

## **IntriCon Corp. 2016 First-Quarter Results Conference Call**

**Moderator: Scott Longval**  
**April 26, 2016**  
**4:00 pm CT**

Operator: Good day and welcome to the IntriCon First Quarter 2016 Results conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Scott Longval, Chief Financial Officer. Please go ahead.

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 call contains certain forward-looking statements. These statements are based on the 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 the 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, 2015.

With that, I'd to introduce Mark for a strategic look at IntriCon's first 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 first quarter. After that, Scott will cover the financials in more detail and then we'll take your questions.

By this time, most of you have had a chance to review our first quarter press release. For the quarter, we delivered revenue of \$18.3 million and margins of 28%, and are pleased to report year-over-year growth from a net sales and gross margin standpoint.

We consciously increased our investment in the first quarter to accelerate expansion and value hearing health, which resulted in a slight decline in net income. Our recent efforts are beginning to gain traction, and we delivered first value hearing health sales gains both year-over-year and sequentially.

We intend to continue focusing our resources on building the infrastructure required to secure high potential growth opportunities in this space. Looking at our three businesses, sales in hearing health grew 16% over the prior year period.

During the quarter, we experienced gains in targeted value hearing health initiatives including value hearing aids, personal sound amplifier products, or PSAPs and assistive listening devices. These gains were partially offset by anticipated decreases in conventional channel sales.

The conventional channel as we previously discussed has experienced the trend of continued market consolidation. As a result, the top six manufacturers now control applications 98% of the global market. However, during this time, market penetration has stagnated as end consumer prices have risen dramatically.

To address this market dynamic, we remain focused on securing other notable partners who can benefit from the Company's value, outcome based hearing health model. We anticipate these

initiatives will drive robust hearing health growth in future quarters. Shortly, I will comment further on these efforts.

Our medical business sales increased 12% in the 2016 first quarter compared to the year ago period, primarily driven by our largest customer Medtronic. The gains stemmed from MiniLink REAL-Time Transmitter and related accessories sales, which are incorporated in Medtronic's MiniMed 530G insulin pump and continuous glucose monitoring system.

We also manufacture various accessories associated with Medtronic's CGM system, including the recently announced MiniMed Connect, which links the MiniMed pump and CGM to certain smart devices providing users with a discrete and real-time view of their blood sugar information. We continue to anticipate Medtronic revenue growth throughout 2016.

Looking at our professional audio communications business, sales declined 16% from the prior year period. We will leverage our core technologies in professional audio communication to support existing customers as well as seek related hearing health and medical product opportunities. We anticipate this business to be relatively flat year-over-year.

I'll now touch briefly on other key initiatives, most notably in value hearing health. On April 21, 2016, the US Food and Drug Administration posted a public workshop to gather stakeholder and public input on draft guidance related to the agencies' pre-market requirements for hearing aids and PSAPs.

The FDA's intent is to consider ways in which regulation can support further device penetration into the hearing market. This is positive for IntriCon. We are aligned with the FDA's efforts to overcome barriers to device access and spur development and innovation in cost effective technology.

These factors create the need for the outcomes based hearing health delivery model we have advocated. Our value hearing health strategy focuses on this need as we continue to build the infrastructure to secure other notable partners who can help drive the company's outcomes based hearing health delivery model.

We look forward to partnering with the FDA and other organizations to bring hearing healthcare to millions of people who today cannot afford it through the conventional channel. Both our earVenture partnership with the Academy of Doctors of Audiology and PC Werth Limited are testaments to the emerging value channels that we believe have significant growth potential.

And they capitalize on IntriCon's established ability to deliver high-quality devices and fitting software while providing access points to directly penetrate the global marketplace.

While both of these initiatives are in their infancy, we anticipate they will drive robust hearing health growth for IntriCon in future quarters. To give an update on both, the company's integration plan for PC Werth is proceeding on schedule.

During the quarter, we delivered initial devices to the National Health Service and are eagerly awaiting customer feedback, which we anticipate receiving within the current quarter. In mid-April, earVenture presented at Audiology Now, the annual convention of the American Academy of Audiology.

This is part of IntriCon's comprehensive marketing and sales plan to convert the 400 plus ADA members who have registered for the earVenture program into consistent customers, as well as solicit non-registered ADA members to join the program.

Our step up - steadfast commitment to value hearing health is focused on long-term value creation. To support this strategy as previously mentioned during the quarter, we continue to increase investment to accelerate expansion.

Additionally, in mid-April, we amended our credit facilities with the private bank, giving the Company added financial flexibility. The amendment includes an increase in IntriCon's term loan to \$6 million from \$4 million, an increase in the revolving credit facility capacity to \$9 million from \$8 million, an increase in the inventory cap on the borrowing base from \$3-1/2 million to \$4 million.

As we look ahead, we're evaluating several options to further enhance our infrastructure and secure channel partners in value hearing health. Lastly, I'd like to extend a welcome to Phil Smith, who joined the Company's Board at the beginning of April.

Phil's years of diverse experience in the medical device and healthcare industries, particularly his involvement in cultivating disruptive channels, will be extremely valuable to IntriCon as we advance our value hearing health focus.

Coming from the investment banking world as well as the leadership side of healthcare, Phil has a unique and valuable perspective on our company, and we look forward to working with him.

Now I'd like to turn the call over to Scott.

Scott Longval: Thank you, Mark. I'll begin by reviewing our first quarter financial results in more detail.

The 2016 first quarter, the company reported net sales of \$18.3 million, up from \$16.6 million in the prior year period. Gross profit margins grew to 28% from 26.1% in the 2015 first quarter; against primarily stemmed from higher overall sales volume.

IntriCon posted net income attributable to shareholders of \$15,000, or 0 cents per diluted share compared to \$284,000 or 5 cents per diluted share for the 2015 first quarter, a loss attributable to the non-controlling interest relates to ADA share of earVenture's losses for the respective period.

Operating expenses for the first quarter were \$4.9 million, \$981,000 over the prior year comparable period. This was chiefly due to the PC Werth acquisition and increased investment to advance our technology portfolio. Specifically, in 2016, we're committed to enhancing our low power DSP and wireless technology portfolio focused on, increasing access to and efficiencies in, the value hearing health distribution channel and medical biotelemetry markets.

Turning to other financial metrics, as Mark previously mentioned, we amended our credit facilities with the private bank, improving our liquidity and financial flexibility. Our debt of \$11.5 million increased sequentially from \$9.8 million, primarily due to the PC Werth alignment efforts and inventory build for launch of several key value hearing health and medical programs.

Our total cash cycle days, at the end of the first quarter, were 77. This is an increase from 65 days at the end of the comparable year period and consistent sequentially with the 2015 fourth quarter. All-in-all, this is solid quarter for IntriCon and we have a lot of exciting things on the horizon.

And now I'd like to turn the call back over to the operator so we can take your questions.

Operator: Certainly. At this time if you would like to ask a question please press star then 1 on your touch-tone phone. You may withdraw yourself from the question queue at any time by pressing the pound key. Once again, star then 1 if you'd like to ask a question.

We'll go first to (Scott Billadu) with Walrus Partners. Please go ahead.

(Scott Billadu): Oh, hi guys. Thanks for taking my question. I'm wondering if you could give us little more info on what exactly happened at the April 21 meeting, maybe flush out exactly what they're doing there.

Obvious they're trying to come up with a common period as soon to come up with the guidance for draft what's based on. I'm just wondering if you could maybe fill us in a little bit about what happened there.

Mark Gorder: Sure, I'd be glad to Scott. This is Mark. The - there's been considerable public pressure coming from a report that was issued by the President's Council of Advisors on Science & Technology, PCAST...

(Scott Billadu): Yes.

Mark Gorder: ...which recommended significant changes to the way hearing healthcare is provided today. And among the recommendations we're loosening regulatory guidelines to allow more innovative channels to provide greater access and lower cost.

And the FDA responded, there's also a second report coming out in June from the Institute of Medicine, which will have a substantial input to it, the PCAST report. It is felt that the IOM report will mirror some of the recommendations of the PCAST report including making some of their own in this direction of providing, allowing greater access at lower cost.

And so the FDA assembled a panel of all interested parties. It was - I listened to the entire broadcast and it was predominantly attended by members of the status quo, the large manufacturers and the existing professional associations like the AAA and the ADA and so on and so forth.

But when you listen between the lines, there's a growing consumer concerns about the cost and the access of hearing aids. And I think the FDA is responding to that pressure and I do believe that over time they will make some regulatory changes.

Of course the timing of that you can't anticipate. But clearly, they're responding to the pressure and starting to gather input. Does that answer your question?

(Scott Billadu): Yes, I'm just trying to, you know, it does. I'm trying to figure out what might be the, you know, what is the outcome, is it just another draft or is there actually something that they can go do up here like CMS with or something.

You have any thoughts off the top of your head on what's the potential outcome from what's happening here?

Mark Gorder: I would probably want to withhold judgement as to the timing of this until I see the IOM report, and the FDA is allowing continued input through I believe it's the 21st of May. And at that point, they'll probably issue some kind of a statement as to what they're going to do with all this input.

But I'll provide another update on the next call, because we're obviously very interested in what's going on there and we think this is very positive for the industry. There's a lot of articles that are starting to appear, like in the New York Times, there's a good article. There's a lot of public pressure starting to up swell in support of making some changes.

So I'll keep the shareholders advised quarter-to-quarter as I hear more information about this.

(Scott Billadu): And then another question just on the amended credit facility. Was that to, you know, allow some, you know, inventory build, you know, in anticipation of either PC Werth ramping? Maybe give us a little thought of what the action taken there, and what should we read from it.

Scott Longval: This is Scott. Thanks Scott for calling in. It basically was us looking to amend our facility to provide a little bit greater flexibility, little more liquidity. We've taken on some efforts as you know with PC Werth. We put in a significant amount of cash over there for working capital and we're beginning to expand that business.

Ad we're also looking at building the infrastructure as we talked about related to the number of value hearing activities and with growth anticipation from some of our larger customers in the second half - in the second quarter in the second half of the year. So, again, it was just a move to move where we could have a little bit more flexibility, allow us to move a little bit quicker, than if we didn't have it in place.

(Scott Billadu): Okay. Thanks guy. I'll get back in queue.

Male: Thanks (Scott)

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Operator: Thank you. As a reminder, if you would like to ask a question please press star then 1 on your touch-tone phone. If you have yourself on mute or speakerphone please take that off for our system to better recognize your signal. Again, star then 1 if you would like to ask a question.

We'll go next to (Larry Haimovitch) with HMTc. Please go ahead.

(Larry Haimovitch): Good afternoon gentlemen.

((Crosstalk))

(Larry Haimovitch): Terrific. How are you?

Male: Pretty good, thanks.

(Larry Haimovitch): I think PC Werth and your initiative in the UK is one of the truly important catalysts that while we all hope to see really come, some really wonderful fruition over the years. I wondered if you could provide a little more color on things that are going on.

You did touched on it in your prepared remarks, but is there any other color you might provide to give us a sense of how this is coming along?

Mark Gorder: Certainly. I got - the initial work that we've done after we acquired it - the acquisition happened relatively rapidly. And then we had to immediately look at moving the business to a new facility. So we spent most of the first quarter organizing that move and relocating to a different building.

It's not far from where it is today, but it's in the Greater London area. But that took a considerable amount of work to get all that done, and yet at the same time keep the revenue and the business going, which has been done. And we are now in the new facility as of this week. And we've undertaken that - I think we've talked in the past about the initial rollout here as we're trying to get initial devices to a number of clinics.

We're targeting about 60 clinics to provide initial devices and training, and gaining feedback from those clinics. And then we're hoping that we can start generating repeat sales from the ones that we've targeted. I think to date we've contacted somewhere between 15 to 30 clinics and provided them with product.

We've received initial orders and we're going to continue to beef up the sales force and continue to push to get to all these clinics by the end of the year. There's 300 clinics over there and by the end of the year, we want to make sure we've covered all 300 clinics.

(Larry Haimovitch): Okay. So the marketing and sales efforts are clearly ramping up over there. And then Scott the acquisition took place toward the end of last year. So, what were the same store sales for IntriCon? In other words, if I back out the acquired sales of PC Werth, it would appear that sales were not flat but flattish. What would be the number if we backed out PC Werth?

Scott Longval: Yes, the organic growth quarter-over-quarter is about 400,000, or a couple percent.

(Larry Haimovitch): Okay.

Scott Longval: And what we're continuing to battle and obviously the reasons we're pursuing channels like PC Werth and the ADA with earVenture is because we're continuing to see the decline in the conventional channel. So...

(Larry Haimovitch): Right, and I was looking at that, yes.

Scott Longval: Those organic growth rates, you know, are been offset by the deterioration. And I think the one thing is we look at that organic, or excuse me, that traditional business, it's becoming a smaller and smaller part of our overall revenue makeup.

So, at some point we're going to start to see what we think is more attractive organic growth rates, or excuse me, attractive revenue growth going forward.

(Larry Haimovitch): Scott, that leads to my next question, which is how - what is the approximate contribution of the professional audio communication business, because as you say, it is

shrinking, but it sounds like still large enough certainly in fact dragging down the overall corporate growth rate.

Scott Longval: Yes, I think there's two effects. We did see our professional audio communication business. That was down about 16% year-over-year. It's about \$1.8 million a quarter and we've kind of pegged it for the year and the guidance that we've given at about \$7-1/2 million to \$8 million is we're anticipating that revenue.

(Larry Haimovitch): So in Q1, that was about 10% of your sales?

Scott Longval: A little less than 10%.

(Larry Haimovitch): Yes. So it's relative contribution is - it's fairly small and shrinking as the other businesses show very nice growth and then as it continues to decline. So, to your point then, I guess, it's effect on the top line is going to diminish over time, because it's fairly small and the other businesses continue to show nice growth.

Scott Longval: Correct.

(Larry Haimovitch): Okay. Good. Yes, because, I mean, I looked at the quarter and I said, "Gee, very nice Medtronic and OEM business, very nice growth in the new hearing aid initiative, but oh gee whiz, look at that, the professional audio dragged you down".

Scott Longval: Correct, and that business is a little bit lumpy as we've talked about in the past from quarter-to-quarter. You know, government contracts kind of come and go but we think that base of, you know, \$1.7 million to \$1.8 million a quarter is a solid base revenue for the PADA business.

(Larry Haimovitch): Great. Okay, thank you. I'll jump back in queue.

Male: Thanks (Larry).

Operator: Thank you. Again as a reminder if you would like to ask a question please press star then 1 on your touch-tone phone. You may withdraw yourself from the question queue at any time by pressing the pound key. Again, star then 1 if you'd like to ask a question.

We'll go back to (Scott Billadu) with Walrus Partners. Please go ahead.

(Scott Billadu): Oh, hi guys. I don't know if you've disclosed that in the past is just, you know, what is the mix of conventional versus value hearing or PSAP? I mean, do you put it in buckets like that so we might have a little sense of what, you know, are we getting to the point like professional audio where the conventional is getting to a point where it's just not - it's going to stop being a headwind?

Mark Gorder: Yes. Good question (Scott) and I think it's very similar to the professional communications business where that base conventional business has kind of plateaued to a level, you know, we don't see much more deterioration from it. It's kind of reached the level where it's going to plateau.

But we have definitely seen that over the last number of years, and we saw it starting about 10 years ago and accelerated a little bit as we started to move more aggressively into this value space, which is where obviously we see the most significant and largest growth opportunity.

(Scott Billadu): Yes.

Scott Longval: We don't historically and we don't have any immediately plans to break that out specifically.

(Scott Billadu): Yes. Okay. Thanks guys.

Scott Longval: Thank you (Scott).

Operator: Thank you. It appears we have no further questions at this time. I would like to turn it back to  
Mark Gorder, CEO.

Mark Gorder: Once again, we appreciate your taking time out of your day to join the call. In closing, I'd  
like to reiterate that I'm encouraged with the strong revenue and gross margins posted during the  
quarter. And further progress we made in developing our value hearing health infrastructure and  
advancing our technology portfolio.

((Inaudible)) we still have more ground to cover we're committed to accelerating targeted  
investment that best positions the company for long-term success in the value hearing health and  
medical biotelemetry markets. Financially, we anticipate second quarter net sales consistent with  
2016 first quarter levels and double digit gains for the full year.

We look forward to updating you on our progress next quarter. Thank you.

Operator: Thank you. This does conclude today's conference. We appreciate your participation. You may  
disconnect at any time and have a great day.

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