INTRICON FOURTH QUARTER 2009 RESULTS CONFERENCE CALL
March 9, 2010, 5:00 PM ET

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the IntriCon Fourth 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 opened for questions. If you have a question, please press the star, followed by the one on your touchtone phone. If you'd like to withdraw your question, please press the star, followed by the two. If you're on a speakerphone, you'll need to pick up the handset before making your selection. This conference is being recorded today, Tuesday, March 9, 2010.

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'd 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 that are subject to uncertainty and changes in circumstances. Given these uncertainties, you should not place undue 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 Analysis of Financial Condition and Results of Operations in our 10-K filing for the year ended December 31, 2008.

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

Mark Gorder: Thank you, Scott, and thank you, everyone, for joining us today. It goes without saying that 2009 was a very challenging year. However, we made significant progress in positioning IntriCon to better support our medical, hearing health, and professional audio communications customers with new devices. More than ever, it is important that we focus our resources and capital on our core strengths while continuing to prudently invest in new initiative that we believe will fuel long-term growth. Our strategy stems from our mission of enhancing mobility and effectiveness of miniature body-worn devices and it's the reason that we've emerged from 2009 stronger than before.

I'll start today by reviewing our 2009 fourth 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 fourth quarter press release. Throughout 2009, we delivered incremental revenue progress, and I am pleased to announce today that for the first time this year our quarterly revenue rose over the prior year. Fourth quarter revenues were the highest of the year, and excluding our discontinued operations, we've once again returned IntriCon to profitability for the quarter.

Just to reiterate, in January, we announced plans to divest our non-core electronics business, Anaheim, California based RTI Electronics, Inc. As a result, RTI Electronics results are now classified as discontinued operations.

Looking at our business, we are excited about the prospects in our respective markets. As we said in today's press release, economic uncertainty remains and we continue to realign our business with the current climate. That being said, we are seeing initial signs that customers are beginning to re-engage. Once again, our medical business recorded its strongest revenue quarter ever, growing 23% from the year-ago period and 10.5% sequentially from the 2009 third quarter. As we've indicated previously, medical revenues are primarily being driven by glucose monitor sales, a device that we manufacture for a large medical OEM.

During the fourth quarter, we unveiled a prototype of our new cardiac diagnostic monitoring device called the Mobile Patient ECG Telemetry System, or MPETS, at the American Heart Association Scientific Sessions in Orlando, Florida. The device is a next generation wireless outpatient monitoring tool which uses a proven automatic arrhythmia detection algorithm. In designing the MPETS, we leveraged Datrix's cardiac monitoring capabilities and IntriCon's wireless strengths to develop a device that allows for more patient comfort and the ability to identify asymptomatic cardiac events. Currently, we are working with the FDA to secure necessary approvals for the device and anticipate it will be made available for sale in mid 2010.

In biotelemetry, we remain active with strategic partner, Advanced Medical Electronics, or AME. We're working with them to develop devices that wirelessly transmit critical diagnostic and therapeutic information. In collaboration with AME, IntriCon has received approvals for grant funding for nine development programs.

Our hearing health business felt the challenging economy's impact throughout 2009. For the fourth quarter, sales declined 4% over the same prior-year period as patients continued to delay hearing aid purchases. While we expect sporadic buying patterns to continue into 2010, the long-term fundamentals remain strong. The over 65 age demographic is the fastest-growing segment of the population of the United States, Europe, and Japan. And we believe that this will ultimately fuel growth in this business.

In 2010, we intend to launch several new hearing health products, including devices based on patented proprietary technology for the emerging open-in-the-canal and open-in-the-ear segments of the market. These devices combine the comfort and performance benefits of open-behind-the-ear hearing aids with the aesthetic appeal of open-in-the-ear and open-in-the-canal devices.

Similar to hearing health, professional audio communications sales were sluggish in 2009 versus the prior year, due to the economy. However, we are seeing indicators that this business is rebounding. Revenue from the second half of the year was up 29% over the first half for this business.

Additionally, the same proprietary technology that IntriCon uses in hearing health, including wireless and digital signal processing, holds important potential for professional audio communications. We are beginning to leverage that on several fronts. In 2010, we plan to introduce a line of situational listening devices intended to help hearing impaired in noisy environments and to listen to television and music by direct wireless connection.

I want to reiterate that as a company, we're excited about the progress we've been able to make, despite the challenges created by the economic downturn. IntriCon's 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. 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.

In 2010, our priorities are developing our core technologies across multiple product platforms; launching new devices based on patented proprietary technology in the hearing health market, combining the comfort and performance benefits of behind-the-ear hearing aids with the visual appear of in-the-ear devices; launching new devices in the biotelemetry arena, specifically in cardiac diagnostic monitoring; and running an efficient and focused organization.

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 fourth quarter, IntriCon reported net sales of 14.2 million, up 5.3% from net sales of 13.4 million for the 2008 fourth quarter. IntriCon's 2009 fourth quarter net loss was 1.6 million, or $0.29 per diluted share, compared with net income of 169,000, or $0.03 per diluted share, from the year-ago period. Two thousand nine fourth quarter results include a net loss of 1.7 million, or $0.32 per diluted share, from discontinued operations. The reported 2009 fourth quarter income from continuing operations, which is comprised of the company's core body-worn device business, medical, hearing health, and professional communications, of 140,000, or $0.03 per diluted share.

As Mark mentioned, we announced plans to divest the company's non-core RTI Electronics business. As a result, the RTI Electronics results are now classified as discontinued operations, included in the 2009 fourth quarter discontinued operations with a loss of 56,000, or $0.01 per diluted share, related to the RTI

Electronics operating results and a charge of 1.7 million, or $0.31 per diluted share, associated with the planned divestiture.

Gross margins in the 2009 fourth quarter were 25.2% compared to 27% in the year-ago quarter. Sequentially, however, gross margin rose from 20.3% in the third quarter of 2009 and were up significantly from the first quarter of 2009 level of 18.4%.

We continue to execute on gross margin improvement initiatives, such as implementing lean Six-Sigma manufacturing principles in our manufacturing facilities.

For the year, IntriCon reported net sales of 51.7 million and a loss of 3.9 million, or $0.73 per diluted share. The 2009 results include a loss of 2.1 million, or $0.39 per diluted share, from discontinued operations and Datrix-related acquisition costs and bank financing fees totaling 561,000, or $0.10 per diluted share. This compares to 2008 net sales of 57.9 million and income of 1 million, or $0.19 per diluted share.

The 2009 loss from continuing operations was 1.8 million, or $0.34 per diluted share. The discontinued operations net loss of 2.1 million included a 438,000 loss related to the RTI Electronics operating results and a charge of 1.7 million associated with the divestiture.

After adding back costs associated with the Datrix acquisition, noncash charges for depreciation, amortization, and stock-based compensation, we generated 914,000 in pro forma income from continuing operations for the quarter. For the year ended December 31, we posted pro forma income of 1.5 million.

It's important to note that IntriCon generated progressively improved results for each of the four quarters of 2009, despite the difficulties posed in the economy. We believe this pro forma information is helpful in the analysis of our operating results by eliminating nonrecurring noncash items. Please refer to our press release for our GAAP to pro forma reconciliation.

Turning to other financial metrics, for the year, IntriCon generated approximately 1.9 million in positive operating cash flow, due largely to tight working capital management. IntriCon's total cash management at December 31, 2009, was 72 days, which is a marked improvement from 93 days for 2008. Cash cycle days are comprised of days sales outstanding, which was 42 days, plus inventory outstanding, which was 69 days at the end of the year, less days payable outstanding, which stood at 39 days for the fourth quarter.

Now taking a step back and putting the year in perspective, for each quarter in 2009, IntriCon generated progressively improved revenue and pro forma income. We've also shown improved cash generation, tight working capital management, and stringent cost control. Importantly, this has been accomplished without impeding our continued commitment to prudent investment in proprietary technology and key research and development initiatives. We feel this strategy will fuel opportunities to capitalize in a more stable economy in the future.

Now, I'd like to turn the call back to the Operator so we can take any 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'd like to withdraw your question, press the star, followed by the two. If you're on a speakerphone, you'll need to pick up the handset before making a selection.

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

Sam Bergman: Good afternoon, Mark and Scott. How are you?

Mark Gorder: Good. How are you, Sam?

Scott Longval: Hi, Sam.

Sam Bergman: Good. A couple quick questions. Can you tell me on the Datrix acquisition, first of all, is there an earnout on that?

Scott Longval: There is not.

Sam Bergman: There is not. In the $14.2 million of sales for the quarter, what was the percentage of medical hearing for the quarter?

Scott Longval: For the quarter, medical—or excuse me. For the quarter, medical made up about 43%, approximately. Hearing health made up about 35%, and the balance was our professional communications business.

Sam Bergman: And what percentage is the—of the 43% in medical, what percentage is the glucose monitoring product?

Scott Longval: About half of that.

Sam Bergman: About half of that. Do you have a pretty good—does management have a pretty good insight on the ramp-up and the continuation of sales going forward in 2010 in that particular market area?

Mark Gorder: Yes, Sam, we do. The forecasts from the customer have been very reliable. And usually, they give us a conservative forecast, and then they usually add to it. So there's been a slow, steady increase in sales over the past three years on that particular product. And we expect to see a similar steady improvement over the coming couple of years.

Sam Bergman: Are there other design wins with this OEM that will add to that revenue line, or not?

Mark Gorder: There are complementary products that support the glucose sensor that will add to revenue in the coming quarters and years.

Sam Bergman: So when are these new products or add-on products going to hit the market for the company?

Mark Gorder: Probably the second half of the year. And there have been continuous additions of new versions and accessories that have come in over the past three years. We expect that that will continue. You won't see a drastic change. I think you'll just see this continuous steady growth in the top line.

Sam Bergman: You had mentioned on the press release or on the call that you have nine programs from the medical. Is that one top of what you had before? Because I thought you had eight before.

Mark Gorder: Yes, Steve. We have received another grant and we continue to apply—support our partner, AME, for additional grants and expect to win more grants in the future. So there's a substantial amount of total government funding that comes from those grants. We get two benefits out of that. One, we get some funding for work that we actually apply to the grant to help complete the grant. And then we have exclusive rights to commercialize the technology in our respective markets. So it's a tremendous advantage for us to get this government funding in that we get core technologies out of it that we can apply into our markets that doesn't show up on our cost line.

Sam Bergman: When is the first design win from these programs going to hit the market for IntriCon?

Mark Gorder: Well, I mentioned in the talk here that we were planning on introducing in the professional audio area a series of products that will assist hearing impaired in difficult listening environments. It doesn't replace a hearing aid. It's complementary to a hearing aid. The technology that comes out of—that goes into this product, the core technology, core wireless technology and some of the digital signal processing, was funded by a grant that was worked on between AME and IntriCon. That'll be the first introduction of a commercializable product that uses the core technologies developed through the AME partnership.

Sam Bergman: And how would that product be sold?

Mark Gorder: It'll be sold OEM to our existing customer base, both hearing health and in professional audio.

Sam Bergman: And going back to the Datrix acquisition, was that finished off in November, closed November, or did you have some sales from Datrix in the quarter?

Scott Longval: No, we did have revenue from Datrix in the quarter. Total revenue was not material, around 150,000.

Sam Bergman: So what was the—at the American Heart Association, you had shown a prototype of the MPETS product that's going to be out somewhere mid year. What was the initial response and what has been the response since then on that particular product?

Mark Gorder: The response has been good so far. The demand for this mobile cardiac outpatient telemetry continues to be present and growing. There are three types of monitoring that are done today with—the three types is the Holter monitor, which is sort of your basic low reimbursement, entry level type monitoring. Then there's event recording, where the patient actually triggers the device to record, based on a feeling that they're having some type of a cardiac event. The mobile cardiac outpatient telemetry is considered more reliable because it detects events and records continuously, based on event detection, and notifies the scanning service that an event is taking place. So it's felt that this type of service will continue to gain market share over the coming years.

The reception of our device is quite good because it's—it has performance specifications as good or better than what's out there on the market available from other merchant-type OEM suppliers.

Sam Bergman: So the technology is better, or is it equal?

Mark Gorder: It's equal to or better, depending on what type of performance you're talking about. There's certain specifications that are equal; some are superior.

Sam Bergman: And what products should—what product in that pipeline should we expect for the technologies to be very different and also competitively better?

Mark Gorder: I think the best way I can hit that one is when we purchased Datrix, the concept of the MPETS was already on the drawing board. So our support there has been to assist them in completing the MPETS device that they had already conceived. We have already started on developing a couple of product lines that would utilize IntriCon core technology, and particularly, our low power physiolink wireless technology in order to produce a much smaller recording device. And we have initiated a project to develop such a product and would anticipate that we'd have it on the market approximately by the end of the year, or worst case, first quarter of next year.

We also have another product that we started in parallel that would also utilize some core IntriCon digital signal processing technology. So those—that product should be on the market also by the end of the year. It's a 12-lead ECG resting—or stress-type device.

Sam Bergman: And the last question and I'll let somebody else get on, you did mention in the press release about body-worn devices becoming more prominent as the year progresses and in the future. There was also a story in *Investors Daily* back maybe six, nine months ago talking about body-worn devices. When do you think the stockholders at IntriCon will reap the rewards from perhaps something that moves the needle on a design win and finally gets into the OEM hands so it produces very good revenue for IntriCon?

Mark Gorder: I think the—obviously, we're working on a number of initiatives now that we hope going forward can continue to drive the top line. The market—the general economy is still somewhat unpredictable, and it's hard to predict when we would get substantial revenue out of those. However, there are a number of initiatives that we feel move the company in that direction. The thing that we have to do, obviously, is drive more IntriCon technology into the design wins we're getting to drive up our gross margins. Our gross margins still aren't sufficient to—they aren't where we want them to be a—recognized as a high technology leader in the body-worn device market. But we have technology on the drawing board that we think can get us there, and we just have to continue to drive it into new products like we're doing with Datrix, like we're doing with this hearing health technology we're introducing, and with this wireless technology in the PADA market. So we have new product lines with proprietary technology going on the market next year, all of which have proprietary IntriCon technology in them that should have better margins than anything we're doing today. So you should see continuous improvement, Sam, in the margins.

Sam Bergman: Thank you very much.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions, please press the star, followed by the one at this time. As a reminder, if you are on a speakerphone, you will need to pick up the handset before pressing star, one. One moment, please.

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

Mark Gorder: Hey, Alvin. How are you doing?

Alvin Hoffman: What competitive advantage would your equipment have in the Holter over equipment that's being offered now, either price-wise or performance-wise? The reimbursement has been cut for that dramatically, as you know, so I guess price is going to be an important factor. Or am I wrong here?

Mark Gorder: No, you are definitely correct. This is Mark. Hi, Alvin. I guess I would answer that twofold. The products that we're designing that would incorporate IntriCon technology are going to be smaller than anything that's on the market. And they're also going to consume less power. And those—the two things go hand-in-hand. In order to miniaturize something, we have to consume less power because the device size, when it's very small, is determined mainly by the battery size. So the less power we consume, the smaller battery we can choose, the smaller the form factor. And we think that the devices that are on the market today are quite clunky and cumbersome, very difficult to use, a lot of wires and cabling. We think that substantial improvements can be made on that. And that will also be—will also more effectively—will consume less power. And I think those would probably be the main advantages for the device that we plan on launching this year.

The other thing, on the cost side, we have a Singapore manufacturing facility that's 13485 certified. We are already in the process of moving some medical device manufacturing over there for one of our large OEM customers. We anticipate being in a very good position to meet any cost pressures that come in this market. And if we have to, we would be well situated to move the manufacturing of these Holter monitors, event recorders, and MCOT recorders over to Singapore. Does that answer your question?

Alvin Hoffman: I believe so. Yes, thank you.

Mark Gorder: You're welcome.

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 will need to pick up the handset before pressing star, one.

And our next question is a follow-up question from the line of Sam Bergman with Bayberry Asset Management. Please go ahead.

Sam Bergman: Just one more question. On the hearing aid market, how competitive—or how wise [ph] a competitor is a company called Ramtron [ph], which I know has had some low power features in the hearing aid business developed, and they also have some promising design opportunities going forward. Are they going head-to-head with you guys in the hearing aid market?

Mark Gorder: Sam, to be honest, I have not heard of that company. How did—is it Ramtron, R-a-m…

Sam Bergman: It's a listed company. R-a-m-t-r-o-n.

Mark Gorder : I do…

Sam Bergman: …t-o-m, excuse—t-r-o-m. Excuse me. And they have won a couple of design wins and also manufacture for some hearing aid companies but I'm not really sure if it's tier two or tier three companies.

Mark Gorder: We just pulled up their website. They look like a contract manufacturer. So it's possible that they've won some electronics assembly for someone, but I've not heard of them and not aware of them being a player in the space that we're competing in.

Sam Bergman: Okay. And the other question I wanted to ask you is regarding Homeland Security. Has there been any developments there for RFPs that are either substantial or can move the needle going forward in 2010?

Mark Gorder: Some of the work that we do we—is done with agencies where we can't discuss the work or the nature of the work. What I can say is from a financial perspective that the technologies we're providing in low power DSP and low power wireless, we have achieved some significant design-ins with some groups that utilize that technology.

Sam Bergman: And is there anything you can talk about? I mean not being specific on programs?

Mark Gorder: Probably not. But we also have initiatives going on in the non what I'd say 'black' side of the government. And we are submitting some work in boom microphones and so forth where we're supporting companies in the—that work with the military as tier one suppliers. We're kind of a tier two supplier to them. Things like boom microphones that go into aircraft in the military applications. And we've launched a couple of programs there that have started to ramp up recently, and those should continue to grow during the course of 2010.

Sam Bergman: And just going back to the last group of questions I had, you did mention about the body-worm devices as a technology you're adding to these devices. Should one be concerned that your technology isn't yet where it should be on these body-worn devices and that's why we're not getting more design wins? Or am I looking at it the wrong way?

Mark Gorder: Here's the way I'd couch it. If you look at the R&D as a percent of sales, back in 2005 we spent about 2.5% of sales on R&D. Part of that was due to the restructuring that we had to do as a result of the Selas Corporation.

Sam Bergman: Right.

Mark Gorder: And our technology pipeline was rather thin at that point. We have—we made the concerted strategic effort to increase R&D as a percent of sales to fill up our core technology pipeline, which we've done very successfully over the past several years to the point where this year we're spending 6.5% of revenue on R&D.

The percent or the content of the devices that we're producing continues to have higher and higher IntriCon intellectual property in it. That's continuously improved over the past four or five years. But I think at some point, you're going to see substantial improvement in results as we phase out older products that have less of our technology and the newer products that have a higher IntriCon content begin to take on a predominant share of the revenue, and particularly in hearing health. So we're hoping that you'll see some improvement in margins in the coming quarters.

Sam Bergman: So some of the older products will be phased out in the coming quarters?

Mark Gorder: Yes. And newer ones will come in. And you should—the technology pipeline continues to be filled because we're continuing to increase R&D as a percentage of sales, plus we have some of the off balance sheet funding that we're getting from these government grants through AME. And only this year are we introducing the first commercializable product that has utilized some of the funding and technology that was developed out of the AME partnership. And that partnership, I think, we've been involved with now for over three years. And that's about the timeline that it takes to develop some of these core technologies. It's usually a three- or four-year process, and we're just staring to benefit from that. So once we start to get those benefits flowing into our product pipeline, that will even have another amplification of improvement in margins.

Sam Bergman: And do you need to add sales people to the Datrix acquisition in order to move sales for the new products?

Mark Gorder: We have already added a consultant who is a specialist in that area. We signed him to a three-year contract with—as a business development expert in that area. And as we start to develop new customer relationships, then we will add additional sales people to provide service and sales support to that. And probably, that will occur by the end of the year. But we've already making a—we've already made a move in the direct sales area to drive revenue and customer relationships in that cardiac diagnostic market. We've called on all the major players now in the cardiac diagnostic market, and we're already in the—we're already going through a round of second calls, where we're discussing with them these product platforms that I discussed earlier, in particular this next generation Holter event recorder which is going to be downsized and utilizing some of our technology. We are asking them for their inputs to help us configure that product platform so that it meets the requirements. So there's a heavy sales and marketing effort already ongoing there.

Sam Bergman: So would you expect that to hurt the bottom line going forward for the next year because of what you need to do to ramp up on sales, or revenues should be driven first before that increment in cost?

Mark Gorder: No, we think the revenue will be forthcoming to offset that cost.

Sam Bergman: Okay. Thank you again.

Mark Gorder: You're welcome, Sam. Good questions.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions, please press the star, followed by the one at this time. As a reminder, if you are on a speakerphone, you will need to pick up the handset before pressing star, one.

And I'm showing there's no further questions in the queue. I'll send it back over to Mr. Gorder for closing comments.

Mark Gorder: Once again, thank you for taking time out of your day to join the call. As we pointed out throughout the year, we focused on building out our capabilities in 2009, both organically and through acquisition. In 2010, we will leverage those capabilities to bring smaller, more advanced devices to market. Our priorities are to develop our core technologies across multiple product platforms, launch new devices in the biotelemetry area, specifically in cardiac diagnostic monitoring, as well as hearing health and professional audio communications, and continue to run an efficient and focused organization.

Thank you again. We look forward to updating you on our progress in the future. Have a good day.

Operator: Thank you. And ladies and gentlemen, that does conclude today's IntriCon Fourth Quarter 2009 Results Conference Call. If you'd like to listen to a replay of today's conference, please dial 303-590-3030 or 1-800-406-7325, enter the passcode 4242155. Once again, those numbers are 303-590-3030 or 1-800-406-7325, enter the passcode 4242155. Thank you for your participation and for using ACT Conferencing. You may now disconnect.

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