

INTRICON CORP
Form 10-Q
May 11, 2009

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, 2009

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)

Registrant's telephone number, including area code **(651) 636-9770**

Edgar Filing: INTRICON CORP - Form 10-Q

N/A

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

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 17, 2009 was 5,350,811 (net of 515,754 treasury shares).

INTRICON CORPORATION

INDEX

	Page Numbers
<u>PART I: FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Condensed Balance Sheets as of March 31, 2009 (Unaudited) and December 31, 2008</u>	3-4
<u>Consolidated Condensed Statements of Operations (Unaudited) for the Three Months Ended March 31, 2009 and 2008</u>	5
<u>Consolidated Condensed Statements of Cash Flows (Unaudited) for the Three Months Ended March 31, 2009 and 2008</u>	6
<u>Notes to Consolidated Condensed Financial Statements (Unaudited)</u>	7-15
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16-24
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	25
<u>Item 4T. Controls and Procedures</u>	25
<u>PART II: OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	26
<u>Item 1A. Risk Factors</u>	26
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	26
<u>Item 3. Defaults Upon Senior Securities</u>	26
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	26
<u>Item 5. Other Information</u>	26
<u>Item 6. Exhibits</u>	27
<u>Signatures</u>	28
<u>Exhibit Index</u>	29

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

INTRICON CORPORATION
Consolidated Condensed Balance Sheets
Assets

	March 31, 2009 (Unaudited)	December 31, 2008
Current assets:		
Cash	\$ 243,798	\$ 249,396
Restricted cash	373,429	385,916
Accounts receivable, less allowance for doubtful accounts of \$284,000 at March 31, 2009 and \$389,000 at December 31, 2008	7,817,340	9,524,743
Inventories	8,841,434	8,852,028
Refundable income tax	41,083	27,645
Note receivable from sale of discontinued operations		225,000
Other current assets	1,258,180	758,193
Total current assets	18,575,264	20,022,921
Machinery and equipment	38,402,125	38,016,681
Less: Accumulated depreciation	30,661,435	30,103,771
Net machinery and equipment	7,740,690	7,912,910
Goodwill	8,266,438	8,266,438
Investment in partnerships	1,299,826	1,386,774
Other assets, net	1,614,794	1,872,774
Total assets	\$ 37,497,012	\$ 39,461,817

(See accompanying notes to the consolidated condensed financial statements)

Table of Contents

INTRICON CORPORATION
Consolidated Condensed Balance Sheets
Liabilities and Shareholders' Equity

	March 31, 2009 (Unaudited)	December 31, 2008
Current liabilities:		
Checks written in excess of cash	\$ 12,548	\$ 95,082
Current maturities of long-term debt	1,574,110	1,503,762
Accounts payable	3,250,054	3,149,671
Income taxes payable	27,297	39,997
Deferred gain	120,478	120,478
Partnership payable	260,000	260,000
Other accrued liabilities	3,593,453	4,251,707
Total current liabilities	8,837,940	9,420,697
Long term debt, less current maturities	5,908,226	6,187,923
Other postretirement benefit obligations	726,353	760,608
Long term partnership payable	760,000	760,000
Dynamic Hearing license agreement payable	350,000	525,000
Deferred income taxes	155,273	155,273
Accrued pension liabilities	548,009	578,388
Deferred gain	731,337	761,456
Total liabilities	18,017,138	19,149,345
Shareholders' equity:		
Common shares, \$1.00 par value per share; 20,000,000 shares authorized; 5,868,573 and 5,858,006 shares issued; 5,352,819 and 5,342,252 shares outstanding at March 31, 2009 and December 31, 2008, respectively.	5,868,573	5,858,006
Additional paid-in capital	14,282,109	14,121,772
Retained earnings	926,044	1,915,334
Accumulated other comprehensive loss	(331,774)	(317,562)
Less: 515,754 common shares held in treasury, at cost	(1,265,078)	(1,265,078)
Total shareholders' equity	19,479,874	20,312,472
Total liabilities and shareholders' equity	\$ 37,497,012	\$ 39,461,817

(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, 2009 (Unaudited)	March 31, 2008 (Unaudited)
Sales, net	\$ 13,330,360	\$ 16,591,380
Cost of sales	10,954,069	12,746,689
Gross margin	2,376,291	3,844,691
Operating expenses:		
Selling expense	779,590	996,226
General and administrative expense	1,581,223	1,652,379
Research and development expense	880,530	787,773
Total operating expenses	3,241,343	3,436,378
Operating (loss) income	(865,052)	408,313
Interest expense	(128,118)	(195,625)
Interest income	3,140	7,260
Equity in (loss) earnings of partnerships	(86,948)	22,156
Other income (expense), net	53,615	(5,458)
(Loss) income before income taxes	(1,023,363)	236,646
Income tax (benefit) expense	(34,073)	86,830
Net (loss) income	\$ (989,290)	\$ 149,816
Earnings (loss) per share:		
Basic and Diluted	\$ (0.19)	\$ 0.03
Average shares outstanding:		
Basic	5,343,033	5,303,083
Diluted	5,343,033	5,589,894

(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,
	2009	2008
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net (loss) income	\$ (989,290)	\$ 149,816
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	616,471	582,520
Stock-based compensation	137,454	128,351
Loss (gain) on disposition of property	1,190	(1,900)
Change in deferred gain	(30,119)	(27,521)
Change in allowance for doubtful accounts	(104,637)	(4,353)
Equity in loss (earnings) of partnerships	86,948	(22,156)
Provision for deferred income taxes		3,000
Changes in operating assets and liabilities:		
Accounts receivable	1,805,311	(1,194,441)
Inventories	1,788	174,131
Other assets	(307,372)	83,045
Accounts payable	100,057	(46,387)
Accrued expenses	(875,559)	(969,581)
Customer advances		(190,062)
Other liabilities	(6,964)	1,211
Net cash provided by (used in) operating activities	435,278	(1,334,327)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(384,238)	(457,546)
Proceeds from sales of property, plant and equipment		1,900
Proceeds from note receivable	225,000	75,000
Net cash used in investing activities	(159,238)	(380,646)
Cash flows from financing activities:		
Proceeds from long-term borrowings	2,600,370	1,953,480
Repayments of long-term borrowings	(2,824,041)	(112,500)
Proceeds from employee stock purchases and exercise of stock options	30,390	98,531
Change in restricted cash	(1,178)	(33,008)
Change in checks written in excess of cash	(82,534)	(214,648)
Net cash (used in) provided by financing activities	(276,993)	1,691,855
Effect of exchange rate changes on cash	(4,645)	35,027
Net (decrease) increase in cash	(5,598)	11,909
Cash, beginning of period	249,396	381,247
Cash, end of period	\$ 243,798	\$ 393,156

(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, 2009 and December 31, 2008, and the consolidated results of its operations for the three months ended March 31, 2009 and 2008. Results of operations for the interim periods are not necessarily indicators of the results of the operations expected for the full year or any other interim period.

Certain prior balances have been reclassified to be consistent with the March 31, 2009 presentation including: \$356,000 of restricted cash previously included in cash on the balance sheet as of March 31, 2008 and \$762,000 of cash previously included in checks written in excess of cash on the balance sheet as of March 31, 2008. The reclassifications did not impact previously reported net income or shareholders' equity.

2. New Accounting Pronouncements

On December 4, 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51 . SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS No. 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this Statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008. Earlier adoption is prohibited. The adoption of SFAS No. 160 did not have a material effect on our results of operations or financial position.

On December 4, 2007, the FASB issued SFAS No. 141 (Revised 2007), Business Combinations . SFAS No. 141(R) will significantly change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141R will change the accounting treatment for certain specific items, including:

- § Acquisition costs will be generally expensed as incurred;
- § Noncontrolling interests (formerly known as minority interests) will be valued at fair value at the acquisition date;
- § Acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies;
- § In-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date;
- § Restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and
- § Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense.

Table of Contents

SFAS No. 141(R) also includes a substantial number of new disclosure requirements. The statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning after December 15, 2008. Earlier adoption is prohibited. This standard will change our accounting treatment for business combinations on a prospective basis and was adopted by the Company in the first quarter of 2009.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles (GAAP) for nongovernmental entities. Prior to the issuance of SFAS No. 162, GAAP hierarchy was defined in the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards No. 69 (SAS No. 69), The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. SAS No. 69 has been criticized because it is directed to the auditor rather than the entity. SFAS No. 162 addresses these issues by establishing that the GAAP hierarchy should be directed to entities because it is the entity (not its auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the U.S. Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company does not expect SFAS 162 to have a material effect on our results of operations or financial position.

3. 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, 2009:

	Three months ended March 31, 2009
Beginning balance (December 31, 2008)	\$ 100,200
Warranty expense	31,000
Closed warranty claims	(41,500)
Ending balance (March 31, 2009)	\$ 89,700

4. Segment and Geographic Information

In accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, and based on the nature of our products and technology, the Company currently operates in two reportable segments: body-worn devices and electronic products. Previously, these were combined in the Company's miniature medical and electronics products segment. The Company determined in 2008 that these segments no longer meet the criteria for aggregation. The nature of the products and services has been deemed separately identifiable, as the Company has further developed technologies and products included in the body-worn device segment. This includes products and technologies developed both internally and externally with our strategic partners like Advanced Medical Electronics Corp. (AME) and Dynamic Hearing Pty Ltd. (Dynamic Hearing). Furthermore, as the underlying products and technology has changed, the economic characteristics of each business segment are not similar. Our electronics products segment margin is subject to more variability due to component material pricing and we believe our future revenue growth and margin will be different for each segment as a result of the proprietary technology included in our body-worn device products. Therefore, segment reporting has been retroactively applied to all periods presented.

Income (loss) from operations is total revenues less cost of sales and operating expenses. Identifiable assets by industry segment include both assets directly identifiable with those operations. General corporate assets consist primarily of cash and cash equivalents, and are included in the body-worn device segment. The accounting policies applied to determine segment information are the same as those described in the summary of significant accounting policies. The Company evaluates the performance of each segment based on income and loss from operations before income taxes. The following table summarizes data by industry segment:

Table of Contents

	Body Worn Devices	Electronic Products	TOTAL
At and for the three months ended March 31, 2009			
Revenues, net	\$ 11,844,000	\$ 1,486,000	\$ 13,330,000
Loss from operations	(702,000)	(163,000)	(865,000)
Total assets	34,474,000	3,023,000	37,497,000
Depreciation and amortization	536,000	80,000	616,000
Capital expenditures	369,000	15,000	384,000
At and for the three months ended March 31, 2008			
Revenues	\$ 14,606,000	\$ 1,985,000	\$ 16,591,000
Income from operations	460,000	(52,000)	408,000
Total assets	36,295,000	3,437,000	39,732,000
Depreciation and amortization	498,000	85,000	583,000
Capital expenditures	451,000	7,000	458,000

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

	March 31, 2009	December 31, 2008
United States	\$ 6,367,505	\$ 6,488,285
Other	1,373,185	1,424,625
Consolidated	\$ 7,740,690	\$ 7,912,910

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 sales exceeds the carrying value of the assets.

The geographical distribution of net sales to geographical areas for the three months ended March 31, 2009 and 2008 were as follows:

Net Sales to Geographical Areas:	Three months ended	
	March 31, 2009	March 31, 2008
United States	\$ 9,316,124	\$ 11,866,581
Germany	581,849	988,950
China	566,869	811,882
Switzerland	526,666	384,685
Japan	424,175	187,185
France	422,988	386,812
Singapore	319,204	162,399
United Kingdom	192,631	182,006
Vietnam	164,603	110,276
Hong Kong	159,715	80,259
All other countries	655,536	1,430,345
Consolidated	\$ 13,330,360	\$ 16,591,380

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.

Table of Contents

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. For the three months ended March 31, 2008, one customer accounted for 11 percent of the Company's consolidated net sales.

At March 31, 2009, three customers accounted for 12 percent, 11 percent and 10 percent of the Company's consolidated accounts receivable, respectively. At December 31, 2008, two customers accounted for 11 percent and 10 percent of the Company's consolidated accounts receivable, respectively.

5. Inventories

Inventories consisted of the following at:

	Raw materials	Work-in process	Finished products and components	Total
March 31, 2009				
Domestic	\$ 3,824,001	\$ 1,383,549	\$ 1,327,635	\$ 6,535,185
Foreign	1,608,487	359,811	337,951	2,306,249
Total	\$ 5,432,488	\$ 1,743,360	\$ 1,665,586	\$ 8,841,434
December 31, 2008				
Domestic	\$ 3,709,213	\$ 1,644,408	\$ 1,281,771	\$ 6,635,392
Foreign	1,609,392	326,874	280,370	2,216,636
Total	\$ 5,318,605	\$ 1,971,282	\$ 1,562,141	\$ 8,852,028

6. Short and Long Term Debt

Short and long term debt is summarized as follows:

	March 31, 2009	December 31, 2008
Domestic Asset-Based Revolving Credit Facility	\$ 3,000,000	\$ 3,000,000
Foreign Overdraft and Letter of Credit Facility	587,500	605,423
Domestic Term Loan	2,615,625	2,756,250
Domestic Capital Equipment Leases	1,279,211	1,330,012
Total Debt	7,482,336	7,691,685
Less: Current maturities	(1,574,110)	(1,503,762)
Total Long Term Debt	\$ 5,908,226	\$ 6,187,923

The Company and its subsidiaries, IntriCon, Inc. (formerly known as Resistance Technology, Inc.), RTI Electronics, Inc. and IntriCon Tibbetts Corporation, referred to as the borrowers, entered into a credit facility with LaSalle Bank, National Association (now Bank of America), referred to as the lender, on May 22, 2007. The credit facility provides 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 Tibbetts acquisition.

Loans under the credit facility are 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 are jointly and severally liable for all borrowings under the credit facility.

As of March 31, 2009, the Company was in compliance with all financial covenants under the credit facility, as amended.

Edgar Filing: INTRICON CORP - Form 10-Q

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 capital lease agreement expires in June 2014, requires monthly payments of \$15,800 and had a present value of future minimum lease payments of \$1,098,000 with an effective interest rate of 5.14% at inception.

Table of Contents

The Company also has entered into several other capital lease agreements to fund the acquisition of machinery and equipment. The total principal amount of all capital leases (including the sale-leaseback described above) was \$1,661,000 with effective interest rates ranging from 5.1% to 8.0%. These agreements range from 3 to 6 years. The outstanding balance under these capital lease agreements at March 31, 2009 and December 31, 2008 was \$1,279,000 and \$1,330,000, respectively. The accumulated amortization on leased equipment was \$325,000 and \$257,000 at March 31, 2009 and December 31, 2008, respectively. The amortization of capital leases is included in depreciation expense for 2009 and 2008.

7. Income Taxes

Income tax benefit for the three months ended March 31, 2009 was \$34,073 compared to expense of \$86,830 for the same period in 2008. The benefit for the three months ended March 31, 2009 was primarily due to benefits on foreign operating losses. The expense for 2008 was primarily due to foreign taxes on German and Singapore operations. The Company is in a net operating loss position 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 (loss) income before income taxes for each jurisdiction that the Company has operations for the three months ended March 31, 2009 and 2008:

	Three months ended	
	March 31, 2009	March 31, 2008
United States	\$ (762,878)	\$ (14,678)
Singapore	(220,393)	145,845
Germany	(40,092)	105,479
(Loss) income before income taxes	\$ (1,023,363)	\$ 236,646

8. Stockholders Equity and Stock-based Compensation

The Company applies the provisions of SFAS No. 123R *Share-Based Payment*, which establishes the accounting for stock-based awards.

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, 2009. 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.

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, 2009. 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.

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 827 and 237 shares issued in lieu of cash for director fees under the director program for the three months ended March 31, 2009 and 2008, respectively.

Table of Contents

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, 2009 and 2008, respectively.

Stock option activity as of and during the three months ended March 31, 2009 was as follows:

	Number of Shares	Weighted- average Exercise Price	Aggregate Intrinsic Value
Outstanding at December 31, 2008	981,650	\$ 5.93	\$
Options forfeited	(7,000)	11.39	
Options granted	16,000	4.00	
Options exercised			
Outstanding at March 31, 2009	990,650	\$ 5.86	\$
Exercisable at March 31, 2009	654,350	\$ 4.37	\$
Available for future grant at December 31, 2008	261,894		
Available for future grant at March 31, 2009	252,067		

The number of shares available for future grant at March 31, 2009 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, 2009, which will become available for grant under the 2006 Equity Incentive Plan in the event of the expiration of such options.

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 Company calculates expected volatility for stock options and awards using both historical volatility as well as the average volatility of our peer competitors. Historical volatility is not strictly used due to the material changes in the Company's operations as a result of the sales of business segments that occurred in 2004 and 2005 (see Note 2 to the Company's consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008).

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 9,740 shares purchased under the plan for the three months ended March 31, 2009 and a total of 43,953 shares purchased as of 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.

Edgar Filing: INTRICON CORP - Form 10-Q

The weighted average remaining contractual life of options exercisable at March 31, 2009 was 5.5 years.

12

Table of Contents

The Company recorded \$137,454 and \$128,351 of non-cash stock option expense related to SFAS No. 123(R) for the three months ended March 31, 2009 and 2008, respectively. As of March 31, 2009, the Company has recorded cumulative non-cash stock option expense related to SFAS No. 123(R) of \$1,157,333. As of March 31, 2009, there was \$835,689 of total unrecognized compensation costs related to non-vested awards that are expected to be recognized over a weighted-average period of 1.9 years.

9. Income Per Share

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

	Three months ended	
	March 31, 2009	March 31, 2008
Numerator:		
Net (loss) income	\$ (989,290)	\$ 149,816
Denominator:		
Basic weighted shares outstanding	5,343,033	5,303,083
Weighted shares assumed upon exercise of stock options		286,811
Diluted weighted shares outstanding	5,343,033	5,589,894
Basic and diluted (loss) earnings per share	\$ (0.19)	\$ 0.03

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.

Excluded from the computation of diluted earnings per share for the three months ended March 31, 2009 and 2008, were options to purchase approximately 990,650 and 218,500 common shares, respectively, with an average exercise price of \$5.86 and \$13.27, respectively, because the effect would have been anti-dilutive.

10. Derivative Financial Instruments

Derivative financial instruments are used by the Company in the management of its interest rate and foreign currency exposure. 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 would be 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. During the three months ended March 31, 2009 and 2008, approximately \$16,000 and \$1,000, respectively, of said adjustments were recorded to interest expense. During the three months ended March 31, 2009 and 2008, ineffectiveness from such hedges was \$0.

At March 31, 2009 and December 31, 2008, 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. The derivative net loss on this contract recorded in accumulated other comprehensive loss at March 31, 2009 and December 31, 2008 was \$123,992 and \$136,248, respectively. The accumulated other comprehensive loss at March 31, 2009 is expected to be reclassified into earnings over the next 18 months, the life of the agreement.

Table of Contents**11. Comprehensive Income**

The components of comprehensive income, as required to be reported by SFAS No. 130, Reporting Comprehensive Income, were as follows:

	Three months ended	
	March 31, 2009	March 31, 2008
Net (loss) income	\$ (989,290)	\$ 149,816
Change in fair value of interest rate swap	12,256	(58,524)
(Loss) gain on foreign currency translation adjustment	(26,468)	31,797
Comprehensive income	\$ (1,003,502)	\$ 123,089

12. Legal Proceedings

We are a defendant along with a number of other parties in approximately 122 lawsuits as of December 31, 2008 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.

13. 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 \$119,000 and \$120,000 for each of the three months ended March 31, 2009 and 2008, 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, 2009 and 2008, the Company paid that firm approximately \$20,000 and \$43,000, 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.

Table of Contents**14. Statements of Cash Flows**

The following table provides supplemental disclosures of cash flow information:

	Three months ended	
	March 31, 2009	March 31, 2008
Interest received	\$ 439	\$ 11,525
Interest paid	79,921	159,423
Income taxes paid	75,784	64,506

15. Investment in Equity Instruments

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 both the three months ended March 31, 2009 and 2008, 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 \$50,000 decrease and a \$59,000 increase 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, 2009 and 2008, respectively.

16. Revenue by Segment

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

	Three Months Ended	
	March 31, 2009	March 31, 2008
<u>Body-Worn Device Segment</u>		
Hearing Health	\$ 4,411,000	\$ 6,456,000
Medical	5,285,000	4,908,000
Professional Audio Communications	2,148,000	3,242,000
<u>Electronic Products Segment</u>		
Electronics	1,486,000	1,985,000
Total Revenue	\$ 13,330,000	\$ 16,591,000

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, we, us or our) is an international firm engaged in designing, developing, engineering and manufacturing body-worn devices and electronic products. Currently, the Company has two operating segments: its body worn device segment and electronics products segment. The Company serves the body-worn device market by designing, developing, engineering and manufacturing micro-miniature injection-molded plastics, microelectronics, micro-mechanical assemblies and complete assemblies, primarily for bio-telemetry devices, medical equipment, hearing instruments, electronics, professional audio and telecommunications devices and computers. In addition to its operations in Minnesota, the Company has facilities in California, Maine, Singapore, and Germany.

Currently, the Company has two operating segments: its body worn device segment and electronics products segment. Prior to 2008, the Company's body-worn device and electronics products segments were combined in the Company's precision miniature medical and electronics products segment. The Company determined these segments no longer meet the criteria for aggregation. The nature of the products and services has been deemed separately identifiable, as the Company has further developed technologies and products included in the body-worn device segment. Furthermore, as the underlying products and technology have changed, the economic characteristics of each business segment are not expected to be similar. Our electronics products segment margin is subject to more variability due to material pricing and we believe our future revenue growth and margin will be different for each segment as a result of the proprietary technology included in our body-worn device products.

Body-Worn Device Segment

Medical

In the medical market, the Company is focused on sales of multiple biotelemetry devices from life-critical diagnostic monitoring devices to drug-delivery systems. Using our nanoDSP and ultra-low power (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, 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 original equipment manufacturer (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 family, 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 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 biotelemetry products used by medical device manufacturers include components found in wireless glucose sensor pumps that introduce drugs into the bloodstream.

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.

Table of Contents

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 product family, IntriCon is building a new generation of affordable, high-quality hearing aids and similar amplifier devices under contracts for OEM's. Digital signal processing (DSP) devices have better clarity, attractive pricing points and an improved ability to filter out background noise. During 2008, we introduced Ethos, our new high-performance adaptive DSP hearing instrument amplifier. In our view, Ethos advanced capabilities are ideally suited for the hearing health market. We believe the introduction of Ethos 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 softness in the market will continue into 2009. 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 Tibbett's 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 ULP nanoLink technology.

Electronics Products Segment

Our electronic products segment business is conducted by RTI Electronics, Inc. (RTIE), a wholly owned subsidiary of the Company. RTIE manufactures and sells thermistors and thermistor assemblies, which are solid state devices that produce precise changes in electrical resistance as a function of any change in absolute body temperature. RTIE sells through its Surge-Gard product line, an inrush current limiting device used primarily in computer power supplies. The balance of sales represents various industrial, commercial and military sales for other thermistor, film capacitor and magnetic products to domestic and international markets.

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, optimize, 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.

Edgar Filing: INTRICON CORP - Form 10-Q

Table of Contents

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 precision miniature medical and electronic products 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;
- § 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 repay debt when it comes due;
- § the loss of one or more of our major customers;
- § ability to identify and integrate acquisitions;
- § effects of legislation;
- § effects of foreign operations;
- § foreign currency risks;
- § 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; and
- § loss of members of our senior management team.

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, 2008 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):

	2009	2008	Change	
			Dollars	Percent
Body-Worn Devices	\$ 11,844	\$ 14,606	(\$ 2,762)	(18.9%)

Edgar Filing: INTRICON CORP - Form 10-Q

Electronic Products

18

\$ 1,486 \$ 1,985 (\$ 499) (25.1%)

Edgar Filing: INTRICON CORP - Form 10-Q

Table of Contents

Our net sales are comprised of four main markets: hearing health, medical, professional audio device and electronics. Sales, net broken down by market for the three months ended March 31, 2009 was as follows: medical 40%, hearing health 33%, professional audio communications 16% and electronics 11%. Sales, net for the three months ended March 31, 2009 were down 20 percent over the same prior year period, as a result of the fluctuations described below.

For the three months ended March 31, 2009, we experienced an increase of 8 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.

Net sales in our hearing health business for the three months ended March 31, 2009 decreased 32 percent from the same period in 2008, primarily due to lower demand from our customers in this market as people delayed hearing aid purchases, compounded by the fact that the first quarter of our fiscal year is typically the weakest. We believe the softness in the market will continue through the first half of 2009, with customers cautiously beginning to replenish inventory levels and reengaging projects during the second half of the year. Despite the anticipated short-term softness, 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 declined 34 percent for the three month period ended March 31, 2009 compared to the same period in 2008, impacted by various customers in this market cautiously working through their inventories and delaying projects due to current economic uncertainties and lower demand for their products. In spite of this decline, 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.

Electronics net sales for the three months ended March 31, 2009 decreased 25 percent from 2008 primarily due to lower demand from our customers in this market. Management has made efforts to reduce this segment cost structure.

Gross margin

Gross margin for the three months ended March 31, was as follows (in thousands):

	2009		2008		Change	
	Dollars	Percent of Sales	Dollars	Percent of Sales	Dollars	Percent
Body-Worn Devices	\$ 2,176	18.4%	\$ 3,489	23.9%	(\$ 1,313)	(37.6%)
Electronic Products	\$ 200	13.5%	\$ 356	17.9%	(\$ 156)	(43.8%)

Gross margin as a percentage of sales decreased for the three months ended March 31, 2009 compared to the prior year period for both operating segments. The declines in gross margin primarily resulted from the lower revenue levels described above combined with lower-margin product mix, partially offset by the increased margin from our higher medical sales. We have various activities underway to increase efficiency and improve our gross margin, such as introducing Six Sigma lean manufacturing methods across various medical and hearing health product lines, conservatively managing our business and reducing expenses, and increasing the percentage of IntriCon proprietary content in the devices we manufacture.

Selling, general and administrative expenses

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

Table of Contents

	2009		2008		Change	
	Dollars	Percent of Segment Sales	Dollars	Percent of Segment Sales	Dollars	Percent
Body-Worn Devices:						
Selling	\$ 619	5.2%	\$ 817	5.6%	(\$ 198)	(24.2%)
General and Administrative	1,378	11.6	1,423	9.7	(55)	(3.9%)
Research and Development	881	7.4	788	5.4	93	11.8%
Electronics Products:						
Selling	\$ 161	10.8%	\$ 179	9.0%	(\$ 18)	(10.1%)
General and Administrative	203	13.7	229	11.5	(26)	(11.4%)
Research and Development						

The decreased body-worn device selling expenses for the three months ended March 31, 2009 as compared to the prior year period were driven by decreases in royalties and commissions as a result of lower revenues, lower salary and benefit expenses from lower headcount levels and decreased bad debt expense. The decrease in body-worn device general and administrative expenses were driven by cost control measures taken by the Company in conjunction with the revenue decreases including lower salary and benefit expenses from reduced headcount levels, partially offset by increases in professional and legal fees compared to the prior year. The increased body-worn device 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, including expenses recognized from our partnership with Dynamic Hearing.

Electronics products SG&A expenses decreased for the three months ended March 31, 2009 as compared to the prior year as a result of management's efforts to reduce this segment cost structure in the face of declining revenues.

Net interest expense

Net interest expense for the three months ended March 31, 2009 was \$125,000 compared to \$188,000 for the same period in 2008. The decrease in net interest expense was due primarily to lower interest rates in effect on lower principal levels of outstanding debt in 2009.

Equity in earnings of partnerships

The equity in earnings of partnerships for the three months ended March 31, 2009 was (\$87,000) compared to \$22,000 for the same period in 2008.

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, 2009 and 2008, respectively.

The Company recorded a \$50,000 decrease and a \$59,000 increase 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, 2009 and 2008, respectively.

Other income (expense), net

Other income (expense), net for the three months ended March 31, 2009, was \$54,000 compared to other income (expense), net of (\$5,000) for the same period in 2008. The change in other income (expense), net primarily related to the changes in foreign currency exchange rates.

Income taxes

Income tax benefit for the three months ended March 31, 2009, was (\$34,000) compared to expense of \$87,000 and for the same period in 2008. The benefit recognized in 2009 was primarily due operating losses incurred on both domestic and foreign operations.

Edgar Filing: INTRICON CORP - Form 10-Q

Table of Contents

Liquidity and Capital Resources

As of March 31, 2009, we had approximately \$0.3 million of cash on hand. Sources of our cash for the three months ended March 31, 2009 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,
	2009	2008
Cash provided (used) by:		
Operating activities	\$ 435	\$ (1,334)
Investing activities	(159)	(381)
Financing activities	(277)	1,692
Effect of exchange rate changes on cash	(5)	35
Increase (decrease) in cash and cash equivalents	\$ (6)	\$ 12

The most significant items that contributed to the \$0.4 million of cash provided by operating activities were changes in operating assets and liabilities of \$0.7 million, depreciation of \$0.6 million and net loss of \$(1.0) million. The change in operating assets and liabilities was primarily due to decreases in accounts receivable, partially offset by decreases in accrued expenses. The change in accounts receivable is due to lower revenue and the timing of sales and customer payments. The change in accrued expenses is primarily due to less accrued expense for salary and benefits.

Net cash used by investing of activities consisted of purchases of property, plant and equipment of \$0.4 million, partially offset by \$0.2 million of cash received from notes receivable.

Net cash used by financing activities of \$0.3 million was comprised primarily of net payments of debt of \$0.2 million.

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

	March 31,	December 31,
	2009	2008
Total borrowing capacity under existing facilities	\$ 12,268	\$ 13,243
Facility Borrowings:		
Domestic revolving credit facility	3,000	3,000
Domestic term loan	2,616	2,756
Foreign overdraft and letter of credit facility	588	605
Domestic capital equipment leases	1,279	1,330
Total borrowings and commitments	7,482	7,691
Remaining availability under existing facilities	\$ 4,786	\$ 5,552

The Company and its subsidiaries, IntriCon, Inc., RTI Electronics, Inc. and IntriCon Tibbetts Corporation, referred to as the borrowers, entered into a credit facility with LaSalle Bank, National Association (now Bank of America), referred to as the lender, on May 22, 2007. The credit facility provides 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 Tibbetts acquisition.

Loans under the credit facility are 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 are jointly and severally liable for all borrowings under the new credit facility.

Edgar Filing: INTRICON CORP - Form 10-Q

Table of Contents

Loans under the credit facility bear interest, at the option of the Company, at:

the London InterBank Offered Rate (LIBOR) plus 1.90%, in the case of revolving line of credit loans, or LIBOR plus 2.15%, in the case of the term loan, 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%.

Interest is payable monthly in arrears, except that interest on LIBOR based loans is payable at the end of the one, two or three month interest periods applicable to LIBOR based loans, or every three months in the case of LIBOR based loans with a six month interest period.

Weighted average interest on the domestic asset-based revolving credit facilities was 3.72% and 6.55% for the three months ended March 31, 2009 and 2008, respectively.

The credit facility will expire and all outstanding loans will become due and payable on June 30, 2012. The term loan requires quarterly principal payments, commencing on September 30, 2007, based on an increasing installment schedule, with any balance due on June 30, 2012. The principal balance of the term loan was \$2,615,625 and \$2,756,250 at March 31, 2009 and December 31, 2008, respectively. In 2008, we used proceeds of \$1,013,000 from the equipment sale-leaseback described below to pay down the term loan.

The outstanding balance of the revolving credit facility was \$3,000,000 at March 31, 2009 and December 31, 2008, respectively. The total remaining availability on the revolving credit facility was approximately \$3,662,000 and \$4,349,000 at March 31, 2009 and December 31, 2008, respectively.

The revolving facility carries a non-use fee equal to 0.25% per year of the unused portion of the revolving line of credit facility, payable quarterly in arrears.

The Company is subject to various covenants under the credit facility, including financial covenants relating to tangible net worth, funded debt to earnings before interest, taxes, depreciation and amortization, fixed charge coverage ratio and capital expenditures. Under the credit facility, except as otherwise permitted, the borrowers may not, among other things, incur or permit to exist any indebtedness; grant or permit to exist any liens or security interests on their assets or pledge the stock of any subsidiary; make investments; be a party to any merger or consolidation, or purchase of all or substantially all of the assets or equity of any other entity; sell, transfer, convey or lease all or any substantial part of its assets or capital securities; sell or assign, with or without recourse, any receivables; issue any capital securities; make any distribution or dividend (other than stock dividends), whether in cash or otherwise, to any of its equityholders; purchase or redeem any of its equity interests or any warrants, options or other rights in respect thereof; enter into any transaction with any of its affiliates or with any director, officer or employee of any borrower; be a party to any unconditional purchase obligations; cancel any claim or debt owing to it; enter into any agreement inconsistent with the provisions of the credit facility or other agreements and documents entered into in connection with the credit facility; engage in any line of business other than the businesses engaged in on the date of the credit facility and businesses reasonably related thereto; or permit its charter, bylaws or other organizational documents to be amended or modified in any way which could reasonably be expected to materially adversely affect the interests of the lender. Effective as of September 30, 2007, the credit facility was amended to change the tangible net worth covenant. Effective as of June 30, 2008, the credit facility was amended to correct an error in the amortization table set forth in the loan agreement. Effective as of December 31, 2008, the credit facility was amended to change the fixed charge coverage covenant to exclude payments made in connection with the June 2008 sale leaseback described below. As of March 31, 2009, the Company was in compliance with all financial covenants under the credit facility, as amended. Based on the results of operations for the past three months, the Company may need to seek waivers or amendments to the financial covenants under the credit facility. While management believes we will be able to comply with covenants, or obtain appropriate waivers and amendments, in the future, no assurance can be given that we will be able to do so.

Upon the occurrence and during the continuance of an event of default (as defined in the credit facility), the lender may, among other things: terminate its commitments to the borrowers (including terminating or suspending its obligation to make loans and advances); declare all outstanding loans, interest and fees to be immediately due and payable; take possession of and sell any pledged assets and other collateral; and exercise any and all rights and remedies available to it under the Uniform Commercial Code or other applicable law. In the event of the insolvency or bankruptcy of any borrower, all commitments of the lender will automatically terminate and all outstanding loans, interest and fees will be immediately due and payable. Events of default include, among other things: failure to pay any amounts when due; material misrepresentation; default in the performance of any covenant, condition or agreement to be performed that is not cured within 20 days after notice from the lender; default in the payment of other indebtedness or other obligation with an outstanding principal balance of more than \$50,000, or of any other term, condition or covenant contained in the agreement under which such obligation is created, the effect of which is to allow the other party to accelerate such payment or to terminate the agreements; the insolvency or bankruptcy of any borrower; the entrance of any judgment against any borrower in excess of \$50,000, which is not fully covered by insurance; the occurrence of a change in control (as defined in the credit facility); certain collateral impairments; and a contribution failure with respect to any employee benefit plan that gives rise

to a lien under ERISA.

Edgar Filing: INTRICON CORP - Form 10-Q

Table of Contents

In June 2006, the Company completed a sale-leaseback of its Vadnais Heights manufacturing facility. The transaction generated proceeds of \$2,650,000, of which \$1,388,000 was used to repay the associated real estate loan and the remainder to pay down our domestic revolver under the Company's prior credit facility. The remaining gain on the sale of \$798,110 is being recognized over the initial 10-year lease term as the renewal options in the lease are not assured and a penalty does not exist if we do not exercise the renewal options.

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 approximately \$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 5.92% and 5.41% for the three months ended March 31, 2009 and 2008, respectively. The outstanding balance was \$588,000 and \$605,000 at March 31, 2009 and December 31, 2008, respectively. The total remaining availability on the international senior secured credit agreement was approximately \$1,123,000 and \$1,203,000 at March 31, 2009 and December 31, 2008, respectively.

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 capital lease agreement expires in June 2014, requires monthly payments of \$15,800 and has a present value of future minimum lease payments of \$1,098,000 with an effective interest rate of 5.14%. The remaining gain on the sale of \$53,705 is being recognized over the initial 6-year lease term.

The Company also has entered into several other capital lease agreements to fund the acquisition of machinery and equipment. The total original principal amount of all capital leases (including the sale-leaseback described above) was \$1,661,000 with effective interest rates ranging from 5.1% to 8.0%. These agreements range from 3 to 6 years. The outstanding balance under these capital lease agreements at March 31, 2009 and December 31, 2008 was \$1,279,000 and \$1,330,000, respectively. The accumulated amortization on leased equipment was \$325,000 and \$257,000 at March 31, 2009 and December 31, 2008, respectively. The amortization of capital leases is included in depreciation expense for the three months ended March 31, 2009 and 2008.

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 its 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

As discussed in note 2 to the Consolidated Condensed Financial Statements, on December 4, 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51. SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS No. 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008. Earlier adoption is prohibited. The adoption of SFAS No. 160 did not have a material effect on our results of operations or financial position.

Table of Contents

On December 4, 2007, the FASB issued SFAS No. 141 (Revised 2007), Business Combinations. SFAS No. 141(R) will significantly change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141R will change the accounting treatment for certain specific items, including:

- § Acquisition costs will be generally expensed as incurred;
- § Noncontrolling interests (formerly known as minority interests) will be valued at fair value at the acquisition date;
- § Acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies;
- § In-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date;
- § Restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and
- § Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense.

SFAS No. 141(R) also includes a substantial number of new disclosure requirements. The statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning after December 15, 2008. Earlier adoption is prohibited. This standard will change our accounting treatment for business combinations on a prospective basis and was adopted by the Company in the first quarter of 2009.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles (GAAP) for nongovernmental entities. Prior to the issuance of SFAS No. 162, GAAP hierarchy was defined in the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards No. 69 (SAS No. 69), The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. SAS No. 69 has been criticized because it is directed to the auditor rather than the entity. SFAS No. 162 addresses these issues by establishing that the GAAP hierarchy should be directed to entities because it is the entity (not its auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the U.S. Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company does not expect SFAS 162 to have a material effect on our results of operations or financial position.

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, 2008.

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, 2008. Other than as described below, there have been no material changes in the Company's market risk exposures which have occurred since December 31, 2008.

ITEM 4T. 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, 2009 (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 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, 2009, 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 12 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, 2008, 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. Submission of Matters to a Vote of Security Holders

None.

ITEM 5. Other Information

None.

Table of Contents

ITEM 6. Exhibits

(a) Exhibits

- 10.1 Annual Incentive Plan for Executives and Key Employees for Fiscal Year 2009 (management contract, compensatory plan or arrangement). Confidential treatment requested for certain portions of this Exhibit, which portions are omitted and filed separately with the SEC.
- 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 11, 2009

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

Date: May 11, 2009

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

Table of Contents

EXHIBIT INDEX

- 10.1 Annual Incentive Plan for Executives and Key Employees for Fiscal Year 2009 (management contract, compensatory plan or arrangement). Confidential treatment requested for certain portions of this Exhibit, which portions are omitted and filed separately with the SEC.
- 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