INTRICON CORP
Form 10-Q
August 14, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013

or

o 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)

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.

x Yes o 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). x Yes o 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 o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

o Yes x No

The number of outstanding shares of the registrant s common stock, $1.00 par value, on July 31, 2013 was 5,701,558.

INTRICON CORPORATION

I N D E X

Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

	June 30, 2013 (Unaudited)	December 31, 2012
Current assets:		
Cash	$ 108	$ 225
Restricted cash	551	563
Accounts receivable, less allowance for doubtful accounts of $106 at June 30, 2013 and $114 at December 31, 2012	6,244	6,877
Inventories	10,139	10,431
Other current assets	1,159	1,424
Current assets of discontinued operations	1,022	1,040
Total current assets	19,223	20,560
Machinery and equipment	33,426	33,577
Less: Accumulated depreciation	28,321	27,578
Net machinery and equipment	5,105	5,999
Goodwill	9,194	9,709
Investment in partnerships	666	773
Other assets, net	997	1,260
Other assets of discontinued operations	314	831
Total assets	$ 35,499	$ 39,132
Current liabilities:		
Checks written in excess of cash	$ 444	$ 637
Current maturities of long-term debt	2,449	2,945
Accounts payable	4,447	4,015
Accrued salaries, wages and commissions	1,614	1,644
Deferred gain	110	110
Other accrued liabilities	2,279	2,143
Liabilities of discontinued operations	235	173
Total current liabilities	11,578	11,667
Long-term debt, less current maturities	7,264	7,222
Other postretirement benefit obligations	582	590
Accrued pension liabilities	499	510
Deferred gain	220	275
Other long-term liabilities	201	146
Total liabilities	20,344	20,410
Commitments and contingencies (note 12)		
Shareholders equity:		
Common stock, $1.00 par value per share; 20,000 shares authorized; 5,702 and 5,687 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	5,702	5,687
Additional paid-in capital	16,104	15,797
Accumulated deficit	(6,274)	(2,360)
Accumulated other comprehensive loss	(377)	(402)
Total shareholders equity	15,155	18,722
Total liabilities and shareholders equity	$ 35,499	$ 39,132

(See accompanying notes to the consolidated condensed financial statements)

3

Table of Contents

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

	Three Months Ended		Six Months Ended	
	June 30, 2013 (Unaudited)	June 30, 2012 (Unaudited)	June 30, 2013 (Unaudited)	June 30, 2012 (Unaudited)
Sales, net	$ 11,479	$ 14,943	$ 25,605	$ 30,296
Cost of sales	9,617	11,174	19,974	22,227
Gross profit	1,862	3,769	5,631	8,069
Operating expenses:				
Sales and marketing	731	754	1,623	1,629
General and administrative	1,367	1,435	2,927	2,889
Research and development	1,249	1,078	2,478	2,161
Restructuring charges (note 3)	199		199	
Total operating expenses	3,546	3,267	7,227	6,679
Operating income (loss)	(1,684)	502	(1,596)	1,390
Interest expense	(154)	(180)	(307)	(359)
Equity in (loss) of partnerships	(77)	(13)	(135)	(37)
Other income (expense)	(7)	(9)	83	(57)
Income (loss) from continuing operations before income taxes and discontinued operations	(1,922)	300	(1,955)	937
Income tax expense	48	57	38	91
Income (loss) before discontinued operations	(1,970)	243	(1,993)	846
Loss from discontinued operations, net of income taxes (note 4)	(1,473)	(325)	(1,921)	(685)
Net income (loss)	$ (3,443)	$ (82)	$ (3,914)	$ 161
Basic income (loss) per share:				
Continuing operations	$ (0.34)	$ 0.04	$ (0.35)	$ 0.15
Discontinued operations	(0.26)	(0.05)	(0.34)	(0.12)
Net income (loss) per share:	$ (0.60)	$ (0.01)	$ (0.69)	$ 0.03
Diluted income (loss) per share:				
Continuing operations	$ (0.34)	$ 0.04	$ (0.35)	$ 0.14
Discontinued operations	(0.26)	(0.05)	(0.34)	(0.11)
Net income (loss) per share:	$ (0.60)	$ (0.01)	$ (0.69)	$ 0.03
Average shares outstanding:				
Basic	5,694	5,670	5,691	5,662
Diluted	5,694	5,670	5,691	5,939

(See accompanying notes to the consolidated condensed financial statements)

Table of Contents

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

	Three Months Ended		Six Months Ended	
	June 30, 2013 (Unaudited)	June 30, 2012 (Unaudited)	June 30, 2013 (Unaudited)	June 30, 2012 (Unaudited)
Net income (loss)	$ (3,443)	$ (82)	$ (3,914)	$ 161
Change in fair value of interest rate swap	12	6	47	5
Gain (loss) on foreign currency translation adjustment	9	(34)	(22)	(20)
Comprehensive income (loss)	$ (3,422)	$ (110)	$ (3,889)	$ 146

(See accompanying notes to the consolidated condensed financial statements)

Table of Contents

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

	Six Months Ended	
	June 30, 2013 (Unaudited)	June 30, 2012 (Unaudited)
Cash flows from operating activities:		
Net income (loss)	$ (3,914)	$ 161
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,254	1,099
Stock-based compensation	265	195
Loss on impairment of long-lived assets and goodwill of discontinued operations	983	
Loss on disposition of property	4	13
Change in deferred gain	(55)	(55)
Change in allowance for doubtful accounts	(8)	(1)
Equity in loss of partnerships	135	37
Changes in operating assets and liabilities:		
Accounts receivable	553	1,220
Inventories	329	(378)
Other assets	474	(829)
Accounts payable	490	(1,599)
Accrued expenses	69	799
Other liabilities	1	128
Net cash provided by operating activities	580	790
Cash flows from investing activities:		
Purchases of property, plant and equipment	(214)	(1,060)
Net cash used in investing activities	(214)	(1,060)
Cash flows from financing activities:		
Proceeds from long-term borrowings	8,899	7,883
Repayments of long-term borrowings	(9,250)	(7,875)
Proceeds from employee stock purchases and exercise of stock options	56	107
Change in restricted cash	7	25
Change in checks written in excess of cash	(193)	253
Net cash (used in) provided by financing activities	(481)	393
Effect of exchange rate changes on cash	(2)	(4)
Net increase (decrease) in cash	(117)	119
Cash, beginning of period	225	119
Cash, end of period	$ 108	$ 238

(See accompanying notes to the consolidated condensed financial statements)

Table of Contents

INTRICON CORPORATION

Notes to Consolidated Condensed Financial Statements (Unaudited) (In Thousands, Except Per Share Data)

1. General

In the opinion of management, the accompanying consolidated condensed financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly IntriCon Corporation's (IntriCon or the Company) consolidated financial position as of June 30, 2013 and December 31, 2012, and the consolidated results of its operations for the three and six months ended June 30, 2013 and 2012. Results of operations for the interim periods are not necessarily indicative of the results of operations expected for the full year or any other interim period.

On June 13, 2013, the Company announced a global restructuring plan to accelerate future growth and reduce costs by approximately $3.0 million annually. As part of the restructuring, the Company is in the process of either selling or disposing of the assets relating to its security, microphone and receiver operations. For all periods presented, the Company classified these businesses as discontinued operations, and, accordingly, has reclassified historical financial data presented herein See Note 4 below.

The Company has evaluated subsequent events occurring after the date of the consolidated financial statements for events requiring recording or disclosure in the financial statements.

2. New Accounting Pronouncements

In February 2013, the FASB expanded the disclosure requirements with respect to changes in accumulated other comprehensive income (AOCI). Under this new guidance, companies will be required to disclose the amount of income (or loss) reclassified out of AOCI to each respective line item on the statements of earnings where net income is presented. The guidance allows companies to elect whether to disclose the reclassification either in the notes to the financial statements or parenthetically on the face of the financial statements. This update is effective for the Company beginning in the fourth quarter of fiscal 2013. Since the accounting guidance only impacts disclosure requirements, its adoption will not have a material impact on the Company s consolidated financial statements.

3. Restructuring Charges

On June 13, 2013 the Company announced a global strategic restructuring plan designed to accelerate the Company s future growth by focusing resources on the highest potential growth areas and reduce costs by approximately $3.0 million annually. As part of this plan, the Company is: reducing investment in certain non-core professional audio communications product lines; aggressively transferring specific product lines from Singapore to the Company s lower-cost manufacturing facility in Batam, Indonesia; reducing global administrative and support workforce; transferring the medical coil operations from the Company's Maine facility to Minnesota to better leverage existing manufacturing capacity, and seeking a buyer for its remaining security, microphone and receiver operations; adding experienced professionals in value hearing health; and focusing more resources in medical biotelemetry. During the three and six months ended June 30, 2013, the Company incurred charges of $199, primarily related to employee termination benefits, from the restructuring of its continuing operations. Additionally, during the second half of 2013, the Company expects to incur approximately $100 to $200 in additional cash charges related to employee termination and moving costs.

4. Discontinued Operations

As part of the global strategic restructuring plan, the Company decided to exit the security, microphone and receiver operations to allow the Company to focus on its core body-worn device segment and to improve the Company s overall margins and profitability. The Company anticipates that it will exit these operations within a one year period and that it will have limited involvement with the operations post disposal. Therefore, under applicable accounting standards, the Company has classified its security, microphone and receivers operations, as discontinued operations for financial reporting purposes in all periods presented.

Table of Contents

Management considered the global strategic restructuring plan a triggering event and therefore, the Company evaluated assets for impairment as of June 13, 2013 and recorded the following costs for the three and six months ended June 30, 2013: (i) a non-cash impairment charge of $515 relating to goodwill and (ii) a non-cash impairment charge of long-lived assets of $468. Additionally, during the second half of 2013, the Company expects to incur approximately $100 to $150 in additional expense and cash charges related to employee termination costs for the discontinued operations.

The following table shows the results of operations of the Company s discontinued operations:

	Three Months Ended		Six Months Ended	
	June 30, 2013 (Unaudited)	June 30, 2012 (Unaudited)	June 30, 2013 (Unaudited)	June 30, 2012 (Unaudited)
Sales, net	$ 611	$ 961	$ 1,155	$ 2,225
Operating costs and expenses	(1,114)	(1,286)	(2,114)	(2,920)
Loss on impairment of long lived assets and goodwill	(983)		(983)	
Operating loss	(1,486)	(325)	(1,942)	(695)
Other expenses, net	13		21	10
Net loss from discontinued operations	$ (1,473)	$ (325)	$ (1,921)	$ (685)

The following table shows the assets and liabilities of the Company s discontinued operations at June 30, 2013 and December 31, 2012:

	June 30, 2013	December 31, 2012
Cash	$ 2	$ 1
Accounts receivable, net	353	294
Inventory, net	647	686
Other current assets	20	59
Current assets of discontinued operations	1,022	1,040
Property and equipment, net	271	785
Other assets	43	46
Other assets of discontinued operations	314	831
Accounts payable	86	31
Accrued compensation and other liabilities	149	142
Current liabilities of discontinued operations	$ 235	$ 173

In determination of the nonrecurring fair value measurements for impairment of goodwill and long-lived assets, the Company utilized the market value approach, considering the fair value of security, microphone and receiver net assets held for sale or disposition. Based on the market value assessment, the Company determined fair values for the identified assets and incurred the impairment charges for the remaining book value of the assets during the three and six months ended June 30, 2013 as set forth in the table below. These charges were reflected in the Company s results from discontinued operations.

Table of Contents

	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 of discontinued operations	$ 271	$	$	$ 271	$ 468
Goodwill of discontinued operations					515

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 six months ended June 30, 2013 and the year ended December 31, 2012:

	June 30, 2013	December 31, 2012
Beginning balance	$ 73	$ 82
Warranty expense	5	42
Closed warranty claims		(51)
Ending balance	$ 78	$ 73

6. Geographic Information

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

	June 30, 2013	December 31, 2012
United States	$ 3,744	$ 4,837
Other primarily Asia	1,390	1,503
Consolidated	$ 5,134	$ 6,340

Long-lived assets consist of property and equipment and certain other assets that 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.

Table of Contents

The geographical distribution of net sales to geographical areas for the three and six months ended June 30, 2013 and 2012 were as follows:

Net Sales to Geographical Areas	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
United States	$ 7,949	$ 10,782	$ 16,930	$ 21,751
Germany	233	397	528	987
China	869	822	2,197	1,336
Switzerland	355	255	788	545
Singapore	5	846	124	1,032
France	389	360	801	737
Japan	399	251	781	658
United Kingdom	142	442	750	1,042
Turkey	66		177	197
Hong Kong	83	153	286	255
Vietnam	240	267	634	563
All other countries	749	368	1,609	1,193
Consolidated	$ 11,479	$ 14,943	$ 25,605	$ 30,296

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. Customer concentrations greater than 10% of consolidated net sales and account receivable are disclosed below.

For the three and six months ended June 30, 2013, two customers accounted for 34% and 37% of the Company s consolidated net sales, respectively. For the three and six months ended June 30, 2012, two customers accounted for a combined 35% and 35% of the Company s consolidated net sales, respectively.

At June 30, 2013, three customers combined accounted for 33% of the Company s consolidated accounts receivable. At December 31, 2012, three customers accounted for a combined 37% of the Company s consolidated accounts receivable.

Table of Contents

7. Inventories

Inventories consisted of the following at:

	Raw materials	Work-in process	Finished products and components	Total
June 30, 2013				
Domestic	$ 3,834	$ 1,240	$ 2,107	$ 7,181
Foreign	2,520	316	122	2,958
Total	$ 6,354	$ 1,556	$ 2,229	$ 10,139
December 31, 2012				
Domestic	$ 3,698	$ 1,379	$ 2,376	$ 7,453
Foreign	2,504	244	230	2,978
Total	$ 6,202	$ 1,623	$ 2,606	$ 10,431

8. Short and Long-Term Debt

Short and long-term debt is summarized as follows:

	June 30, 2013	December 31, 2012
Domestic Asset-Based Revolving Credit Facility	$ 4,955	$ 4,360
Foreign Overdraft and Letter of Credit Facility	1,421	1,795
Domestic Term-Loan	3,250	3,750
Note Payable Datrix Purchase	87	262
Total Debt	9,713	10,167
Less: Current maturities	(2,449)	(2,945)
Total Long-Term Debt	$ 7,264	$ 7,222

Domestic Credit Facilities

The Company and its domestic subsidiaries are parties to a credit facility with The PrivateBank and Trust Company. The credit facility, as amended, provides for:

§ an $8,000 revolving credit facility, with a $200 sub facility for letters of credit. Under the revolving credit facility, the availability of funds depends on a borrowing base composed of stated percentages of the Company s eligible trade receivables and eligible inventory, and eligible equipment less a reserve; and

§ a term loan in the original amount of $4,000.

In December 2012, the Company and its domestic subsidiaries entered into a Fifth Amendment to the Loan and Security Agreement with The PrivateBank and Trust Company. The amendment, among other things:

§ permitted the Company to borrow an additional $1,250 under the term loan by increasing the then current principal balance of the term loan from $2,750 to $4,000, while keeping the existing amortization schedule in place.

Table of Contents

§ increased the inventory cap on the borrowing base from $3,000 to $3,500 and removed eligible equipment from the base. Under the revolving credit facility as amended, the availability of funds depends on a borrowing base composed of stated percentages of the Company s eligible trade receivables and inventory, less a reserve;

§ eliminated the minimum EBITDA covenant and amended certain other financial covenants; and

§ changed the dates when covenant compliance will be tested from monthly to quarterly.

The Company was not in compliance with the fixed charge and leverage covenants under the credit facility as of June 30, 2013 and obtained a covenant waiver from The PrivateBank. The Company expects to seek an extension of the term of this facility or a new credit facility in the second half of 2013. As part of the extension or new credit facility the Company will seek revisions to its existing covenants. However, there is no guarantee that any revisions will be favorable to the Company. Additionally, there can be no assurances that a future covenant violation would not lead The PrivateBank or a new lender to declare an event of default and accelerate our obligations under the credit facility.

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 the Company s leverage ratio 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% depending on the Company s leverage ratio.

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. IntriCon is also required to pay 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.

Weighted average interest on the revolving credit facility was 4.41% for the six months ended June 30, 2013 and 4.52% for the year ended December 31, 2012. The outstanding balance of the revolving credit facility was $4,955 and $4,360 at June 30, 2013 and December 31, 2012, respectively. The total remaining availability on the revolving credit facility was approximately $1,855 and $2,689 at June 30, 2013 and December 31, 2012, respectively. The credit facility expires on August 13, 2014 and all outstanding borrowings will become due and payable.

The outstanding principal balance of the term loan, as amended, is payable in quarterly installments of $250, commencing with the calendar quarter ended December 31, 2012. Any remaining principal and accrued interest is payable on August 13, 2014. 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.

Foreign Credit 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 originally provided for a $1,977 line of credit. The international credit agreement was modified in August 2010 and again in August 2011 to allow for an additional total of $736 in borrowing under the existing base to fund the Singapore facility relocation, Batam facility construction and various other capital needs with varying due dates from 2013 to 2015. 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 3.93% and 3.89% for the six months ended June 30, 2013 and the year ended December 31, 2012. The outstanding balance was $1,421 and $1,795 at June 30, 2013 and December 31, 2012, respectively. The total remaining availability on the international senior secured credit agreement was approximately $647 and $639 at June 30, 2013 and December 31, 2012, respectively.

Table of Contents

Datrix Promissory Note

A portion of the purchase price of the Datrix acquisition was paid by the issuance of a promissory note to the seller in the amount of $1,050 bearing annual interest at 6%. In August 2012, the Company amended the agreement to change the remaining installment of $350 from the original due date of August 13, 2012 to equal monthly principal and interest payments starting in October 1, 2012 over a one year period.

9. Income Taxes

Income tax expense for the three and six months e