Operator: Greetings. Welcome to the inTEST Corporation Third Quarter 2023 Financial Results. [Operator Instructions] Please note this conference is being recorded. I will now turn the conference over to your host, Shawn Southard, with Investor Relations. You may begin.

Shawn Southard: Thank you. Good morning, everyone. We appreciate your interest and thank you for sharing your time with 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 2023 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 intest.com/investor-relations. After our presentation, we will open the lines for Q&A.

Please turn to Slide 2 and 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, uncertainties and other factors are provided in the earnings release, as well as in 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 reconciliations of non-GAAP measures with comparable GAAP measures in the tables that accompany today's release and slides.

With that, please turn to Slide 3, and I will turn the call over to Nick.

Nick Grant: Thank you, Shawn, and good morning, everyone. Thanks for joining us for our third quarter 2023 earnings call.

The inTEST team has delivered another quarter of strong results by executing well on our Five-Point strategy for growth. I want to thank and recognize our team members for their commitment to our strategy, dedication to executing to plan and their hard work delivering these results.

Their exceptional performance allowed us to reach another record for quarterly revenue, achieving $32.7 million in the third quarter. This growth reflects strength in a number of our markets. Our Environmental Technologies division saw strong shipments to the defense/aerospace market in the quarter versus the prior year. Sales remained robust for our induction heating solutions for front-end semi mainly supporting silicon carbide crystal growth and wafer epitaxy applications. Likewise, we saw solid shipments into Auto/EV across all three divisions.

I believe our focus to grow our market share through geographic expansion, market diversification, product development, and deeper customer reach is reflected in this quarter's results. Our efforts in these areas are ongoing as they are key elements of our 5-Point Strategy. As examples of our strategy in progress, let me point to the investments for growth and improved productivity we have made within the businesses we acquired in 2021. Our recently announced new facility supporting Acculogic's design, development and manufacturing of electronic circuit and EV battery test systems will position us well going forward. We believe this consolidation from three buildings to one will drive better collaboration, enhance customer service, and improve operational efficiencies.

Another example is the progress we are making regarding new products at Videology. Since the beginning of the year, we have launched over a half a dozen new cameras, including their Scailx Platform, which is the first of its kind zoom block camera with embedded Edge AI capabilities. It's important to note that this is a step change for this business as prior to us owning them they would have very few new product launches within any given year.

Beyond sales growth, we also delivered profitability according to plan, as we remain focused on capturing operational and financial efficiencies and delivering the leverage potential of our operations. Our 6% increase in sales in the quarter versus a year ago added 10% growth in gross profit, and 18% growth in net earnings. We believe this validates our operating leverage potential as we continue to scale the organization.

I'm extremely pleased with the progress we've made improving working capital efficiency in the quarter. Cash generated from operations was strong, as we continue to reduce inventory to align with demand and supply chain improvements. Duncan will give you more details on the balance sheet shortly.

But before I turn it over to him, let me comment on bookings which has impacted our outlook for the remainder of the year. In the quarter we experienced a shift in customer demand causing what we believe will be some near-term headwinds, not dissimilar to what you have probably heard from others in our space. Over the last couple of quarters, we have provided color regarding the shift in our customers' buying behavior towards a more normalized pattern of smaller, more frequent orders in a just-in-time fashion versus the larger blanket orders that were more common when supply chains were severely constrained. In addition, we've talked about CapEx projects requiring more internal customer approvals before POs are being released.

In Q3, this behavior was amplified resulting in a shift in demand as a number of our customers slowed purchase decisions and delayed projects. We believe this was driven by worsening macroeconomic conditions and sustained higher interest rates. Compared with the trailing second quarter, orders were down 15% as the slowdown was especially apparent in the semi and industrial markets. On an encouraging note, some of the delayed projects from Q3 have already been booked in the fourth quarter; but in general, we expect some of our markets will continue to see cautious spending over the next couple of quarters.

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

Duncan Gilmour: Thank you, Nick.

Starting on Slide 4, as Nick noted, revenue for the third quarter was a record $32.7 million, up 6% versus the same period last year and in line with our guidance.

The $1.9 million year-over-year revenue growth reflected strong sales across most markets and technology offerings. Semi revenue was up 3% to $19.8 million. This increase was driven by front-end induction heating solutions for silicon carbide crystal growth and wafer epitaxy applications. Defense/aerospace revenue increased 77% to $3.4 million.

Moving to Slide 5, gross margin of 46.9% in the quarter, increased 170 basis points compared with the prior-year period driven by higher volume, favorable product mix, improved pricing and continued focus on productivity improvements. Compared with the trailing quarter, gross margin increased 70 basis points, primarily due to a favorable product mix.

Our trailing twelve-month gross profit of $60.4 million grew

$7.0 million with gross margin of 46.6% in line with our outlook for full year gross margin of approximately 46%.

As you can see on Slide 6, our operating expenses were up $1.3 million year-over-year, and increased as a percent of sales to 36.9%. The majority of this was driven by an increase in corporate development expense.

Turning to Slide 7, you can see our bottom line and Adjusted EBITDA results. We had net earnings of $3.0 million, or $0.24 per diluted share, which was up from $2.5 million, or $0.23 per diluted share in the prior-year period.

Adjusted EBITDA was $4.6 million, which improved 3% from last year, while adjusted EBITDA margin contracted 50 basis points to 14.0%.

On an adjusted basis, non-GAAP EPS was $0.28 per diluted share similar to the second quarter of 2022. Adjusted EPS reflects adding back tax-effected intangible asset amortization related to acquisitions, which, on an after-tax basis, amounted to approximately $430,000 in the third quarter.

Slide 8 shows our capital structure and cash flow. As Nick mentioned, we demonstrated strong cash generation from operations of $6.2 million in the quarter. Capital expenditures in the third quarter were approximately $300,000, similar to the 2022 third quarter. Given our modest capital expenditure requirements, free cash flow was $5.9 million, or about double our net earnings.

Cash and cash equivalents at the end of the third quarter of 2023 were $41.7 million, an increase of $4.3 million from June 30, 2023.

With our $40 million remaining borrowing capacity we have over $80 million in liquidity, which includes $30 million of availability from our term loan facility and $10 million on our revolving line of credit. As we have done in prior quarters, we repaid $1 million of debt, bringing total debt down to $13.1 million and our current leverage ratio down to a respectable level of 0.67.

Turning to Slide 9, our third quarter orders of $26.9 million were down 18% year-over-year and 15% sequentially. Strength in orders from security and automotive/EV partially offset lower demand from the semi, industrial, defense/aerospace, and other markets compared with the same quarter last year. As Nick commented, during the quarter orders were notably impacted by a change in customer behavior regarding project timing, with a trend towards slowing decision-making on future projects and resultant order delays. It appears that capital spending has slowed somewhat as customers evaluate their internal rate of return given the higher cost of capital. Compared with the trailing second quarter, the slowdown was especially apparent in the semi and industrial markets.

Backlog at September 30, 2023, was $38.8 million, 19% lower than the prior year and down 13% compared with the trailing quarter.

Approximately 40% of the backlog is expected to ship beyond the fourth quarter of 2023.

Turning to Slide 10 we'll review our updated outlook for 2023.

Given the change in customer behavior regarding project timing, we believe it is prudent to moderate our expectations for the fourth quarter.

Revenue for the fourth quarter of 2023 is expected to be approximately $28 to $30 million with gross margin of approximately 45%. Fourth quarter operating expenses, including amortization, are expected to be approximately $11.7 million. Intangible asset amortization, after tax, is expected to be approximately $430,000.

We expect fourth quarter net interest income to be similar to the third quarter, and our effective tax rate is expected to be 16%.

EPS for the fourth quarter should be in the range of 8 to 13 cents per diluted share, while adjusted EPS should be in the range of 12 to 17 cents per diluted share. As a reminder, we simply adjust for tax-effected amortization expense.

Based on our results for the nine months of 2023 and our outlook for the fourth quarter, we are refining our revenue outlook for the full year to approximately $125 to $127 million.

We are maintaining the outlook for our 2023 gross margin at approximately 46% with expected full-year operating expenses of roughly $47 million. This includes tax-adjusted intangible asset amortization expense of approximately $1.7 million for the purpose of determining adjusted earnings. Our expected effective tax rate remains approximately 16% to 17%.

Finally, our capital expenditures for 2023 are expected to continue to run between 1% to 2% of sales.

As usual, our guidance does not include the potential impact from any unusual non-operating expenses that may occur from time to time.

Looking further ahead, we remain confident that our technology offerings and target markets position us for continued success. However, we currently expect next year will have a slower start and then gradually improve as we execute on our growth plans and gain more clarity on the trajectory of projected borrowing costs.

Additionally, we continue to pursue strategic acquisitions and partnerships to extend our reach and expand our portfolio.

With that, if you will turn to Slide 11, I will now turn the call back over to Nick.

Nick Grant: Thanks, Duncan.

On Slide 11 we would like to highlight the solid progress we are making toward our stated 2025 revenue goal of $200 to $250 million. Even with our tempered Q4 guidance, we expect to have taken inTEST from less than $55 million in revenue in 2020 to over $125 million this year. We will have more than doubled revenue in 3 years, while also driving strong earnings growth. In fact, the compound annual growth rate of our sales will be over 30% during this timeframe. We continue to expect to drive organic growth with our base business in the coming years and we anticipate future acquisitions will augment that growth allowing us to reach our 2025 revenue goal.

Our pipeline of acquisition and partnership opportunities remains active, and with over $40 million of cash on hand and a $30 million term loan facility available, we believe we have sufficient flexibility with our capital structure to execute on our plan.

Slide 12 shows how we expect our revenue growth will translate into strong earnings growth. Our plan remains the same. Reiterating, that our strategy is primarily focused on scaling the Company and maintaining our top-tier margin profile.

Let me sum up on slide 13. As we have noted throughout our prepared comments, our 5-Point Strategy is delivering results for shareholders. Our engineered solutions enable our customers to improve productivity, solve challenging test requirements or create more effective solutions for production of their own portfolio of products. Our technology-segmented organizational structure has generated focus, and we are driving greater collaboration across the Company. As a good example, a couple of weeks ago a joint sales call was conducted with teams from our Electronic Test and Environmental Technologies Divisions who were working together to solve both test and thermal challenges for a new customer. It's great to see this type of collaboration in action, and to be able to leverage our broader portfolio to position inTEST as a more value-added solutions provider.

The inTEST team delivered an outstanding quarter operationally. We continue to unleash the potential of inTEST on our journey to becoming a supplier of choice for innovative test and process technology solutions. Despite the shift in demand last quarter, we are confident our focus is on the right target markets and applications that create the path to achieve our long-term growth aspirations. We continue our efforts in pursuing acquisition opportunities to enhance our product offerings, expand our addressable markets, and deepen our presence in targeted industries. And our Balance Sheet is in a solid position to support our efforts.

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

Question & Answer

Operator: [Instructions] Our first question comes from the line of Jaeson Schmidt with Lake Street.

Jaeson Schmidt, Lake Street Capital Markets, LLC, Research Division
Just want to start on your comments regarding sort of slowing customer demand. I know you highlighted the industrial and semi markets as sort of being the culprits. But just curious if this is broad-based or were concentrated at a few customers within each end market.

Nick Grant: Jaeson, yes. I would say that it is across a number of industries and a number of customers that we've kind of seen this, I'd say, delaying of projects and we kind of highlighted a couple, like you said, I mean, in industrial and semi being noticeably there. But in general, that's why we kind of blamed it more on macroeconomic conditions out there. It's not something that a customer … they're all kind of just getting more cautious.

Jaeson Schmidt: Okay. That's fair. And then just following up on that. I mean, obviously, there are some delays in purchasing decisions, but are you seeing order cancellations at all?

Nick Grant: No. We haven't had any order cancellations at all. And it's just taking longer to get these through. I can tell you, we look at our funnels and our funnels are extremely healthy. Q4 being higher than it was in Q3. So, it's just timing-wise that really is dictating the cautiousness, if you will.

Jaeson Schmidt: Okay. That makes sense. And then just the last one for me, and I'll jump back in the queue. Following up on your comments on M&A. You guys always have a pretty active funnel. But curious if you're seeing valuations starting to come in a bit or if just the number of opportunities are increasing out there?

Nick Grant: I would say for a number of quarters now, we've seen that both valuations becoming more attractive. We're pretty disciplined in our approach on acquisitions here. But aligning better with our positions, if you will, and opportunities are pretty active out there. So, we're pleased with where we are with our M&A here.

Operator: Our next question comes from the line of Peter Wright with Intro-Act.

Peter Wright, Intro-Act
Good job maintaining good operating leverage in an increasingly difficult environment.

Nick, my first question -- 2 questions for you and a question for Duncan. The first question for you is, if you look into the crystal ball and the conversations you're having with your sales guys, do you think that the softness that you experienced in 3Q is more from the procurement departments being proactively risk off? Or do you think that they've already experienced kind of a softening in demand that they're reacting to? And that question is kind of in light of your comment that there's already been some rebooking in the fourth quarter. So, I'm looking at kind of the duration risk that you see from your sales force if they have any color on that for how long this could last.

The second question for you is on your new cameras, can you share anything about the ASP or how you're looking at kind of the true value proposition, whether it be margin mix or how should we look at how the new products are creating incremental value for inTEST if there's any story there?

And then Duncan on the operating leverage side, I see you're not reacting to the softness yet holding operating expenses where you'd expect them to be in the fourth quarter. Can you just remind us if breakeven is still $26 million-ish and what would it take for you maybe to react on that side? And then one little follow-up for you is, do you expect free cash flow to be positive in the fourth quarter? And can you give us a target for free cash flow for the year?

Nick Grant: There's a lot there. Peter, all right. So, let's start with the demand slowing and we truly believe it is more just getting the approvals on these CapEx projects. I mentioned our funnel activities are strong, and we've seen a nice increase quarter-over-quarter. So, the opportunities are the projects that they've got identified are there. And it's just a matter of CapEx budgets are the projects going to meet the internal rate of returns and getting the right signatures that are slowing things there. We haven't seen our funnels decreasing indicating a broader slowdown in demand or anything like that.

Relative to the cameras, the new cameras, these cameras ASPs are very different from our other more CapEx type projects and solutions that we have out there. These things are $1,000 or less in many cases. So, it does change our overall ASP. But in general, we're getting decent margins on these things. And with some of these redesigns, we've improved margins with some of our manufacturing abilities and cost components going into this thing with these new redesigned cameras in it.

So Important to note is this industry, this video space is constantly evolving new sensors, new components being updated, et cetera. So, we think we'll be seeing quite a more frequent product launches out of this business versus what it had done in the past in order to keep the cameras up-to-date and generating the demand for us going forward. Duncan, do you want to tackle the other?

Duncan Gilmour: Yes. So, I think you're in the right ballpark, Peter, in terms of your breakeven that $26 million, $27 million at top line. So that makes sense on cash flow really happy with the working capital improvements that the business has been driving. We're seeing the benefits of that in the quarterly cash flow number for Q3. Obviously, we're projecting a slightly softer P&L picture in Q4, but we're continuing our work on working capital efficiency, and I would still expect this to be positive from a cash perspective, although we're not guiding specifically on that number.

Peter Wright: If I could have one last follow-up. On the Videology cameras that you have, what is driving the new generations that you're producing? Is it new markets? Or is it improved manufacturing and margin profile? What is driving it?

Nick Grant: It's all of the above. The SCAiLX product that I mentioned, is really a first of its kind applicable across all markets or a lot of markets out there with the edge AI computing capabilities. So, it's really unique and not targeted at just one particular application. Some of the others are more specific like our pipe inspection cameras, these are really embedding some upgraded technologies to improve performance of those cameras to help those particular customers improve their ability to identify issues in that. So, it's a combination, cost is also an area that we're driving the team to improve as well. So yes, all of the above.

Operator: Our next question comes from the line of Ted Jackson with Northland Securities.

Ted Jackson, Northland Capital Markets, Research Division
I just have one question, everything I had on my list got checked off. But we've got a weaker fourth quarter. And again, you are correct. You are not the only company that is seeing this kind of slowdown cautiousness within their business and plenty of companies have made very similar comments and taken very similar actions with regards to guidance. But my question for you is now that we're having this disruption in the business, if you would, with regards to the fourth quarter. Does it impact -- I know you're not providing guidance for '24. But I mean, does it change the seasonality that's typical in the business? I mean, would we still expect, based upon your fourth quarter guidance to see a first quarter down sequentially from fourth quarter? That's really my only question.

Duncan Gilmour: I mean, I would say, I think as we've talked about before, we don't really see seasonality per se. Obviously, we're as many other companies are running into some unfavorable market conditions here. But seasonality isn't, I would say, something that is overly dramatic with our business.

Ted Jackson: Well, I mean if I look at it, I mean, the last couple of years. It seems like generally, that absent acquisitions, the first quarter has not been the stronger of your quarters. So, it's all -- but you're -- so no, you're not saying that you don't have an answer for me on that.

Duncan Gilmour: No, I'm saying we don't see seasonality as a dynamic. Obviously, we are impacted by market conditions as every player in the marketplace is.

Operator: It looks like we have reached the end of the question-and-answer session. And I'll now turn the call back over to the President and CEO, Nick Grant, for closing remarks.

Nick Grant: Thank you. Before we close, I want to express my sincere gratitude again to our global team as they continue to deliver outstanding results.
And finally, we will be participating in the Southwest IDEAS Conference in Dallas on November 15th and the CEO Summit in New York on December 12th. We hope to connect with some of you at these events.

We appreciate you taking the time to join us on our call today and for your interest in inTEST. Thank you all and have a great day.

Operator: Thank you. This concludes today's conference call, and you may disconnect your lines at this time. Thank you for your participation.