Zacks Small-Cap Research

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Integral Technologies, Inc. (ITKG-OTC)

ITKG: Expanding Capacity Ahead of Anticipated Demand to Avert Bottlenecks

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	06/05/2014
Current Price (2/20/15)	$0.64
Six- Month Target Price	**$1.25**

OUTLOOK

Integral Technologies is optimistic about upcoming customer orders and has taken steps to avoid potential bottlenecks as the anticipated ramp-up in customer demand occurs, including expanding production capacity and locking in access to key raw materials. Separately, the company recently reported second quarter fiscal 2015 results that continue to illustrate its potential to generate revenue from licensing, engineering support and sales of ElectriPlast, in our view.

SUMMARY DATA

52-Week High	**$0.79**
52-Week Low	**$0.25**
One-Year Return (%)	**113.3**
Beta	**1.04**
Average Daily Volume (sh)	**109,803**
Shares Outstanding (mil)	**106**
Market Capitalization ($mil)	**$68**
Short Interest Ratio (days)	**2.2**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**13**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2015 Estimate	**N/A**
P/E using 2016 Estimate	**N/A**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Elec-Misc Compn**

ZACKS ESTIMATES

Revenue
(in thousands of $)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2012	0.0 A	0.05 A	0.04 A	0.02 A	0.10 A
2013	0.07A	0.05 A	0.07 A	0.06 A	0.25 A
2014	6.41 A	6.31 A	6.31 A	10.14 A	29.17 A
2015	90.8 A	62.0 A	89.4 E	107.3 E	349.5 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2012	-$0.00 A	-$0.00 A	-$0.00 A	-$0.00 A	-$0.01 A
2013	-$0.00 A	-$0.01 A	-$0.00 A	-$0.01 A	-$0.00 A
2014	-$0.02 A	-$0.01 A	-$0.02 A	-$0.01 A	-$0.05 A
2015	-$0.01 A	-$0.01 A	-$0.01 E	-$0.01 E	-$0.04 E

Zacks Projected EPS Growth Rate - Next 5 Years %	**N/A**
Disclosures begins on page 8	**N/A**

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KEY POINTS

- Integral Technologies recently reported second quarter fiscal 2015 results. Revenue of $62,000 was up more than 9-fold year-over-year. This was the second quarter in a row where Integral generated revenue from licensing, engineering support and sales of ElectriPlast.

- Engineering was the largest revenue driver in the quarter, as it was last quarter. Management believes that many companies will require Integral's engineering expertise on conductive plastic applications and specifically on ElectriPlast.

- Some business affiliations, such as with East Penn and Hanwha, have already produced revenue. Management is optimistic about the potential revenue opportunity with other partners, as well.

- The company has also taken steps to avert potential bottlenecks as the anticipated ramp-up in customer demand occurs, including expanding production capacity and locking in access to key raw materials.

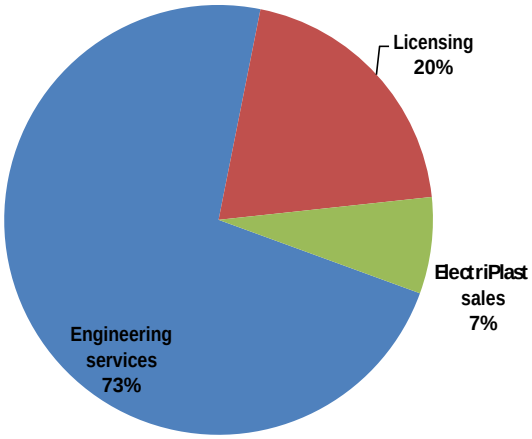
SECOND QUARTER FY 2015 HIGHLIGHTS

Integral Technologies (OTC: ITKG) recently reported second quarter fiscal 2015 results. Revenue of $62,000 was up more than 9-fold compared to $6,250 recorded in the second quarter of fiscal 2014. This was another quarter, we believe, that underscored Integral's potential to generate revenue from licensing, engineering support and sales of ElectriPlast. Revenue in the quarter was driven by all three business lines. Engineering services revenue of $45,000 accounted for 73% of total revenue. The engineering services contribution reflects Integral's recent agreement with East Penn Manufacturing, which operates the largest single-site, lead-acid battery manufacturing facility in the world and, according to management, is a leader in custom wire and cable solutions. Under the terms of the contract, ElectriPlast will provide engineering and design services, materials and finished products to East Penn. The company received a $150,000 payment from East Penn and has recorded 80% of that over the past two quarters. According to Integral, the company and East Penn will discuss their next steps following the completion of the remaining activities outlined in the contract. Separately, Integral's second quarter fiscal 2015 operating loss was ($1,075,913).

Integral also recognized $12,500 of license revenue, as it amortizes the $500,000 payment it received from Hanwha over a 10-year period corresponding to the terms of Hanwha's license. Hanwha has opened a manufacturing line dedicated to ElectriPlast and continues to make progress in Asia, according to management.

Another $4,500 of total revenue came from sales of ElectriPlast. This represented 7% of total revenue. While still fairly minimal, in our view, it represents a 37% sequential improvement from $3,282 of ElectriPlast sales registered in the first quarter of fiscal 2015. We anticipate that revenue streams from all three sources including ElectriPlast sales are likely to ramp substantially over time. However, as we have noted previously, we would also not be surprised to see revenue somewhat lumpy on an interim quarterly basis, as it was in the first half of fiscal 2015.

Integral 2Q FY15 Revenue Breakdown



Source: Company reports

Engineering was the largest revenue driver in the quarter, as noted. Management believes that many companies will require Integral's engineering expertise on conductive plastic applications and on ElectriPlast in order to use ElectriPlast. ElectriPlast is such a new product that others have not developed engineering expertise around it, management believes.

In January 2014, the company opened a Tech Center in Detroit and has also put key engineering personnel in place. For example, in February 2014, Integral added Slobodan Pavlovic to the Detroit Tech Center engineering team. He has extensive industry experience, most recently from Lear Corporation. The company's CTO Mohamad Zeidan was formerly CTO of the Electrical Division for Lear Corporation. Integral's engineering team and the Tech Center can help customers such as East Penn move from the development stage on products incorporating ElectriPlast to design, prototyping and implementation of commercial applications, we believe.

STRONG RELATIONSHIPS WITH KEY PARTNERS

Of the several partnerships the company has announced, East Penn and Hanwha have already produced revenue, as noted above. Management has indicated that the company took steps during the quarter to advance other relationships, as well.

For example, management indicated that it introduced ElectriPlast to an automotive power supply company in Asia, targeting the Hybrid Electric Vehicle (HEV) and Electric Vehicles (EV) automotive niches. The company also announced in October 2014 that Chang Rim, its Asian molding partner, had successfully completed its prototype for a motor casing for the automotive industry.

Consumer adoption of EVs is outpacing those of earlier hybrids, according to IHS. The Toyota Prius had cumulative sales of more than 52,000 cars four years after its 2000 launch. Conversely, four years after the debut of the Nissan Leaf EV, its cumulative sales are approaching the 100,000 mark. Cumulative sales of the Chevrolet Volt/Ampera plug-in hybrid electric vehicle (PHEV) were almost 70,000 four years after its debut.

Earlier in its development, Integral had success with an EV manufacturer but the agreement with Fisker-Karma never produced any meaningful revenue for Integral because Fisker Karma was unable to fund its go-to-market strategy for its electric car. In 2011, Integral forged a deal that seemed as if it could finally **provide proof of concept of ElectriPlast's value** for the automotive sector, specifically the green automotive sector. The company entered into an OEM supplier agreement with Lear Corp. to incorporate ElectriPlast in the manufacture of electrical connectors to be installed on all Fisker Karma electric

vehicles. The Fisker Karma was an electric car that was designed and engineered in California. It was a four-door, four-passenger plug-in hybrid. In 2012, Fisker began to manufacture its first electric cars using ElectriPlast; connectors using ElectriPlast went into production and were used on the Fisker Karma. Subsequently, Fisker Automotive's battery supplier, A123 Systems, declared Chapter 11, forcing Fisker itself to terminate production in July 2012, having generated minimal revenue for Integral. Despite this set-back, as the EV and HEV automotive niches expand, it could create additional opportunities for ElectriPlast, in our view.

Management is optimistic about the potential revenue opportunity with other partners, as well, including BASF and Delphi. On a past quarterly investor call, management noted that Integral has been trialing ElectriPlast applications in the wire and cable niche with Delphi. Management also recently indicated that it anticipates news on further commercialization of ElectriPlast within the next several weeks with one of its partners.

A key partner, in our view, is Delphi. In June 2013, the company entered into a co-development agreement with Delphi Automotive PLC. Delphi Automotive is a leading global supplier of electronics and technologies for automotive, commercial vehicle and other market segments. The two companies intend to jointly develop wire and cable insulation applications using ElectriPlast.

Delphi has a global footprint, with technical centers, manufacturing and customer support facilities in 32 countries. It also has large wire and cable customers. Integral hopes to leverage Delphi’s distribution channels to drive commercial adoption of ElectriPlast in the sector.

The wire and cable industry is roughly a $115 billion industry. Integral’s application is to replace the metal shielding around the cable. The company believes that ElectriPlast has competitive advantages versus the metal that is currently used, including that the manufacturing process is more efficient and that it is lighter weight. The company expects the bulk of cable and wire demand to eventually come from higher voltage cables in transportation and consumer electronics.

Separately, the company also announced that it has developed two new conductive light-weighting materials focusing on the high performance shielding market and applications to use ElectriPlast as a conductor.

EXPANDED PRODUCTION CAPACITY

We believe the company’s optimism about upcoming order flow is reflected in recent steps it has taken to avert a potential supply bottleneck. Earlier this year Integral signed an MOU with Conductive Composites, its nickel plated carbon fiber manufacturer, for Conductive Composites to establish a separate manufacturing line in a new facility dedicated to producing NiC exclusively for ElectriPlast. We view this as another example of Integral setting up access to raw materials and production capacity in order to avoid a potential bottleneck as its anticipated ramp-up in customer demand occurs.

Integral announced that it is expanding its manufacturing agreement with Jasper Rubber to enable Jasper to manufacture ElectriPlast at more than one manufacturing site. The company believes this is necessary to demonstrate to key customers that Integral has sufficient production capacity to support customer demand. The company had completed the start-up of a manufacturing line at a second location which was used to ship ElectriPlast to clients. In addition to assuring adequate supply of ElectriPlast, management also believes this increased production capacity will enhance the efficiency of manufacturing ElectriPlast and lower its overall unitary manufacturing cost.

BALANCE SHEET

The company had $80,552 in cash on its balance sheet as of December 2014. In recent quarters, Integral has taken deleveraging measures and made capital structure improvements**.** For example, on May 1, 2014, Integral repaid a $96,681.70 outstanding convertible promissory note to Asher Enterprises and converted $55,120.00 into 342,035 ITKG shares. Integral also has eliminated convertible notes outstanding to JMJ Financial, as well as all preferred shares outstanding.

Management also expects to raise funds as existing warrants are exercised. This implies no dilution, as the company's fully diluted share count already contemplates the exercise of those warrants. Moreover, management also believes that the warrants are generally in friendly hands and the shares also have a six month restriction following the exercise of the warrants. Outstanding warrants could yield $12.8 million to Integral, according to the company. During the second quarter of fiscal 2015, the company raised $853,547 through the exercise of stock warrant, as well as subscriptions received, debt and some share placements.

RISKS

- The biggest risk, in our view, is that the commercialization strategy for ElectriPlast with existing partners fails to materialize in a meaningful way and Integral needs to seek new affiliations in order to implement its strategy.

- We believe the company faces competitive risk if another company gains traction with a competing technology. For this reason, management has aggressively launched a go-to market strategy to benefit from early mover advantage.

- Market penetration and adoption for ElectriPlast could be slower than the company anticipates or could never materialize.

- The cost of retrofitting manufacturing plants in order to use ElectriPlast as a substitute material could also constrain its adoption.

- Integral is under-capitalized and will likely need to seek additional short-term funding until it reaches a certain revenue level. While the company intends to minimize the impact on its fully diluted share count largely through warrants, Integral could require more funding than management currently anticipates.

PROJECTED INCOME STATEMENT & BALANCE SHEET

Integral Technologies, Inc. Income Statement & Projections

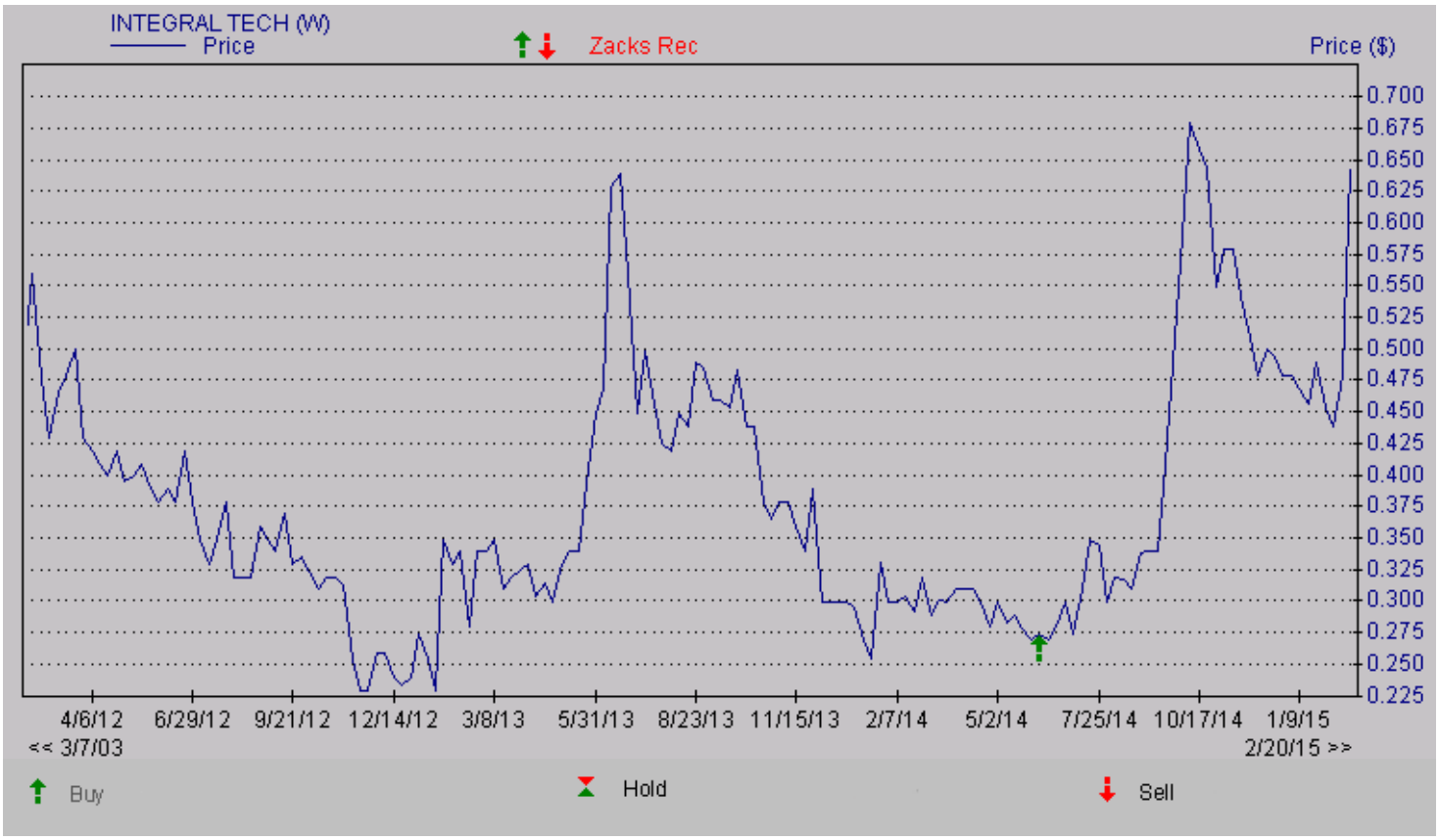
($)	Sep-13	Dec-13	Mar-14	Jun-14		Sep-14	Dec-14	Mar-15	Jun-15	
	1Q14	2Q14	3Q14	4Q14A	FY14A	1Q15A	2Q15A	3Q15E	4Q15E	FY15E
Revenue	6,413	6,309	6,306	10,139	29,167	90,782	62,000	89,426	107,311	349,519
R&D	27,196	16,432	9,616	14,384	67,628	19,349	41,217	15,000	15,000	90,566
S,G&A	1,162,950	819,170	560,353	917,799	3,460,272	909,233	1,096,696	900,000	900,000	3,805,929
Non-recurring	-	-	675,000	-	675,000					-
Other	-	-	-	-	-	-	-	-	-	-
Total operating expense	1,190,146	835,602	1,244,969	932,183	4,202,900	928,582	1,137,913	915,000	915,000	3,896,495
Operating income	**(1,183,733)**	**(829,293)**	**(1,238,663)**	**(922,044)**	**(4,173,733)**	**(837,800)**	**(1,075,913)**	**(825,574)**	**(807,689)**	**(3,546,976)**
Other income net				(49,129)	(49,129)	62	913	(50,000)	(50,000)	(99,025)
Bank charges & interest	62,088	174,688	154,853	10,275	401,904	2,655	35,376	75,000	75,000	188,031
Fair value derivatives	103,842	(93,270)	15,205	(25,777)	-					-
Conv. debentures gain/ chg		(32,432)	-		-					-
Gain/ (loss) debt exting.	(75,429)	27,142	(150,367)		-					-
Financing fees	-	-	-	-	-	-	-	-	-	-
	90,501	76,128	19,691	(64,631)	352,775	2,717	36,289	25,000	25,000	89,006
Net Loss	(1,274,234)	(905,421)	(1,258,354)	(857,413)	(4,526,508)	(840,517)	(1,112,202)	(850,574)	(832,689)	(3,635,982)
Preferred stock dividends	(15,460)	(3,865)	(3,865)	7,730	(15,460)	-	-	-	-	-
Loss for common sharehol	(1,289,694)	(909,286)	(1,262,219)	(849,683)	(4,541,968)	(840,517)	(1,112,202)	(850,574)	(832,689)	(3,635,982)
Loss Per Share	($0.02)	($0.01)	($0.02)	($0.01)	($0.05)	($0.01)	($0.01)	($0.01)	($0.01)	($0.04)
Avg. shares out	77,057,027	77,738,310	81,015,996	83,475,729	85,935,461	99,824,249	104,154,424	104,154,424	104,154,424	104,154,424

Integral Technologies, Inc. Balance Sheet

($)	June 2012	Sept 2012	Dec 2012	March 2013	June 2013	Sept 2013	Dec 2013	March 2014	June 2014	Sept 2014	Dec 2014
Cash	172,173	321,890	284,222	169,064	532,308	309,784	41,878	755,971	199,777	181,196	80,552
Prepaid expense	19,723	111,276	80,928	50,580	20,232	30,227		46,106	23,831	192,732	79,212
Account receivable	-	-	-	-	250,000	-	-	-	-		4,500
Property & equipment	-	-	-	-	-	-	-	-	27,821	35,017	50,572
Other	-	-	-	-	-	-	-	-	-	-	2,500
Total Assets	**$191,896**	**$433,166**	**$365,150**	**$219,644**	**$802,540**	**$340,011**	**$41,878**	**$802,077**	**$251,429**	**$408,945**	**$217,336**
Accounts payable and accruals	2,032,309	2,353,369	2,410,715	1,890,307	2,270,727	1,803,061	1,650,692	943,930	973,220	739,613	776,555
Loan payable				31,708				52,323	60,000		
Notes payable	123,696	79,461	60,529	-	-	53,950	60,000	65,000		110,000	60,000
Deferred revenue	-		67,273		25,000	25,000	25,000	25,000	50,000	125,000	80,000
Loan payable		103,423				20,189					
Convertible debentures	93,356	129,576	48,773	116,207	174,827	108,895	137,030	217,846			44,779
Derivative financial liabilities	84,718	105,610	56,426	107,616	414,102	517,109	300,117	271,957			105,820
Redeemable preferred stock	-	-	120,000	150,000	180,000	210,000	240,000	170,000	-	-	-
Total current liabilities	**$2,334,079**	**$2,771,439**	**$2,763,716**	**$2,295,838**	**$3,064,656**	**$2,738,204**	**$2,412,839**	**$1,746,056**	**$1,083,220**	**$974,613**	**$1,067,154**
Deferred revenue	-				225,000	218,750	212,500	206,250	229,500	408,333	395,833
Redeemable Preferred Stock	-		180,000	150,000	120,000	90,000	60,000	-			
Notes payable	-	-	-	-	-	-	215,000	450,000	420,833	219,000	204,000
Total Liabilities	**$2,334,079**	**$2,771,439**	**$2,943,716**	**$2,445,838**	**$3,409,656**	**$3,046,954**	**$2,900,339**	**$2,402,306**	**$1,733,553**	**$1,601,946**	**$1,666,987**
Total Stockholders' Deficit	**($2,142,183)**	**($2,338,273)**	**($2,578,566)**	**($2,226,194)**	**($2,607,116)**	**($2,706,943)**	**($2,858,461)**	**($1,600,229)**	**($1,482,124)**	**($1,193,001)**	**($1,449,651)**
Total Liabilities and Stockholders'	**$191,896**	**$433,166**	**$365,150**	**$219,644**	**$802,540**	**$340,011**	**$41,878**	**$802,077**	**$251,429**	**$408,945**	**$217,336**

Source: Company reports, Zacks

HISTORICAL ZACKS RECOMMENDATIONS



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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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