

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2005 or

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

For the transition period from _____ to _____

Commission File Number 0-22529

inTEST Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware

(State or other jurisdiction of incorporation or organization)

22-2370659

(I.R.S. Employer Identification Number)

7 Esterbrook Lane

Cherry Hill, New Jersey 08003

(Address of principal executive offices, including zip code)

(856) 424-6886

(Registrant's Telephone Number, including Area Code)

Indicate by check X whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES NO

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

YES NO

Number of shares of Common Stock, \$.01 par value, outstanding as of October 31, 2005:

9,135,778

inTEST CORPORATION

INDEX

PART I. FINANCIAL INFORMATION

	<u>Page</u>
Item 1. Financial Statements (Unaudited)	
Consolidated Balance Sheets as of September 30, 2005 and December 31, 2004	1
Consolidated Statements of Operations for the three months and nine months ended September 30, 2005 and 2004	2
Consolidated Statements of Comprehensive Earnings (Loss) for the three months and nine months ended September 30, 2005 and 2004	3
Consolidated Statement of Stockholders' Equity for the nine months ended September 30, 2005	4
Consolidated Statements of Cash Flows for the nine months ended September 30, 2005 and 2004	5

Notes to Consolidated Financial Statements	6 - 13
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14 - 24
Item 3. Quantitative and Qualitative Disclosures About Market Risk	24
Item 4. Controls and Procedures	25
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	25
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	25
Item 3. Defaults Upon Senior Securities	25
Item 4. Submission of Matters to a Vote of Securities Holders	26
Item 5. Other Information	26
Item 6. Exhibits	26
Signatures	27
Index to Exhibits	27

inTEST CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

	Sept. 30, 2005	Dec. 31, 2004
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 6,724	\$ 7,686
Trade accounts and notes receivable, net of allowance for doubtful accounts of \$231 and \$159, respectively	10,162	6,771
Inventories	7,137	9,401
Refundable domestic income taxes	29	728
Prepaid expenses and other current assets	<u>820</u>	<u>844</u>
Total current assets	<u>24,872</u>	<u>25,430</u>
Property and equipment:		
Machinery and equipment	9,707	12,021
Leasehold improvements	<u>3,371</u>	<u>3,154</u>
	13,078	15,175
Less: accumulated depreciation	<u>(8,834)</u>	<u>(10,621)</u>
Net property and equipment	<u>4,244</u>	<u>4,554</u>
Other assets	316	451
Goodwill	2,440	2,318
Intangible assets, net	<u>332</u>	<u>414</u>
Total assets	<u>\$32,204</u>	<u>\$33,167</u>
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 4,207	\$ 2,102
Accrued wages and benefits	1,473	1,456
Accrued warranty	945	1,216
Accrued sales commissions	626	501
Accrued restructuring and other charges	133	261
Other accrued expenses	1,179	893
Domestic and foreign income taxes payable	280	467
Capital lease obligations	50	106
Deferred rent	<u>118</u>	<u>-</u>
Total current liabilities	<u>9,011</u>	<u>7,002</u>

Capital lease obligations, net of current portion	25	47
Deferred rent, net of current portion	<u>658</u>	<u>-</u>
Total liabilities	<u>9,694</u>	<u>7,049</u>

Commitments and contingencies

Stockholders' equity:

Preferred stock, \$0.01 par value; 5,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock, \$0.01 par value; 20,000,000 shares authorized; 9,410,205 and 9,300,164 shares issued, respectively	94	93
Additional paid-in capital	24,962	24,716
(Accumulated deficit) retained earnings	(149)	3,663
Accumulated other comprehensive income	346	1,049
Deferred stock compensation	(870)	(1,081)
Treasury stock, at cost; 303,095 and 375,648 shares, respectively	<u>(1,873)</u>	<u>(2,322)</u>
Total stockholders' equity	<u>22,510</u>	<u>26,118</u>
Total liabilities and stockholders' equity	<u>\$32,204</u>	<u>\$33,167</u>
	=====	=====

See accompanying Notes to Consolidated Financial Statements.

-- 1 -

inTEST CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net revenues	\$16,448	\$19,509	\$39,288	\$59,231
Cost of revenues	9,979	11,726	25,464	33,821
Gross margin	6,469	7,783	13,824	25,410
Operating expenses:				
Selling expense	2,545	3,213	7,024	9,252
Engineering and product development expense	1,522	1,689	4,458	4,949
General and administrative expense	1,912	2,060	5,890	6,134
Restructuring and other charges	28	-	448	-
Total operating expenses	6,007	6,962	17,820	20,335
Operating income (loss)	462	821	(3,996)	5,075
Other income (expense):				
Interest income	27	16	150	65
Interest expense	(6)	(1)	(11)	(6)
Other	33	21	55	31
Total other income	54	36	194	90
Earnings (loss) before income taxes	516	857	(3,802)	5,165
Income tax expense (benefit)	123	(384)	10	421
Net earnings (loss)	\$ 393	\$ 1,241	\$(3,812)	\$ 4,744
	=====	=====	=====	=====
Net earnings (loss) per common share - basic	\$0.05	\$0.15	\$(0.44)	\$0.56
Weighted average common shares outstanding-basic	8,823,979	8,500,225	8,764,115	8,408,937
Net earnings (loss) per common share - diluted	\$0.04	\$0.14	\$(0.44)	\$0.54
Weighted average common and common share equivalents outstanding-diluted	8,911,672	8,902,440	8,764,115	8,777,053

-- 2 -

inTEST CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS (LOSS)
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net earnings (loss)	\$393	\$1,241	\$(3,812)	\$4,744
Foreign currency translation adjustments	(56)	103	(703)	17
Comprehensive earnings (loss)	\$337	\$1,344	\$(4,515)	\$4,761

See accompanying Notes to Consolidated Financial Statements.

-- 3 -

inTEST CORPORATION
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands, except share data)
(Unaudited)

	Common Stock		Addt'l Paid-In Capital	(Accumulated Deficit) Retained Earnings	Accumulated Other Comprehensive Income	Deferred Stock Compensation	Treasury Stock	Total Stockholders' Equity
	Shares	Amount						
Balance, December 31, 2004	9,300,164	\$ 93	\$24,716	\$ 3,663	\$1,049	\$(1,081)	\$(2,322)	\$26,118
Net loss	-	-	-	(3,812)	-	-	-	(3,812)
Other comprehensive loss	-	-	-	-	(703)	-	-	(703)
Deferred stock compensation related to issuance of restricted stock	5,000	-	16	-	-	(16)	-	-
Amortization of deferred stock compensation	-	-	-	-	-	203	-	203
Elimination of deferred stock compensation related to unvested restricted stock forfeited	(5,000)	-	(24)	-	-	24	-	-
Stock options exercised	13,400	-	44	-	-	-	-	44
Release of shares from escrow in connection with acquisition of Intestlogic	96,641	1	359	-	-	-	-	360
Issuance of 72,553 shares of treasury stock to satisfy profit sharing liability	-	-	(149)	-	-	-	449	300
Balance, September 30, 2005	9,410,205	\$ 94	\$24,962	\$ (149)	\$ 346	\$ (870)	\$(1,873)	\$22,510

See accompanying Notes to Consolidated Financial Statements.

-- 4 -

inTEST CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings (loss)	\$(3,812)	\$ 4,744
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,463	1,563
Foreign exchange loss	54	67
Deferred compensation relating to stock options	204	-
Issuance of treasury stock to satisfy profit sharing liability	300	-
(Gain) loss on disposal of fixed assets	(7)	120
Proceeds from sale of demonstration equipment, net of gain	10	70
Changes in assets and liabilities:		
Trade accounts and notes receivable	(3,689)	(2,901)

Inventories	2,159	(3,179)
Refundable domestic income taxes	699	22
Prepaid expenses and other current assets	5	(228)
Other assets	102	(87)
Accounts payable	2,215	1,288
Accrued wages and benefits	42	830
Accrued warranty	(255)	(46)
Accrued sales commissions	133	143
Accrued restructuring and other charges	(123)	-
Other accrued expenses	309	172
Domestic and foreign income taxes payable	(163)	232
Deferred rent	(79)	-
Net cash provided by (used in) operating activities	(433)	2,810
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(1,337)	(1,569)
Proceeds from sale of property and equipment	163	-
Net cash used in investing activities	(1,174)	(1,569)
CASH FLOWS FROM FINANCING ACTIVITIES		
Deferred rent resulting from landlord provided tenant improvements	854	-
Repayment of capital lease obligations	(78)	(72)
Proceeds from stock options exercised	44	696
Net cash provided by financing activities	820	624
Effects of exchange rates on cash	(175)	(28)
Net cash provided by (used in) all activities	(962)	1,837
Cash and cash equivalents at beginning of period	7,686	5,116
Cash and cash equivalents at end of period	\$ 6,724	\$ 6,953
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Unvested restricted stock awards forfeited	\$ 24	\$ -
Restricted stock awards granted	\$ 16	\$ -
Release of contingent shares related to prior acquisition	\$ 360	\$ 756
Cash payments (refunds) for:		
Domestic and foreign income taxes	\$ (529)	\$ 168
Interest	11	6

See accompanying Notes to Consolidated Financial Statements.

- 5 -

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

(1) NATURE OF OPERATIONS

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

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

The semiconductor industry in which we operate is characterized by rapid technological change, competitive pricing pressures and cyclical market patterns. This industry is subject to significant economic downturns at various times. Our financial results are affected by a wide variety of factors, including, but not limited to, general economic conditions worldwide or in the markets in which we operate, economic conditions specific to the semiconductor industry, our ability to safeguard patents and intellectual property in a rapidly evolving market, downward pricing pressures from customers, and our reliance on a relatively few number of customers for a significant portion of our sales. In addition, we are exposed to the risk of obsolescence of our inventory depending on the mix of future business and technological changes within the industry. As a result of these or other factors, we 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 unaudited consolidated financial statements include our accounts and those of our wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated upon consolidation. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain of our accounts, including long-lived assets, goodwill, inventory, deferred income tax valuation allowances and product warranty reserves, are particularly affected by estimates.

In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the financial position, results of operations, and changes in cash flows for the interim periods presented. Certain footnote information has been condensed or omitted from these consolidated financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2004 (our "2004 Form 10-K").

Reclassification

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

Inventories

Inventory is valued at standard cost, which approximates actual cost computed on a first-in, first-out basis, not in excess of market value. 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, that identifies material that has not been used in a work order during the prior twelve months and the excess quantity of material on hand that is greater than the average annual usage of that material over the prior three years. In addition, in certain cases, additional charges for excess and obsolete inventory are recorded based upon facts that would not give rise to a charge under the objective excess and obsolete inventory criteria including amounts necessary based upon current industry conditions, anticipated product life cycles, new product introductions and expected future use of the inventory. The charges for excess and obsolete inventory we record establish a new cost basis for the related inventory. We incurred excess and obsolete inventory charges of \$559 and \$446 for the quarters ended September 30, 2005 and 2004, respectively, and \$1,026 and \$1,121 for the nine months ended September 30, 2005 and 2004, respectively.

- 6 -

inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Goodwill and Intangibles

We account for goodwill in accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*. Under the provisions of SFAS No 142, goodwill and other indefinite life intangible assets are not subject to amortization. Instead, they are subject to at least an annual assessment for impairment by applying a fair value based test.

Goodwill at both September 30, 2005 and December 31, 2004 relates to the manipulator/docking hardware segment. The following table sets forth changes in the amount of the carrying value of goodwill for the nine months ended September 30, 2005:

Balance - Beginning of period	\$2,318
Goodwill recorded during the year	360
Impact of foreign currency translation	<u>_(238)</u>
Balance - End of period	<u>\$2,440</u>

As of September 30, 2005 and December 31, 2004, definite life intangibles totaled \$332 and \$414, net of accumulated amortization of \$142 and \$120, respectively. The net book value of these intangibles reflects \$46 of unfavorable impact related to currency during 2005. These definite life intangibles are the result of our acquisition of Intestlogic GmbH (formerly known as Intelogic Technologies GmbH) which we completed in October 2002. They are being amortized using the straight-line method over ten years. These definite life intangible assets are technology based and include patented technology. They are allocated to the manipulator/docking hardware segment. Amortization expense for the nine months ended September 30, 2005 and 2004 was \$37 and \$36, respectively. Estimated annual amortization expense for each of the next five years is \$50.

Product Warranties

We accrue product warranty charges quarterly based upon our historical claims experience. In addition, from time to time, we accrue additional amounts based upon known product warranty issues, such as product retrofits. Warranty expense for the quarters ended September 30, 2005 and 2004 was \$164 and \$642, respectively. Warranty expense for the nine months ended September 30, 2005 and 2004 was \$425 and \$1,526, respectively. Warranty expense is included in selling expense in the consolidated financial statements.

The following table sets forth the changes in the liability for product warranties for the nine months ended September 30, 2005:

Balance - Beginning of period	\$1,216
Payments made under product warranty	(696)
Accruals for product warranties issued	<u>425</u>
Balance - End of period	<u>\$ 945</u>

Revenue Recognition

We recognize revenue in accordance with Staff Accounting Bulletin No. 104 ("SAB 104"), *Revenue Recognition*. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. Sales of our products are made through our sales employees, third-party sales representatives and distributors. There are no differences in revenue recognition policies based on the sales channel. We do not provide our customers with rights of return or exchanges. Revenue is generally recognized upon product shipment. Our sales agreements do not typically contain any customer-specific acceptance criteria, other than that the product performs within the agreed upon specifications. We test all products manufactured as part of our quality assurance process to determine that they comply with

specifications prior to shipment to a customer. To the extent that any sales agreements contain customer-specific acceptance criteria, revenue recognition is deferred until customer acceptance.

- 7 -

inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Restructuring and Other Charges

We recognize a liability for restructuring costs at fair value when the liability for such costs is incurred. The three main components of the restructuring plans we implemented in 2004 and 2005 (as more fully discussed in Footnote 5) are related to workforce reductions, the consolidation of excess facilities and asset impairments. Workforce-related charges are accrued when it is determined that a liability has been incurred, which is generally after individuals have been notified of their termination dates and expected severance benefits. Plans to consolidate excess facilities result in charges for lease termination fees and future commitments to pay lease charges, net of estimated future sub-lease income. We recognize charges for consolidation of excess facilities when we have vacated the premises. Assets that may be impaired consist of property, plant and equipment. Asset impairment charges are based on an estimate of the amounts and timing of future cash flows related to the expected future remaining use and ultimate sale or disposal of the asset. These estimates are derived using the guidance of SFAS No. 146, *Accounting for Exit or Disposal Activities*, and SFAS No. 144, *Accounting for the Impairment of Disposal of Long Lived Assets*.

Income Taxes

The asset and liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for operating loss and tax credit carryforwards and for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the periods in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

Net Earnings (Loss) Per Common Share

Net earnings (loss) per common share is computed in accordance with SFAS No. 128, *Earnings Per Share*. Basic earnings (loss) per common share is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding during each period. Diluted earnings (loss) per common share is computed by dividing net earnings (loss) by the weighted average number of common shares and common share equivalents outstanding during each period. Common share equivalents represent stock options and unvested shares of restricted stock and are calculated using the treasury stock method. Common share equivalents are excluded from the calculation if their effect is anti-dilutive. The table below sets forth for the periods indicated a reconciliation of weighted average common shares outstanding -- basic to weighted average common shares outstanding - diluted and the average number of employee stock options and their respective weighted average exercise prices that were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive:

	<u>Three Months Ended</u> <u>Sept. 30,</u>		<u>Nine Months Ended</u> <u>Sept. 30,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Weighted average common shares outstanding -- basic	8,823,979	8,500,225	8,764,115	8,408,937
Potentially dilutive securities:				
Employee stock options	<u>87,693</u>	<u>402,215</u>	<u>-</u>	<u>368,116</u>
Weighted average common shares outstanding -- diluted	<u>8,911,672</u>	<u>8,902,440</u>	<u>8,764,115</u>	<u>8,777,053</u>
Average number of employee stock options excluded from calculation	465,625	-	772,467	65,673
Weighted average exercise price of excluded options	\$2.66	-	\$2.86	\$6.17

Stock-Based Compensation

At September 30, 2005, we have certain stock-based employee compensation plans that are described more fully in Note 13 to our consolidated financial statements in our 2004 Form 10-K. We account for these plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related Interpretations. No stock-based employee compensation cost is reflected in the statement of operations when options granted under these plans have an exercise price equal to the market value of the underlying common stock on the date of grant.

- 8 -

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

During the fourth quarter of 2004, we began granting shares of restricted stock to certain directors, officers and key employees. As of September 30, 2005, we had granted a total of 230,000 shares of restricted stock, net of forfeitures of unvested shares. The fair value of these shares at the date of grant was recorded as deferred stock compensation in the consolidated financial statements. These shares vest over four years (twenty-five percent on each anniversary date). Net compensation expense recognized related to these shares during the first nine months of 2005 was \$203.

The following table illustrates the effect on net earnings (loss) and net earnings (loss) per share for the three and nine months ended September 30, 2005 and 2004 if we had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>Sept. 30,</u>	<u>2004</u>	<u>Sept. 30,</u>	<u>2004</u>
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Net earnings (loss), as reported	\$ 393	\$1,241	\$(3,812)	\$4,744
Add: Stock-based employee compensation expense included in reported net earnings (loss), net of related tax effects (1)	72	--	203	--
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects (1)	_(102)	_(128)	_(351)	_(339)
Pro forma net earnings (loss)	<u>\$ (363)</u>	<u>\$1,113</u>	<u>\$(3,960)</u>	<u>\$4,405</u>
Net earnings (loss) per share:				
Basic - as reported	\$0.05	\$0.15	\$(0.44)	\$0.56
Basic - pro forma	\$0.04	\$0.13	\$(0.45)	\$0.52
Diluted - as reported	\$0.04	\$0.14	\$(0.44)	\$0.54
Diluted - pro forma	\$0.04	\$0.12	\$(0.45)	\$0.50

(1) Due to the valuation allowance provided on our net deferred tax assets, we have not recorded any tax benefits attributable to stock compensation expense.

New Accounting Pronouncements

On October 22, 2004, the American Jobs Creation Act ("AJCA") was signed into law. AJCA contains many tax provisions that may affect us over the next several years as those provisions become effective. AJCA provides for the deduction for U.S. federal income tax purposes of 85% of certain foreign earnings that are repatriated, as defined in AJCA. During the second quarter of 2005, we completed our evaluation and determined that we would not benefit from the repatriation provisions provided by AJCA. Although AJCA also provides a special tax deduction related to our qualified production activity income, we will not benefit from this provision until our U.S. federal income tax loss carryforwards have been fully absorbed. AJCA's transitional rules applicable to the extraterritorial income exclusion regime will apply to us through 2006.

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, *Inventory Costs - an amendment of ARB No. 43*, which is the result of FASB's efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS No. 151 requires idle facility expenses, freight, handling costs, and wasted material (spoilage) costs to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of manufacturing be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

- 9 -

inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

As previously mentioned, we currently apply APB 25 in accounting for our stock compensation plans. Accordingly, no compensation expense has been recognized for employee stock options issued with exercise prices equal to the market price on the date of grant. In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which amends SFAS No. 123 and supersedes APB 25. SFAS No. 123 (revised 2004), requires compensation expense to be recognized for all share-based payments made to employees based on the fair value of the award at the date of grant, eliminating the intrinsic value alternative allowed by SFAS No. 123. Generally, the approach to determining fair value under the original pronouncement

has not changed; however, there are revisions to the accounting guidelines established, such as accounting for forfeitures. We are required to adopt this standard on January 1, 2006. We currently expect that our adoption of this standard will affect our operating results in a manner that is similar to our current proforma disclosures under SFAS No. 123.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. SFAS No. 154 replaces Accounting Principles Board Opinion No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

(3) INVENTORIES

Inventories held at September 30, 2005 and December 31, 2004 were comprised of the following:

	<u>Sept. 30,</u> <u>2005</u>	<u>Dec. 31,</u> <u>2004</u>
Raw materials	\$5,468	\$7,488
Work in process	184	289
Consigned inventory	535	541
Finished goods	<u>950</u>	<u>1,083</u>
	<u>\$7,137</u>	<u>\$9,401</u>

(4) LEASEHOLD IMPROVEMENTS AND DEFERRED RENT

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

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

During the first nine months of 2005, we recorded \$854 of additions to our leasehold improvements which were paid for on our behalf by the landlord of our new facility in San Jose, California. We also recorded this amount as deferred rent. Amortization of deferred rent for the nine months ended September 30, 2005 was \$79.

- 10 -

inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(5) RESTRUCTURING AND OTHER COSTS

During the fourth quarter of 2004, we began the process of restructuring our operations with the goal of significantly reducing our fixed operating costs to position ourselves to more effectively meet the needs and expectations of the fluid ATE market. In mid-November 2004, we announced organization changes and cost structure adjustments (the "2004 Workforce Reduction"). In mid-March 2005, we announced our decision to close our U.K. operations (the "UK Operation Closure"). In late July 2005, we made certain cost structure adjustments at our facility in San Jose, California (the "California Workforce Reduction").

2004 Workforce Reduction

In the quarter ended December 31, 2004, we accrued \$527 for severance and related costs resulting from the termination of 43 domestic and 2 foreign employees. Of this amount, \$266 was paid during the fourth quarter of 2004 and \$261 remained accrued as of December 31, 2004. The severance and related costs were comprised of \$383 in our Manipulator/Docking Hardware segment, \$100 in our Temperature Management segment and \$44 in our Tester Interface segment.

U.K. Operation Closure

In March 2005, we announced our intention to close our U.K. operation. We closed this operation during the quarter ended June 30, 2005. During the nine months ended September 30, 2005, we accrued \$234 for severance and related costs and \$179 for lease termination costs. The \$133 accrual remaining at September 30, 2005 relates primarily to estimated lease termination costs. In accordance with SFAS No. 146, our accrual for lease termination costs includes an estimate of future rental income from a sub-lease arrangement. However, at September 30, 2005, we had not sub-leased this facility. Our U.K. operation is included in our Manipulator/Docking Hardware segment.

California Workforce Reduction

In the quarter ended September 30, 2005 we accrued \$35 for severance and related costs resulting from the termination of six employees at our facility in San Jose, California. This entire amount was paid out during the third quarter of 2005. Our facility in San Jose is the headquarters for our tester interface product segment.

Our restructuring and other costs for the nine months ended September 30, 2005 are summarized as follows:

	<u>2004 Workforce Reduction</u>	<u>U.K. Operation Closure</u>	<u>California Workforce Reduction</u>	<u>Total</u>
Balance - December 31, 2004	\$261	\$ -	\$ -	\$ 261
Accruals in the nine months ended September 30, 2005	-	413	35	448
Severance and other cash payments	<u>(261)</u>	<u>(280)</u>	<u>(35)</u>	<u>(576)</u>
Balance - September 30, 2005	<u>\$ -</u>	<u>\$133</u>	<u>\$ -</u>	<u>\$ 133</u>

(6) EMPLOYEE BENEFIT PLANS

Upon the termination of the Temptronic Equity Participation Plan ("EPP") in July 2001, we acknowledged that it was our intention to contribute \$3,000 in the aggregate to the inTEST 401(k) Plan as a form of profit sharing (not to exceed \$300 per year) for the benefit of Temptronic employees. The amount of these contributions approximates the amount that we had been committed to contribute to the EPP as of its termination date and will be allocated to Temptronic employees annually in the same manner in which the shares held by the EPP had been allocated. The vesting provisions for these contributions will be the same as those of the inTEST 401(k) Plan. All such profit sharing contributions are at the discretion of management. Accruals for a profit sharing contribution of \$150 were made during the second half of 2004. We funded this obligation through the use of 34,137 treasury shares during the first quarter of 2005. Profit sharing contributions totaling \$225 were made during the nine months ended September 30, 2005. We funded \$150 of this obligation through the use of 38,416 treasury shares during the second and third quarters of 2005 and expect to fund the balance of this obligation through the use of additional treasury shares during the fourth quarter of 2005.

- 11 -

inTEST CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(7) SEGMENT INFORMATION

We have three reportable segments: Manipulator/Docking Hardware Products, Temperature Management Systems and Tester Interface Products. The Manipulator and Docking Hardware segment includes the operations of our Cherry Hill, New Jersey manufacturing facility as well as the operations of four of our foreign subsidiaries: inTEST Limited (U.K.) (which was closed during the second quarter of 2005 as discussed more fully in Note 5), inTEST Kabushiki Kaisha (Japan), inTEST PTE, Limited (Singapore) and Intestlogic GmbH (Germany). Sales of this segment consist primarily of manipulator and docking hardware products which we design, manufacture and market, as well as certain other related products which we design and market, but which are manufactured by third parties. The Temperature Management segment includes the operations of Temptronic in Sharon, Massachusetts as well as Temptronic GmbH (Germany). Sales of this segment consist primarily of temperature management systems which we design, manufacture and market under our Temptronic product line. In addition, this segment provides after sale service and support, which is paid for by its customers. The Tester Interface segment includes the operations of inTEST Silicon Valley in San Jose, California. Sales of this segment consist primarily of tester interface products which we design, manufacture and market under our TestDesign product line.

We operate our business worldwide, and all three segments sell their products both domestically and internationally. All three segments sell to semiconductor manufacturers and ATE manufacturers.

Intercompany pricing between segments is either a multiple of cost for component parts or a percentage discount from list price for finished goods.

As of January 1, 2005, we implemented a new cost allocation structure, the effect of which is to better allocate operating expenses to the appropriate product segment. We have reclassified the amounts shown for the prior period to be consistent with our new cost allocation structure.

	<u>Three Months Ended Sept. 30,</u>		<u>Nine Months Ended Sept. 30,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Net revenues from unaffiliated customers				
Manipulator/Docking Hardware	\$10,265	\$10,249	\$20,327	\$32,453
Temperature Management	5,039	6,100	15,431	17,156
Tester Interface	1,772	4,014	5,220	12,614
Intersegment sales	<u>_(628)</u>	<u>_(854)</u>	<u>_(1,690)</u>	<u>_(2,992)</u>
	<u>\$16,448</u>	<u>\$19,509</u>	<u>\$39,288</u>	<u>\$59,231</u>

Intersegment sales:

Manipulator/Docking Hardware	\$ -	\$ 15	\$ -	\$ 74
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Temperature Management	521	592	1,450	1,379
Tester Interface	<u>107</u>	<u>247</u>	<u>240</u>	<u>1,539</u>
	<u>\$ 628</u>	<u>\$ 854</u>	<u>\$1,690</u>	<u>\$2,992</u>

Earnings (loss) before income taxes:

Manipulator/Docking Hardware	\$1,234	\$324	\$(1,037)	\$2,565
Temperature Management	90	134	285	368
Tester Interface	(633)	399	(2,617)	2,233
Corporate	<u>—(175)</u>	<u>—</u>	<u>—(433)</u>	<u>—(1)</u>
	<u>\$ 516</u>	<u>\$857</u>	<u>\$(3,802)</u>	<u>\$5,165</u>

Net earnings (loss):

Manipulator/Docking Hardware	\$1,128	\$ 462	\$(1,089)	\$2,291
Temperature Management	73	99	289	221
Tester Interface	(633)	680	(2,579)	2,233
Corporate	<u>—(175)</u>	<u>—</u>	<u>—(433)</u>	<u>—(1)</u>
	<u>\$ 393</u>	<u>\$1,241</u>	<u>\$(3,812)</u>	<u>\$4,744</u>

- - 12 -

inTEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(7) SEGMENT INFORMATION (Continued)

	<u>Sept. 30,</u> <u>2005</u>	<u>Dec. 31,</u> <u>2004</u>
Identifiable assets:		
Manipulator/Docking Hardware	\$19,294	\$19,907
Temperature Management	8,166	8,507
Tester Interface	<u>4,744</u>	<u>4,753</u>
	<u>\$32,204</u>	<u>\$33,167</u>

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

	<u>Three Months Ended</u> <u>Sept. 30,</u>		<u>Nine Months Ended</u> <u>Sept. 30,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Net revenues from unaffiliated customers:				
U.S.	\$11,422	\$15,453	\$27,671	\$46,482
Europe	1,605	1,425	4,554	5,410
Asia-Pacific	<u>3,421</u>	<u>2,631</u>	<u>7,063</u>	<u>7,339</u>
	<u>\$16,448</u>	<u>\$19,509</u>	<u>\$39,288</u>	<u>\$59,231</u>

	<u>Sept. 30,</u> <u>2005</u>	<u>Dec. 31,</u> <u>2004</u>
Long-lived assets:		
U.S.	\$3,924	\$3,711
Europe	257	739
Asia-Pacific	<u>63</u>	<u>104</u>
	<u>\$4,244</u>	<u>\$4,554</u>

inTEST CORPORATION

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

Overview

As discussed more fully in our 2004 Form 10-K, our business and results of operations are substantially dependent upon the demand for ATE by semiconductor manufacturers and companies that specialize in the testing of ICs. Demand for ATE is driven by semiconductor manufacturers that are opening new, or expanding existing, semiconductor fabrication facilities or upgrading existing equipment, which in turn is dependent upon the current and anticipated market demand for semiconductors and products incorporating semiconductors. In the past, the semiconductor industry has been highly cyclical with recurring periods of oversupply, which often have a severe impact on the semiconductor industry's demand for ATE, including the products we manufacture. This can cause wide fluctuations in both our orders and net revenues and can significantly impact our results of operations, depending on our ability to react quickly to these shifts in demand. These industry cycles are difficult to predict. Because the industry cycles are generally characterized by sequential quarterly growth or declines in orders and net revenues throughout the cycle, year over year comparisons of operating results may not always be as meaningful as comparisons of periods at similar points in either up or down cycles. In addition, during both downward and upward cycles in our industry, while the general trend over several quarters tends to be one of either growth or decline, in any given quarter, the trend in both our orders and net revenues can be erratic. This can occur, for example, when orders are pulled in, pushed out or canceled by a significant customer or when customer forecasts and general business conditions fluctuate during a quarter.

Net Revenues and Orders

The following table sets forth, for the periods indicated, a breakdown of the net revenues from unaffiliated customers both by product segment and geographic area (based on the location of the selling entity).

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>		
	<u>Sept. 30,</u> <u>2005</u>	<u>2004</u>	<u>June 30,</u> <u>2005</u>	<u>Sept. 30,</u> <u>2005</u>	<u>2004</u>
Net revenues from unaffiliated customers					
Manipulator/Docking Hardware	\$10,265	\$10,249	\$ 4,996	\$20,327	\$32,453
Temperature Management	5,039	6,100	5,444	15,431	17,156
Tester Interface	1,772	4,014	2,292	5,220	12,614
Intersegment sales	<u>_(628)</u>	<u>_(854)</u>	<u>_(577)</u>	<u>_(1,690)</u>	<u>_(2,992)</u>
	<u>\$16,448</u>	<u>\$19,509</u>	<u>\$12,155</u>	<u>\$39,288</u>	<u>\$59,231</u>
U.S.	\$11,422	\$15,453	\$ 9,137	\$27,671	\$46,482
Europe	1,605	1,425	1,151	4,554	5,410
Asia-Pacific	<u>3,421</u>	<u>2,631</u>	<u>1,867</u>	<u>7,063</u>	<u>7,339</u>

Our consolidated net revenues for the quarter ended September 30, 2005 totaled \$16.4 million, a \$4.3 million, or 35%, increase as compared to the quarter ended June 30, 2005. As compared to the same quarter in 2004, however, sales for the third quarter of 2005 decreased by \$3.1 million or 16%. The lower net revenues in the third quarter of 2005 as compared to the same period in 2004 reflect that, during the first half of 2004, the ATE industry was in a period of expansion. However, late in the third quarter of 2004 this period of expansion ended and we saw a downward trend in orders which continued throughout the balance of 2004. During 2005, the trend in our orders improved and we have now experienced three quarters of sequential growth in our orders. The positive trend we experienced in our orders in the first nine months of 2005 resulted in sequential quarterly growth in our net revenues over this same time period as reflected in the table above. However, our quarterly net revenues still have not reached the level we experienced in the third quarter of 2004 which we now believe to be the peak of the last up cycle in the ATE industry.

Total orders for the quarter ended September 30, 2005 increased to \$16.7 million on a consolidated basis as compared to \$12.2 million for the second quarter of 2005 and \$11.4 million for the first quarter of 2005. Although we have experienced sequential quarterly growth in our orders during 2005, total orders for our products for the nine months ended September 30, 2005 were \$40.3 million as compared to \$54.2 million for the same period in 2004, a \$13.8 million or 26% decrease. Even though the recent trend in our orders has been positive, we cannot be sure how long this trend will continue or what the rate of increase or decrease in our orders or net revenues will be in future periods. In fact, while the level of our consolidated net revenues for the

- 14 -

inTEST CORPORATION

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

third quarter of 2005 was higher than we had originally projected, based on discussions with our customers, we believe that the higher than expected revenue was due in part to certain customers' programs being accelerated which resulted in demand being pulled in from future quarters. Therefore, although the level of our orders continued to increase during the third quarter of 2005, we currently do not expect the sequential quarterly growth in our orders and net revenues to continue into the fourth quarter of 2005.

Backlog

As of September 30, 2005, our backlog of unfilled orders for all products was approximately \$6.8 million compared to \$6.6 million at June 30, 2005 and \$8.7 million at September 30, 2004. The increase in our backlog as compared to June 30, 2005 reflects the aforementioned increase in orders during the third quarter of 2005, which was offset by higher net revenue levels during this same period. The decrease in our backlog at September 30, 2005 as compared to September 30, 2004 reflects the significance of the aforementioned reduction in demand we have experienced that began during late 2004.

Our backlog includes customer purchase orders that we have accepted, substantially all of which we expect to deliver in the fourth quarter of 2005 or the first quarter of 2006. While backlog is calculated on the basis of firm purchase orders, a customer may cancel an order or accelerate or postpone currently scheduled delivery dates. Our backlog may be affected by the tendency of customers to rely on short lead times available from suppliers, including us, in periods of depressed demand. In periods of increased demand, there is a tendency towards longer lead times that has the effect of increasing backlog. As a result, our backlog at a particular date is not necessarily indicative of sales for any future period.

Cost Containment and Organizational Changes

In response to the sudden downturn in the second half of 2004, we began the process of restructuring our operations with the goal of significantly reducing our fixed operating costs to position ourselves to more effectively meet the needs and expectations of the cyclical ATE market. In November, we announced organizational changes and cost structure adjustments (the "2004 Workforce Reduction") that gave our divisional general managers increased responsibility for marketing, sales and service, thus allowing for the reduction of corresponding central corporate staff. In March 2005, we announced our intention to close our U.K. manufacturing operation (the "U.K. Operation Closure"). In late July 2005, we made certain cost structure adjustments at our facility in San Jose, California (the "California Workforce Reduction").

As a part of the 2004 Workforce Reduction, we eliminated four executive-level positions, reduced approximately 18% of our domestic personnel, and made certain salary and benefit adjustments. During the fourth quarter of 2004, we incurred severance costs of approximately \$527,000 related to these actions. The annualized cost benefit of these actions was estimated to be approximately \$4.5 million; however, we may not realize all of these benefits if we need to increase staffing to meet increasing demand or if we determine that earnings in future periods warrant restoration of all or a portion of salaries and/or benefits for our staff.

As a part of the U.K. Operation Closure, we shut down our manufacturing facility and opened a branch office in the U.K. that will provide customer support to this region. During the first nine months of 2005 we incurred \$234,000 in severance and related costs and \$179,000 in lease termination costs related to these actions. The \$133,000 accrual remaining at September 30, 2005 relates primarily to lease termination costs. In accordance with SFAS No. 146, our accrual for lease termination costs includes an estimate of future rental income from a sub-lease arrangement. At September 30, 2005, we had not sub-leased this facility. We expect the closure of our U.K. manufacturing operation will reduce our annual operating expense structure by approximately \$1.4 million net of the costs associated with the branch office we have opened. We began to see the benefit of these cost reductions during the third quarter of 2005.

During the third quarter of 2005, we reduced staff in our tester interface product segment located in San Jose, California. We incurred \$35,000 in severance costs related to this action. The annualized cost benefit of this action is estimated to be \$272,000, which we expect to see the full benefit of during the fourth quarter of 2005.

We believe our recent reorganization and decentralization will make us a more competitive company and position us to rapidly adapt to new market challenges and opportunities through continued research and development as well as strategic merger and acquisition activities. As part of our continuing focus to determine methods to increase our profitability worldwide while operating in the cyclical ATE markets, we intend to continue reviewing and evaluating actions that could better match our operating costs against our anticipated future revenue and product demand as we pursue additional growth opportunities.

- 15 -

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. (Continued)Excess and Obsolete Inventory Charges

On a quarterly basis, we review our inventories and record charges for excess and obsolete inventory based upon our established objective excess and obsolete inventory criteria, that identifies material that has not been used in a work order during the prior twelve months and the excess quantity of material on hand that is greater than the average annual usage of that material over the prior three years. In addition, in certain cases, additional excess and obsolete inventory charges are recorded based upon facts that would not give rise to a charge under the objective excess and obsolete inventory criteria including amounts necessary based upon current industry conditions, anticipated product life cycles, new product introductions and expected future use of the inventory. The excess and obsolete inventory charges we record establish a new cost basis for the related inventory. See also "Critical Accounting Policies".

We incurred charges for excess and obsolete inventory of \$1.0 million and \$1.1 million for the nine months ended September 30, 2005 and 2004, respectively. The level of these charges was based upon a variety of factors including changes in demand for our products and new product designs. The charges for the first half of 2005 included approximately \$173,000 related to the remaining inventory located at our U.K. manufacturing operation which was closed as of June 30, 2005, as previously discussed. See also "Critical Accounting Policies".

Product Warranty Charges

We accrue product warranty charges quarterly, based upon our historical claims experience. In addition, from time to time, we accrue additional amounts based upon known product warranty issues, such as product retrofits. For the nine months ended September 30, 2005 and 2004, our product warranty charges were \$425,000 and \$1.5 million, or 1.1% and 2.6% of net revenues, respectively. During the first nine months of 2004, we accrued \$513,000 in our positioner/docking hardware segment related to product retrofits and other costs associated with several products we sold to three ATE manufacturers. In addition, during the third quarter of 2004 we recorded charges of approximately \$200,000 as a result of negative trends in our historical claims experience. There were no similar known product retrofit warranty issues for which we needed to accrue additional specific product warranty charges in the first nine months of 2005.

The level of our product warranty charges, both in absolute dollars and as a percentage of net revenues, is affected by a number of factors including the cyclicity of demand in the ATE industry, the prototype nature of much of our business, the complex nature of many of our products and, at our discretion, providing warranty repairs or replacements to customers after the contracted warranty period has expired in order to promote strong customer relations. See also "Critical Accounting Policies".

Product/Customer Mix

Our three product segments each have multiple products that we design, manufacture and sell to our customers. The gross margin on each product we sell can be affected by a number of factors, including the amount of intellectual property (such as patents) utilized in the product, the number of units ordered by the customer at one time, or the amount of inTEST designed and fabricated material included in our product compared with the amount of third-party designed and fabricated material included in our product. The significance of each of these factors, as well as the current market conditions, determines the ultimate sales price we can obtain for our products and the gross margin we can earn on each product.

The mix of products we sell in any period is ultimately determined by our customers' needs and can change significantly from period to period. Our consolidated gross margin can be significantly affected in any given period by a change in the mix of products sold in that period.

We sell our products to both semiconductor manufacturers (end user sales) and to ATE manufacturers (OEM sales) who ultimately resell our equipment with theirs to semiconductor manufacturers. The mix of customers during any given period will affect our gross margin due to differing sales discounts and commissions. For the nine months ended September 30, 2005 and 2004, our OEM sales as a percentage of net revenues were 22% and 42%, respectively.

The impact of an increase in OEM sales as a percentage of net revenues is generally a reduction in our gross margin, as OEM sales historically have had a more significant discount than end user sales. Our current net operating margins on most OEM sales for these product segments, however, are only slightly less than margins on end user sales because of the payment of

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

third party sales commissions on most end user sales. We also expect to continue to experience demands from our OEM customers' supply line management groups to reduce our sales prices to them. This continued price pressure may have the effect of reducing our gross and operating margins if we cannot further reduce our manufacturing and operating costs.

We believe that purchases of most of our products are typically made from semiconductor manufacturers' capital expenditure budgets. Certain portions of our business, however, are generally less dependent upon the capital expenditure budgets of the end users. For example, purchases of certain related ATE interface products, such as sockets and interface boards, which must be replaced periodically, are typically made from the end users' operating budgets. In addition, purchases of certain of our products, such as docking hardware, for the purpose of upgrading or improving the utilization, performance and efficiency of existing ATE, tend to be counter cyclical to sales of new ATE. Moreover, we believe a portion of our sales of temperature management systems results from the increasing need for temperature testing of circuit boards and specialized components that do not have the design or quantity to be tested in an electronic device handler. In addition, in recent quarters we have begun to market our temperature management systems in industries outside semiconductor test, such as the automotive, aerospace, medical and telecommunications industries. We believe that these industries are usually less cyclical than the ATE industry.

Please refer to the section entitled "Risks That Could Affect Future Results" for a discussion of other important factors that could cause our results to differ materially from our prior results or those expressed or implied by our forward-looking statements.

Results of Operations

All of our products are used by semiconductor manufacturers in conjunction with ATE in the testing of ICs. Consequently, the results of operations for each product segment are generally affected by the same factors. Separate discussions and analyses for each product segment would be repetitive and obscure any unique factors that affected the results of operations of our different product segments. The discussion and analysis that follows, therefore, is presented on a consolidated basis and includes discussion of factors unique to each product segment where significant to an understanding of that segment.

The following table sets forth for the periods indicated the principal items included in the Consolidated Statements of Operations as a percentage of total net revenues.

	<u>Percentage of Net Revenues</u>			
	<u>Quarters Ended Sept. 30,</u>		<u>Nine Months Ended Sept. 30,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	<u>60.7</u>	<u>60.1</u>	<u>64.8</u>	<u>57.1</u>
Gross margin	<u>39.3</u>	<u>39.9</u>	<u>35.2</u>	<u>42.9</u>
Selling expense	15.5	16.5	17.9	15.6
Engineering and product development expense	9.2	8.7	11.4	8.4
General and administrative expense	11.6	10.6	15.0	10.4
Restructuring and other charges	<u>0.2</u>	<u>0.0</u>	<u>1.1</u>	<u>0.0</u>
Operating income (loss)	2.8	4.2	(10.2)	8.6
Other income	<u>0.3</u>	<u>0.2</u>	<u>0.5</u>	<u>0.1</u>
Earnings (loss) before income taxes	3.1	4.4	(9.7)	8.7
Income tax expense (benefit)	<u>0.7</u>	<u>(2.0)</u>	<u>0.0</u>	<u>0.7</u>
Net earnings (loss)	<u>2.4%</u>	<u>6.4%</u>	<u>(9.7)%</u>	<u>8.0%</u>

Quarter Ended September 30, 2005 Compared to Quarter Ended September 30, 2004

Net Revenues. Net revenues were \$16.4 million for the quarter ended September 30, 2005 compared to \$19.5 million for the same period in 2004, a decrease of \$3.1 million or 16%. In the third quarter of 2005, the net revenues of our manipulator/ docking hardware segment were relatively unchanged, while the net revenues of our temperature management and tester interface segments decreased \$1.1 million or 17% and \$2.2 million or 56%, respectively, over the comparable period in 2004.

- 17 -

inTEST CORPORATION

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

In our manipulator/docking hardware product segment, the net revenues from unaffiliated customers of our Japanese subsidiary and our Intestlogic operation in Rosenheim, Germany increased \$779,000 or 257% and \$1.3 million or 229%, respectively. These increases offset decreases in the net revenues of the remaining foreign and domestic operations included in this product segment. We attribute the significant increase in the net revenues of our Japanese subsidiary to demand from one customer for certain third party products we sell through this division. We believe the significant increase in the net revenues of our Intestlogic operation reflects strong customer acceptance of the products manufactured by this subsidiary. We believe the significant decreases in the net revenues of our temperature management and tester interface product segments as well as in the remaining operations included in our manipulator/docking hardware segment reflect the aforementioned weaker cyclical demand in the third quarter of 2005 as compared to the stronger demand experienced in the same period in 2004. We believe the larger percentage decrease in our tester interface segment reflects the decreased production requirements of our customers that began in late 2004 and has continued into 2005, and that the smaller percentage decrease in the sales of our temperature management segment reflects the fact that these products are used in less cyclical non-production environments, such as research and development laboratories, as well as in industries outside semiconductor test.

During the quarter ended September 30, 2005, our net revenues from customers in the U.S. decreased 26% while our net revenues from customers in Europe and Asia increased 13% and 30%, respectively, over the comparable prior quarter. The decline in net revenues from U.S. customers reflects the aforementioned decline in demand that began in late 2004 and has continued into 2005. The increases in net revenues from customers in Europe and Asia primarily reflect the increases at our Intestlogic operation and our Japanese subsidiary, as previously discussed.

Gross Margin. Gross margin was 39% for the third quarter of 2005 as compared to 40% for the same period in 2004. The decline in gross margin was primarily the result of an increase in our component material costs as a percentage of net revenues. Our component material costs were 40% for the quarter ended September 30, 2005 compared to 38% for the same period in 2004. We attribute this increase primarily to product and customer mix. Also contributing to the increase, but to a lesser extent, was an increase in excess and obsolete inventory charges. For the quarter ended September 30, 2005 we recorded excess and obsolete inventory charges of \$559,000, or 3% of net revenues, as compared to \$446,000, or 2% of net revenues, for the same period in 2004. These increases were partially offset by decreases in fixed operating costs and direct labor. In absolute dollar terms, fixed operating costs and direct labor decreased \$776,000 and \$235,000, respectively, for the third quarter of 2005 over the comparable prior period. As a percentage of net revenues, direct labor was relatively unchanged at 3%, while our fixed operating costs were 14% and 16% of net revenues for the quarters ended September 30, 2005 and 2004, respectively. We attribute these decreases primarily to the various cost structure and organizational changes we have implemented since late 2004.

Selling Expense. Selling expense was \$2.5 million for the third quarter of 2005 compared to \$3.2 million for the same period in 2004, a decrease of \$668,000 or 21%. We attribute the decrease primarily to a decrease in warranty expense and, to a lesser extent, decreases in salary and benefits expense, travel and freight. Warranty expense decreased \$478,000 from the comparable prior quarter. During the third quarter of 2004, we accrued \$168,000 for product retrofits and other costs associated with several products sold to three ATE manufacturers, as well as \$200,000 as a result of negative trends in our historical claims experience. During 2005 there were no similar charges. The reduction in salary and benefits expense reflects cost containment initiatives implemented late in 2004. The reductions in travel and freight reflect both the decreased business activity in the third quarter of 2005 compared to the same period in 2004 as well as the aforementioned cost containment initiatives.

Engineering and Product Development Expense. Engineering and product development expense was \$1.5 million for the third quarter of 2005 compared to \$1.7 million for the comparable prior period, a decrease of \$167,000 or 10%. We attribute the decrease primarily to a \$260,000 reduction in salary and benefits expense. This reduction was primarily the result of the aforementioned cost containment initiatives. This decrease was partially offset by a \$183,000 increase in the use of third party consultants, primarily by our tester interface product segment related to specific product development projects.

General and Administrative Expense. General and administrative expense was \$1.9 million for the third quarter of 2005 compared to \$2.1 million for the same period in 2004, a decrease of \$148,000 or 7%. We attribute the decrease primarily to a \$236,000 reduction in salary and benefits expense as a result of the aforementioned cost containment initiatives. To a lesser extent there was a reduction in accruals for officer bonuses. In 2005, no profit related bonuses have been accrued as our cumulative results for the year are a net loss. These decreases were partially offset by the recording of \$72,000 of long-term incentive compensation expense during the third quarter of 2005 related to grants of restricted stock, as well as increased levels of professional fees related to legal services.

- 18 -

inTEST CORPORATION

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

Restructuring and Other Charges. Restructuring and other charges were \$28,000 for the third quarter of 2005; there were no comparable expenses incurred during the third quarter of 2004. The restructuring and other charges recorded during the third quarter of 2005 consisted primarily of severance and related costs associated with a workforce reduction at our facility in San Jose, California.

Other Income. Other income was \$54,000 for the third quarter of 2005 compared to \$36,000 for the comparable period in 2004, an increase of \$18,000. The increase in other income was primarily due to an increase in interest income combined with a reduction in the level of foreign exchange losses experienced during the third quarter of 2005 as compared to the same period in 2004.

Income Tax Expense (Benefit). For the quarter ended September 30, 2005, we recorded income tax expense of \$123,000 compared to an income tax benefit of \$384,000 for the same period in 2004. Our effective tax rate was 24% for the third quarter of 2005 compared to (45)% for the same period in 2004. As of both September 30, 2005 and 2004, due to our history of operating losses, we have a full valuation allowance against all deferred tax assets, including net operating loss carryforwards, where we believe it is more likely than not that we will not have sufficient taxable income to utilize these assets before they expire. The income tax expense recorded during the third quarter of 2005 is comprised of a \$52,000 tax benefit related to a domestic income tax refund we received during the quarter. This amount was offset by \$175,000 of foreign income tax expense on the earnings of certain of our foreign operations where we do not have net operating loss carryforwards to offset income tax expense on those earnings. The income tax benefit recorded during the third quarter of 2004 is comprised of a \$482,000 tax benefit related to our domestic operations offset by \$98,000 of foreign income tax expense on the earnings of certain of our foreign operations. The benefit recorded during the third quarter of 2004 related to our domestic operations brought our year-to-date income tax expense on these operations to \$0 as of September 30, 2004. As of September 30, 2004 our estimate was that we would not have sufficient taxable income to fully utilize our remaining Federal net operating loss carryforwards during 2004.

Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004

Net Revenues. Net revenues were \$39.3 million for the nine months ended September 30, 2005 compared to \$59.2 million for the same period in 2004, a decrease of \$19.9 million or 34%. For the first nine months of 2005, the net revenues of our manipulator/docking hardware, temperature management and tester interface segments decreased \$12.1 million or 37%, \$1.7 million or 10% and \$7.4 million or 59%, respectively, over the comparable period in 2004. We believe the decrease in our net revenues reflects the aforementioned weaker cyclical demand in our industry in 2005 compared to 2004. We believe the larger percentage decreases in our manipulator/docking hardware and tester interface segments reflect the decreased production requirements of our customers that began in the third quarter of 2004 and has continued into 2005, and that the smaller percentage decrease in the sales of our temperature management segment reflects the fact that these products are used in less cyclical non-production environments, such as research and development laboratories, as well as in industries outside semiconductor test.

During the nine months ended September 30, 2005, our net revenues from customers in the U.S., Europe and Asia decreased 41%, 16% and 4%, respectively, over the comparable period in 2004. The smaller percentage decline for our European customers was partly the result of the significant appreciation of the Euro against the U.S. dollar that has occurred since the first quarter of 2004. When adjusted to eliminate the effect of the change in exchange rates, the percentage decline in the net revenues from our European customers for the first nine months of 2005 was 19%. In addition, the smaller percentage decline for our European customers reflects the fact that sales of temperature management products represent a higher percentage of our total European sales than they do of our domestic sales, and, as previously discussed, sales of our temperature management products have not been as significantly impacted by the weakened demand in the industry. Finally, the lower percentage decline in sales to European customers can also be attributed to the fact that the sales of our Intestlogic operation in Rosenheim, Germany actually increased in the first nine months of 2005 as compared to the same

period in 2004. We believe this reflects the strong customer acceptance of the products manufactured by this subsidiary. The smaller percentage decline for our customers in Asia primarily reflects an increase in sales of third party products by our Japanese subsidiary during the first nine months of 2005 as compared to the same period in 2004.

Gross Margin. Gross margin was 35% for the nine months ended September 30, 2005 as compared to 43% for the same period in 2004. The decline in gross margin was primarily the result of our fixed operating costs not being as fully absorbed in 2005 due to the significantly lower net revenue levels in the first nine months of 2005 as compared to the same period in 2004. As a

- 19 -

inTEST CORPORATION

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

percentage of net revenues, our fixed operating costs were 20% and 15% for the nine months ended September 30, 2005 and 2004, respectively. In absolute dollar terms, our fixed operating costs decreased \$945,000 during the first nine months of 2005 as compared to the same period in 2004. This decrease was primarily due to lower salary and benefits expense as a result of the cost containment initiatives we put into place during late 2004 and early 2005. This decrease was partially offset by a reduction in the utilization rates of our internal machine shop operations in both our Cherry Hill, New Jersey and our San Jose, California facilities, as well as an increase in our insurance premiums. Our component material costs were 39% for the nine months ended September 30, 2005 as compared to 37% for the comparable period in 2004. We attribute the increase in component material costs primarily to product and customer mix. Our excess and obsolete inventory charges totaled \$1.0 million, or 3% of net revenues, for the first nine months of 2005 as compared to \$1.1 million, 2% of net revenues, for the same period in 2004. Finally, while the absolute dollar value of direct labor decreased by \$424,000, as a percentage of net revenues direct labor increased to 4% for the first nine months of 2005 as compared to 3% for the same period in 2004.

Selling Expense. Selling expense was \$7.0 million for the nine months ended September 30, 2005 compared to \$9.2 million for the same period in 2004, a decrease of \$2.2 million or 24%. We attribute the decrease primarily to a \$1.1 million decrease in product warranty costs as well as lower levels of commission expense. The decrease in product warranty costs is due in part to the fact that the first nine months of 2004 included \$513,000 in charges related to product retrofits and other costs associated with several products we sold to three ATE manufacturers. In addition, during the third quarter of 2004, we recorded charges of approximately \$200,000 as a result of negative trends in our historical claims experience. There were no similar charges in the first nine months of 2005. The decrease in commission expense of \$480,000 was primarily due to the significantly lower net revenue levels. To a lesser extent, decreases in salary and benefits expense, travel expenses, freight and advertising also contributed to the decreased selling expense. The decreases in these expense categories reflect both the aforementioned cost containment initiatives as well as decreased business activity.

Engineering and Product Development Expense. Engineering and product development expense was \$4.5 million for the nine months ended September 30, 2005 compared to \$4.9 million for the same period in 2004, a decrease of \$491,000 or 10%. We attribute the decrease primarily to a \$787,000 reduction in salary and benefits expense. This reduction was primarily the result of the aforementioned cost containment initiatives. To a lesser extent there were also decreases in spending on supplies and travel. These decreases were partially offset by a \$474,000 increase in the use of third party consultants, primarily by our tester interface product segment related to specific product development projects.

General and Administrative Expense. General and administrative expense was \$5.9 million for the nine months ended September 30, 2005 compared to \$6.1 million for the same period in 2004, a decrease of \$244,000 or 4%. We attribute the decrease primarily to a \$357,000 reduction in accruals for officer and employee bonuses. In 2005, no profit related bonuses have been accrued as our cumulative results for the year are a net loss. To a lesser extent, decreases in salary and benefits expense, travel and data processing costs during the first nine months of 2005 as compared to the same period in 2004 also contributed to the reduced level of general and administrative expense. During 2004, we implemented a new company-wide ERP system. The implementation process required significant additional travel and use of third party consultants to complete. The system implementation was completed in 2004; therefore, no charges associated with this process were recorded in 2005. These decreases were partially offset by the recording of \$203,000 of long-term incentive compensation expense during the first nine months of 2005 related to grants of restricted stock. In addition, professional fees associated with our audit and tax services and preparation for compliance with new securities regulations increased \$106,000 for the first nine months of 2005 as compared to the same period in 2004.

Restructuring and Other Charges. Restructuring and other charges were \$448,000 for the nine months ended September 30, 2005; there were no comparable expenses incurred during same period in 2004. The restructuring and other charges recorded during the first nine months of 2005 consisted of \$234,000 in severance and related costs and \$179,000 in lease termination costs resulting from the closure of our U.K. manufacturing operation. In addition we incurred \$35,000 in severance and related costs associated with a workforce reduction at our facility in San Jose, California.

Other Income. Other income was \$194,000 for the nine months ended September 30, 2005 compared to \$90,000 for the same period in 2004, an increase of \$104,000. The increase in other income was primarily due to the receipt of \$79,000 in interest related to a domestic income tax refund we received during the second quarter of 2005 combined with lower levels of foreign exchange losses during the first nine months of 2005 as compared to the same period in 2004.

- 20 -

inTEST CORPORATION

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

Income Tax Expense (Benefit). Income tax expense was \$10,000 for the nine months ended September 30, 2005 compared to \$421,000 for the same period in 2004. Our effective tax rate for the first nine months of 2005 was 0% compared to 8% for the same period in 2004. As of both September 30, 2005 and 2004, due to our history of operating losses, we have a full valuation allowance against all deferred tax assets, including net operating loss carryforwards, where we believe it is more likely than not that we will not have sufficient taxable income to utilize these assets before they expire. The income tax expense recorded during the first nine months of 2005 is comprised of a \$243,000 tax benefit related to a domestic income tax refunds we received during the second and third quarters. This amount was offset by \$253,000 of foreign income tax expense on the earnings of certain of our foreign operations where we do not have net operating loss carryforwards to offset income tax expense on those earnings. The income tax expense recorded during the first nine months of 2004 represents foreign income tax expense on the earnings of these same operations.

Liquidity and Capital Resources

Net cash used in operations for the nine months ended September 30, 2005 was \$433,000 compared to net cash provided by operations of \$2.8 million for the same period in 2004. The shift to cash used in operations for the first nine months of 2005 from cash provided by operations for the same period in 2004 was primarily the result of our \$3.8 million loss in the first nine months of 2005 as compared to income of \$4.7 million for the same period in 2004. During the nine months ended September 30, 2005, accounts receivable increased \$3.7 million due primarily to the increase in sales in the third quarter of 2005. Inventories decreased \$2.2 million as a result of the sales activity during the first nine months of 2005. Refundable domestic income taxes decreased \$699,000 as a result of receiving Federal and state refunds during the second quarter of 2005. Accounts payable increased \$2.2 million over the amount at December 31, 2004 due primarily to the increase in sales in the third quarter of 2005. Other accrued expenses increased \$309,000 during the first nine months of 2005, primarily as a result of an increase in accrued professional fees, taxes and royalties. During this same time period, accrued sales commissions increased \$133,000 as a result of the increased sales activity. These increases were partially offset by decreases in accrued warranty and accrued restructuring of \$255,000 and \$123,000, respectively. These decreases reflect payment of previously accrued amounts.

Purchases of property and equipment were \$1.3 million for the nine months ended September 30, 2005, and were comprised of \$483,000 of purchases we paid for directly and \$854,000 of purchases paid for by our landlord. The purchases of property and equipment we paid for directly consisted of \$160,000 primarily for furniture and equipment for our tester interface division's new facility in San Jose, California, \$117,000 primarily for leasehold improvements for our Cherry Hill facility, and \$118,000 primarily for a combination of demonstration equipment and other equipment used in production for our Temptronic facility. The balance of purchases was for equipment for our foreign subsidiaries. The leasehold improvements for our Cherry Hill facility relate primarily to the relocation of our machine shop. Proceeds from the sale of property and equipment were \$163,000 for the nine months ended September 30, 2005 and relate to the sale of certain assets of our U.K. operation which we closed during the second quarter of 2005, as previously discussed.

The purchases that were paid for by a third-party, which totaled \$854,000, represent tenant improvements made at our tester interface division's new facility in San Jose, CA, which we occupied during the first quarter of 2005. These tenant improvements were paid for by the landlord based upon the terms of our lease agreement. At the same time that we capitalized these assets, we recorded a liability in the same amount for deferred rent which will be amortized on a straight line basis over the lease term and recorded as a reduction of rent expense.

We have no significant commitments for capital expenditures for the balance of 2005, however, depending upon changes in market demand, we may make such purchases as we deem necessary and appropriate.

Net cash provided by financing activities for the nine months ended September 30, 2005 was \$820,000, which represent payments made under capital lease obligations of \$78,000 netted against \$44,000 of proceeds from stock options exercised and the aforementioned \$854,000 in deferred rent resulting from landlord provided tenant improvements.

We have a secured credit facility that provides for maximum borrowings of \$250,000. We have not utilized this facility to borrow any funds. Our usage consists of the issuance of letters of credit in the face amount of \$250,000. We pay a quarterly fee of 1.5% per annum on the total amount of the outstanding letters of credit. The terms of the loan agreement require that we maintain a minimum level of \$200,000 of domestic cash. This credit facility expires on September 30, 2006.

- - 21 -

inTEST CORPORATION

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

As a result of the operating losses we experienced during the first nine months of 2005, our cash balances have declined to \$6.7 million at September 30, 2005 from \$7.7 million at December 31, 2004. During this same period, our trade accounts and notes receivable have increased to \$10.2 million from \$6.8 million.

We believe that our existing cash balances plus the anticipated cash to be provided by operations will be sufficient to satisfy our cash requirements for the foreseeable future. We currently anticipate that we will generate cash flow from operating activities ranging from \$1.5 to \$2.0 million during the fourth quarter of 2005. As a result, we have postponed discussions with several financial institutions about obtaining an increased credit facility, which discussions began during the second quarter of 2005. In light of our improved financial results in the third quarter of 2005 and our current near term outlook, we are evaluating our alternatives and will reconsider the need for obtaining an increased facility when appropriate. We cannot be certain, however, what the rate of increase or decrease in our net revenues or orders will be in future periods. If, as we believe, we have entered the next upturn and should the upturn be more rapid than we expect, or if the upturn should falter and the industry enters another downturn, we may require additional debt or equity financing to meet working capital or capital expenditure needs. We cannot be certain that, if needed, we would be able to raise such additional financing or upon what terms such financing would be available.

New Accounting Pronouncements

On October 22, 2004, the American Jobs Creation Act ("AJCA") was signed into law. AJCA contains many tax provisions that may affect us over the next several years as those provisions become effective. AJCA provides for the deduction for U.S. federal income tax purposes of 85% of certain foreign earnings that are repatriated, as defined in AJCA. During the second quarter of 2005, we completed our evaluation and determined that we would not benefit from the repatriation provisions provided by AJCA. Although AJCA also provides a special tax deduction related to our qualified production activity income, we will not benefit from this provision until our U.S. federal income tax loss carryforwards have been fully absorbed. AJCA's transitional rules applicable to the extraterritorial income exclusion regime will apply to us through 2006.

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, *Inventory Costs - an amendment of ARB No. 43*, which is the result of FASB's efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS No. 151 requires idle facility expenses, freight, handling costs, and wasted material (spoilage) costs to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of manufacturing be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

As previously mentioned, we currently apply APB 25 in accounting for our stock compensation plans. Accordingly, no compensation expense has been recognized for employee stock options issued with exercise prices equal to the market price on the date of grant. In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which amends SFAS No. 123 and supersedes APB 25. SFAS No. 123 (revised 2004), requires compensation expense to be recognized for all share-based payments made to employees based on the fair value of the award at the date of grant, eliminating the intrinsic value alternative allowed by SFAS No. 123. Generally, the approach to determining fair value under the original pronouncement has not changed; however, there are revisions to the accounting guidelines established, such as accounting for forfeitures. We are required to adopt this standard on January 1, 2006. We currently expect that our adoption of this standard will affect our operating results in a manner that is similar to our current proforma disclosures under SFAS No. 123.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. SFAS No. 154 replaces Accounting Principles Board Opinion No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

- - 22 -

inTEST CORPORATION

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

Critical Accounting Policies

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to inventories, identifiable intangibles, long-lived assets and related goodwill, deferred income tax valuation allowances and warranty reserves. We base our estimates on historical experience and on appropriate and customary assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Some of these accounting estimates and assumptions are particularly sensitive because of their significance to our consolidated financial statements and because of the possibility that future events affecting them may differ markedly from what had been assumed when the financial statements were prepared. As of September 30, 2005, there have been no significant changes to the accounting policies that we have deemed critical. These policies are more fully described in our 2004 Report on Form 10-K, as clarified, in the case of the disclosure of our critical accounting policies with respect to inventories, in this Report.

International Operations

Net revenues generated by our foreign subsidiaries were 30% and 22% of consolidated net revenues for the nine months ended September 30, 2005 and 2004, respectively. We anticipate that net revenues generated by our foreign subsidiaries will continue to account for a significant portion of consolidated net revenues in the foreseeable future. The net revenues generated by our foreign subsidiaries will continue to be subject to certain risks, including political and economic instability of foreign countries, the imposition of financial and operational controls or regulatory restrictions by foreign governments, the need to comply with a variety of U.S. and foreign export and import laws, weaknesses in the banking and equity markets of foreign countries, trade restrictions, changes in tariffs and taxes, longer payment cycles, fluctuations in foreign currency exchange rates, and the greater difficulty of administering business abroad. We cannot predict whether quotas, duties, taxes or other charges or restrictions will be implemented by the U.S. or any other country upon the importation or exportation of our products in the future. Any of these factors or the adoption of restrictive policies could have a material adverse effect on our business, financial condition or results of operations.

Net revenues denominated in foreign currencies were 19% and 9% of consolidated net revenues for the nine months ended September 30, 2005 and 2004, respectively. Although we seek to operate our business such that a significant portion of our product costs are denominated in the same currency as the associated sales, we may be adversely affected in the future due to our exposure to foreign operations. Moreover, net revenues denominated in currencies other than U.S. dollars expose us to currency fluctuations, which can adversely affect our results of operations.

Risks That Could Affect Future Results

A number of the matters and subject areas discussed in this Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report that are not historical or current facts deal with potential future circumstances and developments. These forward-looking statements typically can be identified by the use of terminology such as "believes," "expects," "may," "should" or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. Investors and prospective investors are cautioned that such statements are only projections and that actual events or results may differ materially from those expressed in any such forward-looking statements. In addition to other factors described elsewhere in this report, our actual consolidated quarterly or annual operating results have been affected in the past, or could be affected in the future, by factors, including, without limitation: the highly cyclical nature of the semiconductor industry; dependence upon capital expenditures of semiconductor manufacturers; changes in our customers' purchasing patterns; developments and trends in the semiconductor and ATE industries; changes in general economic, business and financial market conditions; future acquisitions and our ability to successfully integrate the businesses, technologies or products that we may acquire; costs and capital requirements associated with future acquisitions and integration of operations; the impairment of goodwill related to prior or future acquisitions; increased competition and potential loss of market share due to the expiration of patent rights; the loss of, or

- 23 -

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

reduction in orders from, one or more major customers; cancellation or delays in shipment of orders in our backlog; competition from other manufacturers of docking hardware, manipulators, tester interfaces and temperature management products; progress of product development programs; technological obsolescence of our inventory and obsolescence due to changes in demand for our products; product warranty expense related to product retrofits and other product replacements driven by the prototype nature of much of our business; unanticipated exchange rate fluctuations; the availability of qualified personnel; the ability to retain key personnel whose salaries have been reduced; strain on our management, employees and other resources due to significant fluctuations in our net revenues; the ability to effectively reduce and control operating costs and successfully restructure our operations to reduce our break-even point; competitive pricing pressures; the mix of products sold; the mix of customers and geographic regions where products are sold; increases in raw materials and fabrication costs associated with our products; the development of new products and technologies by our competitors; our ability to obtain patent protection and to enforce patent rights for existing and developing proprietary technologies; the utilization of management time and the expenses of various professionals retained to assist us with compliance with new securities regulations; changes in financial accounting standards; and the sufficiency of cash balances, lines of credit and net cash from operations. Additional information regarding these risks and uncertainties may be found elsewhere in this report or in our other periodic reports filed with the SEC, including our 2004 Form 10-K.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Exchange Rate Risk Management

We are exposed to currency exchange rate risk in the normal course of our business, primarily in our foreign operations. Our exposure results from the fact that some or all of the product sales at these operations are in one currency and inventory purchases are in another currency. In our Singapore operation, 100% of our sales are in U.S. dollars but some of our manufacturing costs are in Singapore dollars. In our Japanese operation, 100% of our sales are in Japanese yen and inventory purchases are in U.S. dollars. In one of our German operations, our sales are in Euros while inventory purchases are in U.S. dollars. In our other German operation, a portion of our sales are occasionally in U.S. dollars but all of our manufacturing costs are in Euros. From time to time we employ risk management strategies, including the use of forward exchange rate contracts, to manage our exposure to exchange rate risks involving the yen, and may, in the future, use forward exchange rate contracts to manage our exposure to exchange rate risks involving the Singapore dollar or the Euro.

Our objective in managing currency exchange risk is to minimize the impact of significant currency exchange rate fluctuations. We use forward exchange rate contracts to establish a fixed conversion rate between the Japanese yen and the U.S. dollar so that the level of our gross margin from sales in Japan is not negatively affected by significant movements in the Japanese yen to U.S. dollar exchange rate. From time to time, we purchase forward exchange rate contracts in the amounts management deems appropriate in light of the amount of the U.S. dollar denominated obligations of our Japanese subsidiary that are due within the month. We do not purchase forward contracts with settlement dates beyond 30 days. As of September 30, 2005, there were no forward exchange rate contracts outstanding.

It is our policy to enter into forward exchange rate contracts only to the extent necessary to achieve the desired objectives of management in limiting our exposure to significant fluctuations in currency exchange rates. We do not hedge all of our currency exchange rate risk exposures in a manner that would completely eliminate the impact of changes in currency exchange rates on our net earnings. We do not expect that the results of our operations or our liquidity will be materially affected by these risk management activities.

Interest Rate Risk Management

As of September 30, 2005, we had cash and cash equivalents of \$6.7 million. We generally place our investments in U.S. Treasury obligations or money market funds backed by such investments. We do not hold any derivatives related to our interest rate exposure. Due to the average maturity and conservative nature of our investment portfolio, a sudden change in interest rates would not have a material effect on the value of the portfolio. Management estimates that had the average yield of our investments decreased by 100 basis points, our interest income for the nine months ended September 30, 2005 would have decreased by less than \$49,000. This estimate assumes that the decrease occurred on the first day of the period and reduced the yield of each investment by 100 basis points. The impact on our future interest income of future changes in investment yields will depend largely on the gross amount of our cash, cash equivalents and short-term investments. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."

- 24 -

inTEST CORPORATION

Item 4. CONTROLS AND PROCEDURES

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

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

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

Limitations on the Effectiveness of Controls. Our management, including the CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, as opposed to absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within an entity have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns

can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a system of controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, our management has designed the disclosure controls and procedures to provide reasonable assurance that the objectives of the control system were met.

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time we may be a party to legal proceedings occurring in the ordinary course of business. We are not currently involved in any material legal proceedings.

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

None

Item 3. Defaults Upon Senior Securities

None

- 25 -

inTEST CORPORATION

PART II. OTHER INFORMATION (Continued)

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

The Annual Meeting of Stockholders of the Company was held on July 27, 2005 (the "Meeting"). Notice of the Meeting was mailed to stockholders of record on or about June 24, 2005, together with proxy solicitation materials prepared in accordance with Section 14(a) of the Securities Exchange Act of 1934, as amended, and the regulations promulgated thereunder.

In the election of the members of the Board of Directors, there was no solicitation in opposition to the nominees of the Board of Directors for election to the Board of Directors and all such nominees were elected. The number of votes cast for or withheld for each nominee for election to the Board of Directors were as follows:

<u>Nominee</u>	<u>For</u>	<u>Withheld</u>
Alyn R. Holt	8,409,743	252,883
Robert E. Matthiessen	8,614,298	48,328
Richard O. Endres	7,025,410	1,637,216
Stuart F. Daniels, Ph.D.	8,457,632	204,994
James J. Greed, Jr.	8,569,343	93,283
Joseph A. Savarese	6,551,097	2,111,529
James W. Schwartz, Esq.	8,569,343	93,283
Thomas J. Reilly, Jr.	8,619,568	43,058

Item 5. Other Information

None

Item 6. Exhibits

3.1* Articles of Incorporation: Previously filed by the Company as an Exhibit to the Company's Registration Statement on Form S-1, File No. 333-26457, and incorporated herein by reference.

3.2* By-Laws: Previously filed by the Company as an Exhibit to the Company's Registration Statement on Form S-1, File No. 333-26457, and incorporated herein by reference.

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a).

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a).

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Indicates document previously filed

- 26 -

Signatures

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

inTEST Corporation

Date: November 14, 2005 /s/ Robert E. Matthiessen
Robert E. Matthiessen
President and Chief Executive Officer

Date: November 14, 2005 /s/ Hugh T. Regan, Jr.
Hugh T. Regan, Jr.
Treasurer and Chief Financial Officer

Index to Exhibits

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32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Indicates document previously filed

- 27 -

CERTIFICATION

I, Robert E. Matthiessen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of inTEST Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) [Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986];
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2005

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

CERTIFICATION

I, Hugh T. Regan, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of inTEST Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) [Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986];
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2005

/s/ Hugh T. Regan, Jr.
Hugh T. Regan, Jr.
Treasurer and Chief Financial Officer

inTEST CORPORATION

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of inTEST Corporation (the "Company") on Form 10-Q for the period ending September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert E. Matthiessen, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 14, 2005

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

inTEST CORPORATION

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of inTEST Corporation (the "Company") on Form 10-Q for the period ending September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Hugh T. Regan, Jr., Secretary, Treasurer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 14, 2005

/s/ Hugh T. Regan, Jr.
Hugh T. Regan, Jr.
Secretary, Treasurer and Chief Financial Officer