or create more effective solutions themselves. Our growing sales force is reaching more prospects and our new organization, with three business segments, has driven greater collaboration across the Company. This, in turn, creates even more sales opportunities.

We believe that we are unlocking the potential of inTEST through our 5-Point Strategy by driving discipline, accountability, and process improvement throughout the company. These are certainly exciting times for us.

With that, Operator, let's open the lines for questions.

Operator: Today's first question comes from Jaeson Schmidt at Lake Street Capital Markets.

Jaeson Schmidt: I just want to start with the backlog number, because it's impressive how that continues to grow. Is the end market mix within that backlog fairly similar to your current revenue composition?

Nick Grant: Yes, the backlog mix is very similar to what we delivered in Q3 and that's why, as you look at the Q4 forecast, it's in line to what we were able to deliver in Q3. Duncan, any comments?

Duncan Gilmour: I would agree. It's generally representative of what you're seeing. If anything, there might be some slightly longer-term components in the front-end semi space, which has been exceptionally strong. But, for the most part, it's representative of our actual results.

Nick Grant: And again, the record levels we're at now are quite a change from when I joined the company and from the reliance we were on book ship in a quarter. It's great to have this backlog level and visibility looking out a couple of quarters.

Jaeson Schmidt: Okay. Got it. And then, in your prepared remarks, Nick, you mentioned gaining new customers due to your 5-Point Strategy. I just want to be clear. Are these legacy inTEST customers that you are simply more engaged with and are now prioritizing or just the new customers you've been able to gain, given the broader product portfolio from the acquisitions?

Nick Grant: That's a great question, and you're exactly right. Expanding our customer base is one of our key strategies, and we're making a number of efforts across all businesses. It's really a mix there, Jaeson, that we are penetrating some accounts that were legacy inTEST accounts that may have shifted away and then are coming back to us. We see that across some of the businesses there, but we're also going aggressively after new customers, new markets and new applications with technology. That's helping to drive expansion there.

Duncan Gilmour: I would also say that the nice thing that we're seeing is, we're seeing new customers across all of our businesses. I mean, directionally, we're looking at maybe 25, 30 new customers in the quarter, but that's nicely split across our three operating segments.

Jaeson Schmidt: Okay. Got it. And then, just the last one for me and I'll jump back into queue. Just looking at gross margin, there seems to be a slight down shift from your expectations in Q2 and I fully recognize there's a ton of dynamics going on. Can you just help us understand what is the most impactful? Obviously, the supply chain. Duncan, I think you mentioned some FX headwinds, but, earlier this year, there seemed to be some slight headwinds from the acquisition integration. I just want to make sure I'm clear that it's less the acquisition and more just sort of the macro dynamics out there.

Duncan Gilmour: I think there are 4 main elements, Jaeson, and I'd rank them in order as product mix is still a big driver just depending on where that kind of falls out. Secondly, we talked a little bit about customer mix and what we mean there is just how much we are selling maybe through distribution versus direct. You might have noticed our operating expenses were a little bit lower than we anticipated and what you're seeing there is some of that channel mix. We sold a bit more through distribution than expected. The flip side of that is the operating expenses were a little bit lower. From a bottom-line perspective, that item is neutral. Although the global macro supply chain seems to be moderating, we're a bit more localized and the impacts we're seeing are much the same as in prior quarters. We're still kind of working through those inefficiencies.

And then, FX is probably the least impactful of those, but a real item. I mean, most of our revenues are USD, but we have enough where we had a small, maybe 30 basis point, impact on margin just from the strong U.S. dollar.

Jaeson Schmidt: Okay. That makes a lot of sense. I appreciate that color.

Operator: Our next question today comes from Peter Wright at Intro-act.

Peter Wright: Congratulations on another record quarter. I have a couple of questions. First question is kind of tagging on the back of Jaeson's question. The backlog does continue to provide you with more visibility. Nick, I'm hoping you could help us understand, as you're tracking ahead of your plan, if I was just to linearize the growth expectations of what you've guided to on a target model in 2025, how do you think we get there? If you can reflect on cyclicality versus secular growth, do you think your business now is diversified as such that you can continue to grow this business year-on-year to hit that target? If so, help us to understand what that mix is. Looking within the customer mix, is it new geographies? Is it new product mix? Is it new markets? What continues to drive these continual record quarter-after-quarter numbers?

Nick Grant: As you know, we are a very different company than we were in the past. The backlog is really comprised of our efforts and focus on our targeted key markets that we believe have these strong secular tailwinds, as well as the markets that we have the right technology and can bring innovation to create further demand of our products; markets like the Automotive/EV, like the silicon carbide, like Medical Cold Chain, that we've acquired and brought into our business, and security is another area with the acquisition. These are markets that we believe position us well to drive growth, and we're demonstrating that across our businesses quarter-after-quarter here. I really do believe it's the strategy paying off that's driving this, because this is where we wanted to go, and this is where the business is heading.

Peter Wright: It does seem that, when I look at the makeup of the segments that you have, it's not that this record quarter is driven by everything running red hot. You have some businesses that are still ebbing and flowing. it's just the diversity of your business that is driving more stable growth, more secular growth, as opposed to cyclical growth going forward. Is that a fair takeaway?

Nick Grant: Absolutely. One of our strategies was to drive diversification and we're having solid success in that area. That helps with the ebb and flows, if you will, by being in the right industries and the right segments of those industries that can drive growth for us on that. The diversification is absolutely part of it.

Peter Wright: Great. My other question is on gross margins. Four of the 5-Point Strategies I get very clearly. The one that I have a question on is kind of service and support and your efforts there on monetizing service. Do you have any update there? And then, the second part to that gross margin question is, given that inflation is high single digits, can you help us understand how much your prices have moved this year and maybe provide any color on expectations going forward there?

Nick Grant: Let me touch on service; and then, I'll let Duncan address some of the pricing questions. With service, we are making some good inroads here. One of the focus areas we initiated this year was really to drive master service agreements across some key accounts and we are really pleased with the results to date. Within the quarter, we had one of the businesses capture over $1 million of service revenue from master service agreements. These are multiyear agreements. Obviously, those revenues will be recognized over time, but we're really making some progress on that front and challenging the teams to position us better from driving that customer satisfaction, having inventory closer to customers, et cetera. We're seeing the needle move there, which is great. Duncan, do you want to touch on the pricing part of Peter's question?

Duncan Gilmour: Sure. As you may have heard, inflation is still out there, and the battle continues in terms of keeping up from a pricing standpoint. We do look at this pretty closely in terms of understanding our margins and making sure we're not leaking and assessing product mix versus are we pricing aggressively and so on. I'd say the teams certainly are driving hard to keep up with that.

Another thing I'd highlight is that, as I mentioned earlier, we do invoice primarily in USD, even to our overseas customers. From a competitive standpoint, that's kind of challenging from a pricing standpoint, given the strength of the U.S. dollar, so that's something we certainly also must take into account in some of the foreign markets. It's still a very dynamic environment out there, Peter, from a pricing standpoint and we continue to chase that as hard as we can, and that will continue.

Peter Wright: That's fantastic color. One last follow-up, Duncan, for you, on cash generation. It's very strong across the stack, with two places where that cash is residing right now through the year, maybe a little more. Can you provide any color on working capital inventory and accounts receivable? Are you comfortable where those are? How should I think of free cash flow generation in the next immediate period ahead of us?

Duncan Gilmour: It was nice to see that we did generate $1.4 million cash from operations in the quarter. The investment in working capital moderated in Q3. We still did drive dollars into working capital. Inventory is where we've disproportionately invested. As I said, we continue to have to manage through supply chain challenges. I would expect our investment in working capital to continue to moderate going forward, even though we continue to grow.

What we saw in Q3, which was positive cash from operations, I would expect to see that dynamic continue as we're able to, as I said, reduce our investment in working capital, which really, as you mentioned, has been the main kind of drain on cash dollars during the first three quarters of the year.

Nick Grant: I would just add, Peter, that inventory is one area that, as Duncan highlighted, we've been investing. We are comfortable that we don't see any obsolescence issues or anything like that with the products that we're bringing in-house. It really is to support our backlog and our commitment on lead times to customers.

Duncan Gilmour: I should also mention, on the receivables side, which you also touched on, we're not seeing any challenges around collections or any concerns there either. So yes, the money is going into working capital, but we feel okay about that.

Operator: Our next question today comes from Robert Marson with Marson Asset Management.

Robert Marson: Congratulations on another excellent quarter. As you have started planning for next year, are there any businesses or new products or geographies, the things that Peter was talking about in more detail, that set us up for our organic revenue growth for 2023?

Nick Grant: Great question there. We've talked about this in the past as kind of a three-horse race between our segments. All three are in attractive growth markets out there, and some are seeing really strong success with the front-end silicon carbide. I would say our process technologies is positioned extremely well there. The environmental technology is making some nice inroads in our life sciences efforts. When I look into our electronic test with our electric vehicle exposure and battery testing areas, they're really positioning us well. So, I do expect all three to continue to drive growth for us going forward, but as far as one kind of exceeding the others substantially, I don't see that right now.

Robert Marson: Okay. What inning would you say the silicon carbide capacity build-out is in? I know people are really pushing hard to grow capacity. The major semiconductor IDMs are really pushing hard and even Wolfspeed is having some problems. It's not simple nor easy. Do you think this is in the first or second inning or in the fourth inning?

Nick Grant: Another great question and you're right, it's not easy. Very controlled environments are required to grow these silicon carbide crystals, which is why our technology is being preferred out there, but from what we're hearing from our customers, this is very early innings. Some of them are talking about demand continuing to drive capacity expansions through the end of the decade, so, yes, it feels like we're in the early innings for sure.

Operator: Our next question comes from Gregory Weaver at Invicta Capital.

Gregory Weaver: Duncan, on the channel mix you referenced, what products typically are heavier in the distribution channel?

Duncan Gilmour: Some of our thermal stream products, which are back-end semi coming out of our environmental test segment, are heavily skewed towards distribution. Also, some of the North Sciences products, one of the new acquisitions, the new product lines there, again, that's a very heavy distribution kind of business, which we expect to grow over the course of the next few quarters. I think those are the primary ones.

Nick Grant: I would add that our image capture is also an area where we've been developing that go-to-market and adding more distribution through for those cameras and video solutions out there as well. So, yes, those three are the primary product families, if you will, that are going through the distribution.

Gregory Weaver: Okay, and, on the Auto/EV segment, you had a prior couple of quarters of some pretty strong growth, but it's backed off some here. Can you provide any color on the volatility there or is it just kind of inventory at your end customers?

Nick Grant: Exactly that. They have to get their lines up and running the expansion, which relies on a lot of external pieces of equipment on that side of it. So, your comment is spot on. It is kind of a lumpy business, but our activity there remains strong. It's just more of about timing.

Gregory Weaver: Got you. And my last one here is, again, it’s good to see more of the silicon carbide talk here. You inferred that you're booking out into 2023 at this point for especially the silicon carbide. Could you maybe give us a little color? Are the customers concerned about capacity or supply on your end and is there any limitation on growth that they're concerned about?

Nick Grant: More so, what we're seeing is, they want to secure the long lead time items. Some of these things have slipped out six months for electronic components and other products that are going into our solutions, so we're seeing them placing orders to ensure that we get those things in the pipeline and commit to that inventory.

Gregory Weaver: Okay. Is that them inbound to you or you telling them, hey, you better give me more visibility for me to buy this stuff?

Nick Grant: I'd say it's a combination. They're talking to us about what their plans are and we're telling them that, to support them on that, we need to make sure we have this pipeline material flowing. It's a joint discussion and decisions are being made.

Gregory Weaver: Can you provide any generic color on the diversity of the business there in terms of the number of end customers that are pulling now and maybe reorder activity and such?

Nick Grant: That continues to expand. I believe we added three more new customers in the last quarter or at least the last 2 quarters in that space. The investment in this part of the market is in its early stages, and we'll continue to benefit from that.

Operator: Ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to Nick Grant for closing remarks.

Nick Grant: Thank you, Rocco. In summary, we're making excellent progress with the execution of our 5-Point Strategy. I am grateful to the entire inTEST team for their resiliency and persistence to exceed customer expectations. It is this dedication that enabled us to deliver our strong first nine months results. You can note on Slide 14 that we'll be presenting at the Southwest IDEAS Conference on November 16 and at the CEO Summit in New York on December 13. Perhaps we'll see some of you all there. We really appreciate you taking the time to join us on our call today and for your interest in inTEST. Thank you all and stay safe.

Note: This transcript has been edited slightly to make it more readable. It is not intended to be a verbatim recreation of the inTEST Corporation (INTT) financial results teleconference and webcast that occurred on the date noted. Please refer to the webcast version of the call, which is available on the Company's website (www.ir.intest.com), as well as to information available on the SEC's website (https://www.sec.gov/) before making an investment decision. Please also refer to the opening remarks of this call for INTT's announcement concerning forward-looking statements that were made during this call.