

INTRICON

Moderator: Scott Longval
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4:00 pm CT

Operator: Good day and welcome to the IntriCon Fourth Quarter 2015 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 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 undue reliance on these forward-looking statements. Actual results may vary 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, 2014.

With that, I would 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. 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 will take your questions.

By this time, most of you have had a chance to review our fourth quarter press release. We reported very nice financial results. For the quarter, we delivered revenue of \$18.7 million and earnings of 13 cents per share and increased both sequentially and over the prior year.

We're pleased to post record quarterly results from a net sales and gross margin standpoint capping off the strongest year for the company for these metrics, since re-branding as IntriCon a decade ago. In addition to the solid financial results, we made further strides during the quarter advancing our initiatives and value of hearing health.

We concentrated resources on building the infrastructure required to secure high potential growth opportunities, especially in the value hearing health market, as evidenced by our recent announcement of the acquisition of the assets of PC Werth.

Looking at our three businesses, sales in hearing health remained steady with the prior year period. During the quarter, IntriCon continued to experience anticipated decreases in conventional channel sales, but we offset that with gains in targeted value hearing health initiatives, including value hearing aids, personal sound amplifier products, or PSAPs and assistive listening devices.

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

While IntriCon's conventional hearing health sales are down from the prior year, we remain focused on securing other notable partners who can benefit from the company's value, outcomes 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 40% in the 2015 fourth quarter compared to the year ago period primarily driven by our largest customer, Medtronic. Furthermore, for the 2015 full year, we experienced record Medtronic sales volumes.

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 the blood sugar information. We anticipate year-over-year Medtronic revenue growth going forward.

Looking at our professional audio communications business, sales declined 32% from the prior year period. The anticipated decrease was due to the conclusion of the company's Singapore government contract in 2014.

We will continue to leverage our core technologies in professional audio communication to support existing customers as well as seek related hearing health in medical product opportunities. We anticipate this business to be relatively flat throughout 2016.

I'll now briefly touch on other key initiatives, most notably in value hearing health. In early January, the US Food and Drug Administration weighed in on low hearing aid penetration rates

with an announcement that highlighted statistics from the National Institute on Deafness and Other Communication Disorders.

They found that 37.5 million US adults aged 18 and older report some form of hearing loss. However, only 30% of the adults over 70 and 16% of those aged 20 to 69, who could benefit from wearing hearing aids have ever used them. Based on these statistics, the FDA has reopened the public comment period on draft guidance related to the agency's pre-market requirements for hearing aids and PSAPs.

The FDA's intent is to consider ways in which regulation can support further penetration into the hearing market. This is positive for IntriCon. Along the same lines in October 2015, the President's Council of Advisors on Science and Technology, or PCAST, the group that makes policy recommendations to the President also addressed the low cost hearing market penetration levels that IntriCon has long pointed out.

PCAST indicated that untreated hearing loss in the US is a substantial national problem and supported this assessment with references to the barriers to access. Group recommended revising FDA regulations and changing the current distribution channel as well as creating new channels to increase the opportunities for consumer choice. A link to both the FDA announcement and the PCAST letter can be found on our Web site.

We are aligned with the FDA and PCAST efforts to overcome barriers to device access in spur development and innovation in cost effective technology. These factors are driving the need for the outcome-based hearing health model we have discussed.

And we are aggressively building the infrastructure to secure other notable partners who can help support our outcomes based hearing health offering. We look forward to partnering with the FDA

and other organizations to bring hearing healthcare to millions of people who today cannot afford care through the conventional channel.

In fact, 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, earVenture was officially launched in November at the ADA Conference in Washington, DC. To date, more than 400 to the 1288 members have registered to join the earVenture program and we have delivered initial units.

In Q1 2016, earVenture will be rolling out a comprehensive marketing and sales plan to convert those registered members to consistent customers as well as solicit non-registered ADA members to join the program.

With PC Werth, our integration plan, which will include site relocation, reallocating resources and leveraging corporate infrastructure is proceeding on schedule. We anticipate these efforts to be complete by the end of the 2016 third quarter.

Turning to manufacturing and distribution infrastructure as noted in our news release during the quarter, we completed our ERP migration to the JD Edwards EnterpriseOne platform. The launch of this platform further supports our expanded global manufacturing and distribution footprint to efficiently and effectively handle significant sales volumes.

The investment of \$2.4 million holds great significance in scaling our operations, reporting an analysis capability and expansion into new distribution models required for the outcomes based hearing healthcare model.

Putting all of these recent developments and initiatives into context, we have positioned IntriCon as the leader in the emerging hearing healthcare model through ongoing investments in sales, marketing and research and development.

In addition to our current partnerships in customers, we are actively pursuing other prospective partners and customers to expand our outcomes-based hearing healthcare model.

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

Scott Longval: Thank you, Mark. I'll begin reviewing our fourth quarter financial results in more detail. For the 2015 fourth quarter, the company reported net sales of \$18.7 million, up from \$16.5 million in the prior year period.

IntriCon posted net income attributed to shareholders of \$810,000 or 13 cents per diluted share, an increase from net income attributed to shareholders of \$360,000 or 6 cents per diluted share from the 2014 fourth quarter.

Included in the 2015 fourth quarter results, was \$143,000 of PC-related acquisition cost and a net loss of \$265,000 from operations, which totaled and combined \$408,000 loss or 6 cents per diluted share. Gross profit margins grew to 29.2% from 27.1% in the prior year fourth quarter. The gain stemmed primarily to higher overall sales volume.

For the 2015 full year, IntriCon reported net sales of \$69 million in net income attributed to shareholders of \$2.2 million or 36 cents per diluted share. Net income to shareholders excluded

the impact of PC Werth for 2015 would have been \$2.6 million or 42 cents per diluted share. This compares to the 2014 annual net sales of \$68.3 million in net income attributable to shareholders of \$2.2 million or 37 cents per diluted share.

Gross profit margins increased to 27.2% from 27.1% for the full year 2014. Again, the improvement was primarily driven by higher sales volume. Operating expenses for the fourth quarter and the year were \$4.4 million and \$16.2 million respectively increasing \$652,000 and \$1.1 million over the prior year comparable periods. This was chiefly due to the PC Werth acquisition and to increase investment for other value hearing health initiatives.

Turning to other financial metrics, our debt of \$9.8 million increased sequentially from \$7.1 million, primarily due to the PC Werth acquisition, our JD Edwards Enterprise One system upgrade and inventory build for launch of several key value hearing health and medical programs.

Our total cash cycle days at the end of the fourth quarter were 77. This rose from 66 days at the end of the comparable prior year period, mainly as a result of an increase in day sales and inventory of 75 from 98.

Inventory of \$14.5 million increased from the prior year period and sequentially due to several factors including overall business growth, launching of several key value hearing health programs, safety stock build in advance of our system conversion and the addition of PC Werth.

In summary, it was a solid quarter for IntriCon as we continue to drive revenue growth and deliver profitability, while further in high potential growth opportunities. I'd now like to turn the call back over to the operator so we can take your questions.

Operator: 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.

If you have yourself on mute or a speakerphone, please take that off for our system to better recognize your signal. Our first question comes from (Larry Haimovitch) with HMTC. Please go ahead.

(Larry Haimovitch): Good afternoon gentlemen.

Scott Longval: Hi (Larry), how are you doing?

(Larry Haimovitch): I am good, how are you Scott.

Scott Longval: Good.

(Larry Haimovitch): So, the fourth quarter revenue, I don't know if I caught whether it included any contribution from the acquisition. I'm trying to understand if the fourth quarter sales gain is apples to apples or were there are some oranges in there too?

Scott Longval: Included in the fourth quarter revenue from the acquisition was about \$400,000.

(Larry Haimovitch): Okay. So if we back that out what would be the organic sales growth?

Scott Longval: So if you look at the organic sales growth quarter-over-quarter, approximately 11 - excuse me, approximately 9%...

(Larry Haimovitch): Okay.

Scott Longval: ...8%.

(Larry Haimovitch): Can you discuss - maybe Mark would want to do this. But can you discuss some of the strategic initiatives you have going on with the NHS? That seems to be an enormous opportunity for you, I didn't hear very much on the call with regard to, you know, tangible signs of progress or specific strategic initiatives.

And those of us that are investing in the stock many of us think that's kept from all this potential, so I would love to hear a little update from you on that.

Mark Gorder: Certainly, well, as you know, the NHS is the largest single payer provider of hearing aids in the world, they deliver 1.2 million hearing aids. And the acquisition of PC Werth allowed us to build an infrastructure to directly access that channel and we think there are some very unique opportunities there.

We've launched two initial products into that market, roughly - I don't remember the exact date when we launched them, but it was last year -late last year. And there is one in particular called the apt or the kite, I guess we call it over there. It's a small in-the-air device and it's an open fit device and there's nothing like it in their system. And they're quite excited about it. And they're doing initial trials.

They have already started taking orders for that product there. And we anticipate some pretty good progress in that market this year. And we think the long range potential is very good. We should - I hate to throw market share numbers out, but we expect to gain a decent market share over the next few years penetrating that market.

We're going to add more sales people at PC Werth. I think our goal is to have five salespeople on the ground, focused on the 300 NHS clinics. And they're - they've rolled out to maybe 20, 25 clinics so far. And during the course of 2016, we anticipate rolling out to all the clinics.

And we also anticipate putting more products in there during the course of 2016. So this is going to be an ongoing continuous increase in investment into the NHS channel. So we have started taking initial orders. There's nothing material yet, but we expect it by the end of the year that there will be reasonable revenue coming out of the NHS.

(Larry Haimovitch): Do you think that a 10% share of that \$1.2 million unit market is somewhere in the two, three, four year timeframe as a beautiful expectation for those of us as investors?

Mark Gorder: Yes, I'd say that's a reasonable goal.

(Larry Haimovitch): And what would be your thought about an AST to you if you were to get that number?

Mark Gorder: I'm sorry?

(Larry Haimovitch): AST.

Mark Gorder: Oh, AST. The hearing aids in the NHS vary in price somewhere between \$60 to \$120 and we'll have a range of products in all those categories. So I would guess that you could probably take the average of that, maybe \$80 on the average.

(Larry Haimovitch): So \$80 times 120,000 units, at some point is a \$10 million business for you ((inaudible))?

Mark Gorder: Yes. I would say that's realistic goal.

(Larry Haimovitch): Okay, great. Okay, great. Thanks. I'll jump back in queue and let others ask...

(Crosstalk)

Mark Gorder: Good questions. Thank you.

(Larry Haimovitch): Thank you.

Operator: Thank you. We'll go next to with (Dick Ryan) with Dougherty. Please go ahead.

(Dick Ryan): Thank you. Good afternoon guys.

Mark Gorder: Good afternoon, (Dick).

(Dick Ryan): Mark, your guidance suggests a comparable range for Q1 that you had in Q4. What would your full quarter PC Werth contribution be?

Mark Gorder: What would it ((inaudible)) in the fourth quarter, (Dick)?

(Dick Ryan): No, in Q1 how much PC Werth - I mean you're going to have PC Werth for a full quarter in Q1. What were you putting that -into that guidance?

Scott Longval: So we had PC Werth obviously for two months on the fourth...

(Dick Ryan): Oh, it was two months.

Scott Longval: ...quarter. And we did about \$400,000. Part of that we're expecting to see a little bit more robust sales coming out of there in the first quarter. We don't break down, (Dick), to that level, but I could - would suggest it would be, you know, closer to the million dollar range the first quarter.

(Dick Ryan): Okay. And Mark, not only from you, but elsewhere in and around the hearing aid business, we're hearing and seeing disruption come up from a variety of different sources. Can you kind of, you know, set the landscape a little bit as to what you are seeing?

You know, we've seen some FDA approvals for our home hearing kits. It looks like the ball is starting to roll, but can you kind of give us a little more context where we really are and maybe a little more clarity on specific channels that you have that may see a more immediate impact versus something further down the road.

Mark Gorder: Well, I think the - as we listen to the PCAST announcement and the FDA what we're seeing is the start of consumer pressure on the marketplace to change or provide better access and lower prices to people that - we're only penetrating 20% roughly in the US market. And that's obviously not acceptable.

Now that the issue is that the current channel goes through the professionals in some way shape or form. And so, the short-term opportunities are working with the professional like with earVenture to try to allow them to compete in the market against some of the emerging forces like Costco or United Healthcare, or the PSAPs.

So, these - the independent channel that we have got with earVenture and the Academy of Doctors of Audiology, the goal there is to allow them to compete and to be more competitive in the marketplace. Now, in the long run, the PCAST report is suggesting much more change than that. And the issue there is that those channels don't yet exist.

And so there are some opportunities to change the business model, which I think in order to really enact penetration, we've to get into some more creative business models, working with partners that can perhaps get closer to consumer to really affect more rapid change.

But I think the landscape is such that it's forcing change within the conventional channel, which is exhibited by the fact that the ADA members are willing to partner with someone who can help them change as opposed to the big six manufacturers.

In addition, we're seeing this pressure from the PCAST, from the Institute of Medicine, from the consumer groups and that pressure is going under the FDA to create better regulatory environment to allow expansion of new channels to gain access to the 80% that aren't served.

And so what IntriCon is trying to do is position itself to not only affect change within the independence in the conventional channel. But also to position ourselves to take advantage of openings that are being created by pressure from PCAST, the IOM and the FDA, which is going to create a better landscape for more innovative channels closer to the consumer.

(Dick Ryan): Okay. Now you mentioned...

Mark Gorder: Did that answer your question?

(Dick Ryan): ...you mentioned earVenture's kind of rolling out 2016 and NHS. How about AudioNova?

You know, that cranked up, what, middle of last year. What sort of response are you seeing from them?

Mark Gorder: Well, they are launching a kind of a novel concept themselves. And it's dealing with the same kinds of issues that we're seeing in the US. There's also consolidation going on in the

European market where companies like Sonova are buying up distribution channels and putting pressure on the independents like AudioNova.

This initial development that we have done with them is a kind of a value-based device that allows the professional and the Dutch and the German markets to take on customers that can afford the more expensive devices. So, they have attempted to roll this thing out.

It's not going overly speedily, but that's the same thing we're experiencing in the US. It's going to take some time for them to get that rolling. There was also an announcement about AudioNova recently that went on the wire that they have put the company up for sale. We don't know what impact that may or may not have on the IntriCon's initiative, but that's kind of what we said with that one.

That is also very innovative and slow to take up and they're trying to roll it out to all their - and we believe they have 1300 shops within the Netherlands and Germany. And they're attempting to roll that out into those 1300 shops. So far, they have sold some initial product, they have got it rolling, but it's not scaled to the entire AudioNova market. It is only in a few shops that as far as we know today.

(Dick Ryan): Okay, okay, thanks. Scott, I'm not sure I heard what the level of hearing health was in Q4.

Scott Longval: Yes. So, hearing health revenue in the fourth quarter was \$5 million - sorry, \$5.9 million, \$6 million in total.

(Dick Ryan): Okay.

Scott Longval: And that included contributions of about \$400,000, again, from PC Werth.

(Dick Ryan): So, that's where PC Werth is sitting, okay. And one last one, any updates on United Health?

What's the - what progress are they making and kind of where is the status in that relationship?

Mark Gorder: Well, we obviously can't speak to numbers that are internal to United Healthcare, but we can continue to say that they're a very important customer of ours. They continue to grow their business, steady growth - good growth on their part.

And we continue to support them and we have got a great relationship with them. And we continue to believe that they will continue to grow that business at a good steady rate.

(Dick Ryan): Okay, great. Thank you.

Operator: Thank you. As a reminder, it is star then 1 if you'd like to ask a question and the pound key to remove yourself from the queue. Again, that's star then 1 if you'd like to ask a question.

We'll go next to (Scott Billeadeau) with Walrus Partners. Please go ahead.

(Scott Billeadeau): Good afternoon, guys. I got a - most of my questions have been answered. I just was going to do a quick follow-up just on Medtronic business.

Where, you know, as you look forward, any new versions kind of - just trying to get a feel for what we can expect maybe in the next 12 to 18 months from the Medtronic's business.

Mark Gorder: We're designed in with them to all their new versions going forward. And what happens, you know, because it's a medical - a Class 3 medical device, it's a long FDA cycle for approval. And typically they'll start new devices in Europe. And then when they get to a certain point, they bring them into the US. So, we expect continued positive growth out of Medtronic.

The - they're extremely committed to this business. They're investing a lot of money in new products and new markets. And we think we're well positioned. We're designed into all their new versions. And we anticipate continued growth in not only the existing products, but in adding new products into the channel going forward in 2016. Very positive outlook with Medtronic.

Scott Longval: Yes, just a couple of further comments on top of - on Mark's comments. They currently have the 530G system here in the US. I know they've made public comments on getting the 630G launch and released here in the US. And I know that the timing is floating a little bit, but again to Mark's point, we're designed into that.

And then there are some other products that they released midyear, most notably the MiniMed Connect, which we are doing for them as well. And they're anticipating to see a nice revenue growth from that throughout '16. So, stepping back from a macro level, we view Medtronic as a good solid customer that showed - has a track record of steady growth.

And we foresee that through '16 and beyond.

(Scott Billeadeau): Great. And then just thought I'd ask for - as you look forward into '16 I think you made a comment somewhere in the press release of - I think, it was \$4 million - over \$4 million on kind of R&D or on - I'm trying to remember where I saw that.

But was trying to figure out what's the game plan for spending as you look through '16 in terms of some initiatives and maybe on the sales front. You mentioned ramping up some PC Werth. You know, what is required here in the US or is it kind of just pushing partners and looking for partnerships yet?

Mark Gorder: I think the technology development is key to us, we've been increasing our R&D spend year-over-year for the last several years. I think in 2015, it was about 7% of revenue. And we anticipate that it'll be at least that going forward on increased revenue.

And the spending is focused on - in three areas. It's focused on wireless connectivity which we think is critical to enable the development of these new disruptive channels.

In addition, cloud based software fitting systems will be critical and we're investing on those. And finally, low power DSP. There's high quality signal processing in every hearing aid and we have to continue to be state-of-the-art in our signal processing algorithm. So we continue to invest there.

So from an R&D perspective, those three areas will continue to drive year-over-year increases in R&D spending to enable us to develop these channels. In the other infrastructure, I think that each channel will be unique. For example, in UK, we're going to add two more sales people in the UK that are specific to the National Health Service, so that's a very specific increase in sales.

In earVenture, there won't be so much sales as much as marketing, so there their increased marketing expenditures to the ADA members will be required. So, that kind of speaks to the marketing and sales area. Were there any other areas that you were interested in?

(Scott Billeadeau): Well, I think I was just trying to figure out to a certain extent as you -whether it's, you know, United or the - you mentioned a little bit about the earVenture joint venture. Some of that is - you can push, but you can't push to kind of a little bit along what the ride, although you need to continue to develop partnerships...

Mark Gorder: That's...

(Crosstalk)

(Scott Billeadeau): ...give them stools, but you're somewhat long for the ride. Is that correct?

Mark Gorder: That's correct. Yes.

(Scott Billeadeau): Great. I think that's it for me. Thanks guys.

Mark Gorder: You're welcome. Good questions.

Operator: Thank you. Again, that is star then 1 if you'd like to ask a question. We'll go next to (Ken Steinhauser), a Private Investor. Please go ahead.

(Ken Steinhauser): Hi, I'd like to breakdown a little bit the medical device section, the wireless holter monitor versus the insulin devices. Is there any way you can tell me the percentage of increase for the wireless monitor section and how is it doing inside the US and outside the US and how many partners do we now have in that - in the holter monitor area?

Mark Gorder: We don't break out to that level, but I can tell you that the business is relatively flat year-over-year and actually quarter-over-quarter. We're currently working on our Sirona device platform and working with a large OEM that we've been targeting as we have always stated this kind of our goal to get that business jump started and to where we see that market being about \$5 million to \$10 million market.

And that's really, if we look out into '16, one of our most significant objectives as it relates that business, securing the large OEM customer. So I think that business will continue to plug along, shows some modest growth, but we will not see a breakout until we have secured that large OEM customer.

(Ken Steinhauser): Okay. Thank you.

Operator: Thank you. It appears we have no further questions at this time. I'll turn the call back to Mark Gorder, CEO, for any 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 2015 was a very successful year for IntriCon. We posted the strongest revenue and gross margin since our re-branding as IntriCon. And I'm encouraged with the progress we made throughout 2015.

However, we still have more progress to make. Financially, as we carry this positive momentum into 2016, we anticipate higher sales for the full year, with our first quarter revenue consistent with our 2015 fourth quarter, a significant rise over 2015 first quarter revenue.

And strategically we have developed our value hearing health infrastructure, sort new channel partners and enhanced our technology portfolio. With clear evidence of an emerging value hearing health market opportunity and new partnerships coming onboard, coupled with our strong Medtronic business, we are poised for future growth.

We look forward to updating you on our progress next quarter and thank you again for joining our call.

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

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