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INTEST CORP
Form 10-K
March 27, 2017

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2016 or

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

For the transition period from _____ to _____

Commission File Number 1-36117

inTEST Corporation

(Exact name of registrant as specified in its charter)

DELAWARE

22-2370659

(State or Other Jurisdiction of Incorporation or Organization)

(I.R.S. Employer Identification Number)

804 EAST GATE DRIVE, SUITE 200
MT. LAUREL, NEW JERSEY

08054

(Address of Principal Executive Offices)

(Zip Code)

Registrant's telephone number, including area code: (856) 505-8800

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, par value \$0.01 per share

NYSE MKT

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes / / No /X/

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes / / No /X/

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes /X/ No / /

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data

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File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes /X/ No / /

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. /X/

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer / / Accelerated filer / /
Non-accelerated filer (Do not check if a smaller reporting company)/ / Smaller reporting company /X/

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes / / No /X/

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold on June 30, 2016 (the last business day of the registrant's most recently completed second fiscal quarter), was: \$31,138,682.

The number of shares outstanding of the registrant's Common Stock, as of March 17, 2017, was 10,402,058.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement of the Registrant for the Registrant's 2017 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Report, are incorporated by reference into Part III of this Report.

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PART I

Item 1. BUSINESS

Cautionary Statement Regarding Forward-Looking Statements

From time to time, we make written or oral "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, including statements contained in our filings with the Securities and Exchange Commission, or SEC, (including this Report on Form 10-K), our annual report to stockholders and in other communications. These statements do not convey historical information, but relate to predicted or potential future events, such as statements of our plans, strategies and intentions, or our future performance or goals. Our forward-looking 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, and include, but are not limited to, statements made in this Report regarding:

- ◆ the possibility of future acquisitions or dispositions and the successful integration of any acquired operations;
- ◆ the ability to borrow funds to finance major potential acquisitions;
- ◆ the success of our strategy to diversify our business by entering markets outside the integrated circuit, or IC, and automatic test equipment, or ATE, markets, including the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets;
- ◆ indications of a change in the market cycles in the IC and ATE markets or other markets we serve;
- ◆ the success of our 2015 stock repurchase plan;
- ◆ developments and trends in the IC and ATE markets;
- ◆ the development of new products and technologies by us or our competitors;
- ◆ effects of exchange rate fluctuations;
- ◆ the success of our restructuring efforts (the goal of which is to return non-profitable operations to profitability);
- ◆ general economic conditions both domestically and globally;
- ◆ competitive pricing pressures;
- ◆ the anticipated market for our products;
- ◆ the availability of materials used to manufacture our products;
- ◆ the availability of and retention of key personnel;
- ◆ net revenues generated by foreign subsidiaries;
- ◆ the sufficiency of cash balances, lines of credit and net cash from operations;
- ◆ stock price fluctuations; and
- ◆ other projections of net revenues, taxable earnings (loss), net earnings (loss), net earnings (loss) per share, capital expenditures and other financial items.

Investors and prospective investors are cautioned that such forward-looking statements are only projections based on current estimations. These statements involve risks and uncertainties and are based upon various assumptions. We discuss many of these risks and uncertainties under Item 1A "Risk Factors," below, and elsewhere in this Report. These risks and uncertainties, among others, could cause our actual future results to differ materially from those described in our forward-looking statements or from our prior results. We are not obligated to update these forward-looking statements, even though our situation may change in the future.

INTRODUCTION

We are an independent designer, manufacturer and marketer of thermal, mechanical and electrical products that are used by semiconductor manufacturers in conjunction with ATE, in the testing of ICs. In addition, we market our thermal products in markets outside the ATE market, such as the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. Our high-performance products are designed to enable our customers to improve the efficiency of their test processes and, consequently, their profitability.

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Item 1.

BUSINESS (Continued)

We sell our products worldwide. Within the ATE market, we sell our products both directly to major semiconductor manufacturers and semiconductor test subcontractors and indirectly through leading ATE manufacturers. In markets outside the ATE market, we sell our products directly to the end user of the product. Our largest customers include Analog Devices, Inc., Cypress Semiconductor Corporation, Hakuto Co. Ltd., Lumentum Holdings, Inc., NXP Semiconductors N.V., Raytheon Company, Teradyne, Inc., Texas Instruments Incorporated, ViaSat, Inc. and Xcerra Corporation.

The consolidated entity is comprised of inTEST Corporation (parent) and our wholly-owned subsidiaries. inTEST Corporation was incorporated in New Jersey in 1981 and reincorporated in Delaware in April 1997. During 2016, we were in the process of reorganizing our business from three product segments (Thermal Products, Mechanical Products and Electrical Products) into two product segments (inTEST Thermal Solutions ("iTS") and inTEST Electromechanical Semiconductor Products ("EMS")). Certain operational changes undertaken in the first quarter of 2016 in connection with this reorganization are discussed further in Note 3 of our consolidated financial statements included in Item 8 of this Report on Form 10-K. This reorganization was substantially completed as of December 31, 2016. Accordingly, the discussion below and the disclosures in Note 15 of our consolidated financial statements regarding our segments are presented on the basis of three products segments for 2016. Effective January 1, 2017, we will report information about our segments based on two product segments, iTS and EMS, with prior period information reclassified to be comparable to the presentation for 2017.

MARKETS

Overview

Our business is grounded in the ATE market, which provides automated test equipment to the semiconductor market; however, since 2009, we have begun to diversify our served markets to address the thermal test requirements of several other markets outside the ATE market as well as certain thermal process industrial requirements. These include the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. We offer highly specialized engineering solutions in these markets outside the ATE market, the demand for which is limited and which we expect may vary significantly from period to period. During 2016 and 2015, our net revenues in markets outside the ATE market were \$12.2 million and \$10.7 million, respectively, and represented 30% and 27%, respectively, of our total net revenues. In the last five years, our net revenues from sales in markets outside the ATE market have ranged from 18% to 30%.

The level of our net revenues in the various markets we serve outside the ATE market varies significantly from market to market. During 2016 and 2015, our net revenues from the telecommunications market represented 15% and 9%, respectively, of our total net revenues, our net revenues from the defense/aerospace market represented 8% of our total net revenues in both years and our net revenues from the industrial market represented 2% and 4%, respectively, of our total net revenues. The level of our net revenues in these non-ATE markets has varied significantly in the past and we expect will vary significantly in the future as we build our presence in these markets and establish new markets for our products. One of our goals is to further

expand our sales in these markets outside the ATE market; however, due to the nature of our highly specialized product offerings in these non-ATE markets, we do not expect broad market penetration in many of these markets and therefore, do not anticipate developing meaningful market shares in these non-ATE markets. Consequently, we are continuing to evaluate buying patterns and opportunities for growth in these markets that may affect our performance. The following discussion of our markets, therefore, is limited to only the ATE and semiconductor markets, which currently represent the majority of our net revenues.

Semiconductor and ATE Markets

Historically, the semiconductor market has been characterized by rapid technological change, wide fluctuations in demand and shortening product life cycles. Designers and manufacturers of a variety of electronic and industrial products, such as cell phones, telecom and datacom systems, Internet access devices, computers, transportation and consumer electronics, require increasingly complex ICs to provide improved end-product performance demanded by their customers. Semiconductor manufacturers generally compete based on product performance and price. We believe that testing costs represent a significant portion of the total cost of manufacturing ICs. Semiconductor manufacturers remain under pressure to maximize production yields and reduce testing costs. At the same time, the growing complexity of ICs has increased the difficulty of maximizing test yields. In order to address these market trends, semiconductor manufacturers strive for more effective utilization of ATE, smaller test areas and increased wafer level testing.

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Demand for new ATE and related equipment depends upon several factors, including the demand for products that incorporate ICs, the increasing complexity of ICs and the emergence of new IC design, production and packaging technologies. Some of the evolutionary changes in IC technologies included the shift to 300 mm wafers in production, system-on-a-chip, or SOC, where digital, analog and memory functions are combined on a single IC, and chip scale packaging. As a result of these and other advances, semiconductor manufacturers may require additional ATE not only to handle increases in production but also to handle the more sophisticated testing requirements of ICs.

IC Test Process

Semiconductor manufacturers typically produce ICs in multiples of several hundred on a silicon wafer which is later separated or "diced" into individual ICs. Extended leads are then attached to the individual ICs for later connection to other electrical components. In most cases, the ICs are then encapsulated in a plastic, ceramic or other protective housing. These process steps are called "packaging."

Wafers are tested before being diced and packaged, to ensure that only properly functioning ICs are packaged. This testing step has several names, including "front-end test," "wafer test," "wafer probe" or "wafer sort." In front-end test, an electronic handling device known as a wafer prober automatically positions the wafer under a probe card which is electronically connected to a "test head," which connects electrically to a test system. During front-end testing, there is a growing trend of thermally conditioning the wafer during test, especially in the memory and automotive markets. Once the good ICs have been identified, they are packaged.

The packaged ICs also require testing, called "back-end test" or "final test," to determine if they meet design and performance specifications. Packaged ICs are tested after loading into another type of electronic handling device called a "package handler" or "handler," which then transfers the packaged ICs into a test socket which is attached to the test head. These handlers may be temperature controlled for testing. "Wafer probers" and "handlers" are sometimes referred to in this Report collectively as "electronic device handlers."

Testers range in price from approximately \$100,000 to over \$2.0 million each, depending primarily on the complexity of the IC to be tested. Probers and handlers range in price from approximately \$50,000 to \$500,000. A typical test floor of a large semiconductor manufacturer may have 100 test heads and 100 probers or 250 handlers supplied by various vendors for use at any one time. While larger global semiconductor manufacturers typically purchase ATE to test the ICs they manufacture, there are a growing number of semiconductor manufacturers who outsource IC testing to third-party foundries, test and assembly providers.

Test head manipulators, also referred to as positioners, facilitate the movement of the test head to the electronic device handler. Docking hardware mechanically connects the test head to the wafer prober or handler. Tester interface products provide the electrical connection between the test head and the wafer or packaged IC. Traditionally, temperature management products are used in back-end test to allow a manufacturer to test packaged ICs under the extreme temperature conditions in which the IC may be required to operate. However, we believe that temperature-controlled testing will be an increasingly important part of front-end wafer testing as more parameters traditionally tested in back end-test are moved to front-end test.

Trends in IC Testing

ATE is used to identify unacceptable packaged ICs and bad die on wafers. ATE assists IC manufacturers in controlling test costs by performing IC testing in an efficient and cost-effective manner. In order to provide testing equipment that can help IC manufacturers meet these goals, we believe the ATE market must address the following issues:

Change in Technology. End-user applications are demanding ICs with increasingly higher performance, greater speeds, and smaller sizes. ICs that meet these higher standards, including SOC designs, are more complex and dense. These technology trends have significant implications for the IC testing process, including:

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Item 1.

BUSINESS (Continued)

- ◆ the need for test heads of higher complexity;
- ◆ higher signal densities;
- ◆ increasing test speeds; and
- ◆ a new generation of testers for SOC and other technologies.

Need for Plug-Compatibility and Integration

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. Semiconductor manufacturers need test methodologies that will perform increasingly complex tests while lowering the overall cost of testing. This can require combining ATE manufactured by various companies into optimally performing systems. Semiconductor manufacturers have to work closely with various test hardware, software, interface and component vendors to resolve design and compatibility issues in order to make these vendors' products plug-compatible with test equipment manufactured by other vendors.

Testing Under Extreme Conditions. ICs will have to perform across a wider spectrum of temperature and environmental conditions than ever before because of the growing complexity of products in which they are deployed. In recent years, temperature testing has found an increasing role in front-end, wafer-level testing. Creating a uniform thermal profile over much larger wafer areas represents a significant engineering and design challenge for ATE manufacturers.

Demand for Higher Levels of Technical Support. As IC testing becomes more complex, semiconductor manufacturers demand higher levels of technical support on a routine basis. ATE manufacturers must commit appropriate resources to technical support in order to develop close working relationships with their customers. This level of support also requires close proximity of service and support personnel to customers' facilities.

Cost Reduction Through Increased Front-End Testing. As the cost of testing ICs increases, semiconductor manufacturers will continue to look for ways to streamline the testing process to make it more cost-effective, such as the trend to use massive parallel testing, in which semiconductor manufacturers test multiple ICs on the wafer simultaneously. We believe that this factor will lead to more front-end, wafer-level testing.

OUR SOLUTIONS

Historically, we have focused our development efforts on designing and producing high quality products that provide superior performance and cost-effectiveness. We have sought to address each manufacturer's individual needs through innovative and customized designs, use of the best materials available, quality manufacturing practices and personalized service. We have designed solutions to overcome the evolving challenges facing the ATE market and other markets that we serve, which we believe provide the following advantages:

Temperature-Controlled Testing. Our Thermostream (R) products are used by manufacturers in a number of markets to stress test a variety of semiconductor and electronic components, PC boards and sub-assemblies. Our Thermochuck (R) products are used by semiconductor manufacturers for front-end temperature stress screening at the wafer level. Factors motivating manufacturers to use temperature testing include design characterization, failure analysis and quality control as well as determining performance under extreme operating temperatures, all of which contribute to manufacturing cost savings. Our acquisitions of Sigma Systems Corporation ("Sigma"), in October 2008, and Thermonics, Inc. ("Thermonics"), in January 2012, have significantly increased our product offerings in the area of temperature-controlled testing and enabled us to begin serving customers in other markets outside the ATE market. Sigma's thermal platforms and temperature chambers can accommodate large thermal masses and are found in both laboratory and production environments. Thermonics' products provide a range of precision temperature forcing systems and have been melded into Temprotronic's ATS ThermoStream product line. The Thermonics brand is now used to market a family of process chillers for test and industrial applications.

Scalable, Universal, High Performance Interface Technology. Our universal test head manipulators provide a high degree of positioning flexibility with a minimum amount of effort. As a result, our products can be used in virtually any test setting. Our manipulator products are designed to accommodate the increased size of test heads. Our docking hardware offers precise control over the connection to test sockets, probing assemblies and interface boards, reducing downtime and minimizing costly damage to fragile components. Our tester interface products optimize the integrity of the signals transmitted between the test head and the device under test by being virtually transparent to the test signals. This results in increased accuracy of the test data and may thus enable improved test yields. We believe that these characteristics will gain even more significance as testing becomes even more demanding.

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Compatibility and Integration

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. A hallmark of our products has been, and continues to be, compatibility with a wide variety of ATE. Our manipulator and docking hardware products are all designed to be used with otherwise incompatible ATE. We believe this integrated approach to ATE facilitates smooth changeover from one tester to another, longer lives for interface components, better test results, increased ATE utilization and lower overall test costs.

Worldwide Customer Service and Support. We have long recognized the need to maintain a physical presence near our customers' facilities. As of December 31, 2016, we had domestic manufacturing facilities in Massachusetts, New Jersey and California and provided service to our customers from sales and service personnel based in the U.S., Europe and Asia. Our engineers are easily accessible to, and can work directly with, most of our customers from the time we begin developing our initial proposal, through the delivery, installation and use of the product by our customer. In this way, we are able to develop and maintain close relationships with our customers.

OUR STRATEGIES

We remain committed to our goals of being recognized in our markets as the designer and manufacturer of the highest quality and most cost-effective products and becoming the key supplier of all of our customers' product testing needs, other than probers, handlers and testers. Our strategies to achieve these goals include the following:

Pursuing Synergistic Acquisitions. A key element of our growth strategy has been to acquire businesses, technologies or products that are complementary to our current product offerings. Since our initial public offering in 1997, we have acquired several businesses which have enabled us to expand our line of product offerings and have given us the opportunity to market a broader range of products to our customer base. In particular, the acquisitions of Temptronic in 2000, Sigma in 2008 and Thermonics in 2012 provided access to markets that are less sensitive to cyclicity than the ATE market. We seek to make acquisitions that will further expand our product lines as well as increase our exposure to markets outside of the ATE market.

Pursuing Revenue Growth Opportunities Outside the Semiconductor ATE Market. Another element of our growth strategy is to pursue revenue growth opportunities in markets we have not traditionally served, such as the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. We believe that we may be able to reduce some of the cyclicity that we have historically experienced by further diversifying our revenue streams outside the semiconductor ATE market. We see the most potential for this within our Thermal Products segment. During 2016 and 2015, approximately \$12.2 million, or 30%, and \$10.7 million, or 27%, respectively, of our total net revenues were derived from markets outside semiconductor test. These revenues were all generated by our Thermal Products segment. We cannot determine at this time whether we will be successful in building our sales in these non-traditional markets or what the growth rate of our sales in these markets will be in future periods.

Providing Technologically Advanced Solutions. We are committed to designing and producing only the highest quality products which incorporate innovative designs to achieve optimal cost-effectiveness and functionality for each customer's particular situation. Our engineering and design staff is continually engaged in developing new and improved products and manufacturing processes.

Leveraging Our Strong Customer Relationships. Our technical personnel work closely with ATE manufacturers to design tester interface and docking hardware that are compatible with their ATE. As a result, we are often privy to proprietary technical data and information about these manufacturers' products. We believe that because we do not compete with ATE manufacturers in the prober, handler and tester markets, we have been able to establish strong collaborative relationships with these manufacturers that enable us to develop ancillary ATE products on an accelerated basis.

Maintaining Our International Presence. Our existing and potential customers are concentrated in certain regions throughout the world. We believe that we must maintain a presence in the markets in which our customers operate. We currently have offices in the U.S., Germany and Singapore.

Controlling Costs. At the same time as we are pursuing growth opportunities, we will seek ways to more aggressively streamline our cost structure, so that we are positioned to offer products at prices that provide the margin for a reasonable profit as well as the resources for continual product development.

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Item 1.

BUSINESS (Continued)

OUR SEGMENTS

As previously discussed, during 2016, we have been in the process of reorganizing our business from three product segments, which were also our reporting units (Thermal Products, Mechanical Products and Electrical Products) into two product segments (ITS and EMS) which will be our reporting units effective January 1, 2017. Our Thermal Products segment consists of our subsidiaries in Mansfield, Massachusetts (Temptronic Corporation, which manufactures products under the Temptronic, Sigma and Thermonics brand names), Germany (inTEST Thermal Solutions GmbH), and Singapore (inTEST Pte Ltd.). Our Mechanical Products segment consists of our manufacturing operation in Mt. Laurel, New Jersey. Our Electrical Products segment consists of our manufacturing operation in Fremont, California (inTEST Silicon Valley Corporation). ITS consists of all of the operations which were previously included in our Thermal Products segment, while EMS represents a combination of the operations that were formerly part of our Mechanical and Electrical Products segments. The discussion that follows is based on three product segments as this represents the primary way in which we managed our business and reported our results of operations during 2016.

Semiconductor manufacturers use our mechanical products during testing of wafers and specialized packaged ICs. They use our thermal and electrical products in both front-end and back-end testing of ICs. These ICs include microprocessors, digital signal processing chips, mixed signal devices, MEMS (Micro-Electro-Mechanical Systems), application specific ICs and specialized memory ICs, and are used primarily in the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. We custom design most of our products for each customer's particular combination of ATE.

Thermal Products

Our thermal products are sold into the environmental test market encompassing a wide variety of markets including the ATE, automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. Our thermal products enable a manufacturer to test semiconductor wafers and ICs, electronic components and assemblies, mechanical assemblies and electromechanical assemblies. Our thermal products provide the ability to characterize and stress test a variety of materials over extreme and variable temperature conditions that can occur in actual use.

ThermoStream(R) Products: Our ThermoStream(R) products are used in the semiconductor market as a stand-alone temperature management tool, or in a variety of electronic test applications as part of our MobileTemp systems. ThermoStream(R) products provide a source of heated and cooled air which can be directed over the component or device under test. These systems are capable of controlling temperatures to within +/- 0.1 degree Celsius over a range of -100 degrees Celsius to as high as +300 degrees Celsius within 1.0 degree Celsius of accuracy. As a stand-alone tool, ThermoStreams(R) provide a temperature-controlled air stream to rapidly change and stabilize the temperature of packaged ICs and other devices.

Our MobileTemp Series combines our ThermoStream(R) products with our family of exclusive, high-speed ThermoChambers to offer thermal test systems with fast, uniform temperature control in a compact package enabling temperature testing at the test location. MobileTemp Systems are designed specifically for small thermal-mass applications beyond the semiconductor market and have found application in the automotive, electronic, fiber optic and oil field service markets testing such things as electronic sub-assemblies, sensor assemblies, and printed circuit boards.

Traditionally, our customers used ThermoStream(R) products primarily in engineering, quality assurance and small-run manufacturing environments. However, increasingly, our customers use ThermoStream(R) products in longer-run production applications. Sigma has significantly broadened our product line by providing the ability to thermally test devices and assemblies requiring a far larger scale, both physically and thermally, than previously achievable. ThermoStream(R) and MobileTemp products range in price from approximately \$15,000 to \$50,000.

ThermoChambers: Our chamber products are available in a variety of sizes, from small bench-top units to chambers with internal volumes of twenty-seven cubic feet and greater and with temperature ranges as wide as from -190 degrees Celsius to +500 degrees Celsius. Chambers can be designed to utilize liquid nitrogen or liquid carbon dioxide cooling or mechanical refrigeration, and sometimes both. These chambers can accommodate large thermal masses and are found in both laboratory and production environments. Chambers are priced from \$15,000 to \$150,000.

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Thermal Platforms:

Our platforms are available in surface sizes ranging from 7.2 square inches to 616 square inches. They provide a flat, thermally conductive, precisely temperature controllable surface that is ideal for conditioning of testing devices with a flat surface. Platforms are available with temperature ranges as broad as -100 degrees Celsius to +250 degrees Celsius. Thermal platforms can be designed to utilize either liquid nitrogen or liquid carbon dioxide cooling or mechanical refrigeration. Platforms offer virtually unimpeded access to the device under test and their easy access and compact size makes them ideal for convenient bench-top use. Platforms are priced from \$6,500 to \$65,000.

ThermoChuck(R) Products: Our ThermoChuck(R) precision vacuum platform assemblies, used primarily in the semiconductor market, quickly change and stabilize the temperature of semiconductor wafers accurately and uniformly during testing without removing the wafer from its testing environment. Such temperatures can range from as low as -65 degrees Celsius to as high as +300 degrees Celsius. ThermoChucks(R) are incorporated into wafer prober equipment for laboratory analysis and for in-line production testing of semiconductor wafers. ThermoChuck(R) products range in price from approximately \$16,000 to \$120,000.

Thermonics(R) Products: Our Thermonics temperature conditioning products provide tempered gas or fluid to enable customers to maintain desired thermal conditions within their tool or process. Applications include general industrial, chemical processing, energy, electronics and semiconductor markets. Prices range from \$20,000 to greater than \$100,000.

Mechanical Products

Manipulator Products. We offer two lines of manipulator products: the in2(R) and the Cobal Series. These free-standing universal manipulators can hold a variety of test heads and enable an operator to reposition a test head for alternate use with any one of several probers or handlers on a test floor.

The in2(R) and Cobal Series of manipulator products incorporate our balanced floating-head design. This design permits a test head weighing up to 1,100 pounds to be held in an effectively weightless state, so it can be moved manually or with optional powered assistance, up or down, right or left, forward or backward and rotated around each axis (known as six degrees of motion freedom) by an operator using a modest amount of force. The same design features enable the operator to dock the test head without causing inadvertent damage to the fragile electrical contacts. As a result, after testing a particular production lot of ICs, the operator can quickly and easily disconnect a test head that is held in an in2(R) manipulator and equipped with our docking hardware and dock it to another electronic device handler for testing either a subsequent lot of the same packaged ICs or to test different ICs. The in2(R) and Cobal Series manipulators range in price from approximately \$12,000 to \$60,000.

Docking Hardware Products. We offer two lines of docking hardware products: fixed manual docking and Intellidock pin and cup docking. Both types protect the delicate interface contacts and ensure proper repeatable and precise alignment between the test head's interface board and the prober's probing assembly or the handler's test socket as they are brought together, or "docked." Fixed manual docking includes a mechanical cam mechanism to dock and lock the test head to the prober or handler. Intellidock is an automated docking solution that provides operator feedback for each docking step via a touchscreen display. Both types eliminate motion of the test head relative to the prober or handler. This minimizes deterioration of the interface boards, test sockets and probing assemblies which is caused by constant vibration during testing. Our docking hardware products are used primarily with floating-head universal manipulators when maximum mobility and inter-changeability of handlers and probers between test heads is required. By using our docking hardware products, semiconductor manufacturers can achieve cost savings through improved ATE utilization, improved accuracy and integrity of test results, and reduced repairs and replacements of expensive ATE interface products.

We believe our docking hardware products offer our customers the ability to make various competing brands of test heads compatible with various brands of probers and handlers by only changing interface boards. This is called "plug-compatibility." Plug-compatibility enables increased flexibility and utilization of test heads, probers and handlers purchased from various ATE manufacturers. We believe that because we do not compete with ATE manufacturers in the sale of probers, handlers or testers, ATE manufacturers are willing to provide us with the information that is integral to the design of plug-compatible products. Our docking hardware products range in price from approximately \$2,000 to \$25,000.

Item 1.

BUSINESS (Continued)Electrical Products

Our electrical products, which include various types of tester interfaces, provide the electrical connections between the tester and the wafer prober or IC handler to carry the electrical signals between the tester and the probe card on the prober or the test socket on the handler. Our designs optimize the integrity of the transmitted signal. Therefore, our tester interfaces can be used with high speed, high frequency, digital or mixed signal testers used in testing more complex ICs. Because our tester interface products enable the tester to provide more reliable yield data, our interfaces may also reduce IC production costs. We design standard and modular interface products to address most possible tester/prober combinations on the market today. In addition, we provide a custom design service that will allow any of our customers to use virtually any tester, prober or handler combination with any type of device, such as analog, digital, mixed signal and radio frequency. For example, our Centaur(R) modular interface is designed to provide flexibility and scalability through the use of replaceable signal modules which can be easily changed on the test floor as our customers' testing requirements change. In addition to the Centaur(R) modular interface, we also offer over 200 different types of tester interface models that we custom designed for our customers' specific applications. These tester interface products range in price from approximately \$7,000 to \$110,000.

Financial Information About Product Segments and Geographic Areas

Please see Note 15 of our consolidated financial statements included in Item 8 of this Report on Form 10-K for additional data regarding net revenues, profit or loss and total assets of each of our segments and revenues attributable to foreign countries.

MARKETING, SALES AND CUSTOMER SUPPORT

We market and sell our products primarily in markets where semiconductors are manufactured. North American and European semiconductor manufacturers, as well as third-party foundries, test and assembly providers, have located most of their back-end factories in Southeast Asia. The front-end wafer fabrication plants of U.S. semiconductor manufacturers are primarily in the U.S. Likewise, European, Taiwanese, South Korean and Japanese semiconductor manufacturers generally have located their wafer fabrication plants in their respective countries.

Thermal Products: We market our thermal products brands, Temptronic, Sigma and Thermonics, under the umbrella name of inTEST Thermal Solutions and sales to ATE manufacturers are handled directly by our own sales force. Sales to semiconductor manufacturers and customers in other markets in the U.S. are handled through independent sales representative organizations. In Singapore and Malaysia, our sales and service are handled through our internal sales and service staff. In the rest of Asia, our sales are handled through distributors. In Europe, sales managers at our office in Germany, as well as regional distributors and independent sales representatives, sell to semiconductor manufacturers and customers in other markets. We visit our distributors regularly and have trained them to sell and service all of our thermal products.

Mechanical and Electrical Products: In North America, we sell to semiconductor manufacturers principally through the use of independent, commissioned sales representatives. North American sales representatives also coordinate product installation and support with our technical staff and participate in trade shows.

Our internal sales account managers handle sales to ATE manufacturers and are responsible for a portfolio of customer accounts and for managing certain independent sales representatives. In addition, our sales account managers are responsible for pricing, quotations, proposals and transaction negotiations, and they assist with applications engineering and custom product design. Technical support is provided to North American customers and independent sales representatives by employees based in New Jersey, California and Texas.

In Europe, we sell to semiconductor and ATE manufacturers through our internal sales staff and through the use of independent sales representatives. Technical support is provided to European customers by an employee based in the UK or by independent sales representatives who we have trained. In China, Japan, the Philippines, South Korea, Taiwan and Thailand, we sell through the use of independent sales representatives who are supervised by our internal sales staff. In Malaysia and Singapore, our sales are handled by our internal sales staff. International sales representatives are responsible for sales, installation, support and trade show participation in their geographic market areas. Technical support is provided to Asian customers primarily by employees based in Malaysia, the Philippines and Taiwan.

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BUSINESS (Continued)

CUSTOMERS

We market all of our products to end users, which include semiconductor manufacturers and third-party foundries, test and assembly providers, as well as to original equipment manufacturers ("OEMs"), which include ATE manufacturers and their third-party outsource manufacturing partners. In the case of thermal products, we also market our products to independent testers of semiconductors, manufacturers of automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications products, and semiconductor research facilities. Our customers use our products principally in production testing, although our ThermoStream(R) products traditionally have been used largely in engineering development and quality assurance. We believe that we sell to most of the major semiconductor manufacturers in the world.

During the years ended December 31, 2016 and 2015, Hakuto Co. Ltd., one of our distributors, accounted for 13% and 12% of our consolidated net revenues, respectively. These revenues were generated by our Thermal Products segment. During the year ended December 31, 2016, Texas Instruments Incorporated accounted for 10% of our consolidated net revenues. While all three of our operating segments sold products to this customer, these revenues were primarily generated by our Mechanical Products and Electrical Products segments. Our ten largest customers accounted for approximately 50% and 43% of our consolidated net revenues in 2016 and 2015, respectively. The loss of any one or more of our largest customers, or a reduction in orders by a major customer, could materially reduce our net revenues or otherwise materially affect our business, financial condition or results of operations.

Our largest customers in 2016 include:

<u>Semiconductor Manufacturers</u>	<u>ATE Manufacturers</u>	<u>Other</u>
Analog Devices, Inc.	Teradyne, Inc.	Hakuto Co. Ltd.
Cypress Semiconductor Corporation	Xcerra Corporation	Lumentum Holdings, Inc.
NXP Semiconductors N.V.		Raytheon Company
Texas Instruments Incorporated		ViaSat, Inc.

MANUFACTURING AND SUPPLY

As of December 31, 2016, our principal manufacturing operations consisted of assembly and testing at our facilities in Massachusetts, New Jersey and California. We assemble most of our products from a combination of standard components and custom parts that have been fabricated to our specifications by either third-party manufacturers or our own fabrication operation in New Jersey. Our practice is to use the highest quality raw materials and components in our products. The primary raw materials used in fabricated parts are all widely available. We purchase substantially all of our components from multiple suppliers. We purchase certain raw materials and components from single suppliers, however we believe that all materials and components are available in adequate amounts from other sources, although from time to time, certain components may be in short supply because of high demand or the inability of some vendors to consistently meet our quality or delivery requirements.

We conduct inspections of incoming raw materials, fabricated parts and components using sophisticated measurement equipment. This includes testing with coordinate measuring machines in all but one of our

manufacturing facilities to ensure that products with critical dimensions meet our specifications. We have designed our inspection standards to comply with applicable MIL specifications and ANSI standards.

Our Massachusetts facility is ISO 9001:2015 certified. Our New Jersey and California facilities manufacture products only for the semiconductor industry where ISO certification is not required. However, these locations do employ the practices embodied in the ISO 9001:2008.

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BUSINESS (Continued)

ENGINEERING AND PRODUCT DEVELOPMENT

Our success depends on our ability to provide our customers with products and solutions that are well engineered, and to design those products and solutions before, or at least no later than, our competitors. As of December 31, 2016, we employed a total of 25 engineers, who were engaged in engineering and product development. In addition, when the demands of engineering and product development projects exceed the capacity or knowledge of our in-house staff, we retain temporary third-party engineering and product development consultants to assist us. Our practice in many cases is to assign engineers to work with specific customers, thereby enabling us to develop the relationships and exchange of information that is most conducive to successful product development and enhancement. In addition, some of our engineers are assigned to new product research and development and have worked on such projects as the development of new types of universal manipulators, the redesign and development of new thermal products and the development of high performance interfaces.

Since most of our products are customized, we consider substantially all of our engineering activities to be engineering and product development. We spent approximately \$3.7 million in 2016 and \$3.9 million in 2015 on engineering and product development.

PATENTS AND OTHER PROPRIETARY RIGHTS

Our policy is to protect our technology by filing patent applications for the technologies that we consider important to our business. We also rely on trademarks, trade secrets, copyrights and unpatented know-how to protect our proprietary rights. It is our practice to require that all of our employees and third-party product development consultants assign to us all rights to inventions or other discoveries relating to our business that were made while working for us. In addition, all employees and third-party product development consultants agree not to disclose any private or confidential information relating to our technology, trade secrets or intellectual property.

As of December 31, 2016, we held 50 active U.S. patents and had 6 pending U.S. patent applications covering various

aspects of our technology. Our U.S. patents expire at various times beginning in 2017 and extending through 2034. During 2016, two U.S. patents were issued and we had no U.S. patents expire. We do not believe that the upcoming expiration of certain of our patents in 2017 will have a material impact on our business. We also hold foreign patents and file foreign patent applications, in selected cases corresponding to our U.S. patents and patent applications, to the extent management deems appropriate.

While we believe that our patents and other proprietary rights are important to our business, we also believe that, due to the rapid pace of technological change in the semiconductor equipment market, the successful manufacture and sale of our products also depends upon our engineering, manufacturing, marketing and servicing skills. In the absence of patent protection, we would be vulnerable to competitors who attempt to copy or imitate our products or processes. We believe our intellectual property has value, and we have taken in the past, and will take in the future, actions we deem appropriate to protect such property from misappropriation. There can be no assurance, however, that such actions will provide meaningful protection from competition. For additional information regarding risks related to our intellectual property, see "Risk Factors."

COMPETITION

We operate in an increasingly competitive environment within each of our product segments. Some of our competitors have greater financial resources and more extensive design and production capabilities than we do. Certain markets in which we operate have become more fragmented, with smaller companies entering the market. These new smaller entrants typically have much lower levels of fixed operating overhead than we do, which enables them to be profitable with lower priced products. In order to remain competitive with these and other companies, we must be able to continue to commit a significant portion of our personnel, financial resources, research and development and customer support to developing new products and maintaining customer relationships worldwide.

Our competitors include independent manufacturers, ATE manufacturers and, to a lesser extent, semiconductor manufacturers' in-house ATE interface groups. Competitive factors in the markets we serve include price, functionality,

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BUSINESS (Continued)

timely product delivery, customer service, applications support, product performance and reliability. We believe that our long-term relationships with the industry's leading semiconductor manufacturers and other customers, and our commitment to, and reputation for, providing high quality products, are important elements in our ability to compete effectively in all of our markets.

Our principal competitors for Thermostream products are FTS Systems, a part of SP Industries, and MPI Corporation. Our principal competitors for Thermochuck products include Cascade Microtech, Inc., a subsidiary of FormFactor, Inc., ERS Elektronik GmbH and Espec Corp. Our principal competitors for environmental chambers are Cincinnati Sub-Zero Products, Inc., Espec Corp. and Thermotron Industries. Our principal competitor for thermal platforms is Environmental Stress Systems Inc.

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Our principal competitors for manipulator products are Advantest Corporation, Esmo AG, Reid-Ashman Manufacturing and Teradyne, Inc. Our principal competitors for docking hardware products include Advantest Corporation, Esmo AG, Knight Automation, Reid-Ashman Manufacturing and Teradyne, Inc.

Our principal competitors for tester interface products are Advantest Corporation, Esmo AG, Reid-Ashman Manufacturing and Teradyne, Inc.

BACKLOG

At December 31, 2016, our backlog of unfilled orders for all products was approximately \$7.4 million compared with approximately \$2.4 million at December 31, 2015. Our backlog includes customer orders which we have accepted, substantially all of which we expect to deliver in 2017. 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 shorter 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 of these factors, our backlog at a particular date is not necessarily indicative of sales for any future period.

EMPLOYEES

At December 31, 2016, we had 113 full time employees, including 48 in manufacturing operations, 44 in customer support/operations and 21 in administration. Substantially all of our key employees are highly skilled and trained technical personnel. None of our employees are represented by a labor union, and we have never experienced a work stoppage. From time to time we retain third-party contractors to assist us in manufacturing operations and engineering and product development projects.

ADDITIONAL INFORMATION

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports that are filed with the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act, are available free of charge through our website (www.intest.com) as soon as reasonably practicable after we electronically file them with, or furnish them to, the SEC.

Item 1A. RISK FACTORS

The following are some of the factors 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. The risks and uncertainties described below are not the only ones facing us and we cannot predict every event and circumstance that may adversely affect our business. However, these risks and uncertainties are the most significant factors that we have identified at this time. If one or more of these risks actually occurs, our business, results of operations and/or financial condition would likely suffer, and the price of our stock could be negatively affected.

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Item 1A. RISK FACTORS (Continued)

We seek to acquire additional businesses. If we are unable to do so, our future rate of growth may be reduced or limited. We may incur significant expenses related to due diligence or other transaction-related expenses for a proposed acquisition that may not be completed.

A key element of our growth strategy is to acquire businesses, technologies or products that are complementary to our current product offerings. We seek to make acquisitions that will further expand our product lines as well as reduce our overall reliance on the ATE market. We may not be able to execute our acquisition strategy if:

- ◆ we are unable to identify suitable businesses, technologies or products to acquire;
- ◆ we do not have sufficient cash or access to required capital at the necessary time;
- ◆ we are unwilling or unable to outbid larger, more resourceful companies; or
- ◆ we are unable to successfully close proposed acquisitions.

Our acquisition strategy involves financial and management risks which may adversely affect our results in the future.

If we acquire additional businesses, technologies or products, we will face the following additional risks:

- ◆ future acquisitions could divert management's attention from daily operations or otherwise require additional management, operational and financial resources;
- ◆ we might not be able to integrate future acquisitions into our business successfully or operate acquired businesses profitably;
- ◆ we may realize substantial acquisition related expenses which would reduce our net earnings in future years; and
- ◆ our investigation of potential acquisition candidates may not reveal problems and liabilities of the companies that we acquire.

If any of the events described above occur, our earnings could be reduced. If we issue shares of our stock or other rights to purchase our stock in connection with any future acquisitions, we would dilute our existing stockholders' interests and our earnings per share may decrease. If we issue debt in connection with any future acquisitions, lenders may require that we pledge our assets to secure repayment of such debt and impose covenants on us which could, among other things, restrict our ability to increase capital expenditures or to acquire additional businesses.

We seek to further diversify the markets for our thermal products in order to increase the proportion of our sales attributable to markets which are less subject to cyclicalities than the semiconductor and ATE markets. If we are unable to do so, our future performance will remain substantially exposed to the fluctuations of the cyclicalities of the semiconductor and ATE markets.

Since 2009, we have sold our thermal products in markets outside of the ATE market, including the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. During 2016 and 2015, our sales to these non-ATE markets were \$12.2 million and \$10.7 million, respectively, and represented 30% and 27% of our consolidated net revenues, respectively. We offer highly

specialized engineering solutions in these markets outside the ATE market, the demand for which is limited and which we expect may vary significantly from period to period. Our goal is to increase our sales into these and other non-ATE markets; however, in most cases, the expansion of our thermal product sales into these new markets has occurred in the last several years, and we may experience difficulty in expanding our sales efforts further into these markets. These difficulties could include hiring sales and marketing staff with sufficient experience selling into these new markets and our ability to continue to develop products which meet the needs of customers in these markets and which are not currently offered by our competitors. In addition, due to the nature of our highly specialized product offerings in these non-ATE markets, we do not expect broad market penetration in many of these markets. If we are unable to expand our sales in non-ATE markets, our net revenues and results of operations will remain substantially dependent upon the cycles of the semiconductor and ATE markets.

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Item 1A. RISK FACTORS (Continued)

Our restructuring efforts, the goal of which is to return non-profitable operations to profitability, may not be successful.

In recent years, our Mechanical Products segment has experienced significant operating losses. We have undertaken actions at various times over the last few years to address these losses. On January 4, 2016, in conjunction with the formation of the inTEST EMS Products Division, we implemented a workforce reduction which resulted in our recording a restructuring charge of \$99,000 in the first quarter of 2016. These efforts were substantially completed during 2016 and we did not incur any further significant costs associated with these efforts. As a result of the restructuring action taken during 2016, as well as improvements in procurement, our Mechanical Products segment saw its operating loss reduced from \$1.9 million in 2015 to \$74,000 in 2016. We cannot be certain that our efforts to restructure this operation to achieve profitability will be successful. These efforts could require us to utilize additional financial resources to pay severance or fund other costs associated with the restructuring of this operation, which would reduce the amount of our cash and cash equivalents available to fund our short-term working capital requirements.

Our sales are affected by the cyclicity and seasonality of the semiconductor and ATE markets, which causes our operating results to fluctuate significantly.

Our business depends in significant part upon the capital expenditures of semiconductor manufacturers. Capital expenditures by these companies depend upon, among other things, the current and anticipated market demand for semiconductors and the products that utilize them. Typically, semiconductor manufacturers curtail capital expenditures during periods of economic downturn. Conversely, semiconductor manufacturers increase capital expenditures when market demand requires the addition of new or expanded production capabilities or the reconfiguration of existing fabrication facilities to accommodate new products. In addition to being cyclical, the ATE market has also developed a seasonal pattern in the last several years, with the second and third quarters being the periods of strong demand and the first and fourth quarters being periods of weakened demand. We believe this change has been driven by the strong demand for consumer products

containing semiconductor content sold during the year-end holiday shopping season. These market changes and seasonal sales pattern have contributed in the past, and will likely continue to contribute in the future, to fluctuations in our operating results.

Our business is subject to intense competition.

We face significant competition throughout the world in each of our product segments. Some of our competitors have substantial financial resources and more extensive design and production capabilities than we do. Some of our competitors are much smaller than we are, and therefore have much lower levels of overhead than we do, which enables them to sell their competing products at lower prices. In order to remain competitive, we must be able to continually commit a significant portion of our personnel and financial resources to developing new products and maintaining customer satisfaction worldwide. We expect our competitors to continue to improve the performance of their current products and introduce new products or technologies. Over the last several years, in response to significant declines in global demand for our products, some competitors have reduced their product pricing significantly, which has led to intensified price based competition, which has and could continue to materially adversely affect our business, financial condition and results of operations.

Changes in the buying patterns of our customers have affected, and may continue to affect, demand for our products and our gross and net operating margins. Such changes in patterns are difficult to predict and may not be immediately apparent.

In addition to the cyclical and seasonality of the semiconductor and ATE markets, demand for our products and our gross and net operating margins have also been affected by changes in the buying patterns of our customers. We believe that in recent years there have been a variety of changes within the ATE market, including, for example, changing product requirements, longer time periods between new product offerings by OEMs and changes in customer buying patterns. In particular, demand for our mechanical and electrical products, which are sold exclusively within the ATE market, and our operating margins in these product segments have been affected by shifts in the competitive landscape, including (i) customers placing heightened emphasis on shorter lead times (which places increased demands on our available engineering and production capacity increasing unit costs) and ordering in smaller quantities (which prevents us from acquiring component materials in larger volumes at lower cost and increasing unit costs), (ii) the increasing practice of OEMs

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Item 1A. RISK FACTORS

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specifying other suppliers as primary vendors, with less frequent opportunities to compete for such designations, (iii) customers requiring products with a greater range of use at the lowest cost, and (iv) customer supply chain management groups demanding lower prices and spreading purchases across multiple vendors. These shifts in market practices have had, and may continue to have, varying degrees of impact on our net revenues and our gross and net operating margins. Such shifts are difficult to predict and may not be

immediately apparent, and the impact of these practices is difficult to quantify from period to period. There can be no assurance that we will be successful in implementing effective strategies to counter these shifts.

Increased in-house manufacturing capabilities among certain ATE manufacturers may have resulted, and may continue to result, in reductions in our share of the manipulator, docking hardware and tester interface products markets, reduced revenues in our Mechanical and Electrical Products segments and net losses in our Mechanical Products segment.

Over the last several years, certain ATE manufacturers have begun manufacturing and selling certain products made by both our Mechanical and Electrical Products segments, including manipulator, docking hardware and tester interface products. As a result of the loss of these product sales, we may have lost market share in our manipulator, docking hardware and tester interface products, and our Mechanical Products segment has incurred operating losses. To the extent that we cannot replace these lost sales, our market share may decline, which could have a material adverse impact on the financial results of our Mechanical and Electrical Products segments.

We generate a large portion of our sales from a small number of customers. If we were to lose one or more of our large customers, operating results could suffer dramatically.

During the years ended December 31, 2016 and 2015, Hakuto Co. Ltd., one of our distributors, accounted for 13% and 12% of our consolidated net revenues, respectively. These revenues were generated by our Thermal Products segment. During the year ended December 31, 2016, Texas Instruments Incorporated accounted for 10% of our consolidated net revenues. While all three of our operating segments sold products to this customer, these revenues were primarily generated by our Mechanical Products and Electrical Products segments. Our ten largest customers accounted for approximately 50% and 43% of our consolidated net revenues in 2016 and 2015, respectively. The loss of any one or more of our largest customers, or a reduction in orders by a major customer, could materially reduce our net revenues or otherwise materially affect our business, financial condition, or results of operations.

Our operating results often change significantly from quarter to quarter and may cause fluctuations in our stock price.

Historically, our operating results have fluctuated significantly from quarter to quarter. We believe that these fluctuations occur primarily due to the cycles of demand in the semiconductor manufacturing industry. In addition to the changing cycles of demand in the semiconductor manufacturing industry, other factors that have caused our quarterly operating results to fluctuate in the past, and that may cause fluctuations and losses in the future, include:

- ◆ changes in demand in the markets we serve outside the ATE market including the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunication markets;
- ◆ the state of the U.S. and global economies;
- ◆ changes in the buying patterns of our customers;
- ◆ changes in our market share;
- ◆ the technological obsolescence of our inventories;
- ◆ quantities of our inventories greater than is reasonably likely to be utilized in future periods;
- ◆ fluctuations in the level of product warranty charges;
- ◆ competitive pricing pressures;
- ◆ the impairment of our assets due to reduced future demand for our products;
- ◆ costs related to due diligence and transaction-related expenses for a proposed acquisition that does not get completed;
- ◆ costs and timing of integration of our acquisitions and plant consolidations and relocations;

- ◆ excess manufacturing capacity;

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Item 1A. RISK FACTORS (Continued)

- ◆ our ability to control operating costs;
- ◆ costs associated with implementing restructuring initiatives;
- ◆ delays in shipments of our products;
- ◆ the mix of our products sold;
- ◆ the mix of customers and geographic regions where we sell our products;
- ◆ changes in the level of our fixed costs;
- ◆ costs associated with the development of our proprietary technology;
- ◆ our ability to obtain raw materials or fabricated parts when needed;
- ◆ increases in costs of component materials;
- ◆ cancellation or rescheduling of orders by our customers;
- ◆ changes in government regulations; and
- ◆ political or economic instability.

Because the market price of our common stock has tended to vary based on, and in relation to, changes in our operating results, fluctuations in the market price of our stock are likely to continue as variations in our quarterly results continue.

We have experienced and may continue to experience significant variability in our effective tax rates and may have exposure to additional tax liabilities and costs.

We are subject to paying income taxes in the U.S. and various other countries in which we operate. Our effective tax rate is dependent on where our earnings are generated and the tax regulations and the interpretation and judgment of administrative tax or revenue entities in the U.S. and other countries. We are also subject to tax audits in the countries where we operate. Any material assessment resulting from an audit from an administrative tax or revenue entity could negatively affect our financial results.

Our industry is subject to rapid technological change, and our business prospects would be negatively affected if we are unable to quickly and effectively respond to innovation in the semiconductor and ATE markets.

Semiconductor technology continues to become more complex as manufacturers incorporate ICs into an increasing variety of products. This trend, and the changes needed in automatic testing systems to respond to developments in the semiconductor market, are likely to continue. We cannot be certain that we will be successful or timely in developing, manufacturing or selling products that will satisfy customer needs or that will attain market acceptance. Our failure to provide products that effectively and timely meet customer needs or gain market acceptance will negatively affect our business prospects.

A substantial portion of our customers are located outside the U.S., which exposes us to foreign political and economic risks.

We have operated internationally for many years and expect to expand our international operations as necessary to continue expansion of our sales and service to our non-U.S. customers. Our foreign subsidiaries generated 16% and 13% of consolidated net revenues in 2016 and 2015, respectively. Net revenues from foreign customers totaled \$27.2 million, or 68% of consolidated net revenues in 2016, and \$24.6 million, or 63% of consolidated net revenues in 2015. We expect our net revenues from foreign customers will continue to represent a significant portion of total net revenues. However, in addition to the risks generally associated with sales and operations in the U.S., sales to customers outside the U.S. and operations in foreign countries are subject to additional risks, which may, in the future, affect our operations. These risks include:

- ◆ political and economic instability in foreign countries;
- ◆ the imposition of financial and operational controls and regulatory restrictions by foreign governments;
- ◆ the need to comply with a wide variety of U.S. and foreign import and export laws;
- ◆ local business and cultural factors that differ from our normal standards and practices, including business practices that we are prohibited from engaging in by the Foreign Corrupt Practices Act and other anti-corruption laws and regulations;
- ◆ trade restrictions;
- ◆ changes in tariffs and taxes;
- ◆ longer payment cycles;

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Item 1A. RISK FACTORS

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- ◆ fluctuations in currency exchange rates; and
- ◆ the greater difficulty of administering business abroad.

A significant portion of our cash position is maintained overseas.

While much of our cash is in the U.S., a significant portion is generated from and maintained by our foreign operations. As of December 31, 2016, \$1.7 million of our cash and cash equivalents was held by our foreign subsidiaries. Our financial condition and results of operations could be adversely impacted if we are unable to maintain a sufficient level of cash flow in the U.S. to address our cash requirements or we are unable to efficiently and timely repatriate cash from overseas. Any payment of distributions, loans or advances to us by our foreign subsidiaries could be subject to restrictions on, or taxation of, dividends or repatriation of earnings under applicable local law, monetary transfer restrictions and foreign currency exchange regulations in the jurisdictions in which our subsidiaries operate. If we are unable to repatriate the earnings of our subsidiaries it could have an adverse impact on our ability to redeploy earnings in other jurisdictions where they could be used more profitably.

A breach of our operational or security systems could negatively affect our business and results of operations.

We rely on various information technology networks and systems, some of which are managed by third parties, to process, transmit and store electronic information, including confidential data, and to carry out and support a variety

of business activities, including manufacturing, research and development, supply chain management, sales and accounting. A failure in or a breach of our operational or security systems or infrastructure, or those of our suppliers and other service providers, including as a result of cyberattacks, could disrupt our business, result in the disclosure or misuse of proprietary or confidential information, damage our reputation, cause losses and significantly increase our costs. In addition, domestic and international regulatory agencies have implemented, and are continuing to implement, various reporting and remediation requirements that companies must comply with upon learning of a breach. While we have insurance that may protect us from incurring some of these costs, there is no assurance that such insurance coverage is adequate to cover all costs and damages incurred in connection with a cyberattack.

If our suppliers do not meet product or delivery requirements, we could have reduced revenues and earnings.

Certain components may be in short supply from time to time because of high demand or the inability of some vendors to consistently meet our quality or delivery requirements. A significant portion of our material purchases require some custom work and there are not always multiple suppliers capable of performing such custom work on a timely or cost effective basis. If any of our suppliers were to cancel commitments or fail to meet quality or delivery requirements needed to satisfy customer orders for our products, we could lose time-sensitive customer orders, have reduced revenues and earnings, and be subject to contractual penalties, any of which could have a material adverse effect on our business, results of operations and financial condition.

Our business may suffer if we are unable to attract and retain key employees.

The loss of key personnel could adversely affect our ability to manage our business effectively. Our future success will depend largely upon the continued services of our senior management and other key employees or the development of successors with commensurate skills and talents. In the past, during periods of weakened demand which has caused us to experience operating losses, we have implemented temporary salary and benefit reductions and eliminations that have remained in place until our operations returned to profitability. As global economic conditions improve and employment opportunities increase, if we are unable to increase employee salaries and maintain employee benefits commensurate with competitive opportunities, we may not be able to retain our senior management and other key employees. Our business could suffer if we were to lose one of more of our senior officers or other key employees.

If we are not able to obtain patents on or otherwise preserve and protect our proprietary technologies, our business may suffer.

We have obtained domestic and foreign patents covering some of our products which expire between the years 2017 and 2034, and we have applications pending for additional patents. Some of our products utilize proprietary technology that is not covered by a patent or similar protection, and, in many cases, cannot be protected. We cannot be certain that:

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Item 1A. RISK FACTORS

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- ◆ any additional patents will be issued on our applications;

- ◆ any patents we own now or in the future will protect our business against competitors that develop similar technology or products;
- ◆ our patents will be held valid if they are challenged or subjected to reexamination or reissue;
- ◆ others will not claim rights to our patented or other proprietary technologies; or
- ◆ others will not develop technologies which are similar to, or can compete with, our unpatented proprietary technologies.

If we cannot obtain patent or other protection for our proprietary technologies, our ability to compete in our markets could be impaired.

Claims of intellectual property infringement by or against us could seriously harm our businesses.

From time to time, we may be forced to respond to or prosecute intellectual property infringement claims to defend or protect our rights or a customer's rights. These claims, regardless of merit, may consume valuable management time, result in costly litigation or cause product shipment delays. Any of these factors could seriously harm our business and operating results. We may have to enter into royalty or licensing agreements with third parties who claim infringement. These royalty or licensing agreements, if available, may be costly to us. If we are unable to enter into royalty or licensing agreements with satisfactory terms, our business could suffer. In instances where we have had reason to believe that we may be infringing the patent rights of others, or that someone may be infringing our patent rights, we have asked our patent counsel to evaluate the validity of the patents in question, as well as the potentially infringing conduct. If we become involved in a dispute, neither the third parties nor the courts are bound by our counsel's conclusions.

We may not be able to fully execute our share repurchase program.

In October 2015, our Board of Directors authorized our management to repurchase up to \$5.0 million of our common stock commencing in December 2015. We may not be able to purchase this amount of shares in the open market or in privately negotiated transactions in compliance with applicable securities regulations.

Future share repurchases are subject to the discretion of our Board of Directors and will depend, among other things, upon our earnings, capital requirements and financial condition. While we have authorized a share repurchase program, we are not required to repurchase the full dollar amount of shares authorized for repurchase and we may reduce or eliminate our share repurchase program in the future. The reduction or elimination of our share repurchase program, particularly if we do not repurchase the full dollar amount of shares authorized under the program, could adversely affect the market price of our common stock. As of December 31, 2016, we had repurchased a total of 283,137 shares at a cost of \$1,133,000, including fees paid to our broker. Through February 28, 2017, we had repurchased a total of 297,020 shares at a cost of \$1,195,000, including fees paid to our broker.

Item 1B.

UNRESOLVED STAFF COMMENTS

None.

Item 2.

PROPERTIES

At December 31, 2016, we leased five facilities worldwide. The following chart provides information regarding each of our principal facilities that we occupied at December 31, 2016:

<u>Location</u>	<u>Lease Expiration</u>	<u>Approx. Square Footage</u>	<u>Principal Uses</u>
Mansfield, MA	August 2021	52,700	Thermal Products segment operations.
Mt. Laurel, NJ	April 2021	54,897	Corporate headquarters and Mechanical Products segment operations.
Fremont, CA	October 2020	15,746	Electrical Products segment operations.

All of our facilities have space to accommodate our needs for the foreseeable future.

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Item 3. 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 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

Item 5.

MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for Common Stock

Our common stock is traded on NYSE MKT under the symbol "INTT." The following table sets forth the high and low sale prices of our common stock, as reported on the NYSE MKT LLC for the periods indicated. Sale prices have been rounded to the nearest full cent.

	<u>Sales Price</u>	
<u>2016</u>	<u>High</u>	<u>Low</u>
First Quarter	\$4.69	\$3.43

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Second Quarter	4.28	3.48
Third Quarter	4.15	3.65
Fourth Quarter	4.75	3.74

2015

First Quarter	\$4.32	\$3.73
Second Quarter	5.21	4.01
Third Quarter	4.50	3.76
Fourth Quarter	4.25	3.47

On March 17, 2017, the closing price for our common stock as reported on the NYSE MKT was \$6.40. As of March 17, 2017, we had 10,402,058 shares outstanding that were held by approximately 750 beneficial and record holders.

No dividends were paid on our common stock in the years ended December 31, 2016 or 2015. We do not currently plan to pay cash dividends in the foreseeable future. Our current policy is to use any future earnings for stock repurchases under the 2015 Stock Repurchase Plan and for reinvestment in the operation and expansion of our business, including possible acquisitions of other businesses, technologies or products. Payment of any future dividends will be at the discretion of our Board of Directors.

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Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES (Continued)

Purchases of Equity Securities

The following table provides information with respect to purchases made by us or on our behalf of our common stock during the quarter ended December 31, 2016:

<u>Period</u>	Total Number of Shares	Average Price Paid <u>Per Share</u>	Total Number of Shares Purchased as Part of Publicly Announced Plans <u>or Programs</u>	Approximate Dollar Value of Shares That May Yet Be Purchased Under <u>the Plans or</u>
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	<u>Repurchased</u>			<u>Programs</u>
October 1-31	16,705	\$3.98	16,705	\$3,943,000
November 1-30	-	-	-	\$3,943,000
December 1-31	<u>15,829</u>	\$4.33	<u>15,829</u>	\$3,875,000
Total	<u>32,534</u>	\$4.15	<u>32,534</u>	\$3,875,000

On October 27, 2015, our Board of Directors authorized the repurchase of up to \$5.0 million of our common stock from time to time on the open market, in compliance with Rule 10b-18 under the Securities Exchange Act of 1934, or in privately negotiated transactions (the "2015 Repurchase Plan"). Repurchases may be made under a Rule 10b5-1 plan entered into with RW Baird & Co., which permits shares to be repurchased when we might otherwise be precluded from doing so under insider trading laws. The timing and amount of any shares repurchased under the 2015 Repurchase Plan is determined by our management, based on our evaluation of market conditions and other factors. The 2015 Repurchase Plan does not obligate us to repurchase any particular amount of common stock and may be suspended or discontinued at any time without prior notice. The 2015 Repurchase Plan is funded using our operating cash flow or available cash.

During 2016 and 2015, we repurchased 241,805 and 41,332 shares under the 2015 Repurchase Plan, respectively. The total cost to repurchase these shares, including fees paid to our broker, was \$978,000 and \$155,000, respectively. As of December 31, 2016, we had repurchased a total of 283,137 shares under the 2015 Repurchase Plan at a cost of \$1.1 million, which included fees paid to our broker of \$8,000. All of the repurchased shares were retired. The 2015 Repurchase Plan was suspended in May 2016 and resumed in September 2016.

Item 6. SELECTED FINANCIAL DATA

The following table contains certain selected consolidated financial data of inTEST and is qualified by the more detailed Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report on Form 10-K and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the other financial information included in this Annual Report on Form 10-K.

	<u>Years Ended December 31,</u>				
	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Condensed Consolidated Statement of Operations Data:	(in thousands, except per share data)				
Net revenues	\$40,227	\$38,889	\$41,796	\$39,426	\$43,376
Gross margin	20,378	18,698	20,462	19,015	19,059
Operating income	4,146	2,562	4,916	3,962	2,996
Net earnings	2,658	1,861	3,439	3,077	2,156
Net earnings per common share:					
Basic	\$0.26	\$0.18	\$0.33	\$0.30	\$0.21
Diluted	\$0.26	\$0.18	\$0.33	\$0.30	\$0.21
Weighted average common shares outstanding:					
Basic	10,314	10,473	10,432	10,364	10,273
Diluted	10,333	10,494	10,466	10,419	10,347

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Item 6. **SELECTED FINANCIAL DATA** (Continued)

	<u>As of December 31,</u>				
	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Condensed Consolidated Balance Sheet Data:	(in thousands)				
Cash and cash equivalents	\$28,611	\$25,710	\$23,126	\$19,018	\$15,576
Working capital	32,950	30,205	28,032	24,048	19,996
Total assets	42,844	39,984	38,738	35,481	32,399
Long-term debt, net of current portion	-	-	-	-	-
Total stockholders' equity	37,788	35,925	34,368	31,149	27,820

Item 7.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Risk Factors and Forward-Looking Statements

In addition to historical information, this discussion and analysis contains statements relating to possible future events and results that are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements can often be identified by the use of forward-looking terminology such as "believes," "expects," "intends," "may," "will," "should" or "anticipates" or similar terminology. See Part I, Item 1 - "Business - Cautionary Statement Regarding Forward-Looking Statements" for examples of statements made in this report which may be "forward-looking statements." These statements involve risks and uncertainties and are based on various assumptions. Although we believe that our expectations are based on reasonable assumptions, investors and prospective investors are cautioned that such statements are only projections, and there cannot be any assurance that these events or results will occur. Information about the primary risks and uncertainties that could cause our actual future results to differ materially from our historic results or the 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."

Overview

This MD&A should be read in conjunction with the accompanying consolidated financial statements.

Our business and results of operations are substantially dependent upon the demand for ATE by semiconductor manufacturers and companies that specialize in the testing of ICs. Demand for ATE is driven by semiconductor manufacturers that are opening new, or expanding existing, semiconductor fabrication facilities or upgrading existing equipment, which in turn is dependent upon the current and anticipated market demand for semiconductors and products incorporating semiconductors. Such market demand can be the result of market expansion, development of new technologies or redesigned products to incorporate new features, or the replacement of aging equipment. In addition, we continue to focus on design improvements and new approaches for our own products which contribute to

our net revenues as our customers adopt these new products.

In the past, the semiconductor industry has been highly cyclical with recurring periods of oversupply, which often have a severe impact on the semiconductor industry's demand for ATE, including the products we manufacture. This can cause wide fluctuations in both our orders and net revenues and, depending on our ability to react quickly to these shifts in demand, can significantly impact our results of operations. ATE market cycles are difficult to predict and in recent years have become more volatile and, in certain cases, shorter in duration. Because the market cycles are generally characterized by sequential periods of growth or declines in orders and net revenues during each cycle, year over year comparisons of operating results may not always be as meaningful as comparisons of periods at similar points in either up or down cycles. In addition, during both downward and upward cycles in our industry, in any given quarter, the trend in both our orders and net revenues can be erratic. This can occur, for example, when orders are canceled or currently scheduled delivery dates are accelerated or postponed by a significant customer or when customer forecasts and general business conditions fluctuate during a quarter.

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

In addition to being cyclical, the ATE market has also developed a seasonal pattern in the last several years, with the second and third quarters being the periods of strong demand and the first and fourth quarters being periods of weakened demand. We believe this change has been driven by the strong demand for consumer products containing semiconductor content sold during the year-end holiday shopping season.

Third-party market share statistics are not available for the products we manufacture and sell into the ATE market; therefore, comparisons of period over period changes in our market share are not easily determined. As a result, it is difficult to ascertain if ATE market volatility in any period is the result of macro-economic or customer-specific factors impacting ATE market demand, or if we have gained or lost market share to a competitor during the period.

As part of our strategy to reduce the impact of ATE market volatility on our business operations, in 2009, we began to diversify our served markets to address the thermal test requirements of several other markets outside the ATE market. These include the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. We believe that these markets usually are less cyclical than the ATE market. While market share statistics exist for some of the markets we serve outside the ATE market, due to the nature of our highly specialized product offerings in these non-ATE markets, we do not expect broad market penetration in many of these markets and, therefore, do not anticipate developing meaningful market shares in these non-ATE markets. In addition, our orders and net revenues in any given period in these markets do not necessarily reflect the overall trends in these non-ATE markets due to our limited market shares. Consequently, we are continuing to evaluate buying patterns and opportunities for growth in these non-ATE markets that may affect our performance. The level of our orders and net revenues from these non-ATE markets has varied in the past, and we expect will vary significantly in the future, as we work to build our presence in these markets and establish new markets for our products.

While the majority of our orders and net revenues are derived from the ATE market, our operating results do not always follow the overall trend in the ATE market in any given period. We believe that these anomalies may be driven by a variety of factors within the ATE market, including, for example, changing product requirements, longer time periods between new product offerings by OEMs and changes in customer buying patterns. In particular, demand for our mechanical and electrical products, which are sold exclusively within the ATE market, and our operating margins in these product segments have been affected by shifts in the competitive landscape, including (i) customers placing heightened emphasis on shorter lead times (which places increased demands on our available engineering and production capacity increasing unit costs) and ordering in smaller quantities (which prevents us from acquiring component materials in larger volumes at lower cost and increasing unit costs), (ii) the practice of OEMs specifying other suppliers as primary vendors, with less frequent opportunities to compete for such designations, (iii) the in-house manufacturing activities of OEMs building certain products we have historically sold to them, including manipulators and docking hardware, which has had the impact of significantly reducing the size of the available market for those certain products (iv) the role of third-party test and assembly houses in the ATE market and their requirement of products with a greater range of use at the lowest cost, (v) customer supply chain management groups demanding lower prices and spreading purchases across multiple vendors, and (vi) certain competitors aggressively reducing their products' sales prices (causing us to either reduce our products' sales price to be successful in obtaining the sale or causing loss of the sale).

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

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Orders and Backlog

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

	Years Ended December 31,		Change	
	2016	2015	\$	%
Orders:				
Thermal Products	\$27,287	\$23,296	\$3,991	17%
Mechanical Products	9,161	7,065	2,096	30
	<u>8,824</u>	<u>7,087</u>	<u>1,737</u>	<u>25</u>
Electrical Products				
	<u>\$45,272</u>	<u>\$37,448</u>	<u>\$7,824</u>	<u>21</u>
				%
ATE market	\$31,491	\$27,048	\$4,443	16%
	<u>13,781</u>	<u>10,400</u>	<u>3,381</u>	<u>33</u>
Non-ATE market				
	<u>\$45,272</u>	<u>\$37,448</u>	<u>\$7,824</u>	<u>21</u>
				%

Total consolidated orders for the year ended December 31, 2016 were \$45.3 million compared to \$37.4 million for 2015. This increase reflects higher levels of demand from both ATE and non-ATE market customers. The increased demand from the ATE market reflects cyclical strengthening within this market, primarily for our Mechanical and Electrical Products segments. In addition, we believe the higher level of increase for our Mechanical Products segment also reflects that certain of this segment's customers were on reduced capital spending budgets for much of 2015, which decreased the amount of new equipment purchases they made last year. We believe one major factor influencing the reduced capital spending in the ATE market during 2015 was the large number of customer consolidations which occurred in our semiconductor manufacturer customer base between late 2014 and early 2016.

The increase in demand from non-ATE markets primarily reflects higher levels of orders from certain of our customers in the telecommunications and defense/aerospace markets, which were partially offset by a reduction in orders from certain customers in the automotive and industrial markets. Our orders from the telecommunications market increased 106% in 2016 as compared to 2015 and were 16% of consolidated 2016 orders as compared to 10% of consolidated 2015 orders and primarily reflected increased demand from the manufacturers of optical transceiver products. As a percent of our total consolidated orders, orders from non-ATE markets were 30% in 2016 compared to 28% in 2015. The level of our orders in these non-ATE markets has varied in the past, and we expect it will vary significantly in the future as we build our presence in these markets and establish new markets for our products.

At December 31, 2016, our backlog of unfilled orders for all products was approximately \$7.4 million compared with approximately \$2.4 million at December 31, 2015. Our backlog includes customer orders which we have accepted, substantially all of which we expect to deliver in 2017. While backlog is calculated on the basis of firm purchase orders, a customer may cancel an order or accelerate or postpone currently scheduled delivery dates. Our backlog may be affected by the tendency of customers to rely on short lead times available from suppliers, including us, in periods of depressed demand. In periods of increased demand, there is a tendency towards longer lead times that has the effect of increasing backlog. As a result, our backlog at a particular date is not necessarily indicative of sales for any future period.

Net Revenues

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

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

	Years Ended December 31,		Change	
	2016	2015	\$	%
Net revenues:				
Thermal Products	\$24,033	\$24,084	\$ (51)	-%
Mechanical Products	8,309	7,539	770	10
	<u>7,885</u>	<u>7,266</u>	<u>619</u>	<u>9</u>
Electrical Products				
	<u>\$40,227</u>	<u>\$38,889</u>	<u>\$1,338</u>	<u>3</u>
				%
ATE market	\$28,045	\$28,238	\$ (193)	(1)%
	<u>12,182</u>	<u>10,651</u>	<u>1,531</u>	<u>14</u>
Non-ATE market				
	<u>\$40,227</u>	<u>\$38,889</u>	<u>\$1,338</u>	<u>3</u>
				%

Total consolidated net revenues for the year ended December 31, 2016 were \$40.2 million compared to \$38.9 million for 2015, reflecting the aforementioned strengthening in demand within the ATE market, primarily for our Mechanical and Electrical Products segments. While our Thermal Products segment experienced an increase in demand from its non-ATE market customers during 2016 as compared to 2015, this increase was offset by declines in demand from this segment's customers in the ATE market. Historically, the impact of shifts in demand within the ATE market for our Thermal Products segment have frequently lagged the impact of such shifts in demand on our Mechanical and Electrical Products segments. We believe this is the case at present and that the decline in the net revenues of our Thermal Products segment from the ATE market during 2016 reflects the seasonal decline in demand that impacted our other two products segments during most of

2015 and into the first half of 2016.

The increased demand from non-ATE market customers during 2016 as compared to 2015 was primarily from certain customers in the telecommunications market and was partially offset by declines in demand from certain customers in the automotive and industrial markets. As a percent of our total consolidated net revenues, net revenues from customers in non-ATE markets were 30% in 2016 compared to 27% in 2015.

Product/Customer Mix

Our three product segments each have multiple products that we design, manufacture and market to our customers. Due to a number of factors, our products have varying levels of gross margin. The mix of products we sell in any period is ultimately determined by our customers' needs. Therefore, the mix of products sold in any given period can change significantly from the prior period. As a result, our consolidated gross margin can be significantly impacted in any given period by a change in the mix of products sold in that period.

We sell most of our products to semiconductor manufacturers and third-party test and assembly houses (end user sales) and to ATE manufacturers (OEM sales) who ultimately resell our equipment with theirs to both semiconductor manufacturers and third-party test and assembly houses. Our Thermal Products segment also sells into a variety of other markets including the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. The mix of customers during any given period will affect our gross margin due to differing sales discounts and commissions. For both of the years ended December 31, 2016 and 2015, our OEM sales as a percentage of net revenues were 6%.

OEM sales generally have a lower gross margin than end user sales, as OEM sales historically have had a more significant discount. Our current net operating margins on most OEM sales, however, are only slightly less than margins on end user sales because of the payment of third party sales commissions on most end user sales. We have also continued to experience demands from our OEM customers' supply chain managers to reduce our sales prices to them. If we cannot further reduce our manufacturing and operating costs, these pricing pressures will negatively affect our gross and operating margins.

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations

The results of operations for our three product segments are generally affected by the same factors. Separate discussions and analyses for each product segment would be repetitive 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 product segment where significant to an understanding of that segment.

Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

Net Revenues. Net revenues were \$40.2 million for the year ended December 31, 2016 compared to \$38.9 million for the same period in 2015, an increase of \$1.3 million or 3%. For the year ended December 31, 2016, the net revenues of our Mechanical and Electrical Products segments increased \$770,000 or 10% and \$619,000 or 9%, respectively, while the net revenues of our Thermal Products segment were relatively unchanged. We believe the increase in our consolidated net revenues during 2016 primarily reflects the factors previously discussed in the Overview.

Gross Margin. Gross margin was 51% for the year ended December 31, 2016 compared to 48% for the same period in 2015. The improvement in gross margin was primarily the result of a \$559,000 reduction in our fixed operating costs in 2016 as compared to 2015. This decrease reflects a reduction in staff in our Mechanical Products segment and lower facilities related costs in our Thermal and Mechanical Products segments. The headcount reduction in our Mechanical Products segment was the result of the workforce reduction that we implemented on January 4, 2016, as discussed further in Note 3 to our consolidated financial statements. To a lesser extent, there was also a decrease in depreciation expense as a result of fewer equipment rental units on hand during 2016. In addition to the decrease in the absolute dollar value of our fixed operating costs, these costs were also more fully absorbed due to the higher net revenue levels in 2016 as compared to 2015. As a percentage of net revenues, our fixed operating costs decreased from 15% in 2015 to 13% in 2016. To a lesser extent, the improvement in gross margin during 2016 as compared to 2015 also reflects a reduction in our charges for obsolete and excess inventory and lower direct labor costs, reflecting headcount reductions in our Mechanical Products segment.

Selling Expense. Selling expense was \$5.6 million for the year ended December 31, 2016 compared to \$5.8 million for the same period in 2015, a decrease of \$230,000 or 4%. The decrease in selling expense primarily reflects a reduction in staff in our Mechanical Products segment and lower levels of commissions as a result of changes in customer mix in our Thermal Products segment. These decreases were partially offset by an increase in warranty expense.

Engineering and Product Development Expense. Engineering and product development expense was \$3.7 million for the year ended December 31, 2016 compared to \$3.9 million for the same period in 2015, a decrease of \$275,000 or 7%. The decrease in engineering and product development expense primarily reflects a reduction in staff in our Mechanical Products segment and lower spending on materials used in our research and development activities in all of our product segments.

General and Administrative Expense. General and administrative expense was \$7.0 million for the year ended December 31, 2016 compared to \$6.4 million for the same period in 2015, an increase of \$601,000 or 9%. Our expenses for 2016 included \$510,000 for due diligence and transaction-related costs associated with a potential acquisition which we are no longer pursuing and \$99,000 of restructuring charges as a result of the aforementioned workforce reduction implemented on January 4, 2016. Our expenses for 2015 included \$329,000 for due diligence and transaction-related costs associated with a potential acquisition which did not close. Adjusted to exclude these costs, our general and administrative expense would have increased \$321,000, or 5%, for 2016 as compared to 2015. The \$321,000 increase primarily reflects higher salary and benefits expense as a result of changes in compensation structure for our executive management team, an increase in stock-based compensation expense as a result of the vesting of restricted stock awards for our independent directors which occurred upon their re-election at our annual meeting of stockholders in June 2016, and a higher level of profit-based bonuses accrued on our results for 2016. These increases were partially offset by a reduction in the use of certain third-party professionals that assist us with various compliance related matters.

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Income Tax Expense.

For the year ended December 31, 2016, we recorded income tax expense of \$1.5 million compared to \$722,000 for the same period in 2015. Our effective tax rate was 37% for 2016 compared to 28% for 2015. On a quarterly basis, we record income tax expense or benefit based on the expected annualized effective tax rate for the various taxing jurisdictions in which we operate our businesses. The increase in our effective tax rate in 2016 as compared to 2015 primarily reflects the federal tax implications of higher actual and deemed dividends from foreign affiliates during 2016.

Liquidity and Capital Resources

As discussed more fully in the Overview, our business and results of operations are substantially dependent upon the demand for ATE by semiconductor manufacturers and companies that specialize in the testing of ICs. The cyclical and volatile nature of demand for ATE makes estimates of future revenues, results of operations and net cash flows difficult.

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

Liquidity

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

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$28,611	\$25,710
Working capital	\$32,950	\$30,205

As of December 31, 2016, \$1.7 million of our cash and cash equivalents was held by our foreign subsidiaries. When these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. taxes if we repatriate certain of these funds. On July 26, 2016, we repatriated \$921,000 from our German subsidiary. Our effective tax rate for 2016 includes the effect of the additional taxes we expect to incur on these repatriated funds.

We currently expect our cash and cash equivalents and projected future cash flow to be sufficient to support our short-term working capital requirements and any future repurchases of shares under the 2015 Repurchase Plan (which is discussed more fully in Note 13 to our consolidated financial statements). However, we may need additional financial resources to consummate a significant acquisition if the consideration in such a transaction would require us to utilize a substantial portion of, or an amount equal to or in excess of, our

available cash. We do not currently have any credit facilities under which we can borrow to help fund our working capital or other requirements.

Cash Flows

Operating Activities. Net cash provided by operations for the year ended December 31, 2016 was \$4.3 million. During 2016, we recorded net earnings of \$2.7 million, which included non-cash charges of \$599,000 for depreciation and amortization, \$269,000 for amortization of deferred compensation related to stock-based awards and \$226,000 for excess and obsolete inventory charges. During 2016, accounts receivable, accounts payable and inventories increased \$1.0 million, \$459,000 and \$384,000, respectively, compared to the levels at the end of 2015, primarily reflecting the increased level of business activity in 2016. Domestic and foreign income taxes payable increased \$549,000 during 2016 reflecting the increase in our profits and reduced net operating loss carryforwards to offset the taxes due on these profits than were available to utilize during 2015. Prepaid expenses and other current assets decreased \$295,000 during 2016 primarily reflecting the application of a \$242,000 overpayment of federal income taxes during 2015 against our federal income taxes payable for 2016.

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Investing Activities.

During 2016, purchases of property and equipment were \$339,000 which primarily represent additions to leased systems in our Thermal Products segment and computer hardware and software purchases related to a system upgrade for our domestic operations. We have no significant commitments for capital expenditures for 2017; however, depending upon changes in market demand, we may make such purchases as we deem necessary and appropriate.

Financing Activities. During 2016, we utilized \$978,000 to repurchase 241,805 shares of our common stock under the 2015 Repurchase Plan.

New or Recently Adopted Accounting Standards

See Note 2 to the consolidated financial statements for information concerning the implementation and impact of new or recently adopted accounting standards.

Critical Accounting Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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 and deferred income tax valuation allowances. 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.

Inventory Valuation

Inventories are valued at cost on a first-in, first-out basis, not in excess of market value. On a quarterly basis, we review our inventories and record excess and obsolete inventory charges based upon our established objective excess and obsolete inventory criteria. These criteria identify material that has not been used in a work order during the prior twelve months and the quantity of material on hand that is greater than the average annual usage of that material over the prior three years. In certain cases, additional excess and obsolete inventory charges are recorded based upon current market conditions, anticipated product life cycles, new product introductions and expected future use of the inventory. The excess and obsolete inventory charges we record establish a new cost basis for the related inventories. During 2016 and 2015, we recorded inventory obsolescence charges for excess and obsolete inventory of \$226,000 and \$342,000, respectively.

Goodwill, Intangible and Long-Lived Assets

We account for goodwill and intangible assets in accordance with Accounting Standards Codification ("ASC") 350 (Intangibles- Goodwill and Other). Finite-lived intangible assets are amortized over their estimated useful economic life and are carried at cost less accumulated amortization. Goodwill is assessed for impairment at least annually in the fourth quarter, on a reporting unit basis, or more frequently when events and circumstances occur indicating that the recorded goodwill may be impaired. As a part of the goodwill impairment assessment, we have the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount. If we determine this is the case, we are required to perform a two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized. The two-step test is discussed below. If we determine that it is more-likely-than-not that the fair value of the reporting unit is greater than its carrying amounts, the two-step goodwill impairment test is not required.

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Item 7.

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

If we determine it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a result of our qualitative assessment, we will perform a quantitative two-step goodwill impairment test. In the Step I test, the fair value of a reporting unit is computed and compared with its book value. If the book value of a reporting unit exceeds its fair value, a Step II test is performed in which the implied fair value of goodwill is compared with the carrying amount of goodwill. If the carrying amount of goodwill exceeds the implied fair value, an impairment loss is recorded in an amount equal to that excess. The two-step goodwill

impairment assessment is based upon a combination of the income approach, which estimates the fair value of our reporting units based upon a discounted cash flow approach, and the market approach which estimates the fair value of our reporting units based upon comparable market multiples. This fair value is then reconciled to our market capitalization at year end with an appropriate control premium. The determination of the fair value of our reporting units requires management to make significant estimates and assumptions including the selection of appropriate peer group companies, control premiums, discount rate, terminal growth rates, forecasts of revenue and expense growth rates, income tax rates, changes in working capital, depreciation, amortization and capital expenditures. Changes in assumptions concerning future financial results or other underlying assumptions could have a significant impact on either the fair value of the reporting unit or the amount of the goodwill impairment charge. As of December 31, 2016 and 2015, goodwill was \$1.7 million. We did not record any impairment charges related to our goodwill during 2016 or 2015.

Indefinite-lived intangible assets are assessed for impairment at least annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. As a part of the impairment assessment, we have the option to perform a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. If, as a result of our qualitative assessment, we determine that it is more-likely-than-not that the fair value of the indefinite-lived intangible asset is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The quantitative impairment test consists of a comparison of the fair value of the intangible asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. As of December 31, 2016 and 2015, our indefinite-lived intangible asset was a trademark carried at \$510,000. We did not record any impairment charges related to our indefinite-lived intangible asset during 2016 or 2015.

Long-lived assets, which consist of finite-lived intangible assets and property and equipment, are assessed for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. Each impairment test is based on a comparison of the estimated undiscounted cash flows to the recorded value of the asset. If impairment is indicated, the asset is written down to its estimated fair value. The cash flow estimates used to determine the impairment, if any, contain management's best estimates using appropriate assumptions and projections at that time. At December 31, 2016 and 2015, finite-lived intangibles and long-lived assets were \$1.3 million and \$1.7 million, respectively. We did not record any impairment charges related to our long-lived assets during 2016 or 2015.

Income Taxes

Deferred tax assets are analyzed to determine if there will be sufficient taxable income in the future in order to realize such assets. We assess all of the positive and negative evidence concerning the realizability of the deferred tax assets, including our historical results of operations for the recent past and our projections of future results of operations, in which we make subjective determinations of future events. If, after assessing all of the evidence, both positive and negative, a determination is made that the realizability of the deferred tax assets is not more likely than not, we establish a deferred tax valuation allowance for all or a portion of the deferred tax assets depending upon the specific facts. If any of the significant assumptions were changed, materially different results could occur, which could significantly change the amount of the deferred tax valuation allowance established. As of December 31, 2016 and 2015, we had a net deferred tax asset of \$1.1 million and \$1.2 million, respectively, and a deferred tax valuation allowance of \$0 and \$15,000, respectively.

Off -Balance Sheet Arrangements

There were no off-balance sheet arrangements during the year ended December 31, 2016 that have or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition,

revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our interests.

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Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

This disclosure is not required for a smaller reporting company.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Consolidated financial statements are set forth in this Report beginning at page F-1 and are incorporated by reference into this Item 8.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Exchange Act. Because there are inherent limitations in all control systems, 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. 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. 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. 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. 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.

Changes in Internal Control Over Financial Reporting

During the period covered by this Report, there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

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Item 9A. CONTROLS AND PROCEDURES (Continued)

1. Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2016. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control-Integrated 2013 Framework. Based upon this assessment, management believes that, as of December 31, 2016, our internal control over financial reporting is effective at a reasonable assurance level.

This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting, as such an attestation is not required pursuant to rules of the Securities and Exchange Commission applicable to smaller reporting companies.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated by reference from our definitive proxy statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC on or before May 1, 2017, or, if our proxy statement is not filed on or before May 1, 2017, will be filed by that date by an amendment to this Form 10-K.

Item 11.

EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from our definitive proxy statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC on or before May 1, 2017, or, if our proxy statement is not filed on or before May 1, 2017, will be filed by that date by an amendment to this Form 10-K.

Item 12.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 201(d) of Regulation S-K is set forth below. The remainder of the information required by this Item 12 is incorporated by reference from our definitive proxy statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC on or before May 1, 2017, or, if our proxy statement is not filed on or before May 1, 2017, will be filed by that date by an amendment to this Form 10-K.

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Item 12.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS (Continued)

The following table shows the number of securities that may be issued pursuant to our equity compensation plans (including individual compensation arrangements) as of December 31, 2016:

Condensed Consolidated Balance Sheet Data:

Equity Compensation Plan Information

<u>Plan Category</u>	Number of securities to be issued upon exercise of outstanding options, <u>warrants and rights(1)</u>	Weighted-average exercise price of outstanding options, <u>warrants and rights</u>	Number of securities remaining available for future issuance under equity compensation <u>plans(2)</u>
Equity compensation plans approved by security holders	19,800	\$4.37	456,300
Equity compensation plans not approved by security holders	—	—	—
Total	<u>19,800</u>	<u>\$4.37</u>	<u>456,300</u>

- (1) The securities that may be issued are shares of inTEST common stock, issuable upon exercise of outstanding stock options.
- (2) The securities that remain available for future issuance are issuable pursuant to the 2014 Stock Plan.

Item 13.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference from our definitive proxy statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC on or before May 1, 2017, or, if our proxy statement is not filed on or before May 1, 2017, will be filed by that date by an amendment to this Form 10-K.

Item 14.

PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated by reference from our definitive proxy statement for our 2017 Annual Meeting of Stockholders to be filed with the SEC on or before May 1, 2017, or, if our proxy statement is not filed on or before May 1, 2017, will be filed by that date by an amendment to this Form 10-K.

PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

- (a) The documents filed as part of this Annual Report on Form 10-K are:

Condensed Consolidated Balance Sheet Data:

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(i) Our consolidated financial statements and notes thereto as well as the applicable report of our independent registered public accounting firm are included in Part II, Item 8 of this Annual Report on Form 10-K.

(ii) The following financial statement schedule should be read in conjunction with the consolidated financial statements set forth in Part II, Item 8 of this Annual Report on Form 10-K:

Schedule II -- Valuation and Qualifying Accounts

(iii) The exhibits required by Item 601 of Regulation S-K are included under Item 15(b) of this Annual Report on Form 10-K.

(b) Exhibits required by Item 601 of Regulation S-K:

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

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Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

inTEST Corporation

March 27, 2017

By: /s/ Robert E. Matthiessen

Robert E. Matthiessen

President and Chief Executive Officer

Pursuant to the requirements of Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Robert E. Matthiessen

March 27, 2017

Robert E. Matthiessen, President,
Chief Executive Officer and Director
(Principal Executive Officer)

/s/ Hugh T. Regan, Jr.

March 27, 2017

Hugh T. Regan, Jr., Treasurer, Chief
Financial Officer and Secretary
(Principal Financial Officer)

/s/ Alyn R. Holt

March 27, 2017

Alyn R. Holt, Executive Chairman

/s/ Steven J. Abrams

March 27, 2017

Steven J. Abrams, Esq., Director

/s/ Joseph W. Dews IV

March 27, 2017

Joseph W. Dews IV, Director

/s/ William Kraut

March 27, 2017

William Kraut, Director

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Index to Exhibits

Exhibit Number	Description of Exhibit
3.1	Certificate of Incorporation. (1)
3.2	Bylaws as amended on June 23, 2014. (2)

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- 10.1 Lease Agreement between Exeter 804 East Gate, LLC and the Company dated May 10, 2010. (3)
- 10.2 Lease Agreement between AMB-SGP Seattle/Boston, LLC and Temptronic Corporation (a subsidiary of the Company), dated October 25, 2010. (4)
- 10.3 Lease Agreements between Columbia California Warm Springs Industrial, LLC and inTEST Silicon Valley Corporation dated January 9, 2012. (5)
- 10.4 First Amendment to Lease Agreement between Columbia California Warm Springs Industrial, LLC and inTEST Silicon Valley Corporation dated November 18, 2016. (6)
- 10.5 Guaranty Agreements between Columbia California Warm Springs Industrial, LLC and inTEST Corporation dated January 9, 2012. (5)
- 10.6 inTEST Corporation 2014 Stock Plan (7)(*)
- 10.7 inTEST Corporation 2007 Stock Plan. (8)(*)
- 10.8 Form of Restricted Stock Award Agreement. (9)(*)
- 10.9 Form of Non-Qualified Stock Option Agreement. (9)(*)
- 10.10 Form of Incentive Stock Option Agreement. (9)(*)
- 10.11 Change of Control Agreement dated August 27, 2007 between the Company and Robert E. Matthiessen. (10)(*)
- 10.12 Change of Control Agreement dated August 27, 2007 between the Company and Hugh T. Regan, Jr. (10)(*)
- 10.13 Change of Control Agreement dated May 5, 2008 between the Company and James Pelrin. (11)(*)
- 10.14 Amendment to Change of Control Agreement dated December 31, 2008 between the Company and Robert E. Matthiessen. (12)(*)
- 10.15 Amendment to Change of Control Agreement dated December 31, 2008 between the Company and Hugh T. Regan, Jr. (12)(*)
- 10.16 Amendment to Change of Control Agreement dated December 31, 2008 between the Company and James Pelrin. (12)(*)
- 10.17 Compensatory Arrangements of Executive Officers and Directors. (*) (13)
- 14 Code of Ethics. (14)
- 21 Subsidiaries of the Company.
- 23 Consent of RSM US LLP.
- 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 Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Index to Exhibits

(Continued)

- (1) Previously filed by the Company as an exhibit to the Company's Registration Statement on Form S-1, File No. 333-26457 filed May 2, 1997, and incorporated herein by reference.
- (2) Previously filed by the Company as an exhibit to the Company's Form 8-K dated June 23, 2014, File No. 001-36117, filed June 25, 2014, and incorporated herein by reference.
- (3) Previously filed by the Company as an exhibit to the Company's Form 8-K dated May 10, 2010, File No. 000-22529, filed May 13, 2010, and incorporated herein by reference.
- (4) Previously filed by the Company as an exhibit to the Company's Form 8-K dated October 27, 2010, File No. 000-22529, filed October 29, 2010, and incorporated herein by reference.
- (5) Previously filed by the Company as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 2012, File No. 000-22529, filed May 15, 2012, and incorporated herein by reference.
- (6) Previously filed by the Company as an exhibit to the Company's Form 8-K dated November 18, 2016, File No. 001-36117, filed November 22, 2016, and incorporated herein by reference.
- (7) Previously filed as an appendix to the Company's Proxy Statement filed April 30, 2014, and incorporated herein by reference.
- (8) Previously filed as an appendix to the Company's Proxy Statement filed April 27, 2007, and incorporated herein by reference.
- (9) Previously filed by the Company as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 2016, File No. 001-36117, filed May 13, 2016, and incorporated herein by reference.
- (10) Previously filed by the Company as an exhibit to the Company's Form 10-K for the year ended December 31, 2007, File No. 000-22529, filed March 31, 2008, and incorporated herein by reference.
- (11) Previously filed by the Company as an exhibit to the Company's Form 10-Q for the quarter ended June 30, 2008, File No. 000-22529, filed August 14, 2008, and incorporated herein by reference.
- (12) Previously filed by the Company as an exhibit to the Company's Form 10-Q for the quarter ended June 30, 2009, File No. 000-22529, filed August 14, 2009, and incorporated herein by reference.
- (13) Portions of this exhibit were previously filed on the Company's Current Report on Form 8-K dated March 15, 2017, File No. 001-36117, filed March 20, 2017, and incorporated herein by reference.
- (14) Previously filed by the Company as an exhibit to the Company's Form 10-Q for the quarter ended June 30, 2016, File No. 001-36117, filed August 12, 2016, and incorporated herein by reference.

- (*) Indicates a management contract or compensatory plan, contract or arrangement in which a director or executive officers participate.

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inTEST CORPORATION

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FINANCIAL STATEMENT SCHEDULE

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To The Board of Directors and Stockholders
inTEST Corporation

We have audited the accompanying consolidated balance sheets of inTEST Corporation and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive earnings, stockholders' equity, and cash flows for the years then ended. Our audits also included the financial statement schedule of inTEST Corporation listed in Item 15(a). These financial statements and financial statement schedule are

the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of inTEST Corporation and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ RSM US LLP

Blue Bell, Pennsylvania
March 27, 2017

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inTEST CORPORATION
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31,	
	2016	2015
ASSETS:		
Current assets:		
Cash and cash equivalents	\$28,611	\$25,710
Trade accounts receivable, net of allowance for doubtful accounts of \$146 and \$146, respectively	5,377	4,395
Inventories	3,676	3,520
Prepaid expenses and other current assets	342	639
Total current assets	<u>38,006</u>	<u>34,264</u>
Property and equipment:		
Machinery and equipment	4,383	4,377
Leasehold improvements	603	603
Gross property and equipment	4,986	4,980
Less: accumulated depreciation	(4,042)	(3,868)
Net property and equipment	<u>944</u>	<u>1,112</u>
Deferred tax assets	1,110	1,245
Goodwill	1,706	1,706
Intangible assets, net	875	1,104
Restricted certificates of deposit	175	350
Other assets	28	203
Total assets	<u>\$42,844</u>	<u>\$39,984</u>
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,368	\$ 909
Accrued wages and benefits	1,588	1,466
Accrued rent	572	657
Accrued professional fees	419	363
Accrued sales commissions	287	297
Domestic and foreign income taxes payable	575	26
Other current liabilities	247	341
Total current liabilities	<u>5,056</u>	<u>4,059</u>
Commitments and Contingencies (Notes 9 and 11)		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 5,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock, \$0.01 par value; 20,000,000 shares authorized; 10,394,018 and 10,549,423 shares issued, respectively	104	105
Additional paid-in capital	25,578	26,286
Retained earnings	11,671	9,013
Accumulated other comprehensive earnings	639	725
Treasury stock, at cost; 33,077 and 33,077 shares, respectively	(204)	(204)
Total stockholders' equity	<u>37,788</u>	<u>35,925</u>
Total liabilities and stockholders' equity	<u>\$42,844</u>	<u>\$39,984</u>
	=====	=====

See accompanying Notes to Consolidated Financial Statements.

inTEST CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

	Years Ended December 31,	
	2016	2015
Net revenues	\$40,227	\$38,889
Cost of revenues	<u>19,849</u>	<u>20,191</u>
Gross margin	<u>20,378</u>	<u>18,698</u>
Operating expenses:		
Selling expense	5,567	5,797
Engineering and product development expense	3,660	3,935
General and administrative expense	<u>7,005</u>	<u>6,404</u>
Total operating expenses	<u>16,232</u>	<u>16,136</u>
Operating income	4,146	2,562
Other income	<u>61</u>	<u>21</u>
Earnings before income tax expense	4,207	2,583
Income tax expense	<u>1,549</u>	<u>722</u>
Net earnings	\$ 2,658	\$ 1,861
	=====	=====
Net earnings per common share - basic	\$0.26	\$0.18
Weighted average common shares outstanding - basic	10,313,747	10,473,210
Net earnings per common share - diluted	\$0.26	\$0.18
Weighted average common shares and common share equivalents outstanding - diluted	10,332,920	10,493,830

See accompanying Notes to Consolidated Financial Statements.

inTEST CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)

	Years Ended December 31,	
	2016	2015
Net earnings	\$ 2,658	\$ 1,861

Condensed Consolidated Balance Sheet Data:

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Foreign currency translation adjustments	<u>(86)</u>	<u>(268)</u>
Comprehensive earnings	\$ 2,572 =====	\$ 1,593 =====

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share data)

	Common Stock		Additional	Retained	Accumulated		Total
	Shares	Amount	Paid-In	Earnings	Other	Treasury	Stockholder
	-----	-----	-----	-----	Comprehensive	Stock	Equity
	-----	-----	-----	-----	Earnings	-----	-----
Balance, January 1, 2015	10,595,755	\$ 106	\$26,321	\$ 7,152	\$ 993	\$ (204)	\$34,368
Net earnings	-	-	-	1,861	-	-	1,861
Other comprehensive loss	-	-	-	-	(268)	-	(268)
Amortization of deferred compensation related to stock-based awards	-	-	119	-	-	-	119
Forfeiture of unvested shares of restricted stock	(5,000)	-	-	-	-	-	-
Repurchase and retirement of common stock	(41,332)	(1)	(154)	-	-	-	(155)
	-----	-----	-----	-----	-----	-----	-----
Balance, December 31, 2015	10,549,423	105	26,286	9,013	725	(204)	35,925
Net earnings	-	-	-	2,658	-	-	2,658
Other comprehensive loss	-	-	-	-	(86)	-	(86)
Amortization of deferred compensation related to stock-based awards	-	-	269	-	-	-	269
Issuance of unvested shares of restricted stock	86,400	1	(1)	-	-	-	-
Repurchase and retirement of common stock	(241,805)	(2)	(976)	-	-	-	(978)
	-----	-----	-----	-----	-----	-----	-----
Balance, December 31, 2016	10,394,018	\$ 104	\$25,578	\$11,671	\$ 639	\$ (204)	\$37,788
	=====	=====	=====	=====	=====	=====	=====

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Years Ended December 31,	
	2016	2015
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	\$ 2,658	\$ 1,861
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	599	754
Provision for excess and obsolete inventory	226	342
Foreign exchange loss	16	33
Amortization of deferred compensation related to stock-based awards	269	119
Loss on sale of property and equipment	-	15
Proceeds from sale of demonstration equipment, net of gain	129	214
Deferred income tax expense	135	168
Changes in assets and liabilities:		
Trade accounts receivable	(1,009)	570
Inventories	(384)	(113)
Prepaid expenses and other current assets	295	(174)
Restricted certificates of deposit	175	-
Other assets	178	(15)

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Accounts payable	459	(324)
Accrued wages and benefits	126	(36)
Accrued rent	(85)	42
Accrued professional fees	57	(25)
Accrued sales commissions	(10)	(31)
Domestic and foreign income taxes payable	549	4
Other current liabilities	(95)	94
	-----	-----
Net cash provided by operating activities	4,288	3,498
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(339)	(599)
	-----	-----
Net cash used in investing activities	(339)	(599)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Repurchases of common stock	(978)	(155)
	-----	-----
Net cash used in financing activities	(978)	(155)
	-----	-----
Effects of exchange rates on cash	(70)	(160)
	-----	-----
Net cash provided by all activities	2,901	2,584
Cash and cash equivalents at beginning of period	25,710	23,126
	-----	-----
Cash and cash equivalents at end of period	\$28,611	\$25,710
	=====	=====
Cash payments for:		
Domestic and foreign income taxes	\$ 635	\$ 792
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of unvested shares of restricted stock	\$ 369	\$ -
Forfeiture of unvested shares of restricted stock	\$ -	\$ (20)

See accompanying Notes to Consolidated Financial Statements.

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inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(1) NATURE OF OPERATIONS

Condensed Consolidated Balance Sheet Data:

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We are an independent designer, manufacturer and marketer of thermal, mechanical and electrical products that are primarily used by semiconductor manufacturers in conjunction with automatic test equipment ("ATE") in the testing of integrated circuits ("ICs" or "semiconductors"). We also market our thermal products in markets outside the ATE market, such as the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets.

The consolidated entity is comprised of inTEST Corporation (parent) and our wholly-owned subsidiaries. We have three reportable segments, which are also our reporting units: Thermal Products, Mechanical Products and Electrical Products. We manufacture our products in the U.S. Marketing and support activities are conducted worldwide from our facilities in the U.S., Germany and Singapore.

The semiconductor market in which we operate is characterized by rapid technological change, competitive pricing pressures and cyclical as well as seasonal market patterns. This market is subject to significant economic downturns at various times. Our financial results are affected by a wide variety of factors, including, but not limited to, general economic conditions worldwide and in the markets in which we operate, economic conditions specific to the semiconductor market and the other markets we serve, our ability to safeguard patented technology and intellectual property in a rapidly evolving market, downward pricing pressures from customers, and our reliance on a relatively few number of customers for a significant portion of our sales. In addition, we are exposed to the risk of obsolescence of our inventory depending on the mix of future business and technological changes within the markets that we serve. In January 2016, we implemented a workforce reduction, as discussed further in Note 3, which was a key element in restructuring our Mechanical Products segment with the goal of returning this segment to profitability. These efforts were substantially completed during 2016 and we did not incur any further significant costs associated with these efforts. We also continue to implement an acquisition strategy that may cause us to incur substantial expense in reviewing and evaluating potential transactions. We may or may not be successful in locating suitable businesses to acquire. In addition, if we are able to complete an acquisition, we may not be able to successfully integrate the acquired business with our existing business and we may not be able to operate the acquired business profitably. As a result of these or other factors, we may experience significant period-to-period fluctuations in future operating results.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Use of Estimates

The accompanying consolidated financial statements include our accounts and those of our wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated upon consolidation. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain of our accounts, including inventories, long-lived assets, goodwill, identifiable intangibles and deferred tax assets and liabilities including related valuation allowances, are particularly impacted by estimates.

Reclassification

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

Cash and Cash Equivalents

Short-term investments that have maturities of three months or less when purchased are considered to be cash equivalents and are carried at cost, which approximates market value. Our cash balances, which are deposited with highly reputable financial institutions, at times may exceed the federally insured limits. We have not experienced any losses related to these cash balances and believe the credit risk to be minimal.

inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Trade Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. We grant credit to customers and generally require no collateral. To minimize our risk, we perform ongoing credit evaluations of our customers' financial condition. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable. We determine the allowance based on historical write-off experience and the aging of such receivables, among other factors. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. We do not have any off-balance sheet credit exposure related to our customers. There was no bad debt expense recorded in either of the years ended December 31, 2016 or 2015. Cash flows from accounts receivable are recorded in operating cash flows.

Fair Value of Financial Instruments

Our financial instruments, principally accounts receivable and accounts payable, are carried at cost which approximates fair value, due to the short maturities of the accounts.

Inventories

Inventories are valued at cost on a first-in, first-out basis, not in excess of market value. Cash flows from the sale of inventories are recorded in operating cash flows. On a quarterly basis, we review our inventories and record excess and obsolete inventory charges based upon our established objective excess and obsolete inventory criteria. These criteria identify material that has not been used in a work order during the prior twelve months and the quantity of material on hand that is greater than the average annual usage of that material over the prior three years. In certain cases, additional excess and obsolete inventory charges are recorded based upon current market conditions, anticipated product life cycles, new product introductions and expected future use of the inventory. The excess and obsolete inventory charges we record establish a new cost basis for the related inventories. We incurred excess and obsolete inventory charges of \$226 and \$342 for the years ended December 31, 2016 and 2015, respectively.

Property and Equipment

Machinery and equipment are stated at cost. As further discussed below under "Goodwill, Intangible and Long-Lived Assets," machinery and equipment that has been determined to be impaired is written down to its fair value at the time of the impairment. Depreciation is based upon the estimated useful life of the assets using the straight-line method. The estimated useful lives range from one to ten years. Leasehold improvements are recorded at cost and amortized over the shorter of the lease term or the estimated useful life of the asset. Total depreciation expense was \$370 and \$465 for the years ended December 31, 2016 and 2015, respectively.

Goodwill, Intangible and Long-Lived Assets

We account for goodwill and intangible assets in accordance with Accounting Standards Codification ("ASC") 350 (Intangibles - Goodwill and Other). Finite-lived intangible assets are amortized over their estimated useful economic life and are carried at cost less accumulated amortization. Goodwill is assessed for impairment annually in the fourth quarter on a reporting unit basis, or more frequently when events and circumstances occur indicating that the recorded goodwill may be impaired. As a part of the goodwill impairment assessment, we have the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount. If we determine this is the case, we are required to perform a two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized. The two-step test is discussed below. If we determine that it is more-likely-than-not that the fair value of the reporting unit is greater than its carrying amounts, the two-step goodwill impairment test is not

required.

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(2)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Long-lived assets, which consist of finite-lived intangible assets and property and equipment, are assessed for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. Each impairment test is based on a comparison of the estimated undiscounted cash flows to the recorded value of the asset. If impairment is indicated, the asset is written down to its estimated fair value. The cash flow estimates used to determine the impairment, if any, contain management's best estimates using appropriate assumptions and projections at that time.

Stock-Based Compensation

We account for stock-based compensation in accordance with ASC Topic 718 (Compensation - Stock Compensation) which requires that employee share-based equity awards be accounted for under the fair value method and requires the use of an option pricing model for estimating fair value, which is then amortized to expense over the service periods. See further disclosures related to our stock-based compensation plans in Note 12.

Subsequent Events

We have made an assessment of our operations and determined that there were no material subsequent events requiring adjustment to, or disclosure in, our consolidated financial statements for the year ended December 31, 2016.

Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable, and collection of the related receivable is reasonably assured. Sales of our products are made through our sales employees, third-party sales representatives and distributors. There are no differences in revenue recognition policies based on the sales channel. We do not provide our customers with rights of return or exchanges. Revenue is generally recognized upon product shipment. Our customers' purchase orders do not typically contain any customer-specific acceptance criteria, other than that the product performs within the agreed upon specifications. We test all products manufactured as part of our quality assurance process to determine that they comply with specifications prior to shipment to a customer. To the extent that any customer purchase order contains customer-specific acceptance criteria, revenue recognition is deferred until customer acceptance.

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

With respect to sales tax collected from customers and remitted to governmental authorities, we use a net presentation in our consolidated statement of operations. As a result, there are no amounts included in either our net revenues or cost of revenues related to sales tax.

Product Warranties

We generally provide product warranties and record estimated warranty expense at the time of sale based upon historical claims experience. Warranty expense is included in selling expense in the consolidated

financial statements.

Engineering and Product Development

Engineering and product development costs, which consist primarily of the salary and related benefits costs of our technical staff, as well as the cost of materials used in product development, are expensed as incurred.

Foreign Currency

For our foreign subsidiary whose functional currency is not the U.S. dollar, assets and liabilities are translated using the exchange rate in effect at the balance sheet date. The results of operations are translated using an average exchange rate for the period. The effects of rate fluctuations in translating assets and liabilities of these international operations into U.S. dollars are included in accumulated other comprehensive earnings in stockholders' equity. Transaction gains or losses are included in net earnings. For the years ended December 31, 2016 and 2015, foreign currency transaction losses were \$16 and \$33, respectively.

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 years 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.

Net Earnings Per Common Share

Net earnings per common share - basic is computed by dividing net earnings by the weighted average number of common shares outstanding during each period. Net earnings per common share - diluted is computed by dividing net earnings by the weighted average number of common shares and common share equivalents outstanding during each period. Common share equivalents represent unvested shares of restricted stock and stock options and are calculated using the treasury stock method. Common share equivalents are excluded from the calculation if their effect is anti-dilutive.

The table below sets forth, for the periods indicated, a reconciliation of weighted average common shares outstanding - basic to weighted average common shares and common share equivalents outstanding - diluted and the average number of potentially dilutive securities that were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive:

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inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

	<u>Years Ended December</u>	
	<u>31,</u>	
	<u>2016</u>	<u>2015</u>
Weighted average common shares outstanding - basic	10,313,747	10,473,210
Potentially dilutive securities:		
Unvested shares of restricted stock and employee stock options	<u>19,173</u>	<u>20,620</u>
Weighted average common shares outstanding - diluted	<u>10,332,920</u>	<u>10,493,830</u>
Average number of potentially dilutive securities excluded from calculation	18,658	-

Effect of Recently Adopted Amendments to Authoritative Accounting Guidance

In November 2015, the Financial Accounting Standards Board (the "FASB") issued amendments to update the current guidance on the balance sheet classification of deferred taxes which is presented in ASC Topic 740 (Income Taxes). The purpose of the amendments is to simplify the presentation of deferred tax assets. This guidance requires deferred tax assets and liabilities, along with related valuation allowances, to be classified as noncurrent on the balance sheet. As a result, each tax jurisdiction will now only have one net noncurrent deferred tax asset or liability. The new guidance does not change the existing requirement that prohibits offsetting deferred tax liabilities from one jurisdiction against deferred tax assets of another jurisdiction. The amendments are effective for us as of January 1, 2017. Early application is permitted. We elected early application of this guidance effective January 1, 2016. The implementation of these amendments did not have a material impact on our consolidated financial statements. Prior year amounts have been reclassified to be consistent with the current year presentation.

Effect of Recently Issued Amendments to Authoritative Accounting Guidance

In January 2017, the FASB issued amendments to the guidance on accounting for goodwill impairment. The amendments simplify the accounting for goodwill impairment by removing Step II of the goodwill impairment test, which requires a hypothetical purchase price allocation. Under the amendments, a goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The amendments will be applied prospectively and are effective for us as of January 1, 2020, with early application permitted beginning January 1, 2017. We do not expect the implementation of the amendments to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued amendments to clarify the current guidance on the definition of a business. The objective of the amendments is to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments are effective for us as of January 1, 2018 with early application permitted. We do not expect the implementation of these amendments to have a material impact on our consolidated financial statements.

In November 2016, the FASB issued amendments to the guidance on presentation of restricted cash within the

statement of cash flows. The amendments require that restricted cash be included within cash and cash equivalents on the statement of cash flows. The amendments are effective for us as of January 1, 2018, and are to be applied retrospectively. Early application is permitted. We do not expect the implementation of these amendments to have a material impact on our consolidated financial statements.

In March 2016, the FASB issued amendments to the current guidance on accounting for stock-based compensation issued to employees which is contained in ASC Topic 718 (Compensation - Stock Compensation). The new guidance simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments are effective for us as of January 1, 2017. Early application is permitted. We do not expect the implementation of these amendments to have a material impact on our consolidated financial statements.

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In February 2016, the FASB issued amendments to the current guidance on accounting for lease transactions, which is presented in ASC Topic 842 (Leases). The intent of the updated guidance is to increase transparency and comparability among organizations by requiring lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by leases and to disclose key information about leasing arrangements. Under the new guidance, a lessee will be required to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The amendments are effective for us as of January 1, 2019. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. We are currently evaluating the impact of the implementation of these amendments on our consolidated financial statements.

In July 2015, the FASB issued amendments to update the current guidance on the subsequent measurement of inventory, which is presented in ASC Topic 330 (Inventory). The purpose of the amendments is to simplify the subsequent measurement of inventory and reduce the number of potential outcomes. It applies to all inventory other than inventory measured using last-in, first-out or the retail inventory method. Current guidance requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less a normal profit margin. The updated guidance amends this to require that an entity measure inventory within the scope of the updated guidance at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The amendments are effective for us as of January 1, 2017. We do not expect the implementation of these amendments to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued new guidance on the recognition of revenue from contracts with customers. Subsequent to May, 2014, the FASB has issued additional clarifying guidance on certain aspects of this new guidance. This guidance is presented in ASC Topic 606 (Revenue from Contracts with Customers). This new guidance will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective.

Companies can use either the retrospective or cumulative effect transition method. In August 2015, the FASB deferred the effective date of this new guidance for one additional year. As a result, this new guidance is effective for us as of January 1, 2018. Early application is only permitted as of the prior effective date, which in our case would be as of January 1, 2017. We currently plan to implement this new guidance on January 1, 2018 with a cumulative adjustment to retained earnings as opposed to retrospectively adjusting prior periods. During the fourth quarter of 2016, we completed a preliminary review of all our revenue streams to identify any differences in timing, measurement or presentation of revenue recognition. Our implementation process is ongoing; however, based on the results of our assessment to date, we currently do not expect the implementation of this new guidance to have a significant impact on the timing or amount of revenue we recognize in any given period in comparison to the amount recognized under current guidance.

(3)

RESTRUCTURING CHARGES

In recent years, our Mechanical Products segment has experienced significant operating losses. We have undertaken actions at various times over the last few years to address these losses. On January 4, 2016, we implemented a workforce reduction which resulted in our recording a restructuring charge of \$99 in the first quarter of 2016, which is included in general and administrative expense in our statements of operations. This entire amount was paid out in the first quarter of 2016.

(4)

GOODWILL, INTANGIBLE AND LONG-LIVED ASSETS

Goodwill and intangible assets on our balance sheets are the result of our acquisitions of Sigma Systems Corp. ("Sigma") in October 2008 and Thermonics, Inc. ("Thermonics") in January 2012.

Goodwill

All of our goodwill is allocated to our Thermal Products segment. There were no changes in the amount of the carrying value of goodwill for the year ended December 31, 2016.

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inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(4) GOODWILL, INTANGIBLE AND LONG-LIVED ASSETS (Continued)

Intangible Assets

The following table provides further detail about our intangible assets as of December 31, 2016 and 2015:

	<u>December 31, 2016</u>		
	Gross Carrying <u>Amount</u>	Accumulated <u>Amortization</u>	Net Carrying <u>Amount</u>
Finite-lived intangible assets:			
Customer relationships	\$1,480	\$1,328	\$ 152
Patented technology	590	424	166
Software	270	223	47
Trade name	<u>140</u>	<u>140</u>	<u>-</u>
Total finite-lived intangible assets	<u>2,480</u>	<u>2,115</u>	<u>365</u>
Indefinite-lived intangible assets:			
Sigma trademark	<u>510</u>	<u>-</u>	<u>510</u>
Total intangible assets	<u>\$2,990</u>	<u>\$2,115</u>	<u>\$ 875</u>

	<u>December 31, 2015</u>		
	Gross Carrying <u>Amount</u>	Accumulated <u>Amortization</u>	Net Carrying <u>Amount</u>
Finite-lived intangible assets:			
Customer relationships	\$1,480	\$1,166	\$ 314
Patented technology	590	386	204
Software	270	196	74
Trade name	<u>140</u>	<u>138</u>	<u>2</u>
Total finite-lived intangible assets	<u>2,480</u>	<u>1,886</u>	<u>594</u>
Indefinite-lived intangible assets:			
Sigma trademark	<u>510</u>	<u>-</u>	<u>510</u>
Total intangible assets	<u>\$2,990</u>	<u>\$1,886</u>	<u>\$1,104</u>

We generally amortize our finite-lived intangible assets over their estimated useful lives on a straight-line basis, unless an alternate amortization method can be reliably determined. Any such alternate amortization

method would be based on the pattern in which the economic benefits of the intangible asset are expected to be consumed. None of our finite-lived assets have any residual value. The following table provides further information about the estimated useful lives of our finite-lived intangible assets as of December 31, 2016:

	Estimated <u>Useful</u> <u>Life</u>	Remaining Estimated Useful Life at <u>Dec. 31,</u> <u>2016</u>
	- - - - (in months) - - - -	
Finite-lived intangible assets resulting from the acquisition of Sigma:		
Customer relationships	72	-
Software	120	21.0
Patented technology	60	-
Finite-lived intangible assets resulting from the acquisition of Thermonics:		
Customer relationships	72	12.5
Trade name	48	-
Patented technology	132	72.5

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data)

(4) GOODWILL, INTANGIBLE AND LONG-LIVED ASSETS (Continued)

Total amortization expense for the years ended December 31, 2016 and 2015 was \$229 and \$289, respectively. The following table sets forth the estimated annual amortization expense for our finite-lived intangible assets for each of the next five years:

2017	\$212
	65
2018	
	39
2019	
	30
2020	
	15
2021	

Impairment of Goodwill and Indefinite Life Intangible Assets

During December 2016 and 2015, we assessed our goodwill and indefinite life intangible asset for impairment in accordance with the requirements of ASC Topic 350 (Intangibles - Goodwill and Other). Our goodwill impairment assessment is based upon a combination of the income approach, which estimates the fair value of our reporting units based upon a discounted cash flow approach, and the market approach which estimates the fair value of our reporting units based upon comparable market multiples. This fair value is then reconciled to our market capitalization at year end with an appropriate control premium. The discount rates used in 2016 and 2015 for the discounted cash flows were 18.5% and 20.0%, respectively. The selection of these rates was based upon our analysis of market based estimates of capital costs and discount rates. The peer companies used in the market approach operate in our market segment. The determination of the fair value of our reporting units requires management to make significant estimates and assumptions including the selection of appropriate peer group companies, control premiums, discount rate, terminal growth rates, forecasts of revenue and expense growth rates, income tax rates, changes in working capital, depreciation, amortization and capital expenditures. Changes in assumptions concerning future financial results or other underlying assumptions could have a significant impact on either the fair value of the reporting unit or the amount of the goodwill impairment charge.

During the goodwill impairment assessment in both 2016 and 2015, we performed a Step I test to identify potential impairment, in which the fair value of the Thermal Products reporting unit was compared with its book value. This assessment indicated no impairment existed as the fair value of this reporting unit was determined to exceed its carrying value.

During the indefinite life intangible asset impairment assessment in both 2016 and 2015, we compared the fair value of our intangible asset with its carrying amount. This assessment indicated no impairment existed as the fair value of the intangible assets exceeded their carrying values in both 2016 and 2015.

Impairment of Long-Lived Assets and Finite-lived Intangible Assets

As previously noted, our long-lived assets consist of our finite-lived intangible assets and property and equipment. During December 2015, due to continued operating losses experienced in our Mechanical Products segment, we assessed the long-lived assets of this segment for impairment. Our assessment indicated that the property and equipment that is allocated to this segment was not impaired. During 2016, the operations of the Mechanical Products segment were substantially restructured. However, as this segment still experienced an operating loss for 2016, we performed an assessment of the long-lived assets of this segment for impairment during December 2016. Our assessment indicated that the property and equipment that is allocated to this segment was not impaired. During 2016 and 2015, we did not review our Thermal and Electrical Products segment's long lived assets for impairment as there were no events or changes in business circumstances that would indicate an impairment might exist.

(5) MAJOR CUSTOMERS

During the years ended December 31, 2016 and 2015, Hakuto Co. Ltd., one of our distributors, accounted for 13% and 12% of our consolidated net revenues, respectively. These revenues were generated by our Thermal Products segment. During the year ended December 31, 2016, Texas Instruments Incorporated accounted for 10% of our consolidated net revenues. While all three of our operating segments sold products to this customer, these revenues were primarily generated by our Mechanical Products and Electrical Products segments. During the years ended December 31, 2016 and 2015, no other customer accounted for 10% or more of our consolidated net revenues.

(6) INVENTORIES

Inventories held at December 31 were comprised of the following:

	<u>2016</u>	<u>2015</u>
Raw materials	\$2,695	\$2,535
Work in process	728	295
Inventory consigned to others	81	119
Finished goods	<u>172</u>	<u>571</u>
Total inventories	<u>\$3,676</u>	<u>\$3,520</u>

(7) OTHER CURRENT LIABILITIES

Other current liabilities at December 31 were comprised of the following:

	<u>2016</u>	<u>2015</u>
Accrued warranty	\$125	\$ 94
Deferred revenue and customer deposits	74	173
Other	<u>48</u>	<u>74</u>
Total other current liabilities	<u>\$247</u>	<u>\$341</u>

(8) DEBTLetters of Credit

We have issued letters of credit as the security deposits for certain of our domestic leases. These letters of credit are secured by pledged certificates of deposit which are classified as Restricted Certificates of Deposit on our balance sheets. The terms of our leases require us to renew these letters of credit at least 30 days prior to their expiration dates for successive terms of not less than one year until lease expiration. Our outstanding letters of credit at December 31, 2016 and 2015 consisted of the following:

L/C	Lease
-----	-------

<u>Facility</u>	<u>Original L/C Issue Date</u>	<u>Expiration Date</u>	<u>Expiration Date</u>	<u>Letters of Credit Amount Outstanding</u>	
				<u>Dec. 31 2016</u>	<u>Dec. 31, 2015</u>
Mt. Laurel, NJ	3/29/2010	3/31/2018	4/30/2021	\$125 <u>50</u>	\$250 <u>100</u>
Mansfield, MA	10/27/2010	11/08/2017	8/31/2021	<u>\$175</u>	<u>\$350</u>

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data)

(9)

COMMITMENTS AND CONTINGENCIESOperating Lease Commitments

We lease our offices, warehouse facilities and certain equipment under non-cancellable operating leases which expire at various dates through 2021. Total rental expense for the years ended December 31, 2016 and 2015 was \$1,241 and \$1,351, respectively. Certain of our operating leases contain predetermined fixed escalations of minimum rentals and rent holidays during the original lease terms. Rent holidays are periods during which we have control of the leased facility but are not obligated to pay rent. For these leases, we recognize the related rental expense on a straight-line basis over the life of the lease, which includes any rent holiday, and record the difference between the amounts charged to operations and amounts paid as Accrued Rent on our balance sheet. In addition to the monthly rental payments due, most of our leases for our offices and warehouse facilities require us to pay our portion of the common area maintenance, property taxes and insurance charges incurred by the landlord for the facilities which we occupy. These amounts are not included in the minimum rental commitments disclosed below as they are based on actual charges incurred in the periods to which they apply.

The aggregate minimum rental commitments under the non-cancellable operating leases in effect at December 31, 2016 are as follows:

2017	\$1,164
2018	1,224
2019	1,216
2020	1,172
2021	<u>508</u>
Total	<u>\$5,284</u>

(10)

INCOME TAXES

We are subject to Federal and certain state income taxes. In addition, we are taxed in certain foreign countries. As of December 31, 2016 and 2015, there were no cumulative undistributed earnings of our foreign subsidiaries for which U.S. income taxes have not been provided.

Earnings before income taxes was as follows:

	Years Ended <u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Domestic	\$3,345	\$1,868
Foreign	<u>862</u>	<u>715</u>
Total	<u>\$4,207</u>	<u>\$2,583</u>

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(10) INCOME TAXES (Continued)

Income tax expense (benefit) was as follows:

Years Ended <u>December 31,</u>	
<u>2016</u>	<u>2015</u>

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Current

Domestic -- Federal	\$1,295	\$ 523
Domestic -- state	74	45
Foreign	<u>45</u>	<u>(14)</u>

)

Total	<u>\$1,414</u>	<u>\$ 554</u>
-------	----------------	---------------

Deferred

Domestic -- Federal	\$ (39)	\$ 12
Domestic -- state	10	(9)
Foreign	<u>164</u>	<u>165</u>

Total	<u>135</u>	<u>168</u>
-------	------------	------------

Income tax expense	<u>\$1,549</u>	<u>\$ 722</u>
--------------------	----------------	---------------

Deferred income taxes reflect the net tax effect of net operating loss and credit carryforwards as well as temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The following is a summary of the significant components of our deferred tax assets and liabilities as of December 31, 2016 and 2015:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Deferred tax assets:		
Depreciation of property and equipment	\$ 580	\$ 580
Intangibles	311	279
Inventories	182	186
Accrued vacation pay and stock-based compensation	161	151
Net operating loss ("NOL") (state and foreign)	71	264
Allowance for doubtful accounts	55	55
Acquisition costs	28	31
Accrued warranty	9	5
Other	<u>7</u>	<u>13</u>
Total	1,404	1,564
Valuation allowance	<u>-</u>	<u>(15)</u>
Deferred tax assets	<u>1,404</u>	<u>1,549</u>

Deferred tax liabilities:		
Net intangible assets	(212)	(222)
Unremitted earnings of foreign subsidiaries	<u>(82)</u>	<u>(82)</u>
	)	)
Deferred tax liabilities	<u>(294)</u>	<u>(304)</u>
	)	)
Net deferred tax assets	<u>\$1,110</u>	<u>\$1,245</u>

The net change in the valuation allowance for the years ended December 31, 2016 and 2015 were decreases of \$15 and \$85, respectively. In assessing the ability to realize the deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. In order to fully realize the total deferred tax assets, we will need to generate future taxable income prior to the expiration of net operating loss and credit carryforwards which expire in various years through 2036.

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(10) INCOME TAXES (Continued)

An analysis of the effective tax rate for the years ended December 31, 2016 and 2015 and a reconciliation from the expected statutory rate of 34% is as follows:

	<u>Years Ended</u> <u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Expected income tax provision at U.S. statutory rate	\$1,430	\$ 878
Increase (decrease) in tax from:		
Foreign income tax rate differences	(258)	(64)
Current year tax credits (foreign and research)	(140)	(207)
Domestic production activities deduction	(112)	(68)
Changes in valuation allowance	(15)	(85)

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Deemed dividend from foreign subsidiaries	396	151
NOL carryforwards utilized	180	99
Domestic tax expense, net of Federal benefit	55	33
Nondeductible expenses	14	15
Other	<u>(1)</u>	<u>(30)</u>
	)	)
Income tax expense	<u>\$1,549</u>	<u>\$ 722</u>

In accounting for income taxes, we follow the guidance in ASC Topic 740 (Income Taxes) regarding the recognition and measurement of uncertain tax positions in our financial statements. Recognition involves a determination of whether it is more likely than not that a tax position will be sustained upon examination with the presumption that the tax position will be examined by the appropriate taxing authority having full knowledge of all relevant information. Our policy is to record interest and penalties associated with unrecognized tax benefits as additional income taxes in the statement of operations. As of December 31, 2016 and 2015, we did not have an accrual for uncertain tax positions.

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, 2013 and thereafter are subject to examination by the relevant taxing authorities. During the first quarter of 2017, the U.S. taxing authority completed an examination of our federal income tax return for the year ended December 31, 2014 and there were no changes to the tax return as originally filed.

(11)

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 legal proceedings the resolution of which we believe could have a material effect on our business, financial position, results of operations or long-term liquidity.

(12) STOCK-BASED COMPENSATION PLAN

As of December 31, 2016, we have unvested restricted stock awards and stock options outstanding which were granted under the inTEST Corporation 2007 Stock Plan (the "2007 Stock Plan") and the inTEST Corporation 2014 Stock Plan (the "2014 Stock Plan"). The 2007 Stock Plan was approved at our annual meeting of stockholders held on June 13, 2007 and 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. As of December 31, 2016, there were no remaining shares available to grant under the 2007 Stock Plan. The 2014 Stock Plan was approved at our annual meeting of stockholders held on June 25, 2014 and permits the granting of stock options, restricted stock, stock appreciation rights or restricted stock units for up to 500,000 shares of our common stock to directors, officers, other key employees and consultants. As of December 31, 2016, there were 456,300 shares available to grant under the 2014 Stock Plan.

inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(12) STOCK-BASED COMPENSATION PLAN (Continued)

Our unvested restricted stock awards and stock options are accounted for based on their grant date fair value. As of December 31, 2016, total compensation expense to be recognized in future periods was \$316. The weighted average period over which this expense is expected to be recognized is 2.5 years.

The following table summarizes the compensation expense we recorded during 2016 and 2015, related to unvested shares of restricted stock and stock options.

	Years Ended	
	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cost of revenues	\$ 10	\$ 10
Selling expense	6	5
Engineering and product development expense	11	10
	<u>242</u>	<u>94</u>
General and administrative expense	<u>\$269</u>	<u>\$119</u>

There was no compensation expense capitalized in 2016 or 2015.

Stock Options

We record compensation expense for stock options based on the fair market value of the options as of the grant date. No option may be granted with an exercise period in excess of ten years from the date of grant. Generally, stock options will be granted with an exercise price equal to the fair market value of our stock on the date of grant and will vest over four years.

No stock options were granted during 2015. The fair value for stock options granted during 2016 was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

Risk-free interest rate	1.30%
Dividend yield	0.00%
Expected common stock market price volatility factor	.40
Weighted average expected life of stock options (years)	4

The per share weighted average fair value of stock options issued during 2016 was \$1.43.

The following table summarizes the activity related to stock options for the year ended December 31, 2016:

	Number of Shares	Weighted Average Exercise Price
Options outstanding, January 1, 2016	-	\$ -
Granted	19,800	4.37
Exercised	-	-
Canceled	<u>-</u>	-
Options outstanding, December 31, 2016 (none exercisable)	<u>19,800</u>	4.37

Restricted Stock Awards

We record compensation expense for restricted stock awards (unvested 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.

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inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(12)

STOCK-BASED COMPENSATION PLAN (Continued)

The following table summarizes the activity related to unvested shares for the two years ended December 31, 2016:

	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Unvested shares outstanding, January 1, 2015	101,875	\$3.66
Granted	-	-
Vested	(33,125)	3.65
Forfeited	<u>(5,000)</u>	3.97
)		
Unvested shares outstanding, December 31, 2015	63,750	3.64
Granted	86,400	4.27
Vested	(53,125)	3.94
Forfeited	<u>-</u>	-
Unvested shares outstanding, December 31, 2016	<u>97,025</u>	4.04

The total fair value of the shares that vested during the years ended December 31, 2016 and 2015 was \$208 and \$138, respectively, as of the vesting dates of these shares.

(13)

STOCK REPURCHASE PLAN

On October 27, 2015, our Board of Directors authorized the repurchase of up to \$5,000 of our common stock from time to time on the open market, in compliance with Rule 10b-18 under the Securities Exchange Act of 1934, or in privately negotiated transactions (the "2015 Repurchase Plan"). Repurchases may be made under a Rule 10b5-1 plan entered into with RW Baird & Co., which permits shares to be repurchased when we might otherwise be precluded from doing so under insider trading laws. The timing and amount of any shares repurchased under the 2015 Repurchase Plan is determined by our management, based on our evaluation of market conditions and other factors. The 2015 Repurchase Plan does not obligate us to repurchase any particular amount of common stock and may be suspended or discontinued at any time without prior notice. The 2015 Repurchase Plan is funded using our operating cash flow or available cash.

During 2016 and 2015, we repurchased 241,805 and 41,332 shares under the 2015 Repurchase Plan, respectively. The total cost to repurchase these shares, including fees paid to our broker, was \$978 and \$155, respectively. As of December 31, 2016, we had repurchased a total of 283,137 shares under the 2015 Repurchase Plan at a cost of \$1,133, which included fees paid to our broker of \$7. All of the repurchased shares were retired. The 2015 Repurchase Plan was suspended in May 2016 and resumed in September 2016.

(14)

EMPLOYEE BENEFIT PLANS

We have a defined contribution 401(k) plan for our employees who work in the U.S. (the "inTEST 401(k) Plan"). All

permanent employees of inTEST Corporation, Temptronic Corporation and inTEST Silicon Valley Corporation who are at least 18 years of age are eligible to participate in the plan. We match employee contributions dollar for dollar up to 10% of the employee's annual compensation, with a maximum limit of \$5. Employer contributions vest ratably over four years. Matching contributions are discretionary. For the years ended December 31, 2016 and 2015, we recorded \$347 and \$329 of expense for matching contributions, respectively.

(15)

SEGMENT INFORMATION

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

The Thermal Products segment includes the operations of Temptronic Corporation, Thermonics, Sigma, inTEST Thermal Solutions GmbH (Germany), and inTEST Pte, Limited (Singapore). Sales of this segment consist primarily of temperature management systems which we design, manufacture and market under our Temptronic, Thermonics and Sigma product lines. In addition, this segment provides post warranty service and support.

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inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(15)

SEGMENT INFORMATION (Continued)

The Mechanical Products segment includes the operations of our Mt. Laurel, New Jersey manufacturing facility. Sales of this segment consist primarily of manipulator and docking hardware products, which we design, manufacture and market. In addition, this segment provides post warranty service and support for various ATE equipment.

The Electrical Products segment includes the operations of inTEST Silicon Valley Corporation. Sales of this segment consist primarily of tester interface products which we design, manufacture and market.

We operate our business worldwide, and all three segments sell their products both domestically and internationally. All three segments sell to semiconductor manufacturers, third-party test and assembly houses and ATE manufacturers. Our Thermal Products segment also sells into a variety of markets outside of the ATE market, including the automotive, consumer electronics, defense/aerospace, energy, industrial and telecommunications markets. Intercompany pricing between segments is either a multiple of cost for component parts or list price for finished goods.

	Years Ended <u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Net revenues from unaffiliated customers:		
Thermal Products	\$24,033	\$24,084

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Mechanical Products	8,309	7,539
	<u>7,885</u>	<u>7,266</u>
Electrical Products		
	<u>\$40,227</u>	<u>\$38,889</u>
Depreciation/amortization:		
Thermal Products	\$ 440	\$ 581
Mechanical Products	58	79
	<u>101</u>	<u>94</u>
Electrical Products		
	<u>\$ 599</u>	<u>\$ 754</u>
Operating income (loss):		
Thermal Products	\$4,210	\$4,517
Mechanical Products	(74)	(1,902)
Electrical Products	1,063	673
	<u>(1,053)</u>	<u>(726)</u>
Corporate	)	)
	<u>\$4,146</u>	<u>\$2,562</u>
Earnings (loss) before income tax expense (benefit):		
Thermal Products	\$4,193	\$4,479
Mechanical Products	(72)	(1,874)
Electrical Products	1,093	704
	<u>(1,007)</u>	<u>(726)</u>
Corporate	)	)
	<u>\$4,207</u>	<u>\$2,583</u>
Income tax expense (benefit):		
Thermal Products	\$1,544	\$1,252
Mechanical Products	(26)	(524)
Electrical Products	402	197
	<u>(371)</u>	<u>(203)</u>
Corporate	)	)
	<u>\$1,549</u>	<u>\$ 722</u>

Net earnings (loss):		
Thermal Products	\$2,649	\$3,227
Mechanical Products	(46)	(1,350)
Electrical Products	691	507
	<u>(636)</u>	<u>(523)</u>
Corporate	)	)
	<u>\$2.658</u>	<u>\$1.861</u>

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inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data)

(15) SEGMENT INFORMATION (Continued)

	Years Ended December 31,	
	<u>2016</u>	<u>2015</u>
Capital expenditures:		
Thermal Products	\$ 262	\$ 389
Mechanical Products	44	101
	<u>33</u>	<u>109</u>
Electrical Products		
	<u>\$ 339</u>	<u>\$ 599</u>

	December 31,	
	<u>2016</u>	<u>2015</u>
Identifiable assets:		
Thermal Products	\$19,893	\$16,983
Mechanical Products	18,359	19,733
	<u>4,592</u>	<u>3,268</u>
Electrical Products		
	<u>\$42,844</u>	<u>\$39,984</u>

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

	Years Ended <u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Net revenues from unaffiliated customers:		
U.S.	\$13,061	\$14,294
	<u>27,166</u>	<u>24,595</u>
Foreign		
	<u>\$40,227</u>	<u>\$38,889</u>

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Property and equipment:		
U.S.	\$ 691	\$ 797
	<u>253</u>	<u>315</u>
Foreign		
	<u>\$ 944</u>	<u>\$1,112</u>

(16) QUARTERLY CONSOLIDATED FINANCIAL DATA (Unaudited)

The following tables present certain unaudited consolidated quarterly financial information for each of the eight quarters ended December 31, 2016. In our opinion, this quarterly information has been prepared on the same basis as the consolidated financial statements and includes all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the information for the periods presented. The results of operations for any quarter are not necessarily indicative of results for the full year or for any future period.

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inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(16)

QUARTERLY CONSOLIDATED FINANCIAL DATA (Unaudited) (Continued)

Year-over-year quarterly comparisons of our results of operations may not be as meaningful as the sequential quarterly comparisons set forth below that tend to reflect the cyclical and seasonal activity of the semiconductor and ATE markets. Quarterly fluctuations in expenses are related directly to sales activity and volume and may also reflect the timing of operating expenses incurred throughout the year.

	<u>Quarters Ended</u>				
	<u>3/31/16</u>	<u>6/30/16</u>	<u>9/30/16</u>	<u>12/31/16</u>	<u>Total</u>
Net revenues	\$ 8,647	\$10,485	\$10,823	\$10,272	\$40,227
Gross margin	4,067	5,329	5,577	5,405	20,378
Earnings before income tax expense	124	749	1,721	1,613	4,207
Income tax expense	43	263	631	612	1,549
Net earnings	81	486	1,090	1,001	2,658
Net earnings per common share - basic	\$0.01	\$0.05	\$0.11	\$0.10	\$0.26
Weighted average common shares outstanding - basic	10,390,002	10,295,836	10,295,447	10,273,702	10,313,747
Net earnings per common share - diluted	\$0.01	\$0.05	\$0.11	\$0.10	\$0.26
Weighted average common shares outstanding - diluted	10,404,244	10,310,692	10,318,715	10,297,439	10,332,920

	<u>Quarters Ended</u>				
	<u>3/31/15</u>	<u>6/30/15</u>	<u>9/30/15</u>	<u>12/31/15</u>	<u>Total</u>
Net revenues	\$10,188	\$11,559	\$ 9,203	\$ 7,939	\$38,889
Gross margin	4,918	5,846	4,323	3,611	18,698
Earnings (loss) before income tax expense (benefit)	671	1,659	407	(154)	2,583
Income tax expense (benefit)	233	579	97	(187)	722
Net earnings	438	1,080	310	33	1,861
Net earnings per common share - basic	\$0.04	\$0.10	\$0.03	\$0.00	\$0.18
Weighted average common shares outstanding - basic	10,465,414	10,471,888	10,473,928	10,481,612	10,473,210
Net earnings per common share - diluted	\$0.04	\$0.10	\$0.03	\$0.00	\$0.18
Weighted average common shares outstanding - diluted	10,483,527	10,494,457	10,498,911	10,498,369	10,493,830

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inTEST CORPORATION
SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

	Balance at Beginning <u>of Period</u>	Expense <u>(Recovery)</u>	<u>Deductions</u>	Balance at End of <u>Period</u>
Year Ended December 31, 2016				
Allowance for doubtful accounts	146	-	-	146
Warranty reserve	94	125	(94)	125
Year Ended December 31, 2015				
Allowance for doubtful accounts	146	-	-	146
Warranty reserve	118	67	(91)	94

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