

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2020

or

TRANSITION REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number: 1-5005

INTRICON CORPORATION

(Exact name of registrant as specified in its charter)

Pennsylvania

(State or other jurisdiction of
incorporation or organization)

23-1069060

(I.R.S. Employer Identification No.)

**1260 Red Fox Road
Arden Hills, Minnesota**

(Address of principal executive offices)

55112

(Zip Code)

(651) 636-9770

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading Symbol | Name of each exchange on which registered |
|--|----------------|---|
| Common stock, par value \$1.00 per share | IIN | Nasdaq Global Market |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

The number of outstanding shares of the registrant's common stock, \$1.00 par value, on October 31, 2020 was 8,943,370.

INTRICON CORPORATION

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PART I: FINANCIAL INFORMATION

ITEM 1. Financial Statements

INTRICON CORPORATION
Consolidated Condensed Balance Sheets
(In Thousands, Except Share Amounts)

| (unaudited) | <u>September 30,</u> | | <u>December 31,</u> | |
|---|----------------------|-----------------------|---------------------|-----------------------|
| | <u>2020</u> | | <u>2019</u> | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ | 16,081 | \$ | 8,523 |
| Restricted cash | | 647 | | 639 |
| Short-term investment securities | | 14,176 | | 23,451 |
| Accounts receivable, less provision for doubtful accounts of \$365 at September 30, 2020 and \$325 at December 31, 2019 | | 9,192 | | 8,993 |
| Inventories | | 20,463 | | 16,377 |
| Contract assets | | 10,592 | | 10,237 |
| Other current assets | | 1,426 | | 1,975 |
| Current assets of discontinued operations | | - | | 80 |
| Total current assets | | <u>72,577</u> | | <u>70,275</u> |
| Machinery and equipment | | 45,083 | | 41,073 |
| Less: Accumulated depreciation | | 30,915 | | 27,522 |
| Net machinery and equipment | | <u>14,168</u> | | <u>13,551</u> |
| Goodwill | | 13,714 | | 9,551 |
| Intangible assets | | 11,282 | | 5,545 |
| Operating lease right-of-use assets, net | | 3,812 | | 4,372 |
| Investment in partnerships | | 623 | | 1,160 |
| Long-term investment securities | | - | | 8,629 |
| Other assets, net | | 289 | | 510 |
| Total assets | \$ | <u><u>116,465</u></u> | \$ | <u><u>113,593</u></u> |
| Current liabilities: | | | | |
| Current financing leases | \$ | 34 | \$ | 101 |
| Current operating leases | | 1,512 | | 1,729 |
| Accounts payable | | 8,340 | | 9,876 |
| Accrued salaries, wages and commissions | | 4,271 | | 2,274 |
| Other accrued liabilities | | 4,429 | | 2,869 |
| Liabilities of discontinued operations | | - | | 77 |
| Total current liabilities | | <u>18,586</u> | | <u>16,926</u> |
| Noncurrent financing leases | | 2 | | 30 |
| Noncurrent operating leases | | 2,475 | | 2,937 |
| Other postretirement benefit obligations | | 349 | | 382 |
| Accrued pension liabilities | | 667 | | 655 |
| Deferred tax liabilities, net | | 1,104 | | - |
| Other long-term liabilities | | 3,790 | | 2,171 |
| Total liabilities | | <u>26,973</u> | | <u>23,101</u> |
| Commitments and contingencies (Note 18) | | | | |
| Shareholders' equity: | | | | |
| Common stock, \$1.00 par value per share; 20,000 shares authorized; 8,943 and 8,781 shares issued and outstanding at September 30, 2020 and December 31, 2019, respectively | | 8,943 | | 8,781 |
| Additional paid-in capital | | 88,908 | | 86,770 |
| Accumulated deficit | | (7,902) | | (4,286) |
| Accumulated other comprehensive loss | | (474) | | (520) |
| Total shareholders' equity | | <u>89,475</u> | | <u>90,745</u> |
| Non-controlling interest | | 17 | | (253) |
| Total equity | | <u>89,492</u> | | <u>90,492</u> |
| Total liabilities and equity | \$ | <u><u>116,465</u></u> | \$ | <u><u>113,593</u></u> |

(See accompanying notes to the consolidated condensed financial statements)

INTRICON CORPORATION
Consolidated Condensed Statements of Operations
(In Thousands, Except Per Share Amounts)

| (unaudited) | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| Revenue, net | \$ 27,367 | \$ 26,893 | \$ 72,472 | \$ 85,800 |
| Cost of goods sold | 20,169 | 20,120 | 54,096 | 62,253 |
| Gross profit | 7,198 | 6,773 | 18,376 | 23,547 |
| Operating expenses: | | | | |
| Sales and marketing | 1,365 | 2,609 | 5,038 | 9,071 |
| General and administrative | 3,654 | 3,715 | 11,673 | 10,551 |
| Research and development | 1,458 | 840 | 3,868 | 2,902 |
| Restructuring charges | - | - | 1,171 | - |
| Impairment loss | - | - | - | 3,765 |
| Other operating expenses | 253 | - | 746 | - |
| Total operating expenses | 6,730 | 7,164 | 22,496 | 26,289 |
| Operating income (loss) | 468 | (391) | (4,120) | (2,742) |
| Interest income, net | 41 | 240 | 322 | 703 |
| Other income (expense), net | 192 | (52) | 293 | (458) |
| Income (loss) from continuing operations before income taxes and discontinued operations | 701 | (203) | (3,505) | (2,497) |
| Income tax expense | 47 | 87 | 94 | 334 |
| Income (loss) from continuing operations before discontinued operations | 654 | (290) | (3,599) | (2,831) |
| Loss on disposal of discontinued operations (Note 5) | - | - | - | (1,116) |
| Loss from discontinued operations (Note 5) | - | - | - | (597) |
| Net income (loss) | 654 | (290) | (3,599) | (4,544) |
| Less: Income allocated to non-controlling interest | 10 | - | 17 | - |
| Net income (loss) attributable to Intricon shareholders | \$ 644 | \$ (290) | \$ (3,616) | \$ (4,544) |
| Basic income (loss) per share attributable to Intricon shareholders: | | | | |
| Continuing operations | \$ 0.07 | \$ (0.03) | \$ (0.41) | \$ (0.32) |
| Discontinued operations | - | - | - | (0.20) |
| Net income (loss) per share: | \$ 0.07 | \$ (0.03) | \$ (0.41) | \$ (0.52) |
| Diluted income (loss) per share attributable to Intricon shareholders: | | | | |
| Continuing operations | \$ 0.07 | \$ (0.03) | \$ (0.41) | \$ (0.32) |
| Discontinued operations | - | - | - | (0.20) |
| Net income (loss) per share: | \$ 0.07 | \$ (0.03) | \$ (0.41) | \$ (0.52) |
| Average shares outstanding: | | | | |
| Basic | 8,936 | 8,764 | 8,877 | 8,738 |
| Diluted | 9,272 | 8,764 | 8,877 | 8,738 |

(See accompanying notes to the consolidated condensed financial statements)

INTRICON CORPORATION
Consolidated Condensed Statements of Comprehensive Income (Loss)
(In Thousands)

| (unaudited) | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| Net income (loss) | \$ 654 | \$ (290) | \$ (3,599) | \$ (4,544) |
| Realized foreign currency translation loss from discontinued operations previously unrealized, net of taxes of \$0 | - | - | - | 280 |
| Unrealized foreign currency translation adjustment from continuing operations, net of taxes of \$0 | 5 | 9 | 31 | (10) |
| Investment in partnerships, net of taxes of \$0 | - | - | - | 118 |
| Pension and postretirement obligations, net of taxes of \$0 | 5 | 5 | 15 | 15 |
| Comprehensive income (loss) | <u>\$ 664</u> | <u>\$ (276)</u> | <u>\$ (3,553)</u> | <u>\$ (4,141)</u> |

(See accompanying notes to the consolidated condensed financial statements)

INTRICON CORPORATION
Consolidated Condensed Statements of Cash Flows
(In Thousands)

| (unaudited) | Nine Months Ended | |
|--|-----------------------|-----------------------|
| | September 30, 2020 | September 30, 2019 |
| Cash flows from operating activities: | | |
| Net loss | \$ (3,599) | \$ (4,544) |
| Loss from discontinued operations | - | 1,713 |
| Loss from continuing operations | (3,599) | (2,831) |
| Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,311 | 2,448 |
| Equity in loss of partnerships | 90 | 206 |
| Stock-based compensation | 2,044 | 1,514 |
| Change in fair value of contingent consideration | 253 | - |
| Provision for doubtful accounts | 40 | (501) |
| Loss on disposal of assets | 174 | - |
| Impairment loss | - | 3,765 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 1,223 | 3,394 |
| Inventories | (2,139) | 110 |
| Contract assets | (355) | (2,889) |
| Other assets | 593 | (165) |
| Accounts payable | (2,354) | (1,773) |
| Accrued expenses | 1,878 | (1,372) |
| Other liabilities | (1,114) | (123) |
| Net cash provided by operating activities of continuing operations | 45 | 1,783 |
| Net cash provided by (used in) operating activities of discontinued operations | 3 | (24) |
| Net cash provided by operating activities | 48 | 1,759 |
| Cash flows from investing activities: | | |
| Purchases of machinery and equipment | (2,562) | (3,787) |
| Payments for acquisition of a business | (7,128) | - |
| Payments for acquisition of intangible assets | (489) | (696) |
| Purchase of investment securities | (6,110) | (40,590) |
| Proceeds from sale of investment securities | - | 38,015 |
| Proceeds from maturities of investment securities | 23,998 | 6,425 |
| Investment in partnerships | - | (296) |
| Net cash provided by (used in) investing activities of continuing operations | 7,709 | (929) |
| Net cash used in investing activities of discontinued operations | - | (16) |
| Net cash provided by (used in) investing activities | 7,709 | (945) |
| Cash flows from financing activities: | | |
| Payment of financing leases | (79) | (82) |
| Exercise of stock options and employee stock purchase plan shares | 173 | 263 |
| Withholding of common stock upon vesting of restricted stock units | (246) | (304) |
| Net cash used in financing activities | (152) | (123) |
| Effect of exchange rate changes on cash | (39) | (50) |
| Net increase in cash | 7,566 | 641 |
| Cash, cash equivalents and restricted cash, beginning of period | 9,162 | 8,047 |
| Cash, cash equivalents and restricted cash, end of period | \$ 16,728 | \$ 8,688 |
| Non-cash investing and financing: | | |
| Acquisition of machinery and equipment in accounts payable | \$ 75 | \$ 305 |
| Acquisition of a business through liabilities incurred | 3,705 | - |
| Acquisition of a business through issuance of common stock | 982 | - |
| Investment in partnerships | 442 | - |
| Fitting software intangible assets through liabilities incurred and exchange of investment in partnership | - | 3,093 |

(See accompanying notes to the consolidated condensed financial statements)

INTRICON CORPORATION
Consolidated Condensed Statements of Equity
(In Thousands)

| | Shareholders' Equity, Three and Nine Months Ended September 30, 2020 (Unaudited) | | | | | | Total Equity |
|--|--|---------------------|----------------------------|---------------------|--------------------------------------|--------------------------|--------------|
| | Common Stock Number of Shares | Common Stock Amount | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Non-Controlling Interest | |
| Balance December 31, 2019 | 8,781 | \$ 8,781 | \$ 86,770 | \$ (4,286) | \$ (520) | \$ (253) | \$ 90,492 |
| Exercise of stock options, net | 11 | 11 | 4 | - | - | - | 15 |
| Withholding of common stock upon vesting of restricted stock units | 22 | 22 | (220) | - | - | - | (198) |
| Shares issued under the employee stock purchase plan | 5 | 5 | 48 | - | - | - | 53 |
| Stock-based compensation | - | - | 376 | - | - | - | 376 |
| Net loss | - | - | - | (1,979) | - | - | (1,979) |
| Comprehensive income | - | - | - | - | 18 | - | 18 |
| Balance March 31, 2020 | 8,819 | \$ 8,819 | \$ 86,978 | \$ (6,265) | \$ (502) | \$ (253) | \$ 88,777 |
| Exercise of stock options, net | 18 | 18 | (18) | - | - | - | - |
| Withholding of common stock upon vesting of restricted stock units | 14 | 14 | (62) | - | - | - | (48) |
| Shares issued under the employee stock purchase plan | 3 | 3 | 36 | - | - | - | 39 |
| Acquisition of Emerald Medical Services | 80 | 80 | 902 | - | - | - | 982 |
| Stock-based compensation | - | - | 936 | - | - | - | 936 |
| Net (loss) income | - | - | - | (2,281) | - | 7 | (2,274) |
| Comprehensive income | - | - | - | - | 18 | - | 18 |
| Balance June 30, 2020 | 8,934 | \$ 8,934 | \$ 88,772 | \$ (8,546) | \$ (484) | \$ (246) | \$ 88,430 |
| Exercise of stock options, net | 4 | 4 | 11 | - | - | - | 15 |
| Withholding of common stock upon vesting of restricted stock units | 1 | 1 | (1) | - | - | - | - |
| Shares issued under the employee stock purchase plan | 4 | 4 | 47 | - | - | - | 51 |
| Controlling interest acquired in subsidiary | - | - | (253) | - | - | 253 | - |
| Stock-based compensation | - | - | 332 | - | - | - | 332 |
| Net income | - | - | - | 644 | - | 10 | 654 |
| Comprehensive income | - | - | - | - | 10 | - | 10 |
| Balance September 30, 2020 | 8,943 | \$ 8,943 | \$ 88,908 | \$ (7,902) | \$ (474) | \$ 17 | \$ 89,492 |

| | Shareholders' Equity, Three and Nine Months Ended September 30, 2019 (Unaudited) | | | | | | Total Equity |
|--|--|---------------------|----------------------------|---|--------------------------------------|--------------------------|--------------|
| | Common Stock Number of Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings (Accumulated Deficit) | Accumulated Other Comprehensive Loss | Non-Controlling Interest | |
| Balance December 31, 2018 | 8,664 | \$ 8,664 | \$ 84,999 | \$ (509) | \$ (927) | \$ (253) | \$ 91,974 |
| Exercise of stock options, net | 27 | 27 | (9) | - | - | - | 18 |
| Withholding of common stock upon vesting of restricted stock units | 20 | 20 | (255) | - | - | - | (235) |
| Shares issued under the employee stock purchase plan | 3 | 3 | 67 | - | - | - | 70 |
| Stock-based compensation | - | - | 329 | - | - | - | 329 |
| Net income | - | - | - | 775 | - | - | 775 |
| Comprehensive income | - | - | - | - | 130 | - | 130 |
| Balance March 31, 2019 | 8,714 | \$ 8,714 | \$ 85,131 | \$ 266 | \$ (797) | \$ (253) | \$ 93,061 |
| Exercise of stock options, net | 29 | 29 | 22 | - | - | - | 51 |
| Withholding of common stock upon vesting of restricted stock units | 6 | 6 | (6) | - | - | - | - |
| Shares issued under the employee stock purchase plan | 2 | 2 | 48 | - | - | - | 50 |
| Stock-based compensation | 3 | 3 | 534 | - | - | - | 537 |
| Net loss | - | - | - | (5,030) | - | - | (5,030) |
| Comprehensive income | - | - | - | - | 259 | - | 259 |
| Balance June 30, 2019 | 8,754 | \$ 8,754 | \$ 85,729 | \$ (4,764) | \$ (538) | \$ (253) | \$ 88,928 |
| Exercise of stock options, net | 12 | 12 | 16 | - | - | - | 28 |
| Withholding of common stock upon vesting of restricted stock units | 10 | 10 | (79) | - | - | - | (69) |
| Shares issued under the employee stock purchase plan | 2 | 2 | 44 | - | - | - | 46 |
| Stock-based compensation | - | - | 648 | - | - | - | 648 |
| Net (loss) | - | - | - | (290) | - | - | (290) |
| Comprehensive income | - | - | - | - | 14 | - | 14 |
| Balance September 30, 2019 | 8,778 | \$ 8,778 | \$ 86,358 | \$ (5,054) | \$ (524) | \$ (253) | \$ 89,305 |

(See accompanying notes to the consolidated financial statements)

Notes to Consolidated Condensed Financial Statements (Unaudited) (In Thousands, Except Share and Per Share Data)**1. General**

In the opinion of management, the accompanying consolidated condensed financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly Intricon Corporation's ("Intricon", the "Company", "we" or "our") consolidated condensed financial position as of September 30, 2020 and December 31, 2019, the consolidated condensed results of its operations and statements of equity for the three and nine months ended September 30, 2020 and 2019, and the consolidated condensed statements of cash flows for the nine months ended September 30, 2020 and 2019. Results of operations for the interim periods are not necessarily indicative of the results of operations expected for the full year or any other interim period. The preparation of consolidated condensed financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates particularly as it relates to estimates reliant on forecasts and other assumptions impacted by the COVID-19 pandemic.

In March 2020, the World Health Organization categorized COVID-19 (coronavirus) as a pandemic and the President of the United States declared the outbreak a national emergency. There are many uncertainties regarding the COVID-19 pandemic, and the Company is closely monitoring the impact of the pandemic on all aspects of its business, including how it will impact its customers, employees, suppliers, vendors, and business partners. We are unable to predict the impact that the COVID-19 pandemic will have on our financial position and operating results due to numerous uncertainties. The Company expects to continue to assess the evolving impact of the COVID-19 pandemic and intends to make adjustments to its responses accordingly. The Company considered the impacts of the COVID-19 pandemic on the assumptions and estimates used, including reviewing our long-lived assets for impairment, and determined that for the three and nine months ended September 30, 2020, the COVID-19 pandemic did not have a material adverse impact. These consolidated condensed financial statements should be read in conjunction with the consolidated condensed financial statements and the notes thereto included in our 2019 Annual Report on Form 10-K filed with the SEC.

On June 25, 2019, the Company's officers, pursuant to delegated authority from the board, approved plans to discontinue the operations of its United Kingdom (UK) subsidiary within our body worn device segment. For all periods presented, the Company classified this business as discontinued operations, and accordingly, has reclassified historical financial data presented herein. See Note 5.

On May 18, 2020, Intricon Pte. Ltd. ("Buyer"), a wholly-owned subsidiary of the Company, acquired all of the outstanding shares of Emerald Medical Services Pte., Ltd., a Singapore company ("Emerald"), pursuant to a Share Purchase Agreement dated the same date among Buyer, Emerald and the direct and indirect owners of Emerald. Emerald, based in Singapore, is a provider of joint development medical device manufacturing services for complex catheter applications. See Note 3.

On May 20, 2020, the Company announced a strategic restructuring plan designed to accelerate the Company's future growth by focusing resources on the highest potential growth areas. The plan, which was approved by the Company's Board of Directors, was completed as of June 30, 2020. See Note 4.

During the quarter ended September 30, 2020, the Company increased our ownership interest in EarVenture, a subsidiary of the Company, from 50% to 100%.

The consolidated condensed financial statements include the accounts of the Company and its consolidated subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation. The Company evaluates its voting and variable interests in entities on a qualitative and quantitative basis. The Company consolidates entities in which it concludes it has the power to direct the activities that most significantly impact an entity's economic success and has the obligation to absorb losses or the right to receive benefits that could be significant to the entity.

Significant Accounting Policies

The Company's significant accounting policies are detailed in "Note 1: Summary of Significant Accounting Policies" of the Company's Annual Report on Form 10-K for the year ended December 31, 2019.

Business Combinations

We record identifiable assets acquired and liabilities assumed in business combinations recorded at their estimated fair values on the acquisition date. The excess of the purchase price over the estimated fair values of the net tangible and net intangible assets acquired is recorded as goodwill. This requires management to make significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration between goodwill and assets that are depreciated and amortized. Our estimates are based on historical experience, information obtained from the management of the acquired companies and, when appropriate, include assistance from independent third-party appraisal firms. These estimates are inherently uncertain and unpredictable. In addition, unanticipated events or circumstances may occur which may affect the accuracy or validity of such estimates.

Contingent Consideration

Contingent consideration liabilities depend on certain future events and are measured at fair value based on various level 3 inputs and assumptions including forecasts, probabilities of payment and discount rates. Amounts are classified as current if expected to be paid within the next twelve months. The liability for contingent consideration is subject to fair value adjustments each reporting period that will be recognized through the statement of operations. See Note 3 for additional detail on the accounting for the Emerald acquisition.

Reclassification

The Company changed the classification of certain other assets, net to intangible assets on the consolidated condensed balance sheet for the period ended September 30, 2020. To conform with the current period presentation, amounts previously reported as other assets, net, of \$5,545 as of December 31, 2019, have been reclassified to intangible assets to conform with the current period presentation. Refer to Note 11 for additional details.

2. New Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses Topic 326*, which requires certain financial assets to be measured at amortized cost net of an allowance for estimated credit losses, such that the net receivable represents the present value of expected cash collection. In addition, this standard update requires that certain financial assets be measured at amortized cost reflecting an allowance for estimated credit losses expected to occur over the life of the assets. The estimate of credit losses must be based on all relevant information including historical information, current conditions, and reasonable and supportable forecasts that affect the collectability of the amounts. Topic 326 is effective for interim and annual periods beginning January 1, 2022 for smaller reporting companies. This standard update is not expected to have a material impact on our financial position, results of operations and cash flows.

In December 2019, the FASB issued ASU 2019-12, *Simplifying the Accounting for Income Taxes* as part of its overall simplification initiative to reduce costs and complexity in applying accounting standards while maintaining or improving the usefulness of the information provided to users of the financial statements. Amendments include removal of certain exceptions to the general principals of ASC 740, *Income Taxes*, and simplification in several other areas such as accounting for franchise tax (or similar tax) that is partially based on income. ASU 2019-12 is effective for interim and annual periods beginning after December 15, 2020. This standard update is not expected to have a material impact on our financial position, results of operations and cash flows.

In January 2020, the FASB issued ASU 2020-01, *Clarifying the Interactions between Topic 321, Topic 323, and Topic 815*, which clarifies that a company should consider observable transactions that require a company to either apply or discontinue the equity method of accounting under ASC 323, *Investments – Equity Method and Joint Venture*, for the purposes of applying the measurement alternative in accordance with ASC 321, *Investments – Equity Securities*, immediately before applying or upon discontinuing the equity method. ASU 2020-01 is effective for interim and annual periods beginning after December 15, 2020. This standard update is not expected to have a material impact on our financial position, results of operations and cash flows.

In April 2020, the FASB issued ASU 2020-04, *Reference Rate Reform Topic 848*, which provides temporary optional guidance to ease the potential burden in accounting for reference rate reform. Topic 848 provides optional expedients and exceptions for applying U.S. GAAP to transactions affected by reference rate reform if certain criteria are met. ASU 2020-04 is effective as of March 12, 2020. This standard update is not expected to have a material impact on our financial position, results of operations and cash flows.

3. Business Combination

Emerald Medical Services and Emerald Extrusion Services

On May 18, 2020, Intricon Pte. Ltd. (“Buyer”), a wholly-owned subsidiary of the Company, acquired all of the outstanding shares of Emerald Medical Services Pte., Ltd., a Singapore company (“Emerald”), pursuant to a Share Purchase Agreement dated the same date among Buyer, Emerald and the direct and indirect owners of Emerald. Emerald, based in Singapore, is a provider of joint development medical device manufacturing services for complex catheter applications.

In addition, Emerald has a 54% ownership interest in Emerald Extrusion Services LLC. (“EES”), based in California. The 54% ownership interest of EES was transferred from Intricon Pte. Ltd. to Intricon during the third quarter of 2020 with no impact to our consolidated condensed financial statements. Based on this controlling financial interest, the Company has consolidated this entity based on our voting interest.

On May 21, 2020, the Securities and Exchange Commission announced that it has adopted amendments to the financial disclosure requirements in Regulation S-X for acquisitions and dispositions of businesses. This guidance reduces the burden on companies by making more meaningful determinations on the significance of an acquired or disposed business by updating the significance test, among other things. As permitted, Intricon has early adopted this guidance and applied the updates in performing the significance test for the Emerald acquisition. Based on the updated guidance, Emerald is not deemed significant to our consolidated condensed financial statements and therefore, historic and pro forma financial statements are not required to be disclosed.

The total purchase price of \$11,815 consisted of a cash payment paid at closing of \$7,128, subject to a post-closing working capital adjustment of \$291, the issuance of 80 thousand shares of the Company’s common stock valued at \$982 issued at closing, which shares will be held in an escrow account for a period of 18 months to resolve any post-closing claims by the Buyer, as well as a liability for contingent consideration of \$3,414. The liability for contingent consideration consists of a cash payment of \$500 payable in the event that regulatory approval in Japan is obtained for a particular product within twelve months of closing, an earn-out payment of between \$333 and \$1,000 if Emerald has net revenues ranging from \$9.0 million to \$11.0 million during the first year after closing, and additional earn-out payments equal to 28% of all Emerald net revenues arising from the sale of certain products or to certain customers for each of the first three years after closing. The liability for contingent consideration is a fair value measurement based on various level 3 inputs using a scenario-based method. The key assumptions included forecasts of future revenues and cash flows of certain products, and the selection of the discount rate for the contingent consideration liability. The liability for contingent consideration is subject to fair value adjustments each reporting period that will be recognized through the statement of operations. For the period ended September 30, 2020, we recorded \$253 of change in fair value of contingent consideration within other operating expenses primarily due to the Company obtaining regulatory approval in Japan for a particular product as well as increases in the fair value of future estimated payments due to the passage of time. The regulatory approval will result in a cash payment of \$500 to the sellers under the Emerald purchase agreement which will be paid out during the fourth quarter of 2020.

In connection with the acquisition, the Company recorded acquisition costs of \$493 for the nine months ended September 30, 2020 related to legal, professional fees and other miscellaneous costs. These costs are recorded within other operating expenses within the consolidated condensed statements of operations.

Our consolidated condensed statements of operations for the three and nine months ended September 30, 2020 include revenues of \$2,816 and \$3,962, respectively, and net income of (\$48) and \$0, respectively, attributable to the acquiree for the period from May 19 through September 30, 2020.

We accounted for the acquisition in accordance with ASC 805, *Business Combinations*, with identifiable assets acquired and liabilities assumed recorded at their estimated fair value on the acquisition date. We have up to one year from the acquisition date to finalize the purchase price allocation. As such, these estimates may change which would likely result in an increase or decrease in goodwill. A preliminary purchase price allocation of the fair value of the assets acquired and liabilities assumed is included in the table below. A preliminary intangible asset of \$6,400 was recorded as a part of purchase accounting related to the value of identifiable customer relationships acquired. These intangibles are being amortized over an 8 year useful life. The fair value assigned to the identifiable intangible asset was determined primarily by using the excess earnings method. The key assumptions included in the excess earnings method include forecasts of future revenues and cash flows of certain products, and the selection of the discount rates. A preliminary net deferred tax liability of \$1,055 was established on the acquisition date related to book-tax differences from the amortization of the intangibles as well as certain other purchasing accounting adjustments. Preliminary goodwill of \$4,041 was recorded, representing the benefits of increased operating scale and growth opportunities through currently unidentifiable customers. The goodwill balance is not amortizable for tax purposes. As of September 30, 2020, we recorded \$122 in purchase accounting adjustments related to accrued salaries, increasing goodwill and accrued salaries, wages and commissions, respectively, within our consolidated condensed balance sheet.

The purchase price was allocated as follows:

| | | |
|--------------------------|----|---------------|
| Current assets | \$ | 3,104 |
| Machinery and equipment | | 172 |
| Intangible assets | | 6,400 |
| Goodwill | | 4,163 |
| Noncurrent assets | | 169 |
| Current liabilities | | (1,105) |
| Noncurrent liabilities | | (1,088) |
| Total consideration paid | \$ | <u>11,815</u> |

4. Restructuring Charges

On May 20, 2020, the Company announced a strategic restructuring plan designed to accelerate the Company's future growth by focusing resources on the highest potential growth areas. The plan, which was approved by the Company's Board of Directors, was completed as of June 30, 2020, and consisted primarily of transitioning our direct-to-end-consumer operations at Hearing Help Express to solely support partnership initiatives including the reduction of advertising expenses as well as global net workforce reductions. Total restructuring charges for the nine months ended September 30, 2020 were \$1,171, including \$732 related to one-time employee termination benefits, \$326 for lease modification costs at Hearing Help Express and \$113 for losses on disposal of assets. As of September 30, 2020, outstanding restructuring liabilities included unpaid employee termination benefits of \$521.

5. Discontinued Operations

On June 25, 2019, the Company's officers, pursuant to delegated authority from the board, approved plans to discontinue the operations of its UK subsidiary within the body worn device segment. During the first quarter of 2020, the remaining assets and liabilities of the subsidiary were settled.

As the disposal meets the definition of a strategic shift, the results of the UK operations have been classified as loss from discontinued operations, in the accompanying consolidated condensed statements of operations, comprehensive (loss) income and cash flows. Current assets and liabilities of the discontinued operations have been reclassified and reflected on the accompanying consolidated condensed balance sheets as "Current assets of discontinued operations," and "Liabilities of discontinued operations", respectively. Prior periods relating to our discontinued operations have been reclassified to reflect consistency within our consolidated condensed financial statements. There was no income tax expense or benefit related to our discontinued operations for any period presented.

The total assets and liabilities of the UK subsidiary at December 31, 2019 were as follows:

| | December 31, 2019 |
|---------------------------|------------------------------|
| Other current assets | \$ 80 |
| Other accrued liabilities | 77 |
| Net assets (liabilities) | <u>\$ 3</u> |

The loss on disposal of discontinued operations for the nine months ended September 30, 2019 was computed as follows:

| | |
|--|-----------------|
| Cash and cash equivalents | \$ 5 |
| Accounts receivable, net | 72 |
| Write-down of inventory to realizable value | 278 |
| Write-down of property, plant and equipment to salvage value | 298 |
| Other assets and liabilities, net | 71 |
| Realized loss on foreign currency | 280 |
| Net assets disposed | <u>1,004</u> |
| Additional disposal costs, net | 112 |
| Loss on disposal of discontinued operations | <u>\$ 1,116</u> |

The following table shows the results of the UK subsidiary's discontinued operations:

| | Nine Months Ended September 30, 2019 |
|-----------------------------------|---|
| Revenue, net | \$ 1,068 |
| Cost of goods sold | 667 |
| Gross profit | <u>401</u> |
| Sales and marketing | 314 |
| General and administrative | 684 |
| Total operating expenses | <u>998</u> |
| Loss from discontinued operations | <u>\$ (597)</u> |

6. Segment Reporting

The Company currently operates in two reportable segments: body-worn devices and hearing health direct-to-end-consumer (DTEC). The nature of distribution and services has been deemed separately identifiable. Therefore, segment reporting has been applied. The following table summarizes certain data from continuing operations by reportable segment:

| | Body Worn Devices | Hearing Health DTEC | Total |
|--|----------------------|---------------------|-----------|
| For the Three Months Ended September 30, 2020 | | | |
| Revenue, net | \$ 26,415 | \$ 952 | \$ 27,367 |
| Income from continuing operations before income taxes and discontinued operations | 561 | 140 | 701 |
| Depreciation and amortization | 1,244 | 14 | 1,258 |
| Capital expenditures | 578 | 32 | 610 |
| For the Nine Months Ended September 30, 2020 | | | |
| Revenue, net | \$ 68,960 | \$ 3,512 | \$ 72,472 |
| Loss from continuing operations before income taxes and discontinued operations | (1,868) | (1,637) | (3,505) |
| Depreciation and amortization | 3,245 | 66 | 3,311 |
| Capital expenditures | 2,530 | 32 | 2,562 |
| For the Three Months Ended September 30, 2019 | | | |
| Revenue, net | \$ 25,383 | \$ 1,510 | \$ 26,893 |
| Income (loss) from continuing operations before income taxes and discontinued operations | 750 | (953) | (203) |
| Depreciation and amortization | 712 | 108 | 820 |
| Capital expenditures | 1,374 | 54 | 1,428 |
| For the Nine Months Ended September 30, 2019 | | | |
| Revenue, net | \$ 80,924 | \$ 4,876 | \$ 85,800 |
| Impairment loss | - | (3,765) | (3,765) |
| Income (loss) from continuing operations before income taxes and discontinued operations | 5,106 | (7,603) | (2,497) |
| Depreciation and amortization | 2,210 | 238 | 2,448 |
| Capital expenditures | 3,651 | 136 | 3,787 |

The following table summarizes the identifiable assets (excluding goodwill) and goodwill by reportable segment as of the following dates:

| | September 30, 2020 | December 31, 2019 |
|--|-----------------------|----------------------|
| Body Worn Devices: | | |
| Identifiable assets (excluding goodwill) | \$ 100,907 | \$ 101,311 |
| Goodwill | 13,714 | 9,551 |
| Hearing Health DTEC: | | |
| Identifiable assets (excluding goodwill) | 1,844 | 2,651 |

7. Geographic Information

The geographical distribution of long-lived assets to geographical areas consisted of the following at:

| | September 30, 2020 | December 31, 2019 |
|---------------|-----------------------|----------------------|
| United States | \$ 12,749 | \$ 12,215 |
| Singapore | 1,251 | 1,263 |
| Other | 168 | 73 |
| Consolidated | \$ 14,168 | \$ 13,551 |

Long-lived assets consist of machinery and equipment. Excluded from long-lived assets are investments in partnerships, patents, goodwill, intangible assets, operating lease right-of-use (ROU) assets and certain other assets. The Company capitalizes long-lived assets pertaining to the production of specialized parts. These assets are periodically reviewed to ensure the net realizable value from the estimated future production based on forecasted cash flows exceeds the carrying value of the assets.

The geographical distribution of net revenue to geographical areas for the three and nine months ended September 30, 2020 and 2019 were as follows:

| Net Revenue to Geographical Areas | Three Months Ended | | Nine Months Ended | |
|-----------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| United States | \$ 18,136 | \$ 22,483 | \$ 53,152 | \$ 71,059 |
| Europe | 1,926 | 1,248 | 4,070 | 4,480 |
| Asia | 3,595 | 2,780 | 8,586 | 9,508 |
| All other countries | 3,710 | 382 | 6,663 | 753 |
| Consolidated | <u>\$ 27,367</u> | <u>\$ 26,893</u> | <u>\$ 72,472</u> | <u>\$ 85,800</u> |

Geographic net revenue is allocated based on the location of the customer.

For the three and nine months ended September 30, 2020, one customer accounted for 61% of the Company's consolidated net revenue. For the three and nine months ended September 30, 2019, one customer accounted for 59%, of the Company's consolidated net revenue.

Two customers combined accounted for 56% and 51% of the Company's consolidated accounts receivable at September 30, 2020 and December 31, 2019, respectively.

One customer accounted for 92% and 86% of the Company's consolidated contract assets at September 30, 2020 and December 31, 2019, respectively.

8. Investment in Partnerships

Investment in partnerships consisted of the following:

| | September 30, 2020 | December 31, 2019 |
|------------------------|-----------------------|----------------------|
| Investment in Signison | \$ 429 | \$ 852 |
| Other | 194 | 308 |
| Total | <u>\$ 623</u> | <u>\$ 1,160</u> |

The Company has a 50% ownership interest in Signison as of September 30, 2020. Signison is accounted for in the Company's consolidated condensed financial statements using the equity method.

9. Investment Securities

The Company invests in commercial paper, corporate notes and bonds with original maturities of less than two years. The Company classifies these investments as held to maturity based on our intent and ability to hold these investments until maturity. As a result, these investments are recorded at amortized cost, which approximates fair value, using level 2 inputs.

The maturity dates of our investments as of September 30, 2020 are as follows:

| | Less than one year | 1-5 years | Total |
|---|-----------------------|-------------|------------------|
| Commercial Paper Original Maturities of 91 Days or More | \$ 2,496 | \$ - | \$ 2,496 |
| Corporate Notes and Bonds | 11,680 | - | 11,680 |
| Total Investments | \$ 14,176 | \$ - | \$ 14,176 |

The maturity dates of our investments as of December 31, 2019 are as follows:

| | Less than one year | 1-5 years | Total |
|---|-----------------------|-----------------|------------------|
| Commercial Paper Original Maturities of 91 Days or More | \$ 8,461 | \$ - | \$ 8,461 |
| Corporate Notes and Bonds | 14,990 | 8,629 | 23,619 |
| Total Investments | \$ 23,451 | \$ 8,629 | \$ 32,080 |

The Company also maintains excess funds within level 1 money market accounts included within cash and cash equivalents. Cash available in our money market accounts at September 30, 2020 and December 31, 2019 was \$14,394 and \$7,200, respectively.

10. Inventories

Inventories consisted of the following at:

| | Raw materials | Work-in process | Finished products and components | Total |
|---------------------------|------------------|-----------------|-------------------------------------|------------------|
| September 30, 2020 | | | | |
| Domestic | \$ 11,946 | \$ 1,182 | \$ 2,301 | \$ 15,429 |
| Foreign | 3,777 | 1,069 | 188 | 5,034 |
| Total | \$ 15,723 | \$ 2,251 | \$ 2,489 | \$ 20,463 |
| December 31, 2019 | | | | |
| Domestic | \$ 10,379 | \$ 736 | \$ 2,375 | \$ 13,490 |
| Foreign | 2,482 | 215 | 190 | 2,887 |
| Total | \$ 12,861 | \$ 951 | \$ 2,565 | \$ 16,377 |

11. Intangible assets

Definite-lived intangible assets consisted of the following at:

| | September 30, 2020 | | December 31, 2019 | |
|-----------------------|-----------------------|--------------------------|-----------------------|--------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Customer list | \$ 6,400 | \$ (267) | \$ - | \$ - |
| Self-fitting software | 3,975 | (397) | 3,679 | - |
| Technology access | 2,750 | (1,179) | 2,750 | (884) |
| Total | \$ 13,125 | \$ (1,843) | \$ 6,429 | \$ (884) |

The customer list was established as a part of purchase accounting related to our Emerald acquisition; see Note 3. The estimated useful life is eight years with amortization expense recorded within sales and marketing.

In January 2019, the Company purchased the source code for self-fitting software from Soundperience for 1,750 Euros and also transferred our 49% ownership interest in Soundperience to the majority owner for a total investment of \$3,679. Amortization began during the second quarter of 2020 based on an estimated useful life of five years. The amortization expense is recorded within research and development.

The technology access asset provides the Company with wireless hearing aid technology and is being amortized based on an estimated useful life of seven years. The amortization expense is recorded within research and development.

12. Other Accrued Liabilities

Other accrued liabilities consisted of the following at:

| | September 30, 2020 | December 31, 2019 |
|---|--------------------|----------------------|
| Pension | \$ 120 | \$ 120 |
| Postretirement benefit obligation | 71 | 71 |
| Accrued stock compensation | 400 | - |
| Deferred revenue | 250 | 327 |
| Current self-fitting software liability | 253 | 285 |
| Current technology access liability | 989 | 1,236 |
| Current earn-out contingent consideration liability | 1,251 | - |
| Other | 1,095 | 830 |
| Total | \$ 4,429 | \$ 2,869 |

Accrued stock compensation relates to unvested stock awards accounted for as liabilities.

Technology access liabilities are due in equal quarterly installments through January 2022.

The earn-out liability is contingent on certain future events and is measured at fair value based on various level 3 inputs and assumptions including forecasts, probabilities of payment and discount rates. Amounts are classified as current if expected to be paid within the next twelve months. The liability for contingent consideration is subject to fair value adjustments each reporting period that will be recognized through the statement of operations. see Note 3.

13. Other long-term liabilities

Other long-term liabilities consisted of the following at:

| | September 30, 2020 | December 31, 2019 |
|--|-----------------------|----------------------|
| Noncurrent self-fitting software liability | \$ 810 | \$ 922 |
| Noncurrent technology access liability | 495 | 989 |
| Noncurrent earn-out contingent consideration liability | 2,416 | - |
| Other | 69 | 260 |
| Total | \$ 3,790 | \$ 2,171 |

Technology access liabilities are due in equal quarterly installments through January 2022.

The earn-out liability is contingent on certain future events and is measured at fair value based on various level 3 inputs and assumptions including forecasts, probabilities of payment and discount rates. Amounts are classified as noncurrent if expected to be paid beyond the next twelve months. The liability for contingent consideration is subject to fair value adjustments each reporting period that will be recognized through the statement of operations, see Note 3.

14. Leases

The Company's leases pertain primarily to engineering, manufacturing, sales and administrative facilities, with an initial term of one year or more. The Company has three leased facilities in Minnesota, two that expire in 2022 and one that expires in 2023, one leased facility in Illinois that expires in 2022, one leased facility in California that expires in 2022, two leased facilities in Singapore, one that expires in 2020 and one that expires in 2025, one leased facility in Indonesia that expires in 2024, and one leased facility in Germany that expires in 2022.

As discussed in Note 4, the Company incurred \$326 for lease modification costs at Hearing Help Express to reduce square footage by approximately 65% in an effort to reduce future operating costs. The modification had no impact on the lease term.

Certain foreign leases allow for variable lease payments that depend on an index or a market rate adjustment for the respective country and are adjusted on an annual basis. The adjustment is recognized as incurred in profit and loss. The facility leases include options to extend for terms ranging from one year to five years. Lease options that the Company is reasonably certain to execute, are included in the determination of the ROU asset and lease liability. Our Indonesia lease includes embedded forward starting leases that will begin in 2022 and 2024 for additional square footage, which will result in the recognition of an additional ROU asset and lease liability in those periods of approximately \$103 and \$72, respectively. The Company also leases equipment that include bargain purchase options at termination. These leases have been classified as finance leases.

As of September 30, 2020, the Company has a weighted-average lease term of 0.9 years for its finance leases, and 3.1 years for its operating leases. As of September 30, 2020, the Company has a weighted-average discount rate of 5.56% for its finance leases, and 5.13% for its operating leases. Discount rates are determined based on 5 year term incremental borrowing rates at inception of the lease. Operating cash flows for the nine months ended September 30, 2020 from operating leases were \$1,415. Financing lease assets are classified as machinery and equipment within the consolidated condensed balance sheet.

The following tables summarizes lease costs by type:

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| Lease cost | | | | |
| Finance lease cost: | | | | |
| Amortization of right-of-use assets | \$ 21 | \$ 27 | \$ 73 | \$ 76 |
| Interest on lease liabilities | - | 3 | 3 | 8 |
| Operating lease cost | 494 | 462 | 1,368 | 1,379 |
| Variable lease cost* | 147 | 138 | 446 | 417 |
| Total lease cost | \$ 662 | \$ 630 | \$ 1,890 | \$ 1,880 |

*Variable lease costs consist primarily of taxes, insurance, and common area or other maintenance costs for our domestic and foreign building leases.

Maturities of lease liabilities are as follows as of September 30, 2020:

| | Operating Leases | Financing Leases | Total |
|------------------------------------|------------------|------------------|----------|
| 2020 | \$ 416 | \$ 16 | \$ 432 |
| 2021 | 1,687 | 24 | 1,711 |
| 2022 | 1,195 | 3 | 1,198 |
| 2023 | 595 | - | 595 |
| 2024 | 275 | - | 275 |
| 2025 and thereafter | 156 | - | 156 |
| Total lease payments | 4,324 | 43 | 4,367 |
| Less: Interest | (337) | (7) | (344) |
| Present value of lease liabilities | \$ 3,987 | \$ 36 | \$ 4,023 |

15. Income Taxes

Income tax expense for the three and nine months ended September 30, 2020 was \$47 and \$94, compared to \$87 and \$334, for the same period in 2019, respectively. The expense was largely due to our foreign operations. The Company has net operating loss carryforwards for U.S. federal income tax purposes. The Company has recorded a full valuation allowance against US deferred tax assets as of September 30, 2020. Upon acquisition of Emerald, a net deferred tax liability of \$1,055 was established on the acquisition date related to book-tax differences from the amortization of the intangibles as well as certain other assets, see Note 3.

The following was the income (loss) from continuing operations before income taxes and discontinued operations for each jurisdiction in which the Company has operations for the three and nine months ended September 30, 2020 and 2019.

| | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| United States | \$ 521 | \$ (261) | \$ (3,315) | \$ (3,015) |
| Singapore | 140 | (90) | (291) | 131 |
| Indonesia | 16 | 18 | 51 | 58 |
| Germany | 24 | 130 | 50 | 329 |
| Income (loss) from continuing operations before income taxes and discontinued operations | <u>\$ 701</u> | <u>\$ (203)</u> | <u>\$ (3,505)</u> | <u>\$ (2,497)</u> |

CARES Act

On March 27, 2020, the President signed the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), which contained in part, an allowance for deferral of the employer portion of Social Security employment tax liabilities until 2021 and 2022, as well as a COVID-19 employee retention tax credit (“CRC”) of up to \$5,000 per eligible employee.

Based on the timing of the CARES Act, for the three and nine months ended September 30, 2020, the related tax benefits from the CARES Act were not material. We are currently reviewing the potential future benefits related to employee retention tax credits and the payroll tax deferral provision to assess the impact on our financial position, results of operations and cash flows.

16. Shareholders’ Equity and Stock-based Compensation

The Company has a 2006 Equity Incentive Plan and a 2015 Equity Incentive Plan. The 2015 Equity Incentive Plan replaced the 2006 Equity Incentive Plan and new grants may not be made under the 2006 Plan.

Under the 2015 Equity Incentive Plan, the Company may grant stock options, stock awards, stock appreciation rights, restricted stock units (“RSUs”) and other equity-based awards. Under all awards, the terms are fixed on the grant date.

For the nine months ended September 30, 2020, the Company granted 100 RSUs at a weighted average closing price on the date of grant of \$15.61. The RSUs vest in equal, annual installments over a three year period beginning on the first anniversary of the date of grant at which time common stock is issued with respect to vested units.

The Company has also granted stock options under the plans. Options granted under the plans generally vest in equal, annual installments over a three year period beginning on the first anniversary of the date of grant and have a maximum term of 10 years.

Stock award activity as of and during the nine months ended September 30, 2020 was as follows:

| | Outstanding Awards | | | Stock Option Weighted-Average Exercise Price (a) | Aggregate Intrinsic Value |
|--|--------------------|------|-------|---|------------------------------|
| | Stock Options | RSUs | Total | | |
| Outstanding at December 31, 2019 | 746 | 128 | 874 | \$ 6.39 | |
| Awards granted | - | 100 | 100 | - | |
| Awards exercised or released | (49) | (56) | (105) | 4.72 | |
| Outstanding at September 30, 2020 | 697 | 172 | 869 | \$ 6.51 | \$ 6,045 |
| Exercisable at September 30, 2020 | 697 | - | 697 | \$ 6.51 | \$ 3,950 |
| Available for future grant at December 31, 2019 | | | 183 | | |
| Available for future grant at September 30, 2020 | | | 117 | | |

(a) The weighted average exercise price calculation does not include outstanding RSUs

The number of shares available for future grants at September 30, 2020 does not include a total of up to 331 shares subject to options outstanding under the 2006 Equity Incentive Plan, which will become available for grant under the 2015 Equity Incentive Plan as outstanding options under the 2006 Equity Incentive Plan expire, terminate, are cancelled or forfeited or are withheld in a net exercise of such options.

The Company recorded \$332 and \$2,044 of non-cash stock compensation expense for the three and nine months ended September 30, 2020, respectively, compared to \$648 and \$1,514 for the same periods in 2019, respectively. During the nine months ended September 30, 2020, we recorded a cumulative non-cash stock compensation expense adjustment of \$422 for individuals who are retirement eligible and therefore have vested in stock awards according to our plan. The adjustment was not material to our consolidated condensed financial statements for any quarterly or annual period. As of September 30, 2020, there was \$1,791 of total unrecognized compensation costs related to non-vested stock option and RSU awards that are expected to be recognized over a weighted-average period of 1.94 years. The total intrinsic value of options exercised during the nine months ended September 30, 2020 was \$440.

The Company also has an Employee Stock Purchase Plan (the "Purchase Plan"). The Purchase Plan, as amended, through September 30, 2020, provides that a maximum of 300 shares may be sold under the Purchase Plan. There were 12 and 7 shares purchased under the plan for the nine months ended September 30, 2020 and 2019, respectively.

17. Income Per Share

The following table presents a reconciliation between basic and diluted earnings per share:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| Numerator: | | | | |
| Income (loss) from continuing operations before discontinued operations | \$ 654 | \$ (290) | \$ (3,599) | \$ (2,831) |
| Loss from discontinued operations (Note 5) | - | - | - | (1,713) |
| Less: Income allocated to non-controlling interest | (10) | - | (17) | - |
| Net income (loss) attributable to Intricon shareholders | <u>\$ 644</u> | <u>\$ (290)</u> | <u>\$ (3,616)</u> | <u>\$ (4,544)</u> |
| Denominator: | | | | |
| Basic – weighted shares outstanding | 8,936 | 8,764 | 8,877 | 8,738 |
| Dilutive effect from stock awards | 336 | - | - | - |
| Diluted – weighted shares outstanding | <u>9,272</u> | <u>8,764</u> | <u>8,877</u> | <u>8,738</u> |
| Basic income (loss) per share attributable to Intricon shareholders: | | | | |
| Continuing operations | \$ 0.07 | \$ (0.03) | \$ (0.41) | \$ (0.32) |
| Discontinued operations | - | - | - | (0.20) |
| Net income (loss) per share: | <u>\$ 0.07</u> | <u>\$ (0.03)</u> | <u>\$ (0.41)</u> | <u>\$ (0.52)</u> |
| Diluted income (loss) per share attributable to Intricon shareholders: | | | | |
| Continuing operations | \$ 0.07 | \$ (0.03) | \$ (0.41) | \$ (0.32) |
| Discontinued operations | - | - | - | (0.20) |
| Net income (loss) per share: | <u>\$ 0.07</u> | <u>\$ (0.03)</u> | <u>\$ (0.41)</u> | <u>\$ (0.52)</u> |

Earnings per common share was based on the weighted average number of common shares outstanding during the periods when computing the basic earnings per share. Stock options are dilutive when the average market price of Company stock exceeds the exercise price of the potentially dilutive options. When dilutive, stock options are included as equivalents using the treasury stock method when computing the diluted earnings per share. Unvested shares represented by RSUs are also included in the dilution calculation, net of assumed proceeds and equivalent share repurchases.

For the nine months ended September 30, 2020, weighted average options and RSUs outstanding of 389 were excluded from the dilutive calculation as their effect would have been antidilutive based on losses in the period. For the three and nine months ended September 30, 2019, weighted average options and RSUs outstanding of 880 and 903, respectively, were excluded from the dilutive calculation as their effect would have been antidilutive based on losses in the period.

18. Legal Proceedings

The Company is a defendant along with a number of other parties in lawsuits alleging that plaintiffs have or may have contracted asbestos-related diseases as a result of exposure to asbestos products or equipment containing asbestos sold by one or more named defendants. These lawsuits relate to the discontinued heat technologies segment which was sold in March 2005. Due to the non-informative nature of the complaints, the Company does not know whether any of the complaints state valid claims against the Company. Certain insurance carriers have informed the Company that the primary policies for the period August 1, 1967-1978 have been exhausted and that the carriers will no longer provide defense and insurance coverage under those policies. However, the Company has other primary and excess insurance policies that the Company believes afford coverage for later years. Some of these other primary insurers have accepted defense and insurance coverage for these suits, and some of them have either ignored the Company's tender of defense of these cases, or have denied coverage, or have accepted the tenders but asserted a reservation of rights and/or advised the Company that they need to investigate further. Because settlement payments are applied to all years a litigant was deemed to have been exposed to asbestos, the Company believes that it will have funds available for defense and insurance coverage under the non-exhausted primary and excess insurance policies. The Company is also exploring insurance coverage for these lawsuits under primary and excess policies that pre-date 1967. However, unlike the older policies, the more recent policies have deductible amounts for defense and settlements costs that the Company will be required to pay; accordingly, the Company expects that its litigation costs will increase in the future. Further, many of the policies covering later years (approximately 1984 and thereafter) have exclusions for any asbestos products or operations, and thus do not provide insurance coverage for asbestos-related lawsuits. The Company does not believe that the asserted exhaustion of some of the primary insurance coverage for the 1967-1978 period will have a material adverse effect on its financial condition, liquidity, or results of operations. Management believes that the number of insurance carriers involved in the defense of the suits, and the significant number of policy years and policy limits under which these insurance carriers are insuring the Company, make the ultimate disposition of these lawsuits not material to the Company's consolidated condensed financial position or results of operations.

The Company is also involved in other lawsuits arising in the normal course of business. While it is not possible to predict with certainty the outcome of these matters, management is of the opinion that the disposition of these lawsuits and claims will not materially affect our consolidated condensed financial position, liquidity or results of operations.

19. Related-Party Transactions

The Company has a 50% ownership in Signison, a German based hearing health company. Signison owes the Company a notes receivable, net of allowances, of \$429 which is included in investment in partnership on the balance sheet as of September 30, 2020.

20. Revenue by Market

Medical market revenue recognition- Customer orders from the medical market consist of a specified number of assembled and customized parts that the customer further integrates into their production process to produce market ready products. Customer orders do not include additional follow-on goods or services. Each order is for a series of distinct units that comprise a single performance obligation.

With the exception of prompt payment discounts, the transaction price for medical market products is the invoiced amount. Variable consideration in the form of refunds, credits, rebates, price concessions, pricing incentives or other items impacting transaction price are not present.

All of the Company's products manufactured for the medical market are designed to each customer's specifications, do not have an alternative use and cannot be sold or redirected by the Company to others. The Company considers contractual arrangements, laws and legal precedent in determining whether an enforceable right is present. The Company has an enforceable right to payment for any finished or in-process units, including a reasonable margin, if the customer terminates the contract for reasons other than the Company's failure to perform as promised within our medical diabetes market and a select customer within our other medical market. For contractual arrangements in which an enforceable right exists, control of these units is deemed to transfer to the customer over time during the manufacturing process, using the same measure of progress toward satisfying the promise to deliver the units to the customer. Consequently, the transaction price is recognized as revenue over time for contractual arrangements with an enforceable right, based on actual costs incurred in the manufacturing process to date relative to total expected costs to produce all ordered units. The transaction price for contractual arrangements without an enforceable right to payment for any finished or in-process units including a reasonable margin is recognized as revenue at a point in time.

Medical market products are invoiced when shipped and paid within normal commercial terms. The Company records a contract asset for revenue recognized over time in the production process for customized products that have not been shipped or invoiced to the customer.

Revenue recognition for the remaining markets- Revenue for the non-medical markets are recognized at a point in time.

Revenues recognized from our recently acquired subsidiary, Emerald, have been classified within Other Medical.

The following tables set forth, for the periods indicated, timing of revenue recognition by market:

Timing of revenue recognition for the three months ended September 30, 2020:

| | Products and services transferred at point in time | Products and services transferred over time | Total |
|------------------------------------|---|--|------------------|
| Medical: | | | |
| Diabetes | \$ - | \$ 14,518 | \$ 14,518 |
| Other Medical | 4,973 | 1,158 | 6,131 |
| Hearing Health: | | | |
| Value Based DTEC | 953 | - | 953 |
| Value Based ITEC | 1,779 | - | 1,779 |
| Legacy OEM | 2,759 | - | 2,759 |
| Professional Audio Communications: | 1,227 | - | 1,227 |
| Total Revenue, net | <u>\$ 11,691</u> | <u>\$ 15,676</u> | <u>\$ 27,367</u> |

Timing of revenue recognition for the nine months ended September 30, 2020:

| | Products and services transferred at point in time | Products and services transferred over time | Total |
|------------------------------------|---|--|------------------|
| Medical: | | | |
| Diabetes | \$ - | \$ 41,569 | \$ 41,569 |
| Other Medical | 9,154 | 4,402 | 13,556 |
| Hearing Health: | | | |
| Value Based DTEC | 3,513 | - | 3,513 |
| Value Based ITEC | 3,888 | - | 3,888 |
| Legacy OEM | 6,444 | - | 6,444 |
| Professional Audio Communications: | 3,502 | - | 3,502 |
| Total Revenue, net | <u>\$ 26,501</u> | <u>\$ 45,971</u> | <u>\$ 72,472</u> |

Timing of revenue recognition for the three months ended September 30, 2019:

| | Products and services transferred at point in time | Products and services transferred over time | Total |
|------------------------------------|---|--|------------------|
| Medical: | | | |
| Diabetes | \$ - | \$ 15,723 | \$ 15,723 |
| Other Medical | - | 3,376 | 3,376 |
| Hearing Health: | | | |
| Value Based DTEC | 1,510 | - | 1,510 |
| Value Based ITEC | 2,443 | - | 2,443 |
| Legacy OEM | 2,405 | - | 2,405 |
| Professional Audio Communications: | 1,436 | - | 1,436 |
| Total Revenue, net | <u>\$ 7,794</u> | <u>\$ 19,099</u> | <u>\$ 26,893</u> |

Timing of revenue recognition for the nine months ended September 30, 2019:

| | Products and services transferred at point in time | Products and services transferred over time | Total |
|------------------------------------|---|--|------------------|
| Medical: | | | |
| Diabetes | \$ - | \$ 50,837 | \$ 50,837 |
| Other Medical | - | 9,947 | 9,947 |
| Hearing Health: | | | |
| Value Based DTEC | 4,876 | - | 4,876 |
| Value Based ITEC | 7,419 | - | 7,419 |
| Legacy OEM | 7,749 | - | 7,749 |
| Professional Audio Communications: | 4,972 | - | 4,972 |
| Total Revenue, net | <u>\$ 25,016</u> | <u>\$ 60,784</u> | <u>\$ 85,800</u> |

During the quarter ended March 31, 2020, we recorded a cumulative adjustment of \$1.2 million to reduce revenue within our other medical market to correct an error related to prior periods as a result of our determination that a portion of our sales being recognized over time needed to be recognized at a point in time. The adjustment included a reduction of the related cost of goods sold of \$0.8 million and related impacts to reduce the contract asset and an increase to inventory. The adjustment was not material to our Consolidated Financial Statements for any quarterly or annual period.

21. Subsequent Events

Grant of Stock Awards

On October 19, 2020, the Company granted 30 restricted stock units to the former CEO under the Transition Agreement with him, which settled the \$400 other accrued liability that existed as of September 30, 2020.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Business Overview

Headquartered in Arden Hills, Minnesota, Intricon Corporation (together with its subsidiaries referred herein as the “Company”, or “Intricon”, “we”, “us” or “our”) is an international company engaged in designing, developing, engineering and manufacturing miniature interventional, implantable and body-worn medical devices. In addition to its operations in Minnesota, the Company has facilities in Illinois, Singapore, Indonesia, and Germany.

On June 25, 2019, the Company’s officers, pursuant to delegated authority from the board, approved plans to discontinue the operations of its United Kingdom (UK) subsidiary within our body-worn device segment. For all periods presented, the Company classified this business as discontinued operations, and accordingly, has reclassified historical financial data presented herein.

On May 18, 2020, Intricon Pte. Ltd. (“Buyer”), a wholly-owned subsidiary of the Company, acquired all of the outstanding shares of Emerald Medical Services Pte., Ltd., a Singapore company (“Emerald”), pursuant to a Share Purchase Agreement dated the same date among Buyer, Emerald and the direct and indirect owners of Emerald. Emerald, based in Singapore, is a provider of joint development medical device manufacturing services for complex catheter applications.

On May 20, 2020, the Company announced a strategic restructuring plan designed to accelerate the Company’s future growth by focusing resources on the highest potential growth areas. The plan, which was approved by the Company’s Board of Directors, was completed as of June 30, 2020.

During the quarter ended September 30, 2020, the Company increased our ownership interest in EarVenture, a subsidiary of the Company, from 50% to 100%.

The consolidated condensed financial statements include the accounts of the Company and its consolidated subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation. The Company evaluates its voting and variable interests in entities on a qualitative and quantitative basis. The Company consolidates entities in which it concludes it has the power to direct the activities that most significantly impact an entity’s economic success and has the obligation to absorb losses or the right to receive benefits that could be significant to the entity.

The Company’s significant accounting policies are detailed in “Note 1: Summary of Significant Accounting Policies” of the Company’s Annual Report on Form 10-K for the year ended December 31, 2019.

Information contained in this section of this Quarterly Report on Form 10-Q and expressed in U.S. dollars is presented in thousands (000s), except for per share data and as otherwise noted. In addition, information in Item 2 excludes discontinued operations unless otherwise noted.

COVID-19 Pandemic and Uncertainties

The COVID-19 (coronavirus) outbreak has created unique and unprecedented challenges. The outbreak of the novel COVID-19 has evolved into a global pandemic. COVID-19 has spread to many regions of the world, including North America, Asia and Europe. The full extent to which the COVID-19 pandemic impacts our business, operating results and financial condition will depend on future developments that are highly uncertain, cannot be accurately predicted and may be beyond our control. Uncertain factors relating to the COVID-19 pandemic include the duration of the outbreak, the severity of the virus, and the actions, or perception of actions that may be taken, to contain or treat its impact, including declarations of states of emergency, business closures, manufacturing restrictions and a prolonged period of travel, commercial and/or other similar restrictions and limitations.

The Company's priority remains the health and safety of its employees, its customers and their patients, as well as the communities we serve. As the unprecedented threat of COVID-19 emerged, Intricon began implementing measures in an effort to address and prioritize the health and safety of its employees and their communities, while at the same time continuing to support customers and partners. These measures included the following:

- *Health and Safety:* Based on the expertise and recommendations from federal and local government and health agencies, Intricon has implemented remote and flexible work arrangements for employees wherever possible. We have also implemented other measures, such as restricting travel, to protect the health and safety of our customers, their patients and our employees
- *Maintaining Operations:* Consistent with applicable exceptions, we are maintaining streamlined manufacturing, assembly and other related operations at all sites in order to continue providing products to our customers and partners. For our employees involved in such operation-critical processes, we have implemented several other recommended best practices to protect the health and safety of our workforce. In addition, we have modified the shifts of employees involved in other operation-critical processes to minimize risk for these employees.
- *Clinical:* We have postponed our anticipated "Self-fitting Software" clinical trial until such time as we can ensure the health and safety of trial participants.
- *Expense Reduction:* Given the current business climate, executive management has taken steps to strengthen our balance sheet and reduce our cost structure including the deferral of non-strategic investments as well as furloughs and salary reductions in the second quarter of 2020. Salaries were restored to their original levels at the beginning of the third quarter while furloughs were made permanent.

Although our operating facilities remain open as of September 30, 2020, the effects of a COVID-19 outbreak could include the temporary shutdown of our facilities in the United States, Asia or Europe, disruptions or restrictions on the ability to ship our products to our customers as well as disruptions that may affect our customers and suppliers.

Further, as a result of the COVID-19 pandemic and the measures designed to contain its spread, our sales could be negatively impacted as a result of disruption in demand by our customers, which could have a material and adverse effect on our business, results of operations and financial condition. Similarly, our suppliers may not have the materials, capacity, or capability to supply us according to our schedule and specifications. If our suppliers' operations are impacted, we may need to seek alternate suppliers, which may be more expensive, may not be available or may result in delays in shipments to us and subsequently to our customers, each of which would affect our results of operations. The duration of the disruptions to our customers and to our supply chain, and related financial impact to us, cannot be estimated at this time. If such disruptions continue for an extended period of time, the impact could have a material adverse effect on our business, results of operations and financial condition.

U.S. GAAP requires management to make estimates and assumptions that affect the amounts and disclosures of certain assets and liabilities. These estimates and assumptions utilize historical and forward-looking assumptions that the Company believes are reasonable, including but not limited to the potential impacts arising from the coronavirus pandemic. As we learn more about the extent and duration of the pandemic, the Company's estimates and assumptions may evolve. Actual results could differ significantly from those estimates.

In summary, while our business is likely to be impacted in the coming year by global business conditions, including the delay of non-essential medical procedures, device upgrades and new product launches, we have a strong balance sheet that we believe will allow us to maintain our operations and preserve our ability to realize future growth.

Market Overview

Intricon serves as a joint development partner ("JDM") to leading medical device original equipment manufacturers ("OEMs") by designing, developing, engineering, manufacturing and distributing micro-miniature products, microelectronics, micro-mechanical assemblies, complete assemblies and software solutions, primarily for high growth markets, such as diabetes, drug delivery, surgical navigation, hearing health and the professional audio communication market. Revenue from these markets is reported on the respective diabetes, other medical, hearing health value based direct-to-end-consumer, value based indirect-to-end-consumer and legacy OEM, and professional audio lines in the discussion of our results of operations in "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 20 "Revenue by Market" to the Company's consolidated condensed financial statements included herein.

Diabetes, Drug Delivery, and Surgical Navigation Markets

The Company manufactures microelectronics, micro-mechanical assemblies, high-precision injection-molded plastic components and complete devices for leading and emerging medical device manufacturers. Intricon currently serves this market by offering medical manufacturers the capabilities to design, develop, manufacture and distribute medical devices that are easier to use, are more miniature, use less power, and are lighter. Increasingly, the medical industry is looking for wireless, low-power capabilities in their devices.

Intricon currently has a presence in the diabetes, drug delivery and surgical navigation markets. For diabetes, Intricon works with Medtronic to manufacture their wireless continuous glucose monitors (CGM), sensor assemblies, and accessories associated with Medtronic's insulin pump and CGM system. In September 2016, the FDA approved Medtronic's current generation insulin pump system, the MiniMed 670G system. The MiniMed 670G was the world's first hybrid closed loop insulin delivery system. In March 2018, the FDA approved the Guardian Connect, Medtronic's standalone CGM system that allows patients to stay ahead of high and low glucose events. In late 2019, Medtronic received approval and began distributing the 670G system in select European countries, subject to local regulatory requirements. In September 2020, Medtronic announced FDA approval for the MiniMed 770G Insulin Pump System with smartphone connectivity. This latest system by Medtronic expands the benefits of hybrid closed loop therapy to younger children living with type 1 diabetes and makes it easier to access and share real-time CGM and pump data. The system will enable caregivers and care partners to see user data remotely on their smartphones, with proactive in-app notices sent when glucose levels are out of range. The data can also be shared automatically with clinicians and educators to help facilitate more effective telehealth visits and product trainings. This connectivity also gives Medtronic the ability to provide upgrades to future technology via software updates which can further enhance security and device features. We are excited that our components are designed into and support such a revolutionary diabetes management system. Looking ahead, we believe there are opportunities to expand our diabetes product offering with Medtronic, as well as move into new markets outside of the diabetes market.

Intricon has a suite of medical coils and micro coils technology that it offers to various OEM customers. These products are currently used in surgical navigation markets, such as interventional pulmonology and electrophysiology. On May 18, 2020 Intricon acquired privately held Emerald Medical Services Pte Ltd. (Emerald). Emerald, based in Singapore, provides joint engineering and manufacturing services for complex medical devices, including catheters covering a range of applications for cardiology, peripheral vascular, neurology, radiology and pulmonology. Emerald's production capability consists of design, development, manufacturing, testing and non-sterile packaging services. The acquisition expands Intricon's medical coil and micro-miniature medical device engineering and manufacturing capabilities in surgical navigation and accelerates diversification into potential new end-markets.

Intricon manufactures bubble sensors and flow restrictors that monitor and control the flow of fluid in an intravenous infusion system as well as a family of safety needle products for an OEM customer that utilizes Intricon's insert and straight molding capabilities. These products are assembled using full automation, including built-in quality checks within the production lines.

The Company is committed to increasing investments to support its medical business development efforts. In early 2019, the Company hired a vice president of medical business development, and in connection with the Emerald acquisition, has engaged one of the former owners of Emerald as a corporate development consultant aimed to leverage our core competencies and diversify our medical revenue base. The Company believes it has significant opportunities to serve the emerging home care markets through its already developed core competencies and capabilities to develop devices that are more technologically advanced, smaller and lightweight.

Hearing Healthcare Market

In the United States alone, there are approximately 40 million adults that report some degree of hearing loss. In adults, the most common cause of hearing loss is aging and noise. In fact, by the age of 65, one out of three people have hearing loss. The hearing-impaired population is expected to grow significantly over the next decade due to an aging population and more frequent exposure to loud sounds that can cause noise-induced hearing loss. It is estimated that hearing aids can help more than 90 percent of people with hearing loss, however the current market penetration into the U.S. hearing-impaired population is approximately 20 percent, a percentage that has remained essentially unchanged for the last four decades. The primary deterrents to greater penetration are cost and access. Along with this, the legacy hearing aid distribution channel is an oligopoly of six large hearing aid manufacturers who utilize brick-and-mortar and licensed audiologists to sell devices while controlling the channel dynamics. As a result, the average cost of a hearing aid sold in the US market today is over \$2,400 per device, more than double the cost from fifteen years ago. Approximately 70 percent of the hearing-impaired have hearing loss in both ears (referred to as a binaural loss), driving the total cost to almost \$5,000 on average for a set of hearing aids.

Today in the US market, the legacy channel pushes all hearing-impaired through the same inefficient, costly channel. However, a very large portion of the hearing-impaired market – mostly notably those with mild to moderate losses – could be properly served with the proper combination of high quality, outcome-based devices, advanced fitting software and consumer services/care best practices – all at much lower cost. We believe fundamental change is needed and are excited about the opportunity that we created through thoughtful hard work and planning: a chance to deliver superior outcomes-based affordable hearing healthcare, by combining state-of-the-art devices and software technology, designed to support a more efficient delivery model.

We believe several factors have come together over the last few years to enable the emergence of a market disruptive, high-quality, low cost distribution model. These factors include the continued consolidation of retail (causing escalating hearing aid prices), consumer outcry, consumer education, advancements in technology (such as behind-the-ear devices, advanced digital signal processing, low-power wireless, and self-fitting software) as well as regulatory actions and pronouncements by the U.S. Food and Drug Administration (FDA), the President’s Council of Advisors on Science and Technology and the National Academies of Science, Engineering and Medicine.

On August 18, 2017, President Donald Trump signed into law H.R. 2430, the FDA Reauthorization Act of 2017, which includes a section concerning the regulation of OTC hearing aids. The law is designed to enable adults with mild to moderate hearing loss to access OTC hearing aids without being seen by a hearing care professional. The law requires the FDA to create and regulate a category of OTC hearing aids to ensure they meet the same high standards for safety, consumer labeling, and manufacturing protection that all other medical devices must meet; however, the FDA has been delayed in promulgating regulations regarding OTC hearing aids due to COVID-19 priorities at the FDA, which delay will likely have an adverse impact on hearing health markets over the course of 2020. Today, Intricon serves both the value-based hearing healthcare channel and the legacy hearing health channel.

Value-Based Hearing Healthcare

The Company believes the value-based hearing healthcare (VBHH) market offers significant growth opportunities. In contrast to the legacy channel dynamics, the VBHH market channel is flexible and able to serve the end consumer through a variety of modalities which may include self-fitting, remote programing and adjustments, customer support call centers and brick-and-mortar stores. The average price of a hearing aid sold through this channel is less than twenty-five percent of the average \$2,400 device price typically sold through the legacy channel. In 2018, the Company commissioned an ethnographic research study, which identified a \$3+ billion annual VBHH market opportunity. To best approach this market opportunity, the Company has sharpened its Indirect-to-end-Consumer (ITEC) focus to identify potential high-profile partners that value its ability to deliver superior hearing aids, self-fitting software and customer care to the U.S. market. Moreover, the Company has refocused its Direct-to-End-Consumer (DTEC) efforts towards supporting product development and as a testing platform. Over the past decade we have invested in the manufacturing footprint, product technology and fitting software to provide individuals access to affordable, quality outcomes-based hearing healthcare.

The Company is also focused on serving its current value-based ITEC customers, who also sell products and services directly to the end consumer. We have established ourselves as a leader in supplying this portion of the market with advanced, outcome-based products and accessories. The Company has formed strong relationships with various customers in the channel, including geriatric product retailers and other indirect-to-end-consumer hearing aid providers.

In January 2019, the Company purchased the source code for the Sentibo Smart Brain self-fitting software from Soundperience, positioning the Company to capitalize on the pending over-the-counter (OTC) hearing aid regulation. Sentibo Smart Brain self-fitting software is designed to improve both channel productivity and the quality of first-time fittings, resulting in lower prices, greater access and increased customer satisfaction. This software is being used in the German market today, most notably through Signison, the Company’s joint venture with the owner of Soundperience.

We strongly believe that incorporating self-fitting technology is a critical step in creating our high-quality, low-cost hearing healthcare ecosystem. The Sentibo Smart Brain self-fitting software technology has the potential to drastically reduce the price of hearing aids, drive greater access and increase customer satisfaction.

Legacy OEM Hearing Health Channel

We also believe there are niches in the legacy hearing health channel that will embrace our outcomes-based products and technologies in the United States and Europe. High costs of legacy devices and retail consolidation have constrained the growth potential of the independent audiologist and dispenser. We believe our software and product offering can provide independent audiologists and dispensers the ability to compete with larger retailers, such as Costco, and manufacturer owned retail distributors.

Professional Audio Communications

Intricon entered the high-quality audio communication device market in 2001, and now has a line of miniature, professional audio headset products used by customers focused on emergency response needs. The line includes several communication devices that are extremely portable and perform well in noisy and/or hazardous environments. These products are well suited for applications in the fire, law enforcement, safety, aviation and military markets. In addition, the Company has a line of miniature ear- and head-worn devices used by performers and support staff in the music and stage performance markets.

Core Technologies Overview

Over the past several years, the Company has increased investments in the continued development of critical core technologies: Microminiaturization, Miniature Transducers, Ultra-Low-Power (ULP) Digital Signal Processing (DSP), ULP Wireless and Fitting Software. These core technologies serve as the foundation of current and future product platform development, designed to meet the rising demand for smaller, portable, more advanced devices and the need for greater efficiencies in the delivery models. The continued advancements in this area have allowed the Company to further enhance the mobility and effectiveness of miniature body-worn devices.

Microminiaturization

Intricon excels at miniaturizing miniature interventional, implantable and body-worn medical devices. We began honing our microminiaturization skills over 30 years ago, supplying components to the hearing health industry. Our core miniaturization technology allows us to make devices for our markets that are one cubic inch and smaller. We also are specialists in devices that run on very low power, as evidenced by our ULP wireless and DSP. Less power means a smaller battery, which enables us to reduce size even further, and develop devices that fit into the palm of one's hand.

Miniature Transducers

Intricon's advanced transducer technology has been pushing the limits of size and performance for over a decade. Included in our transducer line is a suite of medical coils and micro coils technology that are currently used in surgical navigation markets, such as interventional pulmonology and electrophysiology. The recent Emerald acquisition expands Intricon's medical coil and micro-miniature medical device engineering and manufacturing capabilities in surgical navigation and accelerates diversification into potential new end markets.

ULP DSP

DSP converts real-world analog signals into a digital format. Through our nanoDSP™ technology, Intricon offers an extensive range of ULP DSP amplifiers for hearing, medical and professional audio applications. Our proprietary nanoDSP incorporates advanced ultra-miniature hardware with sophisticated signal processing algorithms to produce devices that are smaller and more effective. The Company further expanded its DSP portfolio including improvements to its Reliant CLEAR™ feedback canceller, offering increased added stable gain and faster reaction time. Additionally, the DSP technologies are utilized in the Audion8™, our eight-channel hearing aid amplifier, the Audion16™ and Audion16+™, our wide dynamic range compression sixteen-channel hearing aid amplifier. The amplifiers are feature-rich and are designed to fit a wide array of applications. In addition to multiple compression channels, the amplifiers have a complete set of proven adaptive features which greatly improve the user experience with proven outcomes.

ULP Wireless

Wireless connectivity is fast becoming a required technology, and wireless capabilities are especially critical in new body-worn devices. Intricon's BodyNet™ ULP technology, including the nanoLink™ and PhysioLink™ wireless systems, offers solutions for transmitting the body's activities to caregivers and wireless audio links for professional communications and surveillance products, including diabetes monitoring and audio streaming for hearing devices.

Fitting Software

The ability to efficiently and effectively fit hearing aids is critical to building a value based eco-system of hearing healthcare. By developing more advanced fitting software systems, individuals can benefit from fittings that conform to their specific loss, while eliminating the need for an in-person appointment. In addition to the traditional fitting software, AccuFit, used in the conventional channel, Intricon has made significant investments in various advanced fitting software solutions, including its purchase of the source code for the Sentibo Smart Brain self-fitting software, that can enable remote and self-fitting solutions. Intricon believes these advanced fitting solutions, along with the other components of the eco-system, will drive access, affordability and superior customer satisfaction to the millions of individuals that cannot receive care today, primarily due to high cost and low access.

Forward-Looking and Cautionary Statements

Certain statements included in this Quarterly Report on Form 10-Q or documents the Company files with the Securities and Exchange Commission, which are not historical facts, or that include forward-looking terminology such as “may”, “will”, “believe”, “anticipate”, “expect”, “should”, “optimistic” “continue”, “estimate”, “intend”, “plan”, “would”, “could”, “guidance”, “potential”, “opportunity”, “project”, “forecast”, “confident”, “projections”, “scheduled”, “designed”, “future”, “discussion”, “if” or the negative thereof or other variations thereof, are forward-looking statements (as such term is defined in Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933, and the regulations thereunder), which are intended to be covered by the safe harbors created thereby. These statements may include, but are not limited to statements in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Notes to the Company’s Consolidated Condensed Financial Statements” such as estimates of future results, the expected results and impacts of the Emerald acquisition, statements regarding the estimated costs and expenses of the restructuring and estimated annual expense savings, net operating loss carryforwards, the ability to meet cash requirements for operating needs, the ability to meet liquidity needs, assumptions used to calculate future level of funding of employee benefit plans, the adequacy of insurance coverage and the impact of new accounting pronouncements and litigation. Forward-looking statements also include, without limitation, statements as to the Company’s expected future results of operations and growth, strategic alliances and their benefits, government regulation, potential increases in demand for the Company’s products, the Company’s ability to meet working capital requirements, the Company’s business strategy, the expected increases in operating efficiencies, anticipated trends in the Company’s markets, estimates of goodwill impairments and amortization expense of other intangible assets, the effects of litigation and the amount of insurance coverage, and statements as to trends or the Company’s or management’s beliefs, expectations and opinions.

Forward-looking statements are subject to risks and uncertainties and may be affected by various factors that may cause actual results to differ materially from those in the forward-looking statements. In addition to the factors discussed in this Quarterly Report on Form 10-Q, certain risks, uncertainties and other factors can cause actual results and developments to be materially different from those expressed or implied by such forward-looking statements, including, without limitation, the following:

- the adverse economic conditions associated with the COVID-19 global health pandemic and the associated financial crisis;
- stay-at-home and other orders, which could cause material delays and cancellations of elective procedures, curtailed or delayed spending by customers and result in disruptions to our supply chain, closure of our facilities, delays in product launches or diversion of management and other resources to respond to the COVID-19 pandemic;
- the adverse economic conditions associated with the COVID-19 global health pandemic and the associated financial crisis;
- the impact of global and regional economic and credit market conditions on healthcare spending;
- the risk that the COVID-19 pandemic disrupts local economies and causes economies to enter prolonged recessions;
- our ability to identify, complete and integrate acquisitions, including integrating our acquisition of Emerald, and any unknown liabilities of Emerald that may arise;
- our ability to successfully implement our business and growth strategy, including our restructuring strategy;
- the volume and timing of orders received by the Company, particularly from Medtronic;
- changes in estimated future cash flows;
- our ability to collect our accounts receivable;
- foreign currency movements in markets that we serve;
- changes in the global economy and financial markets;
- weakening demand for our products due to general economic conditions;
- changes in the mix of products sold;

- our ability to meet demand;
- changes in customer requirements;
- FDA approval, timely release and acceptance of our products and the products of our customers;
- competitive pricing pressures;
- pending and potential future litigation;
- cost and availability of electronic components and commodities for our products;
- our ability to create and market products in a timely manner and develop products that are inexpensive to manufacture;
- the loss of one or more of our major customers;
- effects of legislation and regulation, including the timing and terms of the final OTC regulations;
- effects of foreign operations;
- our ability to develop new products;
- our ability to recruit and retain engineering and technical personnel;
- the costs and risks associated with research and development investments;
- our ability and the ability of our customers to protect intellectual property;
- cybersecurity threats;
- loss of members of our senior management team; and
- other risk factors set forth in our most recent Annual Report on Form 10-K or any prior Quarterly Report on Form 10-Q, which are incorporated by reference into this Report.

For a description of these and other risks, see Part I, “Item 1A. Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2019 and the other risks described elsewhere in this Quarterly Report on Form 10-Q, or in other filings the Company makes from time to time with the Securities and Exchange Commission. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates particularly as it relates to estimates reliant on forecasts and other assumptions impacted by the COVID-19 pandemic.

Certain accounting estimates and assumptions are particularly sensitive because their significance to the consolidated condensed financial statements and the possibility that future events affecting them may differ markedly. The accounting policies of the Company with significant estimates and assumptions include the Company’s revenue recognition, inventory valuation, goodwill, certain long-lived assets and contingent consideration liabilities. These and other significant accounting policies are described in and incorporated by reference from “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and Note 1 to the consolidated condensed financial statements contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2019.

Business Combinations

We record identifiable assets acquired and liabilities assumed in business combinations recorded at their estimated fair values on the acquisition date. The excess of the purchase price over the estimated fair values of the net tangible and net intangible assets acquired is recorded as goodwill. This requires management to make significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration between goodwill and assets that are depreciated and amortized. Our estimates are based on historical experience, information obtained from the management of the acquired companies and, when appropriate, include assistance from independent third-party appraisal firms. These estimates are inherently uncertain and unpredictable. In addition, unanticipated events or circumstances may occur which may affect the accuracy or validity of such estimates.

Contingent Consideration

Contingent consideration liabilities depend on certain future events and are measured at fair value based on various level 3 inputs and assumptions including forecasts, probabilities of payment and discount rates. Amounts are classified

as current if expected to be paid within the next twelve months. The liability for contingent consideration is subject to fair value adjustments each reporting period that will be recognized through the statement of operations. See Note 3 for additional detail on the accounting for the Emerald acquisition.

Strategic Restructuring Plan

As previously announced, on May 15, 2020, the management of the Company committed the Company to, and began executing on, a strategic restructuring plan designed to accelerate the Company's future growth by focusing resources on the highest potential growth areas. The plan, which was supported by the Company's Board of Directors, was completed by the end of the 2020 second quarter.

Following the Company's decision in the first quarter to no longer pursue a direct-to-end-consumer approach to the hearing health market, we made the decision to transition our remaining direct-to-end-consumer operations at Hearing Help Express to solely support our partnership initiatives. In addition, while continued uncertainties remain from the COVID-19 pandemic, we are taking many significant steps to decrease our expenditure profile and current spending run-rate. The following are significant items included in our strategic restructuring plan:

- We completed a global net workforce reduction of 32 positions, including many of the previously furloughed positions, resulting in an expected annual cost savings of approximately \$2.4 million
- We changed our focus to seeking partners in the hearing health market, resulting in approximately \$2.0 million reduction in Hearing Help Express consumer advertising expense in 2020 as compared to 2019; and
- In connection with the strategic restructuring plan, we incurred a \$1.2 million restructuring charge during the second quarter ended June 30, 2020 related to one-time employee termination costs as well as losses on disposal of assets

Results of Operations

Revenue, net

Below is a summary of our revenue by main markets for the three and nine months ended September 30, 2020 and 2019:

| Three Months Ended September 30, | 2020 | 2019 | Change | |
|---|------------------|------------------|--------------------|----------------|
| | | | Dollars | Percent |
| Medical: | | | | |
| Diabetes | \$ 14,518 | \$ 15,723 | \$ (1,205) | -7.7% |
| Other Medical | 6,131 | 3,376 | 2,755 | 81.6% |
| Total | \$ 20,649 | \$ 19,099 | \$ 1,550 | 8.1% |
| Hearing Health: | | | | |
| Value Based DTEC | \$ 953 | \$ 1,510 | \$ (557) | -36.9% |
| Value Based ITEC | 1,779 | 2,443 | (664) | -27.2% |
| Legacy OEM | 2,759 | 2,405 | 354 | 14.7% |
| Total | \$ 5,491 | \$ 6,358 | \$ (867) | -13.6% |
| Professional Audio Communications | \$ 1,227 | \$ 1,436 | \$ (209) | -14.6% |
| Total Net Revenue | \$ 27,367 | \$ 26,893 | \$ 474 | 1.8% |
| | | | Change | |
| Nine Months Ended September 30, | 2020 | 2019 | Dollars | Percent |
| Medical: | | | | |
| Diabetes | \$ 41,569 | \$ 50,837 | \$ (9,268) | -18.2% |
| Other Medical | 13,556 | 9,947 | 3,609 | 36.3% |
| Total | \$ 55,125 | \$ 60,784 | \$ (5,659) | -9.3% |
| Hearing Health: | | | | |
| Value Based DTEC | \$ 3,513 | \$ 4,876 | \$ (1,363) | -28.0% |
| Value Based ITEC | 3,888 | 7,419 | (3,531) | -47.6% |
| Legacy OEM | 6,444 | 7,749 | (1,305) | -16.8% |
| Total | \$ 13,845 | \$ 20,044 | \$ (6,199) | -30.9% |
| Professional Audio Communications | \$ 3,502 | \$ 4,972 | \$ (1,470) | -29.6% |
| Total Net Revenue | \$ 72,472 | \$ 85,800 | \$ (13,328) | -15.5% |

For the three and nine months ended September 30, 2020, we experienced a decrease of 7.7% and 18.2%, respectively, in net revenue in the diabetes medical market compared to the same period in 2019 driven by the timing of certain international orders filtering through various local regulatory requirements as well as a delay in orders due to uncertainty surrounding the COVID-19 pandemic. Although we cannot predict the specific extent or duration of the impact of the COVID-19 pandemic on our financial and operating results, we anticipate the potential for future impacts on various product lines in our medical diabetes market. We have proactively communicated with customers to understand their needs and forecast the financial implications from these conversations.

Other medical net revenue for the three and nine months ended September 30, 2020, increased 81.6% and 36.3% compared to the same period in 2019. The increase was driven by the three and nine month revenues derived from Emerald since the purchase date of \$2,816 and \$3,962, respectively, partially offset by a one-time revenue adjustment. During the first quarter we recorded a cumulative adjustment of \$1.2 million to reduce revenue within our other medical market to correct an error related to prior periods as a result of our determination that a portion of our sales being recognized over time needed to be recognized at a point in time. The adjustment included a reduction of the related cost of goods sold of \$0.8 million and related impacts to reduce the contract asset and an increase to inventory. The adjustment was not material to our consolidated condensed financial statements for any quarterly or annual period.

Net revenue in our hearing health value based direct-to-end-consumer (DTEC) business for the three and nine months ended September 30, 2020 decreased 36.9% and 28.0% compared to the same period in 2019 due to reductions in advertising spend in an effort to control costs as part of our strategic restructuring plan.

Net revenue in our hearing health value based indirect-to-end-consumer (ITEC) business for the three and nine months ended September 30, 2020 decreased 27.2% and 47.6% compared to the same period in 2019. The revenue decline was largely attributed to the absence of hiHealthInnovations revenue in 2020.

Net revenue in our hearing health legacy OEM business for the three months ended September 30, 2020 increased 14.7% compared to the same period in 2019 due to increase international orders due to pent-up demand related to COVID-19. Net revenue in our hearing health legacy OEM business for the nine months ended September 30, 2020 decreased 16.8% compared to the same period in 2019 due to decreased demand partially caused by the COVID-19 pandemic.

As it relates to our overall Hearing Health business, we believe that the FDA has been delayed in promulgating regulations regarding OTC hearing aids due to COVID-19 priorities at the FDA, which delay will likely have an adverse impact on hearing health markets over the course of 2020.

Net revenue to the professional audio device sector decreased 14.6% and 29.6% for the three and nine months ended September 30, 2020 compared to the same period in 2019 due to order delays as a result of the COVID-19 pandemic. Intricon will continue to leverage its core technology in professional audio to support existing customers, as well as pursue related hearing health and medical product opportunities.

Gross profit

Gross profit, both in dollars and as a percent of revenue, for the three and nine months ended September 30, 2020 and 2019, was as follows:

| | 2020 | | 2019 | | Change | |
|---|-----------|--------------------|-----------|--------------------|------------|---------|
| | Dollars | Percent of Revenue | Dollars | Percent of Revenue | Dollars | Percent |
| Three Months Ended September 30, | | | | | | |
| Gross Profit | \$ 7,198 | 26.3% | \$ 6,773 | 25.2% | \$ 425 | 6.3% |
| | 2020 | | 2019 | | Change | |
| | Dollars | Percent of Revenue | Dollars | Percent of Revenue | Dollars | Percent |
| Nine Months Ended September 30, | | | | | | |
| Gross Profit | \$ 18,376 | 25.4% | \$ 23,547 | 27.4% | \$ (5,171) | -22.0% |

Gross profit as a percentage of revenue for the three months ended September 30, 2020 improved slightly from the prior year period primarily due to higher volumes as well as cost reductions put in place by the Company during the second quarter. Gross profit as a percentage of revenue for the nine months ended September 30, 2020 decreased over the comparable prior year period primarily due to lower revenues and changes in product mix.

Sales and Marketing, General and Administrative, Research and Development Expenses, and Other Operating Expenses

Sales and marketing, general and administrative and research and development expenses for the three and nine months ended September 30, 2020 and 2019 were as follows:

| | 2020 | | 2019 | | Change | |
|---|----------|--------------------|----------|--------------------|------------|---------|
| | Dollars | Percent of Revenue | Dollars | Percent of Revenue | Dollars | Percent |
| Three Months Ended September 30, | | | | | | |
| Sales and Marketing | \$ 1,365 | 5.0% | \$ 2,609 | 3.0% | \$ (1,244) | -47.7% |
| General and Administrative | 3,654 | 13.4% | 3,715 | 4.3% | (61) | -1.6% |
| Research and Development | 1,458 | 5.3% | 840 | 1.0% | 618 | 73.6% |
| Other Operating Expenses | 253 | 0.9% | - | 0.0% | 253 | 100.0% |
| | | | | | | |
| | | | | | | |
| Nine Months Ended September 30, | | | | | | |
| Sales and Marketing | \$ 5,038 | 7.0% | \$ 9,071 | 10.6% | \$ (4,033) | -44.5% |
| General and Administrative | 11,673 | 16.1% | 10,551 | 12.3% | 1,122 | 10.6% |
| Research and Development | 3,868 | 5.3% | 2,902 | 3.4% | 966 | 33.3% |
| Other Operating Expenses | 746 | 1.0% | - | 0.0% | 746 | 100.0% |

Sales and marketing expenses decreased compared to the same periods in 2019. The decrease was due to lower DTEC marketing, support costs, wages and bad debt expenses.

General and administrative expenses for the three months ended September 30, 2020, decreased slightly from the prior year period due to restructuring and cost reductions put in place by the Company during the second quarter of 2020. General and administrative expenses for the nine months ended September 30, 2020, were greater than the prior year periods primarily due to one-time severance expense and non-cash stock compensation, including a transition payment of \$443 (equal to one year's salary) and \$400 of RSUs issuable to our CEO per the Transition Agreement signed in June 2020.

Research and development expenses increased over the prior year periods due to increases in outside service and support costs as well as the amortization of Sentibo Fitting Software which was placed into service during the 2020 second quarter.

Other operating expenses increased over the prior year periods due to \$493 of acquisition related costs for the purchase of Emerald and \$253 of change in fair value of contingent consideration primarily due to the Company obtaining regulatory approval in Japan for a particular product as well as increases in the fair value of future estimated payments due to the passage of time. The regulatory approval will result in a cash payment of \$500 to the sellers under the Emerald purchase agreement, which will be paid out during the fourth quarter of 2020.

Restructuring charges

Restructuring charges for the nine months ended September 30, 2020 were \$1,171. Refer to Note 4 for additional details.

Impairment loss

Impairment loss for the nine months ended September 30, 2019 was \$3,765. There were no impairment losses identified for the comparable current year periods. The impairment losses related to a write-off of goodwill and intangible assets due to negative cash flows within our Hearing Help Express reporting unit.

Interest income, net

Interest income, net for the three and nine months ended September 30, 2020 was \$41 and \$322 compared to \$240 and \$703 for the comparable periods in 2019 due to an overall reduction in our investment balance. The investment balance has decreased as we have deposited proceeds of maturing securities into a money market account in order to maintain liquidity during the COVID-19 pandemic and have recently begun reinvesting excess cash.

Other income (expense), net

Other income (expense), net for the three and nine months ended September 30, 2020 was \$192 and \$293 compared to (\$52) and (\$458) for the same periods in 2019. The increase over the prior year periods is primarily due to Singapore government funds paid to our subsidiaries for COVID-19 relief.

Income tax expense

Income tax expense for the three and nine months ended September 30, 2020 was \$47 and \$94 compared to \$87 and \$334 for the same periods in 2019. The change in income tax expense relates to a reduction of foreign income taxes paid in the current period.

Liquidity and Capital Resources

During the COVID-19 pandemic, we believe we continue to maintain adequate liquidity to operate our businesses. As of September 30, 2020, we had \$16,081 of cash on hand as well as \$14,176 of short-term investment securities maturing within the next twelve months. Sources of our cash for the nine months ended September 30, 2020 have been from our investing activities, as described below. The Company's cash flows from operating, investing and financing activities, as reflected in the statement of cash flows, are summarized as follows:

| | Nine Months Ended | |
|---|--------------------|--------------------|
| | September 30, 2020 | September 30, 2019 |
| Cash (used in) provided by continuing operations: | | |
| Operating activities | \$ 45 | \$ 1,783 |
| Investing activities | 7,709 | (929) |
| Financing activities | (152) | (123) |
| Effect of exchange rate changes on cash | (39) | (50) |
| Net increase in cash from continuing operations | 7,563 | 681 |
| Cash provided by (used in) discontinued operations, net | 3 | (40) |
| Net increase in cash | \$ 7,566 | \$ 641 |

Net cash provided by operating activities was \$45 for the nine months ended September 30, 2020, compared to net cash provided by operating activities of \$1,783 for the same period in 2019. The variance was primarily attributable to lower cash earnings due to lower gross profit related to order delays as a result of delays in international regulatory approval for certain customers, as well as the payment of restructuring charges and acquisition related costs in the current period, partially offset by increases in accrued expenses.

Net cash provided by investing activities was \$7,709 for the nine months ended September 30, 2020, compared to net cash used in investing activities of \$929, for the same period in 2019. The variance primarily consisted of net proceeds from maturing investment securities partially offset by payments for the Emerald acquisition; see Note 3.

Net cash used in financing activities was \$152 for the nine months ended September 30, 2020, compared to net cash used in financing activities of \$123, for the same period in 2019. The slight increase was due primarily due to a decrease in cash received from the exercise of stock options and employee stock purchase plan shares partially offset by a decrease in the withholding of shares from vesting RSU awards to pay withholding taxes.

The Company had the following bank arrangements:

Domestic Credit Facilities

The Company and its domestic subsidiaries are parties to a credit facility with CIBC Bank USA. The credit facility, as amended through the date of this filing, provides for a \$12,000 revolving credit facility, with a \$200 sub facility for letters of credit. Under the revolving credit facility, the availability of funds depends on a borrowing base composed of stated percentages of the Company's eligible trade receivables and eligible inventory, and eligible equipment less a reserve. The credit facility matures on December 15, 2022.

On May 13, 2020, the Company and its domestic subsidiaries entered into a Fourteenth Amendment to Loan and Security Agreement and Waiver (the "Fourteenth Amendment") with CIBC Bank USA. The Fourteenth Amendment, among other things:

- Increased the Company's revolving loan borrowing capacity to \$12.0 million from its then current capacity of \$7.0 million;
- Added provisions addressing interest rates following the unavailability of the London Interbank Offered Rate or LIBOR;
- Eliminated the funded debt to EBITDA ratio and fixed charge coverage ratio for the quarter ending June 30, 2020;
- Added a financial covenant requiring that at all times until September 30, 2020, the borrowers maintain at least \$15.0 million of liquidity, calculated as the sum of (a) cash on hand, plus (b) cash equivalent investments, plus (c) available borrowing capacity under the revolving credit facility.

The Company was in compliance with all applicable covenants under the credit facility as of September 30, 2020.

Foreign Credit Facility

In addition to its domestic credit facilities, the Company's wholly-owned subsidiary, Intricon, PTE LTD., has an international senior secured credit agreement with Oversea-Chinese Banking Corporation Ltd. that provides for an asset-based line of credit. Borrowings bear interest at a rate of .75% to 2.5% over the lender's prevailing prime lending rate.

Capital Adequacy

We believe that funds expected to be generated from operations, funds maintained in liquid investments and funds available under our revolving credit loan facility will be sufficient to meet our anticipated cash requirements for operating needs for at least the next 12 months. While management believes that we will be able to meet our liquidity needs for at least the next 12 months, no assurance can be given that we will be able to do so.

As of September 30, 2020, and December 31, 2019, the Company had a total borrowing capacity under its credit facilities of \$14,261 and \$9,589, respectively, with no borrowings outstanding at each reporting period.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

ITEM 4. Controls and Procedures

The Company's management, with the participation of its chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of September 30, 2020 (the "Disclosure Controls Evaluation"). Based on the Disclosure Controls Evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures were effective to provide a reasonable level of assurance that: (i) information required to be disclosed by the Company in the reports the Company files or submits under the Securities Exchange Act of 1934, as amended ("Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) information required to be disclosed in the reports the Company files or submits under Exchange Act is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure, all in accordance with Exchange Act Rule 13a-15(e).

Our assessment of the effectiveness of our internal controls over financial reporting excluded the assets and operations acquired on May 18, 2020 in the Emerald transaction. Emerald's assets and operations are less than 20% of total assets and revenues (excluding Emerald's goodwill and intangible assets which were integrated into the Company's systems and control environment) of the consolidated condensed financial statement amounts as of and for the period ended September 30, 2020. Such exclusion was in accordance with SEC guidance that an assessment of a recently acquired business may be omitted in management's report on internal control over financial reporting, provided the acquisition took place within twelve months of management's evaluation. This exclusion is expected to apply to our assessment as of December 31, 2020 as well.

There were no changes in our internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), during the quarter ended September 30, 2020 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

The information contained in Note 18 to the Consolidated Condensed Financial Statements in Part I of this quarterly report is incorporated by reference herein.

ITEM 1A. Risk Factors

In addition to the foregoing and the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2019, with the following risk factors, which could materially affect the Company’s business, financial condition or future results. The risks described in our Annual Report on Form 10-K and below are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

The Company’s business, financial condition and results of operations for fiscal year 2020 and beyond could be materially adversely affected by the ongoing COVID-19 (coronavirus) outbreak.

The outbreak of the novel COVID-19 (coronavirus) has evolved into a global pandemic. COVID-19 has spread to many regions of the world, including North America, Asia and Europe. The full extent to which the COVID-19 pandemic impacts our business, operating results and financial condition will depend on future developments that are highly uncertain, cannot be accurately predicted and may be beyond our control. Uncertain factors relating to the COVID-19 pandemic include the duration of the outbreak, the severity of the virus, and the actions, or perception of actions that may be taken, to contain or treat its impact, including declarations of states of emergency, business closures, manufacturing restrictions and a prolonged period of travel, commercial and/or other similar restrictions and limitations.

We cannot predict the duration or scope of the pandemic, actions that may be taken by governments and businesses in response to the pandemic, or the impacts of the pandemic on healthcare systems. These impacts and associated responses of the COVID-19 pandemic could materially adversely impact our business, financial condition and results of operations in a number of ways, including but not limited to:

- Temporary shutdown of our facilities in Minnesota, Singapore and Indonesia as a result of employee illness or government restrictions, disruptions or restrictions on the ability to ship our products to our customers as well as disruptions that may affect our customers and suppliers;
- Reduced revenues as a result of disruptions in our operations or in demand by our customers, including our major customers. For example, our revenues in the first half of 2020 declined, in part due to delays in orders from our clients as a result of the uncertainty surrounding the COVID-19 pandemic;
- Our suppliers may not have the materials, capacity, or capability to supply us according to our schedule and specifications. If our suppliers’ operations are impacted, we may need to seek alternate suppliers, which may be more expensive, may not be available or may result in delays in shipments to us and subsequently to our customers;
- Reduced cash flow from our operations due to reductions in revenues or collections from our customers and increases in operating costs related to actions taken in response to the pandemic. For example, we have experienced higher operating costs associated with newly added health screenings, temperature checks and enhanced cleaning and sanitation protocols to protect our employees, which we expect could continue or could increase in these or other areas;
- Reduced revenues or earnings may require us to perform impairment assessments of our long-lived assets, goodwill and other assets and result in charges to earnings;
- Reduced business productivity due to inefficiencies in employees working from home or increasing physical distancing and other pandemic response protocols in our production facilities;
- Diminished ability, or inability, to complete clinical trials and other activities required to achieve regulatory clearing for our products under development due to lack of access to healthcare facilities, healthcare providers and patients. For example, we have postponed our anticipated “self-fitting software” clinical trial until such time as we can ensure the health and safety of trial participants; this delay could adversely affect our hearing health business;
- Increased susceptibility to the risk of information technology security breaches and other disruptions due to increased volumes of remote access to our information systems from our employees working at home;
- National or global economic recessions, including those brought on by the COVID-19 outbreak, which may have a negative effect on the demand for our products and our operating results;

- Potential delays in the over-the-counter hearing aid regulations required to be promulgated by the U.S. Food and Drug Administration due to COVID-19 priorities, which delay will likely have an adverse impact on our hearing health business over the course of 2020 and beyond;
- Diminished ability to retain personnel over concerns about workplace exposure to COVID-19, or to hire and effectively train new personnel, due to physical distancing protocols; and
- Increased volatility in our stock price due to financial market instability.

The duration of the disruptions to our customers and to our supply chain, and related financial impact to us, cannot be estimated at this time. If such disruptions continue for an extended period of time, the impact could have a material adverse effect on our business, results of operations and financial condition.

These and other impacts of the COVID-19 pandemic could have the effect of heightening many of the other risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019. The ultimate impact depends on the severity and duration of the current COVID-19 pandemic and actions taken by governmental authorities and other third parties in response, each of which is uncertain, rapidly changing and difficult to predict. Any of these disruptions could materially adversely impact our business, financial condition and results of operations.

We recently acquired Emerald Medical Services and we may explore other acquisitions that complement or expand our business. Acquisitions pose significant risks and may materially adversely affect our business, financial condition and operating results.

In May 2020, we acquired all of the outstanding shares of Emerald Medical Services, a company incorporated and based in Singapore. Emerald Medical Services represents a new and exciting business opportunity; however, we do not have any prior experience in the complex medical catheter business, and we may not be able to successfully integrate or profitably operate this business, which may result in our not realizing the value paid for the acquisition. We recorded goodwill and intangible assets in connection with the acquisition, and if we are not able to realize the value paid, it could lead to impairment of the assets acquired, for which we would need to recognize an expense charge. Our success will be largely influenced by management's ability to hire and retain skilled personnel and determine the proper customer base and marketing channels to achieve our planned profitability levels.

As part of our business strategy, we may in the future pursue acquisitions of other businesses or technologies that we believe could complement, enhance or expand our current business or product lines, diversify our revenue base or that might otherwise offer us growth opportunities. We may have difficulty finding these opportunities or, if we do identify these opportunities, we may not be able to complete the transactions for various reasons, including a failure to secure financing.

The Emerald Medical Services acquisition, and any other transactions that we are able to identify and complete, involve a number of risks, including: the diversion of our management's attention from our existing business to integrate the operations and personnel of the acquired or combined business or joint venture; possible adverse effects on our operating results during the integration process; unanticipated liabilities and litigation; and our possible inability to achieve the intended objectives or achieve the anticipated benefits of the transaction. In addition, we may not be able to successfully or profitably integrate, operate, maintain and manage our newly acquired operations or employees. Future acquisitions also may result in dilutive issuances of equity securities or the incurrence of additional debt.

Our success depends on our senior management team and if we are not able to retain them, or recruit suitable replacements, it could have a materially adverse effect on us.

We are highly dependent upon the continued services and experience of our senior management team, including Scott Longval who was recently appointed as president and chief executive officer to replace Mark S. Gorder, who retired at the end of September 2020. Mr. Longval will also continue to serve as chief financial officer until a replacement can be found. We depend on the services of Mr. Longval and the other members of our senior management team to, among other things, continue the development and implementation of our business strategies and maintain and develop our client relationships. Certain members of our management team are approaching retirement and the Company must locate and employ suitable replacements from within or outside the Company. If we fail to successfully and timely attract and appoint a new chief financial officer, and replacements for other members of senior management as they retire, with persons with the appropriate level of expertise, we could experience adverse impacts on our business and results of operations. Any significant leadership change and accompanying senior management transition, such as our recent change in the president and chief executive officer, and the hiring of other new leaders in key roles, involves inherent risk and any failure to ensure a smooth transition could hinder our strategic planning, execution and future performance.

We do not maintain key-man life insurance for any members of our senior management team.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

As previously reported, on May 18, 2020, Intricon Pte. Ltd. (“Buyer”), a wholly-owned subsidiary of the Company, acquired all of the outstanding shares of Emerald Medical Services Pte., Ltd., a Singapore company (“Emerald”), pursuant to a Share Purchase Agreement dated the same date among Buyer, Emerald and the direct and indirect owners of Emerald. As part of the purchase price, the Company issued to the owners a total of 80,000 shares of common stock of the Company. The issuance of these shares was made pursuant to the exemption from registration provided by Section 4(a)(2) of the Securities Act of 1933, as amended, for an issuance not involving a public offering based upon certain representations made by the owners.

ITEM 3. Defaults upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures.

Not applicable.

ITEM 5. Other Information

Not applicable.

ITEM 6. Exhibits

(a) Exhibits

- [10.1](#) [Transition Agreement by and between Mark S. Gorder and the Company dated as of June 29, 2020, \(incorporated by reference from the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 30, 2020\).](#)
- [10.2](#) [Employment Agreement dated as of October 1, 2020 between Scott Longval and the Company, \(incorporated by reference from the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 26, 2020\).](#)
- [10.3](#) [Amended and Restated 2015 Equity Incentive Plan \(incorporated by reference from the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 2, 2020\).](#)
- [31.1*](#) [Certification of principal executive officer and principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- [32.1*](#) [Certification of principal executive officer and principal financial officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 101* The following materials from IntriCon Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2020, formatted in Inline XBRL (eXtensible Business Reporting Language): (i) Consolidated Condensed Balance Sheets (Unaudited); (ii) Consolidated Condensed Statements of Operations (Unaudited); (iii) Consolidated Condensed Statements of Comprehensive Income (Loss) (Unaudited); (iv) Consolidated Condensed Statements of Equity (Unaudited); (v) Consolidated Condensed Statements of Cash Flows (Unaudited); and (vi) Notes to Consolidated Condensed Financial Statements (Unaudited).
- 104* The cover page from the Company's Quarterly Report on Form 10-Q as of and for the quarter ended September 30, 2020, formatted in Inline XBRL (included as Exhibit 101).

* Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTRICON CORPORATION
(Registrant)

Date: November 9,
2020

By: /s/ Scott Longval

Scott Longval
President, Chief Executive Officer and Chief Financial Officer
(principal executive officer and principal financial officer)

CERTIFICATION Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

I, Scott Longval, certify that:

1. I have reviewed this quarterly report on Form 10-Q of IntriCon Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2020

/s/ Scott Longval

Scott Longval
President, Chief Executive
Officer and Chief Financial
Officer
(principal executive officer
and principal financial
officer)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Scott Longval, President, Chief Executive Officer and Chief Financial Officer (principal executive officer and principal financial officer) of Intricon Corporation (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

- 1) the quarterly report on Form 10-Q of the Company for the quarterly period ended September 30, 2020 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 9, 2020

/s/ Scott Longval

Scott Longval
President, Chief Executive Officer and
Chief Financial Officer
(principal executive officer and
principal financial officer)

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Section 1350 of Chapter 63 of Title 18 of the United States Code) and is not being filed as part of the Report or as a separate disclosure document.
