

Company: IntriCon
Conference Title: 4th Quarter 2016 Results
Moderator: Scott Longval
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Operator: Good day and welcome to the IntriCon Fourth Quarter 2016 results conference call.

Today's conference is being recorded. At this time I'd 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 CEO. Before we begin I'd like to preface our remarks with a customary safe harbor statement. Today's call contains 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 undue reliance on these forward-looking statements as actual results may vary materials from the expectations contained in today's call. Important factors that could cause such differences include, among others, those set forth in the headings, risk factors and management's discussion of analysis of financial condition and results of operation and our 10K filing for the year ended Thursday, 31st December 2015. With that, I'd like to turn it over to Mark for a strategic look at IntriCon's fourth quarter.

Mark Gorder: Thank you, Scott and thank you everyone for joining us today. I would like to begin by reviewing key highlights and results for the fourth quarter. After that, Scott will cover the financials in more detail and then we'll take your questions. By this time, most of you had a chance to review our fourth quarter press release. For the quarter, net sales of \$17.7 million reflected the continued timing shift and orders from our largest medical customer. That said, sales rose 14% sequentially from the 2016 third quarter and included a \$1 million contribution from Hearing Help Express.

Fourth quarter results reflect our efforts to right side and focus our business to take advantage of the emerging value hearing health opportunity while maximizing our core medical business. To that end, we made meaningful progress establishing a new direct to consumer distribution channel during the quarter and look forward to a strong first quarter in 2017 in both hearing health and medical.

Looking at our three businesses, sales in our medical business decreased 8% in the 2016 fourth quarter as I indicated this was primarily driven by timing shifts with our largest customer Metronic. The lower sales to Metronic were expected as they managed the transition of their recently FDA approved MiniMed 630g system. That transition is now over and we began ramping up MiniMed 630g production in the fourth quarter, which resulted in a \$1 million sequential increase in Metronic revenue from the 2016 third quarter.

Looking ahead, we believe that we are well positioned with Metronic with 2017 first quarter sales expected to be at record levels and growth to continue throughout the year. In addition to the MiniMed 630g system, we are also designed into the MiniMed 670g system, which was also recently approved by the FDA, in a schedule to be launched in the Spring of 2017. Additionally, we are working on other revenue opportunities with Metronic that could result in notable gains in the second half of 2017.

Turning to hearing health. Sales increased 4% from the prior year fourth quarter primarily stemming from the \$1 million contribution from Hearing Help Express, which I highlighted earlier. As announced in November, we acquired a 20% stake in HHE, a direct to consumer mail order hearing aid provider. Last month we exercised our option to acquire the remaining 80% stake in HHE. The deal is expected to close in mid-2017.

What's attractive about HHE is that it gives IntriCon direct access to consumers and the emerging valued based hearing health care market. As we all know, untreated hearing loss in the United

States is a substantial problem and high device costs have created significant barriers to access for most Americans. HHE offers a lower priced alternative for consumers to purchase devices directly. Circumventing layers of costs associated with the conventional hearing aid channel. We look forward to building on the HHE platform by leveraging our own technically advanced device and making targeted investments in management, marketing and advertising and ultimately incorporating an on-line component.

Since taking our initial stake, we have made meaningful progress integration and optimizing HHE. We detail some of those efforts in today's press release. By the end of the first quarter, we intend to hire a DTC executive to manage HHE. We've already identified several key candidates. We'll enhance HHE's sales and marketing capabilities and increase advertising, a tactic historically proven to drive sales and lastly introduce IntriCon's digital hearing aids and other technical advancements to HHE's customer base.

Over the next few quarters we intend to establish and report on key DTC metrics to highlight this business and to allow you better track our progress. Looking at some of the other hearing health initiatives, we also saw contributions from PC Worth during the quarter. That said, we took steps in January to reduce PC Worth's costs structure by \$200,000 and refocus sales efforts into the National Health Service or NHS clinics.

We are currently working with NHS for approval of a third device the K940D, which will enhance our sales capabilities. The K940D which is a traditional behind the ear device, is very appealing to the NHS because of its broad fitting range and advanced features. We anticipate approval of the K940D in the second quarter.

In addition to HHE and PC Worth, we are focused on driving growth and creating efficiencies in our other value based hearing health care initiatives. Domestically we continue to work with Ear Venture, a joint venture with the Academies of Doctors of Audiology of the ADA. Over 650 ADA

members have registered to join the Ear Venture program. And while audiologists have shown great interest in Ear Venture, they have been slow to participate due to targeted big six pricing in audiologist struggles and our unwillingness to embrace a new business model. Given that fact, we have taken steps to right size Ear Venture without compromising the ability to promote the business model. While we do not view Ear Venture near term as a meaningful contributor to sales, it continues to provide valuable industry insights and has the potential for future value by connecting it to our emerging DTC channel.

Acknowledging the significant opportunity we have with HHE, has prompted us to focus our efforts with the ADA and NHS and take these actions. Over the last decade, we have invested in technology and low cost manufacturing to design and build superior devices and fitting solutions to address the estimated \$1 billion annual value hearing health market. And that's what we're doing by going direct to the consumers.

On the technology front, we continue to make great strides. In the first half of 2017, we anticipate a targeted release of our first wireless hearing aid to Lumen™ 200b in the U.S. and German markets. This device will allow for commanded control from a smart phone or related accessory. In addition, we have enhanced our self-fitting software technology through our Signazon joint venture in Germany. By the end of the third quarter, we intend to have our wireless Lumen™ 200b hearing aid integrated into the self-fitting software and begin targeted pilots in Germany. By the end of the year, we anticipate a similar offering in the U.S. market. This system will provide for efficient fitting and greater access and move us further along the path to establishing a holistic ecosystem of care and hearing health.

With significant opportunities ahead of us, we felt it was critical to focus our financial and operational resources. As such, we have made the strategic decision to divest our non-core cardiac diagnostic business or CDM business. We have found a buyer for the business and the sale is expected to close in the first quarter of 2017.

Given all that we have accomplished in 2016, we are excited about IntriCon's bright future and what we can accomplish with HHE and we look forward to sharing our progress with you. Now I'd like to turn the call over to Scott.

Scott Longval: Thank you, Mark. I'll begin reviewing our fourth quarter financials in more detail. The 2016 fourth quarter reported net sales was \$17.7 million compared to \$18.4 million in the prior year. The decline was primarily due to year-over-year revenue shifts from Metronic as Mark noted. Net sales did rise, however, 14% sequentially from the 2016 third quarter and included a \$1 million contribution from HHE, so progress is being made. IntriCon posted a net loss attributable to shareholders of \$1.9 million or \$0.27 per share versus net income attributed to shareholders of \$810,000 or \$0.13 per diluted share for the 2015 fourth quarter. It's important to note, that the 2016 fourth quarter included losses from discontinued operations of \$1 million versus \$0.15 per diluted shares of which \$800,000 resulted from a non-cash write down of assets related to the pending sale of our CDM business. Gross profit margins were 25.9% compared to 29.3% in the prior year fourth quarter. That decrease was primarily again due to lower revenue.

Fourth quarter operating expenses were \$5 million compared to \$4.2 million in the prior year fourth quarter and this increase was largely due to the consolidation of sharing Health Express during the fourth quarter.

In terms of guidance based on the information that's currently available, we anticipate the 2017 first quarter net sales to range somewhere between \$18.6 million to \$18.8 million and post a positive EPS from continued operations. And for the year, we expect the revenue range to be between \$78 million and \$80 million.

With that, I'd now like to turn the call back over to the Operator so we can take any questions.

Operator: Thank you. If you'd like to ask a question, please signal by pressing star one on your telephone key pad. If you are using a speakerphone, please make sure your mute function is turned off to allow you signal to reach our equipment. Once again, please press star one if you'd like to ask a question. And we'll pause for just a moment to allow everyone an opportunity to signal for questions. We'll take our first question from Ross Strehlow with RBC.

Ross Strehlow: Yeah, hi Mark and Scott.

Mark Gorder: Hey Ross.

Ross Strehlow: You mentioned that you're working on other opportunities for – with Metronic. Care to elaborate on what they are.

Mark Gorder: Currently we're working with the diabetes group on the sensor and monitor portion of their wireless glucose offering and with that there's a number of related accessories that we're doing. We're also looking at other operation that we could perform and service them. And those are kind of the things that we're targeting for potentially the second half of the year.

Ross Strehlow: That soon?

Mark Gorder: We can't go into great detail about that, but we're excited about those opportunities clearly.

Ross Strehlow: Can you put – can you put any type of a potential dollar range on what that could mean to your revenues say a couple of years down the road or however you want to give a timeframe.

Mark Gorder: Yeah, I think for the different activities we've engaged with them that we are not working on now would be meaningful revenue. Probably somewhere in the range of \$5 to \$10 million annually for the different things we're talking with them about.

Ross Strehlow: Okay. Great, great. And then, going to the hearing side, you know, I'm fairly new to the story, did you – do you guys break out your revenues based upon the hearing and the Metronics. Can you give us an idea of how much revenues you had in the whole hearing aid area?

Scott Longval: So we do – Ross, we do break that out in totality and one of the things to note going forward, we're going to be breaking the revenue out even further to highlight what we're doing in the direct to consumer channels. So Mark mentioned here today in the fourth quarter, we did \$1 million with Hearing Help Express. We'll continue to break that number out through 2017. In the fourth quarter, we do talk about Metronic and what we do with Metronic. That business was about \$7.2 million in the quarter and then total hearing health revenue in the quarter was approximately \$6 million.

Ross Strehlow: Okay. Of that \$6 million, does that include the \$1 million from the HHE?

Scott Longval: No it does not. So it's an additional \$1 million on that of that.

Ross Strehlow: Okay, okay. Good. Thanks for that. And then was HHE profitable?

Scott Longval: Broke even in the first – excuse me, in the fourth quarter and as we look to accelerate that business we think it's going to be slightly profitable in two – at least the first half of 2017 and then as aggressively as we can roll out the sales and marketing program, we're anticipating to gain leverage on the bottom line in the second half of the year.

Ross Strehlow: Yeah, and that's what I was going to ask next. Because based upon kind of what you are talking about on and it is exciting what you're doing in that direct to consumer, but you've also got a fair amount of, you know, expense associated with the developing the business. So are, you know, so what type of profit – are you expecting the profitability to continue to increase in spite of those expenses or how should we think of that.

Scott Longval: Yes, as Mark talked earlier in his comments, we'll be doing a – or laying out metrics going forward that I think will help you better understand, but at a high level, Ross, what we want to do it come in there and offer product at a lower cost based on the fact that we control the manufacturing, which puts us in a unique position within anybody in that market. Further, it is just driving efficiencies in some of the processes they have today and driving efficiencies in the marketing and advertising spent. And over the first four months, we've already identified areas where we can drive those types of efficiencies and gain leverage. So I think it's a little premature for us to lay out what exactly that means to the bottom line in the first half of the year. But what we want to do is be in a position to have key metrics to really highlight the progress that we are making and set up those metrics for the second half of 2017.

Ross Strehlow: Okay and we can talk about this at a later date too as you – as time progresses but – okay that's all from me. Thanks guys.

Scott Longval: Thanks Ross.

Operator: Thank you and we'll now take our next question from Dick Ryan with Dougherty. Please go ahead.

Dick Ryan: Thank you. Say Mark, when will you be introducing the digital hearing aids through the DTC channel. I'm not sure if I caught that and that maybe ties to this German effort that your

going to introduce with your self-fitting hearing aid. Can you give us a little more clarity on that as well.

Mark Gorder: You bet Dick. The two – those two efforts are actually not connected but the rolling the digital hearing aids into HHE will start probably in March and will be completed by – by the end of the second quarter. We're going to roll several product lines in there. But that will be complete by the end of the second quarter. And the effort in Germany is more to develop and pilot self-fitting technologies. So there – there are a number of steps we're going to take there. The first step was to develop this partnership with the individual than invented this technology. And then – we're doing that now. And then what we intend to do in the – in the second quarter is to integrate – we mentioned we were going to launch our Lumen™ 200b wireless hearing aid by the end of the second quarter. So in the third quarter we anticipate integrating that wireless hearing aid into the self-fitting technology so that an individual can sit down at a smart device like and iPad® and manipulate the iPad® and self-fit their hearing aid wirelessly while their doing it. And then in the fourth quarter we would then take that technology and do a pilot in the U.S. market at HHE. So those are probably the steps by quarter that we anticipate of four 2017. Does that help with that question?

Dick Ryan: Sure, sure. And then on rolling out the remaining 80%, I think that's now been pushed to mid-year. What's – what's the – I mean delaying that. I mean you're already deep in the integration of it, so what's the time line there.

Mark Gorder: Yup. Right now, we are working with the bank to figure out what the best cost structures at to complete the acquisition. And again we think that's something mid-year as we look at it just from a practical standpoint right now we're in 100% control of the operations of the business and everything that we're doing sounds and acts like we own 100%. So that's not really slowing us down from an operational or strategical – strategic standpoint.

Dick Ryan: It looks like your ventures kind of stalled out and your making some changes with PC Worth over at the NHS. What – you’ve got – your looking for your third approval, but sort of revenues have we seen beyond kind of their core product line that they’ve always had and what sort of success have you been getting in front of the clinicians?

Mark Gorder: We’ll – I’ll take the Ear Venture question first, Dick. I think what we’ve seen there is a couple of things. We’ve made it – we’ve made assumptions that the [inaudible] would be willing to change to a different business model and we also assume they would be looking for an alternative to the big six manufacturers. And what we found was that they’re very reluctant to change their business model. Its – even though they recognize they need to change and we’ve got a number of these people signed up, there’s still not over that hump of actually making the change. And what’s kind of made that more difficult for them, is the big guys have come in and targeted price reductions to directly offset what we’re trying to do. And that slowed them down even though they should be changing because their buying from the people competing with them. Because of the big guys have consolidated retail and their – the six manufacturers own all these retail shops that are directly competing with the independents. So we find it frustrating that they aren’t changing, but we think they’re going to change eventually. And we want to be in a position to link our DTC efforts into the professional because we do think there’s going to be need to provide additional care to a certain percentage of the patients that we deal with at Hearing Help Express.

On to PCW, the – in 2016 as you recall, we acquired that business at the end of 2015 due to some difficulties that the business ran into. We would have preferred initially that that be a distribution arrangement but in order to secure our channel in the contract to the NHS we actually took over the business and ran it. There were some difficulties stabilizing that business during the first half of 2016. There were some of the product lines in PCW were actually contracted from the big six and when they found that we had bought PCW, they pulled those product lines. That resulting in some lost revenue and loss in the second quarter. In addition, we had to move the

business which resulted in some onetime costs that we had to deal with plus the, you know, the inconveniences that you run into trying to move a business. So we're hoping that during the second half of last year, we stabilized that and our goal now is to try to drive hearing aid unit growth in there while getting that business to a profitable position. And we think we will with what the steps we've taking in cost reduction with the fact that we've got the move and the lost product lines from the big guys behind us. The fact that we get this 940g in there, we think we will have this business in a good position by mid-year. And to date, the hearing aid sales have been very slow because we – we didn't have a complete product line. The 940g is a more versatile behind the ear hearing aid with a wider fitting range and its more modern look to it than the initial ones we put in there. And we had out app product in there which is a small in ear device, but that's a very niche product. And what the clinics are waiting for was for us to fill out the product line. So we will have completed that in the second quarter and we hope that all these efforts we put into it will allow us to drive the business forward. But those have been some of the reasons why its been slower than – than anticipated.

Dick Ryan: Okay. Great. One last one, I mean you've had some inklings of legislative efforts but certainly the FDA getting rid of the those waivers would obviously help the DTC markets. But what else are you seeing in maybe the conventional channel that's coming your way or going the other way, if you will.

Mark Gorder: Well I think that all of the direction is going in the direction of greater consumer choice and less regulation. And probably – we probably mentioned this at the investor call on Thursday, 26th January, but the Senators Warner and Grassley had introduced a bill calling for an over the counter category of hearing aids and it had put that bill before Congress. And I think as a result of that, the FDA has sped up their review of their regulations and are now considering and taking input on what should a OTC category look like and how should it be regulated. And I think movement in that direction will be very swift. I would guess that, if we're talking a year from now, we will hear – we will have some kind of document from the FDA with some guidance

recommendations for an OTC category. And that only is going to help. The waiver already helps us. We can already do what we need to do. The OTC category might allow us to more rapidly move self-fitting technology into the direct to consumer market. So I would guess we're going to make good progress on a regulator front during 2017.

Dick Ryan: Okay. Thank you.

Operator: Thank you. And once again, as a reminder that is star one if you'd like to ask a question. We'll move onto our next question from Scott Billeadeau with Walrus Partners.

Scott Billeadeau: Hi guys. I'm wondering if you could give us a little feeling of what the – what your selling. You know the cardiac monitoring business, give us a sense what – what is the revenue. Is there any profitability there? What – as that goes away, what's it do to the company?

Mark Gorder: Sure. So in the fourth quarter, we had about \$200,000 worth of revenue from the cardiac business and for the year it was about \$1.2 million. And that's been relatively consistent, Scott, over the last couple of years. We have sustained some more significant losses from that business. If you look at the financial statements for the year, we recorded a loss of a little over a \$1 million from that business. Directly related to the operations and then we wrote down some assets. So for us, it was a business that has promise but we have to focus. We have real significant opportunities in large markets with both Metronic and everything we're doing on the value hearing health side. So the thought process behind that was we need to focus our time effort in resources. And so it was a decision that was made that we thought would best position us to realize the opportunities in front of us.

Scott Billeadeau: Okay, great. And then I found a tread go through and just, you know, the break out of revenue, I though you said Metronic was like \$7.2 million, direct to consumer was like \$1 million, the rest of the hearing health was about \$6 million, that leads to, you know, roughly \$14.2

million, because there's a couple hundred, of course I don't know if that was in discontinue. But where's the other three year, three and a half, how would you bucket that.

Mark Gorder: Yup. So we have medical business outside of Metronic. We do business for Smith's Medical and some other large medical OEMs. That makes up a little over \$2.5 million. And we also have a professional and audio communications business over in Singapore and that's selling high end headsets into groups like Bose, Audiotechnica[?] and the Singapore government. So that makes up the balance of the revenue.

Scott Billeadeau: Okay. And then on going forward just wondering on the R&D line, you know, is there – what's the game plan there in terms of what you expect to be spending. Obviously there will be some spending on the DTC that is more – that's more SG&A I guess or probably more S for the most part there. But any thoughts on the R&D line will look like going forward.

Mark Gorder: What we're doing as a result of this focusing Scott is it allows us to kind of stabilize the R&D line and R&D dollars that where going into a cardiac will be diverted into the emerging value based hearing health and will be put towards accelerating development of our wireless hearing aid that we talking about here recently. I think it was Dick's question that I addressed there that we have a number of initiatives coming up quarter by quarter this year and that – that diverted R&D will be targeted there. So we would anticipate that the R&D line is probably stable and slightly down from 2016.

Scott Billeadeau: Okay. Great and then follow up on just the Ear Ventures business, I think you talked about how – is there a little – these guys are getting some good dollar margins from the big guys even though the prices are coming down, there's so much cushion there or is it more of a I don't get – I don't get in trouble for selling IBM, so to speak, if I sell one of the big guys. Do you have a sense or is it that there is good margin there and that's the issue as opposed to any thing

with, you know, brand or preserved difference in quality that that's keeping that group from selling your product.

Mark Gorder: Well, I think it's more of the – the – there in a business where its retail model of selling 20 – an average \$2,300 per ear hearing aids and that's their business. And IntriCon is not in that business. We're in the business of providing outcome based medical devices that achieve the best consumer satisfaction in difficult listening environments. So we don't put a lot of the bells and whistles on there that they're used to in the retail model. There model is probably geared to complexity and ours is geared to simplicity. Because the consumer needs devices that are very easy to operate and you take them out of the box and they work. So I think the – we're in – we're in a different business and so when we go and offer them that business model, they look at it as one little product niche in their total offering. And they're having difficulty figuring how do I fit this value based – outcome based medical device into my general offering of retail hearing aids at \$2,300 apiece. Were as in direct to consumer, we don't have that issue. We're selling that to everybody. I don't know if that makes sense.

Scott Billeadeau: Yeah, no I – like you say, there is – the issue is they are even with these independent guys, it's still, you know, they still most of their money is made on the margin for selling these things not on a health care service. I mean that's just the way this stuff is pedalled at this point. Is that right?

Mark Gorder: Exactly right Scott.

Scott Longval: And I think what we're finding is what's reinforcing our excitement about the direct to consumer market where Mark talked about some of the big six coming and offering target price reductions. Those price reductions did not get shared with the consumer. So, even my introducing lower prices into that market, it ultimately does not get passed to the consumer. And with the growing need and the heightened awareness, its only demanding a new disruptive channel.

Scott Billeadeau: Yeah, and I guess that's the issue is – does – as you do the direct, does there have to be – there has to be some test or audiologist some way and it's a matter of to bypass that whole margin for these guys. What can be done, I'm not quite sure, what can be done directly now without that guy involved.

Mark Gorder: Well, the current DTC model, we have a very good – we call it our customer care center at HHE and there's about 9 to 10 licensed professionals who are actually taking those calls and assisting the patients in adapting to their hearing aids. So a healthcare component of a DTC offering is very critical. You can't – you can't take them out of the box and just put them on and adjust. You need some professional assistance and we provide that at HHE and I think the – when you start thinking about if you combine this customer care model with self-fitting technology that can provide remote access and ultimately you are going to – for a large number of these patients that don't need this gold standard where you go in to a bricks and mortar shop and have somebody hand hold you at a very high price, we can – by putting technology in the device and using that to our advantage, I like to call it the uberization of the hearing healthcare model, is that the technology infrastructure allows you to replace some of what the professional does and – by putting it into the – into the fitting technology. So we think that our model is a great compromise in taking people that don't need the gold standard and giving them a very high quality medical outcome based device.

Scott Billeadeau: Okay, great. Thanks guys.

Mark Gorder: Thank you Scott.

Operator: Thank you and that concludes today's question and answer session. I would now like to turn the conference back over to Mr. Mark Gorder, Chief Executive Officer, for closing remarks.

Mark Gorder: Thank you Operator. Once again, we appreciate you taking time out of your day to join the call. In closing, I'd like to reiterate that I'm excited with the direction we are heading. Our established medical business is rebounding nicely and is a long run way for success. With record first quarter sales on the near-term horizon. In the emerging value-based hearing healthcare channel, we're faced with tremendous opportunity. We've taken meaningful steps forward and look forward to additional progress in the coming quarter. With solid execution, the future looks bright for our organization and we look forward to updating you next quarter. Thank you very much.

Operator: Thank you. And that does conclude today's conference. Thank you for your participation.