

INTRICON, #4174661
INTRICON THIRD QUARTER 2009 RESULTS
October 28, 2009, 5:00 PM ET
Chairperson: Mark Gorder (Mgmt.)

Operator: Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the IntriCon Third Quarter 2009 Results conference call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be open for questions. If you have a question, please press the star, followed by the one on your touchtone phone. If you like to withdraw your question, please press the star, followed by the two. If you're on a speakerphone, you need to pick up your handset before making your selection. This conference is being recorded today, Wednesday, October 28th of 2009.

I would now like to turn the conference over to Mr. Scott Longval, Chief Financial Officer. Please go ahead, sir.

Scott Longval: Thank you, Operator. Joining me on today's call is Mark Gorder, IntriCon's CEO. Before we begin, I would like to preface our remarks with the customary Safe Harbor statement.

Today's conference call contains certain forward-looking statements. These statements are based on current estimates and assumptions of IntriCon's management and are subject to uncertainty and changes in circumstances. Given these uncertainties, you should not place undo reliance on these forward-looking statements. Actual results may vary materially from the expectations contained in today's call. Important factors that could cause such differences include, among others, those set forth under the headings Risk Factors and management's discussion and financial—and analysis of financial condition and results of operation in our 10-K filing for the year ended December 31st, 2008.

With that, I'd like to now introduce Mark for a strategic look at IntriCon's third quarter.

Mark Gorder: Thank you, Scott, and thank you everyone, for joining us today. I would like to begin by reviewing our 2009 third quarter results and key highlights for the Company. Then I will discuss our strategy and growth plan. After that, Scott will cover the financials in more detail before we open up the call for questions.

By this time most of you have had a chance to review our third quarter press release. In short, conditions were consistent with what we've been experiencing in the past year. Sequentially, I am pleased to report that we're making both top and bottom line progress.

Revenue was increased through the 2009 first and second quarters and we're narrowing our net loss quarter-over-quarter. We're still seeing order delays due to economic uncertainty and lower demand. However, we're mitigating the economy's effect by continuing to make internal adjustments to reduce costs and

better align our business model with the current climate. We are very encouraged by the fact that our medical business recorded its strongest quarter ever, growing 13.7% from the year ago period and up 5% sequentially from the 2009 second quarter. Medical revenues are primarily being driven by glucose monitor sales, a device that we manufacture for a large medical OEM.

In hearing health, patients continue to delay hearing aid purchases, resulting in lower sales levels. Hearing health is being impacted by pricing competition as well. As a result, more lower-priced devices are being sold, resulting in lower revenue for the same unit sales. We believe this is a temporary decline; as the market recovers, this trend should reverse itself. The long-term fundamentals for this business remain strong due to the aging population.

We are seeing some initial positive signs in our professional audio communications business as customers are beginning to restock inventories. Additionally, we remain focused on expanding our securities business by aggressively marketing our technical capabilities. Overall, we believe this business has stabilized and we'll post flat to modest sequential growth over the next few quarters as customers slowly start to replenish product.

Net sales for our core electronic segment declined—our non-core electronic segment declined 23.9% from the year earlier third quarter and 30.3% from the prior year nine months. Over the past few quarters, we have aggressively reduced costs to more properly align expenses with lower revenues. In addition to continuing to reduce the cost structure, we are exploring all strategic options for this segment. For the foreseeable future, we expect to face a challenging selling environment, particularly in hearing health. We remain focused on expanding our capabilities so that when we emerge from the current economic climate, IntriCon is poised to capitalize with newly differentiated offerings.

In line with that commitment, in August, we acquired Datrix, a supplier of patient monitoring devices with worldwide distribution to leading medical OEMs. Datrix gives us access to what we believe to be an estimated \$80 million market for cardiac diagnostic monitoring, or CDM, with particular emphasis on the emerging biotelemetry space. Datrix is currently developing a new wireless cardiac monitoring device. We are on track to unveil prototypes of our new device at the 2009 American Heart Association Scientific Session this November in Orlando, Florida.

In the biotelemetry arena, we remain active with strategic partner, Advanced Medical Electronics. IntriCon continues to work to develop devices that wirelessly transmit critical diagnostic and therapeutic information. In collaboration with AME, we have received approvals for grant funding for eight development programs, and we are in the process of applying for several more.

I want to reiterate that, as a company, we're making progress from where we were at the start of the year. Financial performance is improving and we're taking definitive steps to further our position as the body-worn device company. As I have previously noted, the marketplace is moving towards wireless body-worn

devices that offer critical monitoring capabilities. We're seeing that across nearly every industry, and we intend to support OEMs in the marketplace with new devices and continue to prudently invest in new initiatives that we believe will fuel long-term growth.

Now I'd like to turn the call back to Scott for an in-depth discussion of our financial performance.

Scott Longval:

Thank you, Mark. For the third quarter, IntriCon reported net sales of 14.2 million versus net sales of 16.1 million for the 2008 third quarter. The decline was due to the factors Mark just detailed. IntriCon's 2009 third quarter net loss was \$736,000 or \$0.14 per diluted share compared with net income of 309,000 or \$0.06 per diluted share for the year ago period. Included in the 2009 third quarter results were Datrix-related acquisition costs and bank financing charges totaling 532,000 or \$0.10 per diluted share.

For the quarter, the body-worn device segment, consisting of medical, hearing health and professional communications, recorded a net loss of 179,000 or \$0.03 per diluted share versus net income of 426,000 or \$0.08 per diluted share for the fiscal 2008 third period. We recorded a small, non-core electronics segment net loss of 25,000 or \$0.01 per diluted share compared to a 2008 third quarter non-core net loss of 117,000 or \$0.02 per diluted share. The charges related to the Datrix transaction were corporate charges and not associated with either business segment.

Gross margins for the 2009 third quarter were 20.5% compared to 24.5% in the year ago quarter. We continue to execute on gross margin improvement initiatives, such as implementing lean six sigma manufacturing principles in all of our manufacturing facilities. Additionally, our previously announced cost reduction program remains in effect indefinitely. We will continue to focus on these activities for the remainder of the fiscal 2009 and into fiscal 2010 to further increase margins and lower operating expenses.

On a pro forma basis, IntriCon's net income for the fiscal 2009 third quarter improved sequentially. After adding back costs associated with the Datrix acquisition, the debt refinancing and non-cash charges for depreciation, amortization and stock-based compensation, the Company generated 532,000 in pro forma net income for the quarter. We believe that this pro forma information helps analyze IntriCon's operating results, while eliminating non-recurring non-cash items. A reconciliation of GAAP-based net income to pro forma net income is included in the press release we issued today.

For the nine-month period, IntriCon reported net sales of 41.5 million and a net loss of 2.3 million or \$0.43 per diluted share. Included in the nine-month results were Datrix-related acquisition costs and bank financing charges of 546,000 or \$0.10 per diluted share. This compares to 2008 net sales of 50.2 million and net income of 869,000 or \$0.16 per diluted share. We decreased operating expenses in all categories except research and development. Exclusive of R&D, year-over-year operating expenses fell by 1.1 million or 13.1% for the nine-month period.

Looking at our nine-month results from a pro forma perspective, we generated pro forma net income of 376,000 and again, as previously stated, the Company has generated progressively improved pro forma results for each of the three quarters of 2009.

On a year-to-date basis, IntriCon generated 1.3 million in positive operating cash flow, largely due to tight working capital management. IntriCon's total cash cycle at September 30th, 2009, was 72 days using a three-month rolling average, a marked improvement from the second quarter of 92 days for the 2009 first and second quarters.

But taking a step back and putting the year into perspective, for each of the three quarters of 2009, IntriCon has generated progressively improved pro forma net income. We also have shown improved cash generation despite all the difficulties posed in the—posed in the current economic climate. This has been accomplished without impeding our continued commitment to prudent investments and proprietary technology in key research and development initiatives. We feel this strategy will fuel opportunities and capitalize on a more stable economy in the future.

Now finally, before I turn the call back over to the Operator for Q&A, I'd like to note that on Tuesday, November 3rd, we will be presenting at the 39th Annual TechAmerica AeA Classic Financial Conference at eight thirty in the morning at the Marriot San Diego Hotel and Marina in San Diego. We will be issuing a press release tomorrow regarding our attendance at the conference.

Now I'd like to turn back the call to the Operator so we can take some of your questions.

Operator: Thank you, sir. We will now begin the question and answer session. As a reminder, if you have a question, please press the star, followed by the one on your touchtone phone. If you would like to withdraw your question, press the star, followed by the two. If you're on a speakerphone, you need to pick up the handset before making your selection.

And our first question comes from the line of Stan Bergman with Mayberry Asset Management. Please go ahead.

Sam Bergman: Good afternoon, Mark and Scott.

Mark Gorder: How are you doing, Sam?

Scott Longval: Hi, Stan.

Sam Bergman: Good. And yourself?

Mark Gorder: Good.

Sam Bergman: A couple of questions; can you tell me how many employees started the year with the Company and what the final count is at the end of the third quarter?

Mark Gorder: Yes, I'll have Scott look that up here.

Scott Longval: As we look at the headcount, we've obviously had a dramatic cut in headcount throughout the year. If you exclude the acquisition, we started the year with about 622 employees. We ended the year with about 582 employees, and then we picked up an additional seven with the Datrix acquisition. So headcount is down significantly from where we were at the beginning of the year.

Sam Bergman: It just seems to me that the headcount didn't drop quick enough for the reduced sales that you had.

Scott Longval: Well as we look at—as we kind of looked at what—how we were going to attack the shortfall in the revenues, we did a number of things. The first thing that we did in the—towards the beginning of the year was, across the board, salary reductions. We suspended our 401K match and cut out a number of other level of expenses. Our thought process was we were going to continue to monitor the revenue levels, and with that, we wanted to make sure that we were not going to be turning over good talent for when the market did come back, that we would not be in a position to execute our strategic initiatives.

Mark Gorder: I'd add to that, Sam, that we did tiered wage reductions. It was 20% for myself, 15 for the executives, 10% for management and 5% for hourly people. It had kind of the equivalent of about a, at least a 10% headcount reduction and we felt that rather than do the headcount reduction, we wanted to maintain our development staff and some of the other key people so that when we finally did experience a comeback, which we're starting to see now, that we're in a strong position to rapidly accelerate our growth by introducing these new products. So we felt that was a good trade-off, a combination of actual headcount reductions and then these tiered wage reductions.

Scott Longval: And, Sam, just as a couple of data points, if I look at the headcount at the end of the year, we were at 622 heads. At the end of the first quarter, we were down to 583. So you can see in a short three-month period we acted—reacted very quickly. I say—I would say that our headcount has leveled off at those levels we were at the beginning of the first quarter.

Operator: Thank you. And our next question comes from the line of Sheldon Chester with RBC Wealth Management. Please go ahead.

Sheldon Chester: Yes, first of all, I applaud the progress you are making now. But could you see any products that you are working on now becoming a—as significant a product, similar to the blood glucose monitor that you have now?

Mark Gorder: I think there are a couple of areas that—where we see some great potential going forward. I think with the new Datrix acquisition and the launch of this mobile

cardiac outpatient telemetry device, so we're calling it our MPETS Device at the AHA, we think that—there's only one other supplier of that technology in the market today and we think that the launch of that, we're going to demo that product at the American Heart Association in November, and then probably we'll be ready in production some time around April of next year, and we think that that'll get a nice reception in the market because there is only one other supplier.

And we think also that the existing products of Datrix that have not been well marketed—because basically the business as we bought it was only—only had a marketing presence in the US market and not a strong one because it was a, basically a one-man operation and he was limited to how much marketing he could do. But now with IntriCon, we're putting together a—I would say a global marketing effort to get not only broader coverage in the US market, getting into more accounts, but also expanding into Europe through our Munich office and getting after the European market, which is just as big as the US market for cardiac diagnostic marketing. So we see some really good potential there.

In the hearing health side, we're launching a couple of new amplifiers that we think will do well next year. Our glucose sensor business continues to grow steadily forward and we expect good results from that next year. So I think all in all, we're pretty optimistic about—on a quarter-for-quarter basis going forward.

Sheldon Chester: Thank you.

Operator: Thank you. Ladies and gentlemen, at this time if are there any additional questions, please press the star, followed by the one at this time. If you would like to withdraw your question, please press the star, followed by the two.

And our next question comes from the line of Sam Bergman with Mayberry Asset Management. Please go ahead.

Sam Bergman: It's Bayberry Asset Management and I'm sorry for the disconnect. So I have a few other questions.

Mark Gorder: Sure. Fire away, Sam.

Sam Bergman: In regard to the medical business and the increase in sales, has there been any new design wins that made up the increase in sales or has it just been incremental increases from the glucose monitoring business?

Mark Gorder: It's a combination. We've had some good design wins and ramp-ups outside in other product areas in addition to the glucose sensor. And then the glucose sensor itself has had variations introduced with new features and—that complement the original launch, which is helping to generate that growth.

Sam Bergman: So is there any other technology that you see down the road that could stunt that growth in the glucose monitoring or is that going—I know you said it's going to continue in 2010, but is there any other new technology that you're concerned about?

Mark Gorder: Not that I think would have any impact in the next year or two. There may be some technologies that could potentially impact us out a few years but that's always the case, I think, in any market. But at least in the—in our shorter term time horizon of one to two years, we anticipate continued incremental growth in that business.

Sam Bergman: And going to the non-core electronics business, what was the sales, or rough sales figure from that business in the third quarter? Was it over, like 1.3 million or was it less than that?

Scott Longval: Well, you're right on, Sam, it was, in the third quarter right on 1.3 million. So there was a little bit of a pick up in growth there in the third quarter. And if you recall, what we—when we've talked about our non-core business, you know, it had obviously a rough first half of the year, and what we communicated to our investors is the first thing that we got to do is stabilize this business. So we were very aggressive in reducing the cost structure and in the third quarter, as you can see, we're getting some of the fruits of that work. The net income or net loss for that segment was about \$25,000 and it was actually cash flow positive as a whole. So we've kind of completed what we would like to call Phase One, which is stabilizing that business, and as we go forward, we'll continue to look at strategic options now.

Sam Bergman: Wouldn't it make more sense at this particular time, even though it's breaking even, to either try to sell it or close it down because it's not a strategic fit and it doesn't—and you're probably not adding any more investments to that particular division anyways?

Mark Gorder: Yes. That's a good question and what—obviously, what we go through as a management team is, look, how do we maximize the value of this asset? And right now, we are in kind of that discovery phase of trying to understand, what's the best use of IntriCon's capital as a whole? And if there's an argument to be made that there's something to be done with that business, we will do that. But at this point, we're just trying to look at all options and try to understand how are we going to maximize the value of that asset?

Sam Bergman: At this particular time, is that particular asset being marketed or not?

Mark Gorder: I can't discuss that.

Sam Bergman: Okay. Going to Datrix, in regards to the product line that you're going to hopefully launch in November and then it's going to ramp up and start selling in March or April of next year, do you need FDA approval in this country and overseas?

Mark Gorder: Yes, I was going to—I would characterize what we're doing in November as a demonstration of the prototypes and, yes, we still do need the FDA approval and I would expect that we would have that by roughly the April or April timeframe.

So that's probably more the official time when we we're going to actually do a launch.

Sam Bergman: And that—and when you do that launch, who would be your customers for that particular product?

Mark Gorder: Well we would go to all the major players in that market. Now those include CardioNet, LifeWatch, Team Medical, Philips Medical, Biomedical Systems, Midmark and there are several other smaller ones – wouldn't want to insult anyone by leaving them out – but those are the players that we would go after.

Sam Bergman: So do you feel that your technology combining Datrix with your body-worn devices is superior to the other vendor that's out there presently with the new product that's going to come out?

Mark Gorder: The new product that is going come out was already started before we bought the company.

Sam Bergman: Okay.

Mark Gorder: And it's an incremental improvement over the existing technology that's on the market today. What I would anticipate is the future product lines will be based on proprietary IntriCon technology that'll be infused into the cardiac monitoring devices, which should provide significant advantages in both miniaturization and performance. And in particular, we would be infusing our low-power DS, digital signal processing technology and our low power wireless in there, and we feel that that's going to have significant advantages. So those—the development of those products will start here shortly. We're currently going through our strategic planning cycle. We've got the Datrix technology teams and our partner, Advanced Medical Electronics and ourselves are going to meet in November to map out a plan for product development for cardiac monitoring devices for the coming couple of years. And in those plans, we'll include pushing this technology into new devices so, yes, we do think it's going to make a big impact but the current devices and incremental improvement that it started before we bought the company.

Sam Bergman: So if you look at the newer device once it comes out with your own technology or your proprietary technology, will it also have any price advantages?

Mark Gorder: We would price it to what the market would bear, and we would hope that we may be able to make some incremental price improvement over the existing devices due to the improved performance and miniaturization.

Sam Bergman: And do you think that that product with your technology is the product that's coming out in April?

Mark Gorder: No, with our technology it won't—it'll—typically development cycles are about a year.

Sam Bergman: Yes, okay, so—

Mark Gorder: So assuming we start in November, we would expect to have new products with our technology in it towards the end of 2010.

Sam Bergman: So how much success do you think you can have with a product that's coming out as a prototype in November, the one that was started by Datrix already?

Mark Gorder: We think it'll—we think it will have very good success because there's only one other supplier in the market that sells on an OEM basis. So we think—and there's been a lot of turmoil in that market, if you follow the various press releases from the suppliers and customers in that market, in particular with CardioNet, that we think there is opportunities there to be aggressive and win some business.

Sam Bergman: And the other—last question is, in the past I know, Mark, and I think, Scott, both of you had bought stock on the open market; haven't seen anything like that in the past six months. Do you think after the window opens after this quarterly report, there'd be some insider purchasing?

Mark Gorder: Speaking for myself in particular, I have some options that are coming due at the end of 2010, and so I'm kind of looking at my—planning my purchases based on what the stock price is around the time of those options being due. I don't know the exact date, but I think it's towards the end of 2010, December. So that's kind of my plan. I can't, of course, speak to the directors or—

Scott Longval: Well I can't speak for the directors either. The one thing, Sam, that I will tell you is, obviously as you go through the process, such as the Datrix transaction that went on for four to five months, that put us in a—put management and some of the directors and officers in the Company in a blackout period so—

Sam Bergman: Right.

Scott Longval: While I understand that there hasn't been a ton of activity, I know that our Chairman of the Board recently purchased 20,000 shares but, prior to that, we were in a blackout period for about six months.

Sam Bergman: Okay, so I just wanted, actually, one remaining question regarding the Homeland Security business of the corporation that you purchased a couple of years back. Can you tell me what—if there's been an increase in RFPs from the Government on Homeland Security products on that division or not?

Mark Gorder: The—for whatever reason, the business there was somewhat affected by the change in administrations and we saw a little bit of a pullback when—during the election time period, and now we're seeing that start to pick back up. There's more RFP activity. In addition, we've been very aggressive in going to our customers, our Homeland Security customers and introducing them to our proprietary technology, the low-power wireless, low-power DSP, and we have been successful in convincing them to put out some RFPs based on this proprietary technology, so we're feeling very good about the trend there. I think

around the election time it slowed down a little bit but in the last quarter or so, it's been picking back up.

Sam Bergman: So would you say, Mark, those RFPs that are out there right now, is it possible any of them could be a double or a triple for IntriCon if you were to win one of those?

Mark Gorder: Yes, it's kind of speculative. You know, if you—obviously, if you win a good one, it—I wouldn't call it a triple but maybe a double.

Sam Bergman: Okay.

Mark Gorder: And there's a couple of them out there that could be in that range but, you know, you know how Government contracts are; you think you're going to get one in January and then you get it next January.

Sam Bergman: I understand.

Mark Gorder: But we remain optimistic, and we've got a number of good proposals that we're working on.

Sam Bergman: Okay. Thank you very much. Continue the good work. You guys are doing a good job there.

Mark Gorder: Thanks, Sam, good questions.

Sam Bergman: Bye now.

Operator: Thank you. And our next question comes from the line of Alvin Hoffman with Boenning & Scattergood. Please go ahead.

Alvin Hoffman: Afternoon.

Mark Gorder: Hi, Alvin.

Scott Longval: Good afternoon, Alvin.

Alvin Hoffman: Could you break down your segment sales by percentages?

Scott Longval: Sure. So our largest segment, fastest growing segment, probably no surprise is our medical business; it makes up about 40% of the overall revenue. Hearing health, about 33% of our overall revenue; professional communications, 18%; and then the non-core electronics makes up the balance, which is about 9%.

Alvin Hoffman: Fine. Thank you.

Scott Longval: Yes.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions, please press the star, followed by the one. If you are on a speakerphone, you need to pick up the handset before pressing star, one. And I'm showing there's no further questions in the queue. I'll turn it back over for—to management for any closing comments.

Mark Gorder: This is Mark Gorder speaking again. Once again, thank you for taking time out of your day to join the call. In closing, I'd like to reiterate that, as a company, we're making progress. Financial performance is improving sequentially. And we're taking definitive steps to further our position as the body-worn device company. We intend to support OEMs in the marketplace with new devices and continue to prudently invest in new initiatives that will—that we believe will fuel long-term growth.

Thank you again. We appreciate the good questions, and we look forward to updating you on our progress in the future.

Operator: Thank you. Ladies and gentlemen, that does conclude today's IntriCon Third Quarter 2009 Results conference call. If you would like to listen to a replay of today's call, please dial 303-590-3030 or 1-800-406-7325, enter the pass code 4174661. Once again, those numbers are 303-590-3030 or 1-800-406-7325, enter the pass code 4174661. Thank you for your participation and for using ACT Conferencing, you may now disconnect.

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