

INTRICON CORP
Form 10-Q
May 17, 2010
[Table of Contents](#)

**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 March 31, 2010

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)

Edgar Filing: INTRICON CORP - Form 10-Q

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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 April 26, 2010 was 5,475,248 (net of 515,754 treasury shares).

INTRICON CORPORATION

INDEX

	Page Numbers
<u>PART I: FINANCIAL INFORMATION</u>	
<u>Item 1.</u> <u>Financial Statements</u>	
<u>Consolidated Condensed Balance Sheets as of</u> <u>March 31, 2010 (Unaudited) and December 31, 2009</u>	3-4
<u>Consolidated Condensed Statements of Operations (Unaudited)</u> <u>for the Three Months Ended March 31, 2010 and 2009</u>	5
<u>Consolidated Condensed Statements of Cash Flows (Unaudited)</u> <u>for the Three Months Ended March 31, 2010 and 2009</u>	6
<u>Notes to Consolidated Condensed Financial Statements (Unaudited)</u>	7-18
<u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19-27
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	28
<u>Item 4.</u> <u>Controls and Procedures</u>	28
<u>PART II: OTHER INFORMATION</u>	
<u>Item 1.</u> <u>Legal Proceedings</u>	29
<u>Item 1A.</u> <u>Risk Factors</u>	29
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	29
<u>Item 3.</u> <u>Defaults Upon Senior Securities</u>	29
<u>Item 4.</u> <u>(Removed and Reserved)</u>	29
<u>Item 5.</u> <u>Other Information</u>	29
<u>Item 6.</u> <u>Exhibits</u>	30
<u>Signatures</u>	31
<u>Exhibit Index</u>	32

Table of Contents**PART I: FINANCIAL INFORMATION****ITEM 1. Financial Statements**

INTRICON CORPORATION
Consolidated Condensed Balance Sheets
Assets

	March 31, 2010 (Unaudited)	December 31, 2009
Current assets:		
Cash	\$ 491,486	\$ 385,055
Restricted cash	321,745	405,745
Accounts receivable, less allowance for doubtful accounts of \$226,000 at March 31, 2010 and at December 31, 2009	7,570,179	7,083,694
Inventories	8,297,085	8,220,996
Refundable income tax		63,676
Other current assets	598,101	815,742
Current assets of discontinued operations	1,242,312	1,139,813
Total current assets	18,520,908	18,114,721
Machinery and equipment	35,933,986	35,516,164
Less: Accumulated depreciation	29,205,782	28,725,359
Net machinery and equipment	6,728,204	6,790,805
Goodwill	9,708,979	9,716,841
Investment in partnerships	1,225,278	1,237,178
Other assets of discontinued operations	124,245	141,877
Other assets, net	1,438,348	1,361,355
Total assets	\$ 37,745,962	\$ 37,362,777

(See accompanying notes to the consolidated condensed financial statements)

Table of Contents

INTRICON CORPORATION
Consolidated Condensed Balance Sheets
Liabilities and Shareholders' Equity

	March 31, 2010 (Unaudited)	December 31, 2009
Current liabilities:		
Checks written in excess of cash	\$ 249,461	\$ 101,416
Current maturities of long-term debt	1,714,802	1,708,839
Accounts payable	3,878,749	3,637,329
Income taxes payable	19,628	
Deferred gain	110,084	110,084
Partnership payable	260,000	260,000
Liabilities of discontinued operations	1,034,169	926,409
Other accrued liabilities	3,291,447	2,866,584
Total current liabilities	10,558,340	9,610,661
Long term debt, less current maturities	7,109,030	7,729,797
Other postretirement benefit obligations	738,465	756,000
Long term partnership payable	500,000	500,000
Deferred income taxes	122,753	128,753
Accrued pension liabilities	503,893	543,194
Deferred gain	577,942	605,463
Total liabilities	20,110,423	19,873,868
Commitments and contingencies (note 14)		
Shareholders' equity:		
Common shares, \$1.00 par value per share; 20,000,000 shares authorized; 5,990,412 and 5,985,862 shares issued; 5,474,658 and 5,470,108 shares outstanding at March 31, 2010 and December 31, 2009, respectively.	5,990,412	5,985,862
Additional paid-in capital	15,118,128	14,986,840
Retained deficit	(1,986,891)	(2,005,187)
Accumulated other comprehensive loss	(221,032)	(213,528)
Less: 515,754 common shares held in treasury, at cost	(1,265,078)	(1,265,078)
Total shareholders' equity	17,635,539	17,488,909

Edgar Filing: INTRICON CORP - Form 10-Q

Total liabilities and shareholders' equity	\$ 37,745,962	\$ 37,362,777
--	---------------	---------------

(See accompanying notes to the consolidated condensed financial statements)

Table of Contents

INTRICON CORPORATION
Consolidated Condensed Statements of Operations
(Unaudited)

	Three Months Ended	
	March 31,	March 31,
	2010	2009
	(Unaudited)	(Unaudited)
Sales, net	\$ 14,553,464	\$ 11,843,962
Cost of sales	10,877,590	9,667,777
Gross profit	3,675,874	2,176,185
Operating expenses:		
Selling expense	786,824	619,035
General and administrative expense	1,443,956	1,378,217
Research and development expense	1,119,093	880,530
Total operating expenses	3,349,873	2,877,782
Operating income (loss)	326,001	(701,597)
Interest expense	(169,718)	(124,914)
Equity in loss of partnerships	(11,900)	(86,948)
Other income, net	44,582	56,755
Income (loss) from continuing operations before income taxes and discontinued operations	188,965	(856,704)
Income tax expense (benefit)	10,691	(49,528)
Income (loss) before discontinued operations	178,274	(807,176)
Loss from discontinued operations, net of income taxes	(159,978)	(182,114)
Net income (loss)	\$ 18,296	\$ (989,290)
Basic and diluted income (loss) per share:		
Continuing operations	\$ 0.03	\$ (0.15)
Discontinued operations	\$ (0.03)	\$ (0.04)
Net income (loss)	\$ 0.00	\$ (0.19)
Average shares outstanding:		
Basic and diluted	5,470,858	5,343,033

(See accompanying notes to the consolidated condensed financial statements)

Table of Contents

INTRICON CORPORATION
Consolidated Condensed Statements of Cash Flows
(Unaudited)

	Three Months Ended	
	March 31,	March 31,
	2010	2009
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net income (loss)	\$ 18,296	\$ (989,290)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	649,128	616,471
Stock-based compensation	118,714	137,454
Loss on disposition of property		1,190
Change in deferred gain	(27,521)	(30,119)
Change in allowance for doubtful accounts	95,603	(104,637)
Equity in loss of partnerships	11,900	86,948
Provision for deferred income taxes	(6,000)	
Changes in operating assets and liabilities:		
Accounts receivable	(663,136)	1,805,311
Inventories	(142,876)	1,788
Other assets	73,195	(307,372)
Accounts payable	241,846	100,057
Accrued expenses	553,751	(875,559)
Other liabilities	41,938	(6,964)
Net cash provided by operating activities	964,838	435,278
Cash flows from investing activities:		
Purchases of property, plant and equipment	(462,229)	(384,238)
Proceeds from note receivable		225,000
Net cash used in investing activities	(462,229)	(159,238)
Cash flows from financing activities:		
Proceeds from long-term borrowings	2,095,155	2,600,370
Repayments of long-term borrowings	(2,709,960)	(2,824,041)
Proceeds from employee stock purchases and exercise of stock options	14,684	30,390
Change in restricted cash	62,355	(1,178)
Change in checks written in excess of cash	148,045	(82,534)
Net cash used in financing activities	(389,721)	(276,993)
Effect of exchange rate changes on cash	(6,457)	(4,645)
Net increase (decrease) in cash	106,431	(5,598)
Cash, beginning of period	385,055	249,396
Cash, end of period	\$ 491,486	\$ 243,798

(See accompanying notes to the consolidated condensed financial statements)

Table of Contents

INTRICON CORPORATION

Notes to Consolidated Condensed Financial Statements (Unaudited)

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 or the Company) consolidated financial position as of March 31, 2010 and December 31, 2009, and the consolidated results of its operations for the three months ended March 31, 2010 and 2009. Results of operations for the interim period are not necessarily indicators of the results of the operations expected for the full year or any other interim period.

On January 1, 2010, the Company purchased the remaining 10 percent minority interest of its German subsidiary for approximately \$18,000. The non-controlling interest was immaterial for all periods presented.

Segment Disclosures A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. The Company's segments have similar economic characteristics and are similar in the nature of the products sold, type of customers, methods used to distribute the Company's products and regulatory environment. Management believes that the Company meets the criteria for aggregating its operating segments of its continuing operations into a single reporting segment.

The Company has evaluated subsequent events through the date of this filing and has appropriately included all matters requiring disclosures herein.

2. New Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements, which amends Accounting Standards Codification (ASC) 820, Fair Value Measurements, by requiring additional disclosures for transfers in and out of levels 1 and 2 and activity in level 3 fair value measurements. Additionally, the amendment clarifies existing disclosure requirements surrounding the level of disaggregation and valuation techniques and inputs. This guidance became effective for us January 1, 2010 and did not have a material impact on our consolidated financial statements.

3. Discontinued Operations

In December 2009, the Company's Board of Directors authorized management to exit the non-core electronics products segment operated by its wholly-owned subsidiary, RTI Electronics, Inc. and divest the assets used in the business. The decision to exit the electronics products segment was made to allow the Company to focus on its core body-worn device segment and to improve the Company's overall margins and profitability. In connection with its decision to divest the electronics business, the Company evaluated assets for impairment and costs of terminating employees and recorded the following: (i) an impairment charge of \$685,000 relating to goodwill, (ii) a reduction to realizable value of \$720,000 to tangible assets, and (iii) \$275,000 in employee termination costs for the year ended December 31, 2009. Additional costs related to employee terminations of \$92,500 were recorded during the three months ended March 31, 2010. Additional future employee termination costs are expected to be approximately \$90,000 in 2010.

Table of Contents

The following table shows the results of operations of the Company's electronic products segment (in thousands):

	Three Months Ended March 31,	
	2010	2009
Sales, net	\$ 1,362	\$ 1,486
Operating costs and expenses	(1,519)	(1,650)
Operating loss	(157)	(164)
Other expense, net	(3)	(3)
Loss from operations before income tax expense	(160)	(167)
Income tax expense		15
Net loss from discontinued operations	\$ (160)	\$ (182)

The following table shows the assets and liabilities of the electronic products segment at March 31, 2010 and December 31, 2009 (in thousands):

	2010	2009
Cash	\$ 4	\$ 5
Accounts receivable, net	801	757
Inventory, net	396	332
Other current assets	41	46
Current assets of discontinued operations	1,242	1,140
Property and equipment, net	98	116
Other assets of discontinued operations	26	26
Accounts payable	346	351
Accrued compensation and other liabilities	688	575
Current liabilities of discontinued operations	\$ 1,034	\$ 926

Information regarding the nonrecurring fair value measurement completed during the three month period ended December 31, 2009 was as follows:

2009 (in thousands):	Fair Value as of measurement date	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Impairment Charge
Long-lived assets and goodwill of discontinued operations	\$ 116	\$	\$	\$ 116	\$ 910

There were no additional impairments identified for the three months ended March 31, 2010.

4. Acquisition

On August 13, 2009, the Company acquired all of the outstanding stock of Jon Barron, Inc. doing business as Datrix (Datrix), a privately held developer, manufacturer, tester and marketer of medical devices and related software products, based in Escondido, California. The

Edgar Filing: INTRICON CORP - Form 10-Q

acquisition provided the Company entry into the ambulatory electrocardiograph (AECG) and event recording markets.

The purchase price included a closing cash payment of \$1,225,000, issuance of 75,000 shares of restricted common stock of the Company, valued at \$270,000 based on the fair value of the common stock on August 13, 2009, and the issuance of a promissory note in the amount of \$1,050,000 bearing annual interest at 6%, subject to adjustment. In addition, the Company paid off Datrix's outstanding line of credit with Wells Fargo of \$130,000 at closing.

Table of Contents

The principal amount of the promissory note is payable in three installments of \$350,000 on August 13, 2010, August 13, 2011 and August 13, 2012. The note bears annual interest at 6% and is payable with each installment of principal as set forth above.

The assets and liabilities of Datrix were recorded as of the acquisition date at their respective fair values and consolidated with those of the Company. Likewise, the results of operations of the Datrix operations since August 13, 2009 have been included in the accompanying consolidated statements of operations. The allocation of the net purchase price of the acquisition resulted in goodwill of approximately \$2,128,000. The goodwill represents operating and market synergies that the Company expects to be realized as a result of the acquisition and future opportunities and is not tax deductible. The purchase price allocation is based on estimates of fair values of assets acquired and liabilities assumed. The valuation required the use of significant assumptions and estimates. These estimates were based on assumptions the Company believed to be reasonable.

The purchase price was as follows as of August 13, 2009 (amounts in thousands):

Cash paid to seller at closing	\$ 1,225
Cash paid to Wells Fargo at closing	130
Stock consideration	270
Seller note at close	1,050
Total purchase price	\$ 2,675

The following table summarizes the purchase price allocation for the Datrix acquisition (amounts in thousands):

Cash	\$ 13
Other current assets	522
Intangible assets (weighted average life of 2.4 years)	125
Goodwill Body-Worn Segment	2,128
Current liabilities	(113)
Total preliminary purchase price allocation	\$ 2,675

Results from operations of Datrix are not considered material to the financial statements for 2009. Proforma results are also not considered material for 2009. Acquisition costs of \$277,000 were primarily incurred and recorded in the three month period ended September 30, 2009.

5. Product Warranty

In general, the Company warrants its products to be free from defects in material and workmanship and will fully conform to and perform to specifications for a period of one year. The following table presents changes in the Company's warranty liability for the three months ended March 31, 2010:

	Three months ended March 31, 2010
Beginning balance (December 31, 2009)	\$ 70,700
Warranty expense	27,700
Closed warranty claims	
Ending balance (March 31, 2010)	\$ 98,400

Table of Contents**6. Geographic Information**

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

	March 31, 2010	December 31, 2009
United States	\$ 5,636,000	\$ 5,893,000
Other	1,187,000	1,229,000
Consolidated	\$ 6,823,000	\$ 7,122,000

Long-lived assets consist of property and equipment as they are difficult to move and relatively illiquid. Excluded from long-lived assets are investments in partnerships, patents, license agreements and goodwill. The Company capitalizes long-lived assets pertaining to the production of specialized parts. These assets are periodically reviewed to assure 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 sales to geographical areas for the three months ended March 31, 2010 and 2009 were as follows:

	Three months ended	
	March 31, 2010	March 31, 2009
Net Sales to Geographical Areas:		
United States	\$ 10,022,135	\$ 8,380,328
Germany	887,381	572,849
China	839,557	532,923
Switzerland	201,518	162,611
Japan	267,589	424,175
France	394,588	422,988
Singapore	459,950	299,899
United Kingdom	76,811	150,019
Vietnam	272,993	163,703
Hong Kong	175,548	150,896
All other countries	955,394	583,571
Consolidated	\$ 14,553,464	\$ 11,843,962

Geographic net sales are allocated based on the location of the customer. All other countries include net sales primarily to various countries in Europe and in the Asian Pacific.

For the three months ended March 31, 2010, one customer accounted for 24 percent of the Company's consolidated net sales. For the three months ended March 31, 2009, two customers accounted for 16 percent and 13 percent of the Company's consolidated net sales, respectively.

At March 31, 2010, two customers accounted for 11 percent and 10 percent of the Company's consolidated accounts receivable, respectively. At December 31, 2009, two customers accounted for 16 percent and 11 percent of the Company's consolidated accounts receivable, respectively.

Table of Contents**7. Inventories**

Inventories consisted of the following at:

	Raw materials	Work-in process	Finished products and components	Total
March 31, 2010				
Domestic	\$ 3,543,699	\$ 1,638,338	\$ 1,092,801	\$ 6,274,838
Foreign	1,366,626	398,319	257,302	2,022,247
Total	\$ 4,910,326	\$ 2,036,657	\$ 1,350,103	\$ 8,297,085
December 31, 2009				
Domestic	\$ 3,650,572	\$ 1,679,985	\$ 934,554	\$ 6,265,111
Foreign	1,515,502	216,577	223,806	1,955,885
Total	\$ 5,166,074	\$ 1,896,562	\$ 1,158,360	\$ 8,220,996

8. Short and Long Term Debt

Short and long term debt is summarized as follows:

	March 31, 2010	December 31, 2009
Domestic Asset-Based Revolving Credit Facility	\$ 3,985,000	\$ 4,450,000
Foreign Overdraft and Letter of Credit Facility	708,000	678,000
Domestic Term Loan	3,075,000	3,250,000
Domestic Capital Equipment Leases	6,000	11,000
Note Payable Datrix Purchase	1,050,000	1,050,000
Total Debt	8,824,000	9,439,000
Less: Current maturities	(1,715,000)	(1,709,000)
Total Long Term Debt	\$ 7,109,000	\$ 7,730,000

To finance a portion of the Datrix acquisition and replace the Company's existing credit facilities with Bank of America, including capital leases, the Company and its domestic subsidiaries entered into a new three year credit facility with The PrivateBank and Trust Company on August 13, 2009. The credit facility provides for:

- § an \$8,000,000 revolving credit facility, with a \$200,000 subfacility 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; and
- § a \$3,500,000 term loan.

Table of Contents

Loans under the credit facility are secured by a security interest in substantially all of the assets of the Company and its domestic subsidiaries including a pledge of the stock of its domestic subsidiaries. Loans under the credit facility bear interest at varying rates based on predefined levels of Funded Debt / EBITDA, at the option of the Company, at:

- § the London InterBank Offered Rate (LIBOR) plus 3.00% - 4.00%, or
- § the base rate, which is the higher of (a) the rate publicly announced from time to time by the lender as its prime rate and (b) the Federal Funds Rate plus 0.5%, plus 0.25% - 1.25%.

Weighted average interest on the new domestic asset-based revolving credit facility was 4.41% for the three months ended March 31, 2010 and 4.07% for the year ended December 31, 2009. The outstanding balance of the revolving credit facility was \$3,985,000 and \$4,450,000 at March 31, 2010 and December 31, 2009, respectively. The total remaining availability on the revolving credit facility was approximately \$2,796,000 and \$2,821,000 at March 31, 2010 and December 31, 2009, respectively.

The outstanding principal balance of the term loan is payable in quarterly installments of varying amounts ranging from \$168,750 to \$187,500. Any remaining principal and accrued interest is payable on August 13, 2012. IntriCon is also required to use 100% of the net cash proceeds of certain asset sales (excluding inventory and certain other dispositions), sale of capital securities or issuance of debt to pay down the term loan.

In March 2010, the Company entered into an amendment with the PrivateBank to waive certain covenant violations at December 31, 2009 and January 31, 2010 and reset certain covenant thresholds defined in the original agreement. The Company was in compliance with all applicable covenants under the credit facility, as amended, as of March 31, 2010.

Upon termination of the Bank of America credit facility, the Company was required to settle the outstanding obligations of \$121,000 for the liability related to its interest rate swap agreement with Bank of America and recognize the corresponding charge of \$121,000 in interest expense in the three month period ended September 30, 2009, which was previously included in accumulated other comprehensive loss. In addition, the Company expensed the remaining deferred financing costs of \$86,000 related to the Bank of America facility, which was also included in interest expense in the three month period ended September 30, 2009.

The prior credit facility provided for:

- § a \$10,000,000 revolving credit facility, with a \$200,000 subfacility for letters of credit. Under the revolving credit facility, the availability of funds depends on a borrowing base composed of stated percentages of our eligible trade receivables and eligible inventory, less a reserve.
- § a \$4,500,000 term loan, which was used to fund the Company's May, 2007 acquisition of Tibbetts Industries, Inc.

Loans under the credit facility were secured by a security interest in substantially all of the assets of the borrowers including a pledge of the stock of the subsidiaries. All of the borrowers were jointly and severally liable for all borrowings under the credit facility.

In June 2008, the Company completed a sale-leaseback of machinery and equipment with Bank of America. The transaction generated proceeds of \$1,098,000, of which \$1,013,000 was used to pay down the domestic term loan. The facility was repaid on August 13, 2009 with proceeds borrowed under the new PrivateBank facility.

In addition to its domestic credit facilities, the Company's wholly-owned subsidiary, IntriCon, PTE LTD., entered into an international senior secured credit agreement with Oversea-Chinese Banking Corporation Ltd. that provides for a \$1.8 million line of credit. Borrowings bear interest at a rate of .75% to 2.5% over the lender's prevailing prime lending rate. Weighted average interest on the international credit facilities was 4.04% for the three months ended March 31, 2010 and the outstanding balance was \$708,000 and \$678,000 at March 31, 2010 and December 31, 2009, respectively. The total remaining availability on the international senior secured credit agreement was approximately \$1,150,000 and \$1,177,000 at March 31, 2010 and December 31, 2009, respectively.

Table of Contents**9. Income Taxes**

Income tax expense for the three months ended March 31, 2010 was \$11,000 compared to benefit of \$50,000 for the same period in 2009. The expense (benefit) for the three months ended March 31, 2010 and 2009 were primarily due to foreign operating income (loss). The Company has net operating loss carryforwards for U.S. federal income tax purposes and, consequently, minimal federal benefit or expense from the domestic operations was recognized as the deferred tax asset has a full valuation allowance.

The following was the income (loss) before income taxes for each jurisdiction that the Company has operations for the three months ended March 31, 2010 and 2009:

	Three months ended	
	March 31, 2010	March 31, 2009
United States	\$ 157,879	\$ (596,219)
Singapore	(26,090)	(220,393)
Germany	51,176	(40,092)
Income (loss) before income taxes and discontinued operations	\$ 188,965	\$ (856,704)

10. Stockholders Equity and Stock-based Compensation

The Company has a 1994 stock option plan, a 2001 stock option plan, a non-employee directors stock option plan and a 2006 equity incentive plan. New grants may not be made under the 1994, the 2001 and the non-employee directors stock option plans; however certain option grants under these plans remain exercisable as of March 31, 2010. The aggregate number of shares of common stock for which awards could be granted under the 2006 Equity Incentive Plan as of the date of adoption was 698,500 shares. Additionally, as outstanding options under the 2001 stock option plan and non-employee directors stock option plan expire, the shares of the Company's common stock subject to the expired options will become available for issuance under the 2006 Equity Incentive Plan. On April 21, 2010, the Company's shareholders approved an amendment to the 2006 Equity Incentive Plan to increase (i) the authorized number of shares of the Company's common stock reserved and issuable under the plan by an additional 250,000 shares and (ii) the maximum number of incentive stock options that may be granted under the plan to be the same as the maximum number of shares that may be granted under the plan. The amendment was approved by the Company's board of directors in March, 2010 and subsequently approved by shareholders.

Under the various plans, executives, employees and outside directors receive awards of options to purchase common stock. Under the 2006 Equity Incentive Plan, the Company may also grant stock awards, stock appreciation rights, restricted stock units and other equity-based awards, although no such awards, other than awards under the programs discussed in the next two paragraphs, had been granted as of March 31, 2010. Under all awards, the terms are fixed on the grant date. Generally, the exercise price equals the market price of the Company's stock on the date of the grant. Options under the plans generally vest over three years, and have a maximum term of 10 years.

Table of Contents

Additionally, the board has established the non-employee directors' stock fee election program, referred to as the director program, as an award under the 2006 equity incentive plan. The director program gives each non-employee director the right under the 2006 equity incentive plan to elect to have some or all of his quarterly director fees paid in common shares rather than cash. There were 785 and 827 shares issued in lieu of cash for director fees under the director program for the three months ended March 31, 2010 and 2009, respectively.

On July 23, 2008, the Compensation Committee of the Board of Directors approved the non-employee director and executive officer stock purchase program, referred to as the management purchase program, as an award under the 2006 Plan. The purpose of the management purchase program is to permit the Company's non-employee directors and executive officers to purchase shares of the Company's common stock directly from the Company. Pursuant to the management purchase program, as amended, participants may elect to purchase shares of common stock from the Company not exceeding an aggregate of \$100,000 during any fiscal year. Participants may make such election one time during each twenty business day period following the public release of the Company's earnings announcement, referred to as a window period, and only if such participant is not in possession of material, non-public information concerning the Company, subject to the discretion of the Board to prohibit any transactions in common stock by directors and executive officers during a window period. There were no shares purchased under the management purchase program during the three months ended March 31, 2010 and 2009, respectively.

Stock option activity as of and during the three months ended March 31, 2010 was as follows:

	Number of Shares	Weighted- average Exercise Price	Aggregate Intrinsic Value
Outstanding at December 31, 2009	1,053,800	\$ 5.67	
Options forfeited			
Options granted	85,000	3.16	
Options exercised			
Outstanding at March 31, 2010	1,138,800	\$ 5.49	\$
Exercisable at March 31, 2010	822,100	\$ 5.28	\$
Available for future grant at December 31, 2009	161,404		
Available for future grant at March 31, 2010	75,814		

The number of shares available for future grant at March 31, 2010 does not include a total of up to 397,700 shares subject to options outstanding under the 2001 stock option plan and non-employee directors' stock option plan as of March 31, 2010, which will become available for grant under the 2006 Equity Incentive Plan in the event of the expiration of such options.

Table of Contents

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of subjective assumptions, including the expected stock price volatility. Because the Company's options have characteristics different from those of traded options, in the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of its options. The weighted average fair value of options granted was \$1.71, respectively, for options granted during the three months ended March 31, 2010. The weighted average fair value of options granted was \$1.83 for options granted during the three months ended March 31, 2009.

The Company calculates expected volatility for stock options and awards using both historical volatility as well as the average volatility of our peer competitors. The Company's historical volatility is not the sole input due to the material changes in the Company's operations as a result of the sales of business segments that occurred in 2005 and May 2010.

The Company currently estimates a nine percent forfeiture rate for stock options, but will continue to review this estimate in future periods.

The Company also has an Employee Stock Purchase Plan (the Purchase Plan). A maximum of 100,000 shares may be sold under the Purchase Plan. There were 3,765 shares purchased under the plan for the three months ended March 31, 2010 and a total of 9,740 shares purchased for the three months ended March 31, 2009.

The risk-free rates for the expected terms of the stock options and awards and the Purchase Plan is based on the U.S. Treasury yield curve in effect at the time of grant.

The weighted average remaining contractual life of options exercisable at March 31, 2010 was 5.1 years.

The Company recorded \$119,000 and \$137,000 of non-cash stock option expense for the three months ended March 31, 2010 and 2009, respectively. As of March 31, 2010, there was \$560,000 of total unrecognized compensation costs related to non-vested awards that are expected to be recognized over a weighted-average period of 1.4 years.

11. Income Per Share

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

	Three months ended	
	March 31, 2010	March 31, 2009
Numerators:		
Income (loss) before discontinued operations	\$ 178,274	\$ (807,176)
Loss from discontinued operations, net of taxes	(159,978)	(182,114)
Net income (loss)	\$ 18,296	\$ (989,290)
Denominator:		
Basic weighted shares outstanding	5,470,858	5,343,033
Weighted shares assumed upon exercise of stock options		
Diluted weighted shares outstanding	5,470,858	5,343,033
Basic and diluted (loss) earnings per share:		
Continuing operations	\$ 0.03	\$ (0.15)
Discontinued operations	(0.03)	(0.04)
Basic and diluted (loss) earnings per share:	\$ 0.00	\$ (0.19)

The dilutive impact summarized above relates to the periods when the average market price of Company stock exceeded the exercise price of the potentially dilutive option securities granted. 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. When dilutive, stock options are included as equivalents using the treasury stock market method when computing the diluted earnings per share.

Table of Contents

Excluded from the computation of diluted earnings per share for the three months ended March 31, 2010 and 2009, were options out of the money with rights to purchase approximately 651,100 and 990,650 common shares, respectively, with an average exercise price of \$7.61 and \$5.86, respectively, because the effect would have been anti-dilutive.

12. Derivative Financial Instruments

Derivative financial instruments are used by the Company in the management of its interest rate and foreign currency exposure. There were no foreign currency derivative financial instruments for the periods presented. The Company does not hold or issue derivative financial instruments for trading purposes. When entered into, the Company formally designates the derivative financial instrument as a hedge of a specific underlying exposure if such criteria are met, and documents both the risk management objectives and strategies for undertaking the hedge. The Company formally assesses, both at inception and at least quarterly thereafter, whether the derivative financial instruments that are used in hedging transactions are effective at offsetting changes in either the fair value or cash flows of the related underlying exposure. Because of the high correlation between the derivative financial instrument and the underlying exposure being hedged, fluctuations in the value of the derivative financial instruments are generally offset by changes in the fair values or cash flows of the underlying exposures being hedged. Any ineffective portion of a derivative financial instrument's change in fair value is immediately recognized in earnings.

The Company uses interest rate swaps to manage its interest rate risk. The swaps are designated as cash flow hedges with the changes in fair value recorded in accumulated other comprehensive loss and as a derivative hedge asset or liability, as applicable. The swaps settle periodically in arrears with the related amounts for the current settlement period payable to, or receivable from, the counter-parties included in accrued liabilities or accounts receivable and recognized in earnings as an adjustment to interest expense from the underlying debt to which the swap is designated.

Upon termination of the Bank of America credit facility, the Company was required to settle the outstanding obligations of \$121,000 for the liability related to its interest rate swap agreement with Bank of America and recognize the corresponding charge of \$121,000 in interest expense in the three month period ended September 30, 2009, which was previously included in other comprehensive income.

In conjunction with the new credit facility, the Company entered into an interest rate swap agreement with The Private Bank and Trust Company. At March 31, 2010, the Company had a United States Dollar (USD) denominated interest rate swap outstanding which effectively fixed the interest rate on floating rate debt, exclusive of lender spreads, at 5.36% for a notional principal amount of \$2,000,000 through September 2010.

Interest rate swaps, which are considered derivative instruments, of \$0 and \$35,000 are reported on the balance sheet at fair value in other current liabilities at March 31, 2010 and December 31, 2009, respectively.

13. Comprehensive Income (Loss)

The components of comprehensive (loss) income were as follows:

	Three months ended	
	March 31,	March 31,
	2010	2009
Net income (loss)	\$ 18,296	\$ (989,290)
Change in fair value of interest rate swap	34,600	12,256
(Loss) gain on foreign currency translation adjustment	(42,104)	(26,468)
Comprehensive (loss) income	\$ 10,792	\$ (1,003,502)

Table of Contents**14. Legal Proceedings**

We are a defendant along with a number of other parties in approximately 122 lawsuits as of March 31, 2010, (approximately 122 lawsuits as of December 31, 2009) 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. Due to the noninformative nature of the complaints, we do not know whether any of the complaints state valid claims against us. Certain insurance carriers have informed us that the primary policies for the period August 1, 1970-1973, have been exhausted and that the carriers will no longer provide a defense under those policies. We have requested that the carriers substantiate this situation. We believe we have additional policies available for other years which have been ignored by the carriers. Because settlement payments are applied to all years a litigant was deemed to have been exposed to asbestos, we believe when settlement payments are applied to these additional policies, we will have availability under the years deemed exhausted. We do not believe that the asserted exhaustion of the primary insurance coverage for this period will have a material adverse effect on our 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, to which these insurance carriers are insuring us, make the ultimate disposition of these lawsuits not material to our consolidated financial position or results of operations.

The Company's former wholly owned French subsidiary, Selas SAS, filed for insolvency in France and is being managed by a court appointed administrator. The Company may be subject to additional litigation or liabilities as a result of the French insolvency proceeding.

We are 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 financial position, liquidity or results of operations.

15. Related-Party Transactions

One of the Company's subsidiaries leases office and factory space from a partnership consisting of three present or former officers of the subsidiary, including Mark Gorder, a member of the Company's Board of Directors and the President and Chief Executive Officer of the Company. The subsidiary is required to pay all real estate taxes and operating expenses. In the opinion of management, the terms of the lease agreement are comparable to those which could be obtained from unaffiliated third parties. The total base rent expense, real estate taxes and other charges incurred under the lease was approximately \$121,000 and \$119,000 for each of the three months ended March 31, 2010 and 2009, respectively. Annual lease commitments, which include base rent expense, real estate taxes and other charges, approximate \$477,000 through October 2011.

The Company uses the law firm of Blank Rome LLP for legal services. A partner of that firm is the son-in-law of the Chairman of the Company's Board of Directors. For the three months ended March 31, 2010 and 2009, the Company paid that firm approximately \$16,000 and \$20,000, respectively, for legal services and costs. The Chairman of our Board of Directors is considered independent under applicable Nasdaq and SEC rules because (i) no payments were made to the Chairman or the partner directly in exchange for the services provided by the law firm and (ii) the amounts paid to the law firm did not exceed the thresholds contained in the Nasdaq standards. Furthermore, the aforementioned partner does not provide any legal services to the Company and is not involved in billing matters.

16. Statements of Cash Flows

The following table provides supplemental disclosures of cash flow information:

	Three months ended	
	March 31, 2010	March 31, 2009
Interest received	\$ 304	\$ 439
Interest paid	114,474	79,921
Income taxes paid	6,537	75,784

Table of Contents**17. Investment in Partnerships**

The Company owns a 9% partnership interest in the Hearing Instrument Manufacturers Patent Partnership (HIMPP), and is a party to a license agreement that grants the Company access to over 45 US registered patents. The Company recorded a \$37,000 decrease in the carrying amount of the investment, reflecting amortization of the patents, other intangibles and the Company's portion of the partnership's operating results for each of the three months ended March 31, 2010 and 2009, respectively.

The Company's subsidiary, IntriCon Tibbetts Corporation, owns a 50% interest in a joint venture with a Swiss company to market, design, manufacture, and sell audio coils to the hearing health industry. The Company has recorded a \$25,000 increase and a \$50,000 decrease in the carrying amount of the investment, reflecting the Company's portion of the joint venture's operating results for the three months ended March 31, 2010 and 2009, respectively.

Condensed financial information of the unaudited joint venture was as follows:

	March 31, 2010	December 31, 2009
Balance Sheet:		
Current assets	\$ 806,000	\$ 833,000
Non-current assets	262,000	224,000
Total assets	\$ 1,068,000	\$ 1,057,000
Current liabilities	565,000	604,000
Non-current liabilities		
Stockholders' equity	503,000	453,000
Total liabilities and stockholders' equity	\$ 1,068,000	\$ 1,057,000

	Three Months Ended	
	March 31, 2010	March 31, 2009
Income Statement:		
Net revenues	\$ 839,000	\$ 446,000
Net income (loss)	\$ 50,000	\$ (100,000)

18. Revenue by Market

The following tables set forth, for the periods indicated, net revenue by market:

	Three Months Ended	
	March 31, 2010	March 31, 2009
Hearing Health	\$ 5,370,000	\$ 4,411,000
Medical	6,508,000	5,285,000
Professional Audio Communications	2,675,000	2,148,000
Total Revenue	\$ 14,553,000	\$ 11,844,000

Table of Contents

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 to as the Company, IntriCon, we, us or our) is an international firm engaged in designing, developing, engineering and manufacturing body-worn devices.

In addition to its operations in Minnesota, the Company has facilities in Maine, Singapore and Germany.

Currently, the Company operates in one business segment, the body-worn device segment. In 2009, the Company decided to exit its non-core electronic products segment, to allow for greater focus on its body-worn device segment. The Company is in the process of disposing the assets relating to the electronic products segment. For all periods presented, the Company classified its former electronics products segment as discontinued operations.

Market Overview: Body-Worn Devices

Products and Industries Served

IntriCon designs, develops and manufactures miniature and micro-miniature body-worn products based on its proprietary technology to meet the rising demand for smaller, portable and more advanced devices. Our expertise is focused on three main markets: medical, hearing health and professional audio communications. Within these chosen markets, we combine ultra-miniature mechanical and electronics capabilities with proprietary technology including ultra low power (ULP) wireless and digital signal processing (DSP) capabilities that enhances the performance of body-worn devices.

Medical

In the medical market, the Company is focused on sales of multiple bio-telemetry devices from life-critical diagnostic monitoring devices to drug-delivery systems. Using our nanoDSP and ULP nanoLink technology, the Company manufactures microelectronics, micro-mechanical assemblies, high-precision injection-molded plastic components and complete bio-telemetry devices for emerging and leading medical device manufacturers. Targeted customers include medical product manufacturers of portable and lightweight battery powered devices, as well as a variety of sensors designed to connect a patient to an electronic device.

The medical industry is faced with pressures to reduce the costs of healthcare. IntriCon currently serves this market by offering medical manufacturers the capabilities to design, develop and manufacture components for medical devices that are easier to use, more miniature, use less power, and lighter. These devices measure with greater accuracy and provide more functions while reducing the costs to manufacture these devices. IntriCon manufactures and supplies bubble sensors and flow restrictors that monitor and control the flow of fluid in an intravenous infusion system. IntriCon also manufactures 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. Other examples include sensors used to detect pathologies in specific organs of the body and monitoring devices to detect cardiac, respiratory functions, and blood glucose levels. The early and accurate detection of pathologies allows for increased likelihood for successful treatment of chronic diseases and cancers. Accurate monitoring of multiple functions of the body, such as heart rate, breathing and blood glucose levels, aids in generating more accurate diagnosis and treatments for patients.

In addition, there has been an industry-wide trend toward further miniaturization and ambulatory operation enabled by wireless connectivity, which is also referred to as bio-telemetry. Through the further development of our ULP BodyNet family, a series of wirelessly enabled products including our new wireless nanoLink and physioLink families, we believe the bio-telemetry offers a significant future opportunity. Increasingly, the medical industry is looking for wireless, low-power capabilities in their devices. We believe our strategic partnership with Advanced Medical Electronics Corp. (AME) will allow us to develop new bio-telemetry devices that better connect patients and care givers, providing critical information and feedback. Current examples of IntriCon bio-telemetry products used by medical device manufacturers include components found in wireless glucose sensor pumps that introduce drugs into the bloodstream. In 2009, we also entered the cardiac diagnostic monitoring (CDM) market with our acquisition of Datrix, a supplier of patient monitoring devices. We are leveraging Datrix's cardiac monitoring capabilities and incorporating IntriCon's core competencies to develop and launch a new line of CDM devices, including a wireless CDM device that we call Centauri (formerly referred to as MPETS), which we anticipate will be available for sale later in 2010.

Table of Contents

Hearing Health

IntriCon manufactures hybrid amplifiers and integrated circuit components (hybrid amplifiers), along with faceplates for in-the-ear and in-the-canal hearing instruments. IntriCon is a leading manufacturer and supplier of microminiature electromechanical components to hearing instrument manufacturers. These components consist of volume controls, microphones, receivers, trimmer potentiometers and switches. Components are offered in a variety of sizes, colors and capacities in order to accommodate a hearing manufacturer's individualized specifications.

Hearing instruments, which fit behind or in a person's ear to amplify and process sound for a hearing impaired person, generally are composed of four basic parts and several supplemental components for control or fitting purposes. The four basic parts are microphones, amplifier circuits, miniature receivers/speakers and batteries, all of which IntriCon manufactures, with the exception of the battery. IntriCon's hybrid amplifiers are a type of amplifier circuit. Supplemental components include volume controls, trimmer potentiometers, which shape sound frequencies to respond to the particular nature of a person's hearing loss, and switches used to turn the instrument on and off and to go from telephone to normal speech modes. Faceplates and an ear shell, molded to fit the user's ear, often serve as housing for hearing instruments. IntriCon manufactures its components on a short lead-time basis in order to supply just-in-time delivery to its customers and, consequently, order backlog amounts are not meaningful.

Using our ULP BodyNet family technology, specifically nanoDSP and our new wireless nanoLink and physioLink technologies, IntriCon is building a new generation of affordable, high-quality hearing aids and similar amplifier devices under contracts for OEM's. DSP devices have better clarity, attractive pricing points and an improved ability to filter out background noise. During 2009, we introduced our Scenic DSP amplifier with acoustic scene analysis, our new high-performance adaptive DSP hearing instrument amplifier. In our view, Scenic advanced capabilities are ideally suited for the hearing health market. Additionally, in 2010 we introduced the Overtus DSP amplifier. The Overtus DSP amplifier is designed to optimize open in the canal (ITC) type fittings. The amplifier algorithm contains two patented features, an advanced adaptive feedback canceller optimized for open ITC fittings and an acoustic switch eliminating the need for a mechanical switch and allowing for further miniaturization. We believe the introduction of both Scenic and Overtus solidifies our position as a leader of high-performance adaptive DSP hearing instrument amplifiers. Furthermore, we believe our strategic alliance with Dynamic Hearing will allow us to develop new body-worn applications and further expand both our hearing health and professional audio product portfolio.

Overall, we believe the hearing health market holds significant opportunities for the Company. In the United States, Europe and Japan, the 65-year-old-plus age demographic is the fastest growing segment of the population, and many of those individuals could, at some point, benefit from a hearing device that uses IntriCon's proprietary technology.

While it harbors great potential, the hearing health market is experiencing slowness due to macroeconomic conditions. In general, the U.S. market does not provide insurance reimbursement for hearing aid purchases. People can defer their hearing aid purchase. We believe the hearing health market will experience slow, steady growth in 2010. Reimbursement trends in Europe are more favorable, with insurers and the governments covering more devices.

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 focusing on homeland security and emergency response needs. The line includes several communication devices that are extremely portable and perform well in noisy 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. Our May 2007 acquisition of Tibbetts Industries provided the Company access to homeland security agencies in this market. We believe performance in difficult listening environments and wireless operations will continue to improve as these products increasingly include our proprietary nanoDSP, wireless nanoLink and physioLink technologies.

Edgar Filing: INTRICON CORP - Form 10-Q

Table of Contents

In 2010, we plan to introduce a line of situational listening devices (SLD s) intended to help hearing impaired people hear in noisy environments like restaurants and automobiles, and to listen to television and music by direct wireless connection. Such devices are intended to be supplements to their conventional hearing aids, which do not handle those situations well. The SLD s will be based on our ULP wireless nanoLink technology and our physioLink technology, which was recently demonstrated at the annual convention of the American Academy of Audiology. The product line consists of an earpiece, TV transmitter, companion microphone, iPod/iPhone transmitter, and USB transmitter.

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, expect, should, optimi continue 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 Condensed Consolidated Financial Statements such as 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, 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, 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 changes in accounting pronouncements, 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 ability to successfully implement the Company s business and growth strategy;
- § risks arising in connection with the insolvency of our former subsidiary, Selas SAS, and potential liabilities and actions arising in connection therewith;
- § the volume and timing of orders received by the Company;
- § changes in estimated future cash flows;
- § ability to collect on our accounts receivable;
- § foreign currency movements in markets the Company services;
- § changes in the global economy and financial markets;
- § weakening demand for the Company s products due to general economic conditions;
- § changes in the mix of products sold;
- § ability to meet demand;
- § changes in customer requirements;
- § timing and extent of research and development expenses;
- § acceptance of the Company s products;

Edgar Filing: INTRICON CORP - Form 10-Q

- § competitive pricing pressures;
- § pending and potential future litigation;
- § cost and availability of electronic components and commodities for the Company's products;
- § ability to create and market products in a timely manner and develop products that are inexpensive to manufacture;
- § ability to comply with covenants in our debt agreements;
- § ability to repay debt when it comes due;
- § the loss of one or more of our major customers;
- § ability to identify and integrate Datrix and other acquisitions;
- § effects of legislation;
- § effects of foreign operations;
- § foreign currency risks;
- § ability to recruit and retain engineering and technical personnel;

Edgar Filing: INTRICON CORP - Form 10-Q

Table of Contents

§ the costs and risks associated with research and development investments;

§ our ability and the ability of our customers to protect intellectual property;

§ loss of members of our senior management team; and

§ our ability to liquidate the assets marked as discontinued operations

For a description of these and other risks, see "Risk Factors" in Part I, Item 1A: Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and 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.

Results of Operations

Sales, net

Consolidated net sales for the three months ended March 31, were as follows (in thousands):

	2010	2009	Change Dollars	Percent
Consolidated net sales	\$ 14,553	\$ 11,844	\$ 2,709	22.9%

Our net sales are comprised of three main markets: hearing health, medical and professional audio device. Below is a summary of our sales by main markets for the three months ended March 31, 2010 and 2009 (in thousands):

	2010	2009	Change Dollars	Percent
Medical	\$ 6,508	\$ 5,285	\$ 1,223	23.1%
Hearing Health	\$ 5,370	\$ 4,411	\$ 959	21.7%
Professional Audio Communications	\$ 2,675	\$ 2,148	\$ 527	24.5%

For the three months ended March 31, 2010, we experienced an increase of 23 percent in net sales in the medical equipment market as a direct result of increased sales to existing OEM customers. Management believes there is an industry-wide trend toward further miniaturization and ambulatory operation enabled by wireless connectivity, referred to as bio-telemetry, which resulted in further growth in our medical business. We have experienced solid growth in our most advanced biotelemetry device, a continuous wireless glucose monitor, which we manufacture for a major medical OEM. We are also working with our strategic partner, AME, on proprietary biotelemetry technologies that will enable us to develop new devices that connect patients and care givers, providing critical information and feedback. In 2009, we also entered the cardiac diagnostic monitoring (CDM) market, with our acquisition of Datrix, a supplier of patient monitoring devices.

Net sales in our hearing health business for the three months ended March 31, 2010 increased 22 percent from the same period in 2009, primarily due to higher demand from our customers and general pickup in the economy. We believe our longer term prospects in our hearing health business remain strong as we continue to develop advanced technologies, such as our nanoDSP, which will enhance the performance of hearing devices. In addition, we believe the market indicators in the hearing health industry, including the aging world population, suggest long-term industry growth.

Net sales to the professional audio device sector increased 25 percent for the three month period ended March 31, 2010 compared to the same period in 2009, primarily due to higher demand from our customers and general pickup in the economy. We believe our extensive portfolio of communication devices that are portable and perform well in noisy or hazardous environments will provide for future long-term growth in this market. These products are well suited for applications in fire, law enforcement, safety, aviation and military markets.

Table of Contents**Gross profit**

Gross profit, both in dollars and as a percent of sales, for the three months ended March 31, was as follows (in thousands):

	2010		2009		Change	
	Dollars	Percent of Sales	Dollars	Percent of Sales	Dollars	Percent
Gross profit	\$ 3,676	25.3%	\$ 2,176	18.4%	\$ 1,500	68.9%

In 2010, gross profit increased primarily due to higher sales volume and product mix. We have various activities underway to further increase our gross profit, such as transferring our microphone and receiver production from our Maine operation to our lower cost Singapore facility, increasing the percentage of IntriCon proprietary content in the devices we manufacture and working to introduce Six Sigma lean manufacturing methods into key medical device product lines.

Selling, general and administrative expenses

Selling, general and administrative expenses (SG&A) for the three months ended March 31 were as follows (in thousands):

	2010		2009		Change	
	Dollars	Percent of Sales	Dollars	Percent of Sales	Dollars	Percent
Operating expenses:						
Selling	\$ 787	5.4%	\$ 619	5.2%	\$ 168	27.1%
General and Administrative	1,444	9.9	1,378	11.6	66	4.8%
Research and Development	1,119	7.7	881	7.4	238	27.0%

The increased selling expenses for the three months ended March 31, 2010 as compared to the prior year period were driven by increases in royalties and commissions as a result of higher revenues and additional sales expense from the August 2009 acquisition of Datrix. The slight increase in general and administrative expenses was primarily driven by additional operating expenses from the acquisition of Datrix. The increased research and development expenses as compared to the prior year were due to our continued emphasis on investing in research and development projects to develop new products and technology to further enhance our product portfolio.

Interest expense

Net interest expense for the three months ended March 31, 2010 was \$170,000 compared to \$125,000 for the same period in 2009. The increase in interest expense was due primarily to the August 13, 2009 debt financing with The PrivateBank and Trust Company including both higher interest rates and borrowings.

Table of Contents**Equity in earnings (loss) of partnerships**

The equity in (loss) earnings of partnerships for the three months ended March 31, 2010 was (\$12,000) compared to (\$87,000) for the same period in 2009, due to changes in carrying amounts described below.

The Company recorded a \$37,000 decrease in the carrying amount of the HIMPP investment, reflecting amortization of the patents, other intangibles and the Company's portion of the partnership's operating results for both the three months ended March 31, 2010 and 2009, respectively.

The Company recorded a \$25,000 increase and a \$50,000 decrease in the carrying amount of IntriCon Tibbetts Corporation's investment in joint venture, reflecting the Company's portion of the joint venture's operating results for the three months ended March 31, 2010 and 2009, respectively.

Other income, net

Other income, net for the three months ended March 31, 2010, was \$45,000, compared to other income, net of \$57,000 for the same period in 2009.

Income taxes

Income tax expense (benefit) for the three months ended March 31, 2010, was \$11,000, compared to a benefit of (\$50,000) and for the same period in 2009. The expense and (benefit) for the three months ended March 31, 2010 and 2009 were primarily due to foreign operating income (loss).

Liquidity and Capital Resources

As of March 31, 2010, we had approximately \$0.5 million of cash on hand. Sources of our cash for the three months ended March 31, 2010 have been from our operations, 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 (in thousands):

	Three months Ended	
	March 31,	March 31,
	2010	2009
Cash provided by (used in):		
Operating activities	\$ 965	\$ 435
Investing activities	(462)	(159)
Financing activities	(390)	(277)
Effect of exchange rate changes on cash	(7)	(5)
Increase (decrease) in cash and cash equivalents	\$ 106	\$ (6)

Table of Contents

The most significant items that contributed to the \$1.0 million of cash provided by operating activities were changes in operating assets and liabilities of \$0.1 million and improved net income. The change in operating assets and liabilities was primarily due to increases in accounts receivable, partially offset by increases in accrued expenses. The change in accounts receivable was due to higher revenue and the timing of sales and customer payments. The change in accrued expenses was primarily due to more accrued expense for commissions, salary and benefits.

Net cash used by investing of activities consisted of purchases of property, plant and equipment of \$0.5 million.

Net cash used by financing activities of \$0.4 million was comprised primarily of net payments of debt of \$0.6 million.

The Company had the following bank arrangements (in thousands):

	March 31, 2010	December 31, 2009
Total borrowing capacity under existing facilities	\$ 11,713	\$ 12,376
Facility Borrowings:		
Domestic revolving credit facility	3,985	4,450
Domestic term loan	3,075	3,250
Foreign overdraft and letter of credit facility	708	678
Total borrowings and commitments	7,768	8,378
Remaining availability under existing facilities	\$ 3,945	\$ 3,998

To finance a portion of the Datrix acquisition and replace the Company's existing credit facilities with Bank of America, including capital leases, the Company and its domestic subsidiaries entered into a new three year credit facility with The PrivateBank and Trust Company on August 13, 2009. The credit facility provides for:

§ an \$8,000,000 revolving credit facility, with a \$200,000 subfacility 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; and

§ a \$3,500,000 term loan.

Loans under the credit facility are secured by a security interest in substantially all of the assets of the Company and its domestic subsidiaries including a pledge of the stock of its domestic subsidiaries. Loans under the credit facility bear interest at varying rates based on predefined levels of Funded Debt / EBITDA, at the option of the Company, at:

§ the London InterBank Offered Rate (LIBOR) plus 3.00% - 4.00%, or

§ the base rate, which is the higher of (a) the rate publicly announced from time to time by the lender as its prime rate and (b) the Federal Funds Rate plus 0.5%, plus 0.25% - 1.25%.

Weighted average interest on the new domestic asset-based revolving credit facility was 4.41% for the three months ended March 31, 2010 and 4.07% for the year ended December 31, 2009. The outstanding balance of the revolving credit facility was \$3,985,000 and \$4,450,000 at March 31, 2010 and December 31, 2009, respectively. The total remaining availability on the revolving credit facility was approximately \$2,796,000 and \$2,821,000 at March 31, 2010 and December 31, 2009, respectively.

The outstanding principal balance of the term loan is payable in quarterly installments of varying amounts ranging from \$168,750 to \$187,500. Any remaining principal and accrued interest is payable on August 13, 2012. IntriCon is also required to use 100% of the net cash proceeds of certain asset sales (excluding inventory and certain other dispositions), sale of capital securities or issuance of debt to pay down the term loan.

Table of Contents

In March 2010, the Company entered into an amendment with the PrivateBank to waive certain covenant violations at December 31, 2009 and January 31, 2010 and reset certain covenant thresholds defined in the original agreement. The Company was in compliance with all applicable covenants under the credit facility, as amended, as of March 31, 2010.

Upon termination of the Bank of America credit facility, the Company was required to settle the outstanding obligations of \$121,000 for the liability related to its interest rate swap agreement with Bank of America and recognize the corresponding charge of \$121,000 in interest expense in the three month period ended September 30, 2009, which was previously included in other accumulated comprehensive loss. In addition, the Company expensed the remaining deferred financing costs of \$86,000 related to the Bank of America facility, which was also included in interest expense in the three month period ended September 30, 2009.

The prior credit facility provided for:

§ a \$10,000,000 revolving credit facility, with a \$200,000 subfacility for letters of credit. Under the revolving credit facility, the availability of funds depends on a borrowing base composed of stated percentages of our eligible trade receivables and eligible inventory, less a reserve.

§ a \$4,500,000 term loan, which was used to fund the Company's May, 2007 acquisition of Tibbetts Industries, Inc.

Loans under the credit facility were secured by a security interest in substantially all of the assets of the borrowers including a pledge of the stock of the subsidiaries. All of the borrowers were jointly and severally liable for all borrowings under the credit facility.

In June 2008, the Company completed a sale-leaseback of machinery and equipment with Bank of America. The transaction generated proceeds of \$1,098,000, of which \$1,013,000 was used to pay down the domestic term loan. The facility was repaid on August 13, 2009 with proceeds borrowed under the new PrivateBank facility.

In addition to its domestic credit facilities, the Company's wholly-owned subsidiary, IntriCon, PTE LTD., entered into an international senior secured credit agreement with Oversea-Chinese Banking Corporation Ltd. that provides for a \$1.8 million line of credit. Borrowings bear interest at a rate of .75% to 2.5% over the lender's prevailing prime lending rate. Weighted average interest on the international credit facilities was 4.04% for the three months ended March 31, 2010 and the outstanding balance was \$708,000 and \$678,000 at March 31, 2010 and December 31, 2009, respectively. The total remaining availability on the international senior secured credit agreement was approximately \$1,150,000 and \$1,177,000 at March 31, 2010 and December 31, 2009, respectively.

We believe that funds expected to be generated from operations, the available borrowing capacity through our revolving credit loan facilities and the control of capital spending will be sufficient to meet our anticipated cash requirements for operating needs for at least the next 12 months. If, however, we do not generate sufficient cash from operations, or if we incur additional unanticipated liabilities, we may be required to seek additional financing or sell equity or debt on terms which may not be as favorable as we could have otherwise obtained. No assurance can be given that any refinancing, additional borrowing or sale of equity or debt will be possible when needed or that we will be able to negotiate acceptable terms. In addition, our access to capital is affected by prevailing conditions in the financial and equity capital markets, as well as our own financial condition. 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.

Recent Accounting Pronouncements

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements, which amends ASC 820, Fair Value Measurements, by requiring additional disclosures for transfers in and out of levels 1 and 2 and activity in level 3 fair value measurements. Additionally, the amendment clarifies existing disclosure requirements surrounding the level of disaggregation and valuation techniques and inputs. This guidance became effective for us January 1, 2010 and did not have a material impact on our consolidated financial statements.

Table of Contents

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.

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, accounts receivable reserves, inventory valuation, goodwill, long-lived assets, deferred taxes policies and employee benefit obligations. 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 financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Table of Contents

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

For information regarding the Company's exposure to certain market risks, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. There have been no material changes in the Company's market risk exposures which have occurred since December 31, 2009.

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 March 31, 2010 (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).

There were no changes in the Company's internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), during the quarter ended March 31, 2010, 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.

Table of Contents

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

The information contained in note 14 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 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, 2009, which could materially affect the Company's business, financial condition or future results. The risk factors in the Company's Annual Report on Form 10-K have not materially changed. The risks described in our Annual Report on Form 10-K 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.

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

None.

ITEM 3. Defaults upon Senior Securities

None.

ITEM 4. (Removed and Reserved)

ITEM 5. Other Information

None.

Table of Contents

ITEM 6. Exhibits

(a) Exhibits

- 10.1 First Amendment and Waiver dated March 12, 2010 to Loan and Security Agreement dated as of August 13, 2009 by and among IntriCon Corporation, RTI Electronics, Inc., IntriCon Tibbetts Corporation, IntriCon Datrix Corporation and The PrivateBank and Trust Company.
- 31.1 Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of principal executive officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of principal financial officer to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

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: May 17, 2010

By: /s/ Mark S. Gorder
Mark S. Gorder
President and Chief Executive Officer
(principal executive officer)

Date: May 17, 2010

By: /s/ Scott Longval
Scott Longval
Chief Financial Officer and Treasurer
(principal financial officer)

Table of Contents

EXHIBIT INDEX

10.1	First Amendment and Waiver dated March 12, 2010 to Loan and Security Agreement dated as of August 13, 2009 by and among IntriCon Corporation, RTI Electronics, Inc., IntriCon Tibbetts Corporation, IntriCon Datrix Corporation and The PrivateBank and Trust Company.
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of principal executive officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of principal financial officer to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002