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

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

Shawn Southard: Thank you. Good morning, everyone. We appreciate you joining the call today and your interest in inTEST Corporation.

Here with me are Nick Grant, our President and CEO, and Duncan Gilmour, our Chief Financial Officer and Treasurer.

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

If you'll turn to Slide 2, I will review the Safe Harbor statement. You should be aware that we may make some forward-looking statements during the formal discussions, as well as during the Q&A session. These statements apply to future events that are subject to risks and uncertainties, as well as other factors that could cause actual results to differ materially from what is stated here today.

These risks and uncertainties and other factors are provided in the earnings release, as well as in other documents filed by the Company with the Securities and Exchange Commission. These documents can be found on our website or at sec.gov.

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

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

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

I plan to provide some high-level remarks for you, then I'll hand it off to Duncan to speak to the specific results of the quarter and full year. Once he's finished, he'll hand it back to me to speak to our Orders and Backlog, and our expectations and goals for 2023 and beyond. Then we'll take your questions and I'll wrap up with a few closing remarks.

Let me start by saying I'm extremely pleased with the results we were able to achieve in 2022. I want to acknowledge the outstanding efforts of our employees across the globe. Solid execution of our 5-Point Strategy by our results driven team delivered record performance in 2022 including orders, backlog, and revenue. Revenue and orders for the quarter and the year were also in-line with our previously announced preliminary results. Our fourth quarter revenue surpassed $32 million - up 45%, and our full year revenue was approximately $117 million - up 38%, versus the prior year.

These results include a full year of the impact of the acquisitions we made in 2021 and integrated in 2022 including North Sciences, formerly Z-Sciences and Videology, both acquired in October 2021, and Acculogic, which was acquired in December 2021. Going forward these operations will be fully accounted for as a part of our organic revenue.

Our organic revenue grew a very healthy 28% in the fourth quarter and 17% for the full year.

Fourth quarter orders of $31 million increased 3%, while our full year 2022 orders of $130 million increased 27% versus the prior year with strong demand in semiconductor, automotive including electric vehicles or EVs, defense/aerospace, and life sciences. Additionally, our backlog at the end of the fourth quarter remained strong at $47 million.

By expanding our addressable markets, building out our sales channels, building our talent and staffing, and driving innovation with new products, we've successfully expanded our geographic reach, widened our customer base, and grew our target market offerings and positions. Further demonstrating the success of our strategy, we integrated the three acquisitions that added new technologies and deepened our presence in our target markets.

Our goal with the 5-Point Strategy is to accelerate growth while diversifying the business. To remind everyone, the elements of our strategy are:

- Global and market expansion;
- Innovation and differentiation;
- Service and support;
- Talent and culture; and
- Strategic acquisitions and partnerships.

As a result of the investments and focus we have made in these areas to expand our customer base and increase channel partners, we were able to capture organic revenue growth across all our markets last year. This growth was fueled both by end market demand for our highly engineered technology solutions as well as the impact of the acquisitions.

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

Duncan Gilmour: Thank you, Nick.

Starting on Slide 4, revenue for the fourth quarter 2022 was $32.4 million, up 45%, or $10 million, versus the same period last year and at the top end of our guidance range of $30 to $32 million.

This revenue growth of $10 million comprised $3.7 million of acquired revenue, and $6.3 million of organic revenue, representing 28% year-over-year organic revenue growth. Independent of organic or acquired, inorganic categories, we experienced strong demand across our offerings contributing to growth in all our target markets.

Silicon carbide growth applications, along with test solutions for analog and mixed signal applications, drove semi sales to $19.5 million, up 58% year-over-year. Demand for both our existing and acquired technologies grew in the defense/aero market, while our acquisitions were the main contributor to growth in the security, auto/EV, and life sciences markets – and this broadening contribution is indicative of the Company's strategy to diversify and expand revenue with new customers and from new markets.

Moving to Slide 5, gross margin of 46.2% in the quarter, was very similar to the prior-year Q4 period. Compared with the trailing quarter, gross margin improved 100 basis points reflecting higher volume and beneficial shifts in product mix.

Supply chain and logistics challenges are abating somewhat – or more realistically, are becoming a normalized part of our business. Our teams have continued to adapt admirably through these challenging times.

As you can see on Slide 6, our operating expenses were relatively consistent with our trailing third quarter, and down 110 basis points as a percentage of revenue, driven by operating leverage as the business scales.

As a percentage of revenue, operating expenses declined more than 1,000 basis points from the prior year period. Note that last year's fourth quarter included $1.3 million in transaction costs related to acquisitions and financing. The $0.9 million total increase over the prior-year period includes the incremental operating expenses from acquired businesses which added approximately $1.9 million. We also invested in sales & marketing and engineering as we executed on our strategy to drive growth.

Pre-Tax intangible asset amortization was down $43,000 from the third quarter.

Turning to Slide 7, you can see our bottom line and Adjusted EBITDA results. We had net earnings of $3.2 million or $0.30 per diluted share for the fourth quarter. On an adjusted basis, non-GAAP EPS was $0.34 per share compared with $0.28 per share in the third quarter. Adjusted EPS reflects adding back tax effected acquired intangible amortization.

On an after-tax basis, acquired intangible amortization amounted to $463,000 in the fourth quarter. We expect after tax intangible amortization for the first quarter to decline slightly to approximately $450,000.

Adjusted EBITDA, which excludes stock-based compensation, was
$5.3 million, a nice improvement over both the prior-year and trailing quarters.

Slide 8 shows our capital structure and cash flow. After the $25m increase in our term loan facility at the end of Q3, we ended the year with $30 million available under this facility. We also have the full $10 million available under our working capital revolver. We believe we are effectively leveraging the balance sheet to achieve our goals and have the financial flexibility to continue executing on our 5-Point Strategy for growth. We continue to balance that with our objective to maintain a total debt to Adjusted EBITDA ratio under 2.5x. As you can see on the slide, our current leverage ratio is just 1x giving us considerable flexibility to continue to pursue our acquisition strategy.

Our cash and equivalents at the end of the fourth quarter were $13.4 million. We also have $1.1 million in restricted cash related to a pre-payment on a customer order. As we did in the prior two quarters, we repaid $1 million of debt, bringing it down to $16.1 million. Note that repayment of debt does not increase funding available under the terms of our term-loam facility.

While for the year we used cash from operations to fund both growth and build inventory to address supply chain shortages, we have in the last two quarters been converting more earnings to cash and generated $2.3 million in cash from operations in the fourth quarter and $3.7 million in the second half of 2022. As we go forward, we expect we will continue to generate positive cash flow from operations.

Capital expenditures during the year were $1.4 million, up from about $1.0 million in 2021. Our capex requirements continue to be planned at about 1% to 2% of revenue.

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

Nick Grant: Thanks, Duncan.

As previously mentioned, our fourth quarter orders were $31 million – an increase of 3% versus the prior-year. This reflected increases across all end markets except in semi. Our orders to the semi market declined $6.6 million compared with last year's fourth quarter, but I'll remind you that last year's fourth quarter benefitted from a record approximately $10 million order for our induction heating solutions serving silicon carbide crystal growth.

Sequentially, our orders declined 4% driven by the timing of orders for semi and automotive/EV markets. This was partially offset by increased orders for the life sciences, security, and other markets.

Our backlog at the end of the year, was approximately $47 million, up 37% versus the prior year. Our Backlog declined sequentially about 2% as supply chain constraints moderated enabling us to increase shipments to better meet customer demand. Approximately 45% of the backlog is expected to ship beyond the first quarter of 2023.

Now I'd like to speak to our outlook for the First Quarter 2023 and our Full Year 2023 expectations on Slide 10.

As we enter 2023, we're excited about where we're headed. While the quarterly cadence of orders may be a bit lumpy, we are confident that we can achieve our revenue target, which represents high single-digit organic growth. In fact, this is despite the variability that we expect in our back-end semi market. Encouragingly, our customers in this space are indicating they continue to see positive secular growth trends over the long-term. In addition, we continue to pursue strategic acquisitions and partnerships to expand our portfolio and better serve our target markets.

We expect revenue for the first quarter of 2023 to be in the range of $30 to $32 million with a gross margin of approximately 45%.

First quarter operating expenses, including amortization, should run between $11.1 million and $11.3 million.

Intangible asset amortization is expected to be approximately $540,000 pre-tax, or $450,000 after tax.

Given loan balances and current rates, our interest expense should be approximately $190,000 for the quarter.

We anticipate first quarter 2023 EPS to be in the range of 21 to 26 cents, while adjusted EPS should be in the range of 25 to 30 cents. As a reminder, we simply adjust for tax-effected amortization expense.

We expect our high single-digit growth this year to be driven by strong demand across nearly all technology offerings and end markets. Customers' demand for our products in automotive/EV, defense/aerospace, and life sciences industries has been strengthening where we have broadened our exposure through acquisitions. Additionally, demand for our front-end Semi applications around Silicon Carbide Crystal Growth remains robust. We do expect our back-end Semi to moderate in the second half of the year.

Revenue for the full year 2023 is expected to range from $125 to $130 million. This does not include the potential impact from any additional acquisitions we may make.

Our gross margin in 2023 is expected to be consistent with 2022, or about 45% to 46%. Operating expenses should be in the range of $44 to $46 million. This includes intangible asset amortization expense of approximately $2.1 million for the full year. This translates to tax adjusted amortization expense of approximately $1.7 million for determining adjusted earnings. Our effective tax rate is expected to be similar to 2022, or approximately 16-17%.

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

Slide 11 highlights our revenue growth goals for 2025 that we outlined during our 2022 Investor Day. This demonstrates the success that we are having against our plan. Based on our 2023 revenue expectation of $125 to $130 million, we will have grown the Company at a greater than 30% CAGR since we implemented our 5-Point Strategy. We expect to continue driving high single digit organic growth, coupled with strategic acquisitions, enabling us to achieve our 2025 goal of between $200 and $250 million in revenue.

This includes targets for additional acquisitions we may make in between now and then. Acquisitions are an important element of our long-term strategy. We have an active pipeline of opportunities, and we have flexibility with our capital structure that we believe will allow us to execute on our plan.

If you'll turn to Slide 12, given our expectations for topline growth, we believe we can drive meaningful earnings and cash generation as we scale. We believe our plan positions us to deliver divisional operating income of $40+ million, adjusted EBITDA of approximately $30+ million and improve earnings power to approximately $20+ million - all by 2025.

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

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

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

Q&A

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

Jaeson Schmidt: Congrats on the strong finish to the year and really strong outlook. I know in your prepared remarks, you mentioned that you expect growth across all your segments. Just curious if you could let us know what end market you feel most confident on? And I guess relatedly, which end market do you think is the biggest risk?

Nick Grant: Jason thanks for the comments. I'm really pleased with the results last year. We do anticipate our technology divisions will drive growth in 2023. Different product platforms serving different markets with our innovation should continue to create demand. So as for which segments, we believe the automotive/EV will be a nice segment for us, and just a reminder, that does not include our silicon carbide crystal growth solutions. Those are in our semi segment. We do believe front-end semi will be strong again in 2023, and our Life Science applications should also continue to grow. So, we're pretty excited. We believe we've got the right target markets we're going after. We've got the right products. And yes, we have the right teams in place.

Jaeson Schmidt: Okay. That's helpful. And then just as a follow-up. Your comments on the semi market or expectation for the semi market to moderate in the second half. I was just curious if that is what your customers are telling you that they will need this digestion period or if you guys are being a bit more conservative just given the momentum you expect here in the first half?

Nick Grant: We're working closely with our customers for timing on when these CapEx projects actually get funded. There is still a bit unknown, like whether they slip a quarter or two. So, we don't want to throw something out there that we're not confident we can achieve.

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

Ted Jackson: Thank you very much and again, I'm going to reiterate congratulations on the quarter and the year. I have two questions for you. And the first one, you've actually really done a nice job in kind of highlighting already. But you do break out revenue across seven different verticals. And I just kind of wanted to get a description and maybe out of the verticals that you haven't talked about as much, but what's really the growth drivers for them.

So maybe we can talk a little bit about defense and you've hit the semi and auto/EV pretty well. What's the key macro driver in each of them? And then what particular product benefits from that? And then my second question, just wanted to touch on the M&A strategy. It's a pretty important part of your growth. Clearly, looking around, can you put a little color around what type of activity is going on there, how full the pipeline is and kind of the markets or the segments within your business that you're looking to grow through that?

Nick Grant:

Relative to the market segments, we've touched a little bit on semi. We believe front-end semi will continue to drive nice demand for us in 2023 and beyond. Back-end semi, we indicated we saw from 2021 historical highs, in 2022, a little bit of moderation. We are forecasting that to continue in 2023, and our front-end semi should still more than offset that back-end moderation. So, we believe semi will grow overall.

As we look at auto/EV and our applications for our battery test solutions, we continue to drive more innovation with our products. We believe, we'll be creating some nice demand this year. We also are seeing some good demand for our chillers from a number of the traditional players in the auto/EV space. Shifting to Life Sciences, we continue to make good progress penetrating this space with two o four acquired businesses, North Sciences, which was Z-Science and Videology. North Sciences is the ultra-low temperature freezers and chillers serving the medical cold chain space. We are gaining traction in that market and believe that will be a nice growth engine for us this year. Likewise at Videology, the innovation we're driving with our new camera, the Scale X product that was launched at the end of Q4 is really ramping up to be formally in production at the end of Q1. That has some nice benefits for some applications in the Life Sciences space. We think that will be a good demand generator.

Then defense/aero, a market that was slow at the end of 2021 and the first part of 2022. We really started seeing some nice demand pick back up in the second half of 2022, and we expect that will continue in 2023.

Then the second part of your question on the M&A front. Our teams remain very active on M&A. As we've commented in the past, the approach we take is really more of a bottoms-up approach where each of the three technology divisions are driving pursuits and targeting companies to build the right relationships, so they see the benefits of being part of inTEST. That activity continues.

As for timing, it really comes down to when you have an agreed upon price and due diligence has been fully vetted. So, that's really up in the air. We stay very active in that front, and it will remain a key part of our core growth strategies going forward.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Peter Wright with Intro-act.

Peter Wright: Great. I'd like to add my congratulations, guys, on a wonderful record quarter and thank you for taking my questions.

My first question is on visibility and looking at your order backlog. You did mention lumpiness, I'm hoping you can help us understand in light of just such stable backlog over the last several quarters. What is driving lumpiness maybe on a forward-looking basis? Is there any attitude of customers that might be entering signs of reluctance? Or is it just size? If you could help us understand that.

And then my second question is looking at your guidance, there's clear signs of efficiencies projected forward. So if I look at kind of a 9-ish percent revenue growth number and your OpEx only grown about 3%, taking the midpoint, that's very good efficiencies going forward. If you could help us understand what some of those efficiencies are, that would be helpful.

Nick Grant: I'll touch on the orders and the lumpiness and then I'll let Duncan speak a to the guidance and the leverage. So relative to the lumpiness that we see, Peter, is this shift that we've noticed from customers placing longer lead time blanket orders, that will lay out deliveries over multiple quarters. Due to the size of those orders when they come in, it really can create a very lumpy pattern in the order timing.

We mentioned the large $10 million order we got at the end of 2021, which was making a bit of a tough comparison in Q4 of 2022. Throughout 2022, our largest order was $3 million. We do anticipate that we'll see three or more sizeable orders that can really skew numbers depending on timing. So that's really what's driving the comment around lumpiness. It's just this marketplace has driven customer behavior to try to lock in pricing and secure supply over longer lead times.

Duncan Gilmour: I would also add, that's why our quarter-over-quarter order numbers, for example, are never going to be as stable or smooth as we're going to see in terms of revenue. So, I think part of what we're trying to convey is just the fact that there is going to be that quarter-to-quarter lumpiness because of that dynamic.

On the efficiency point, I think you captured it, to some extent, in your question, Peter. It's really all about growing our expenses at a slower rate than we're growing the top line. Over the long term, that's exactly what we're trying to do. So, I think as you pointed out, high single-digit top line growth, with lower mid-single digit expense growth, helps drive our efficiency and improve profitability. Obviously, there's mix shifts and things like that going on within the business as well that can change things with respect to profitability metrics. It's really as simple as that, quite honestly.

Peter Wright: That's wonderful. If I could have one follow-up. If you could just help us understand what free cash flow was for the year. And the purpose of the question is really to try and understand the earnings power in your 2025 guidance. So if I look at the lower end, even if your range conservatively in a 10% margin, you're looking at $20 million of net income. If you have to acquire about $50 million of sales to achieve that, I'm trying to understand how much of it you can fund from operations, cash generation, and how much it will be somewhat dilutive to existing share count today. And the heart of the question is, what do you think earnings power per share is in 2025?

Duncan Gilmour: So let me unpack that a little bit. First, on free cash flow. As I think we outlined in our materials, for the full year, free cash flow was negative $2.8 million. It's important to understand that the second half of the year, our cash from operations of $3.7 million, translates to free cash flow of just over $3 million in the second half. In the first half of the year, we did use a lot of cash in terms of building inventory, building the balance sheet, given the growth that we've seen: backlog increasing from $25 million to $30 million in the back end of 2021, up close to $50 million closing out 2022. I think the second half of the year is indicative of what we see moving forward as we've made that investment in the balance sheet, so to speak.

With that cash from operations, we'll continue to pay down debt as we've done this year. We've taken our debt down by $4 million during the year. We'll continue to do that. We have our term loan facility available to us, which we talked about. We expanded that facility and have $30 million available there to use for acquisitions moving forward. We've talked about, from a leverage perspective, not wanting to be more than 2.5x from a borrowing perspective. We were sitting at 1x at the end of the year with $16 million of debt and $16 million of trailing 12 months EBITDA.

As we pay down debt, obviously, the debt number will come down. We'll continue to drive the business forward in terms of the cash generation. So, our borrowing capacity will increase. Depending on the size of any acquisition, obviously, we'll look to use debt to the extent we can, but we have other options available to us: capital markets, raising equity. So I think it's a shifting equation depending on what we're looking at. Hopefully, that gives you a little bit of flavor from a balance sheet perspective of where we are and where we think we're heading.

Operator: Thank you. Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Mr. Grant for final comments.

Nick Grant: Thank you, Melissa. I want to reiterate, that I am exceptionally proud of our global team, who delivered these outstanding results for 2022. We are driving a culture of openness, collaboration, and accountability at inTEST which we believe enabled us to deliver on our commitments to our customers throughout the year. We are making great progress toward our vision to be the supplier of choice for innovative test and process technology solutions globally.

Please note on Slide 14 that we will be presenting at the Sidoti Small Cap Conference on March 23rd; the Inaugural E.F. Hutton Global Conference on May 10th; and the Stifel Cross Sector Insight Conference on June 6th. We hope to see you all at these events.

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