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Greg Anderson
The LGL Group, Inc.
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Operator: Good morning, everyone and welcome to the LGL Group Full Year and Q4 2013 Earnings Report. At this time, all participants are in a listen-only mode. Later, you will have the opportunity to ask questions during the question-and-answer session. You may register to ask a question at anytime by pressing "star" and "one" on your touchtone phone. You may withdraw yourself from the queue by pressing the "pound" key. This call also has a visual PowerPoint component in addition to the conference call. To view the PowerPoint, please click on the "Join the Meeting" link you received in your invitation and include it in the press release announcing today's call. If you need assistance seeing the presentation, simply press "star-zero" on your touchtone phone and an operator will assist you. I will be standing by if you should need any assistance and it's now my pleasure to turn the conference over to the Company's Chief Financial Officer, Mr. LaDuane Clifton. Please go ahead.

LaDuane Clifton: Good morning and thank you for joining our call today. With me is our President and CEO, Mr. Greg Anderson and LGL's Vice Chairman, Michael Ferrantino. We prepared a slide presentation for your reference that may be viewed as part of today's web conference. The presentation materials are also available on our website which is www.lglgroup.com. Please locate these and use them as a reference for today's call. This call will be recorded and will be available for playback later today or tomorrow on our website. Other financial information and recent press releases are posted on our website as well. Please note that our comments are covered by the Safe Harbor Statement. If at any time you need assistance during the call on web conference, please press "star-zero" for the operator. At this time, I would like to introduce Mr. Anderson.

Greg Anderson: Good morning, everyone and thank you for joining our fourth quarter and FY2013 earnings call. I'll start – if you take a look at slide 13, I've just got a couple of slides that help background the Company. From a snapshot perspective, we've been around a long time. Our 2013 annual revenues were just at $26 million. We got a good mix of in and outside the United States, stock price range over the 52 weeks of $5.20 up to $6.50, market cap rate, under $15 million. Cash and cash equivalents are under $9 million and we serve a very large market.

LGL subsidiary at present is MtronPTI and it's a B2B OEM kind of business really serving communications for both Internet as well as aerospace and defense. We've got a nice balance demand between about two-thirds aerospace and defense and about one-third Internet communications. Our IP really centers around our crystal technology really getting into what's called low-noise oscillators and are really are higher frequency filtering capability.

We've got a nice platform. It's global. We've got multiple US sites, some international sales locations and supply around the world. We do have an India manufacturing presence and really gives us some advantages for cost especially in the performance product end of our market.

Our margins, we can protect those really by staying in sort of this high performance, high value, high rel kinds of products. We strive for long product lifecycles with repeat revenue streams. We've got a management team with a good experience base around supply around the world.

Our growth opportunities, we really focus on these longstanding relationships that we have with our large OEMs, this industry's leaders. Of course, we're always after share gain opportunities as we develop new products and broaden our OEM both portfolios as well as our basis of who we serve.

So a number of things take place in the fourth quarter of 2013 and I tried to just grab a few of those to share with you this morning. Lots of details under each one of these but last May, we started talking about the strategic review process. We're here to say today that that process is completed. In the fourth quarter of last year, we implemented a restructuring plan, took that charge of $600,000.00 and that is what we had expected – planned and expected. We did have a modest book to bill and that helped our backlog by a few percent and really lots of change in 2013 so that we, frankly speaking, don't repeat that kind of performance and we're really trying to position the company for 2014 not only in better financial terms but really in growth and a bit of transformation of where we're actually allocating our capital.

The highlights or most of these are really lowlights for the fourth quarter. Financially, revenues are $5.7 million. That's the least that we've had in our 12-quarter roll, down 6%, down notably over the fourth quarter of '12. Re-margins remained essentially flat at 22% even on the decrease revenue. We had a $0.50 loss on adjusted pretax. Backlogs at the end of the fourth quarter were $8.6 million up 2.4% sequentially and adjusted EBITDA was mere 18% negative for the fourth quarter.

If we take a look at the full year, I mentioned we had revenues of 26 million just a little bit more. That's down almost 12% sequentially over '12. Gross margin was 26% for the year. That's flat even though we had these reduced revenues that really is an indication that we were doing some cost management along the way and really had some operational gains to be able to maintain those margins. Our full adjusted pretax loss was $1.40 per share and the year ended up at just – at near 10% negative EBITDA – adjusted EBITDA.

Here's the picture form of those financials. Again, we can talk about, in the blue, we have the bars as our revenue. Gray is the margin revenue and red of course is the negative EBITDA. That is certainly the challenge is to manage our cost as well as get that top line growing and that's what we expected to discuss a bit more in today's call. Cash and cash equivalents were $3.35 per share or $2.29 on adjusted working capital. We got a book value of just under $6.50.

Slide nine, we've used this slide a number of times. I think it still stands. It's a good slide and it talks about why we think we can grow this business. We do have a good capital position and it allows us to invest organically. We're always looking for these key new products that can broaden and differentiate who we are to our clients. We've got lots of good offerings to our clients and the question is, can we widen that and actually go upstream with that?

Many of our components are very sticky in our client systems and so sometimes there's a long period between buys. Sometimes it's nine months. Sometimes it's even a year but those revenues do come back and frankly speaking, they have nice margin to them when they do come back. Much of our R&D today is really in this RF and microwave space where we're trying to go up in frequency, targeting things like software-defined radios and low-noise radar. Lots of harsh environment timing for G-sense and vibration and extreme temperatures. We find an awful lot of that in the aerospace or avionic sector.

We do have a strong position in commercial avionics. There's lots of tough news out there in the defense side of our business but frankly in the commercial avionics side, the backlogs that we see with the Boeings and the Airbuses eventually trickles down to us and that's we have a strong position and they're both in communications as well as in control systems for that sector. I mentioned our backlog came up just slightly to $8.6 million.

This slide is just a GAAP to non-GAAP reconciliation. I won't spend time going through that. So once we work towards growth, a couple of negatives. Certainly, in this Internet communications space, it's better reduced demand for us and price compressions have been difficult. So even when we might be up on the unit basis, maybe top line doesn't see it just because of the kind of price concessions that we have to make. In some cases, we're choosing not to participate in that business. In some cases, we can participate effectively and do. We mentioned the US government spending is still an uncertainty. If there's any positive, we're really on the communications side, not so much on the missile side of that particular spend and so there's forecast with tactical radios, UAVs, communication systems. I think in the large part, those are generally positive. Of course, we're in there fighting for share.

We continue to have strong new product revenue streams. Even though our revenues are down, the – what we call the 36-month new product portion of that is actually at a very healthy 15% to 20% range and both our timing products and our filtering products. We continue to be encouraged by that that that will then lead us to some top-line growth. We've talked lots of times about our working capital position. It is strong. We entered into this restructuring in the fourth quarter. We executed that. We believe we've got that behind us now and so those efficiencies, we should be able to see those in margins and income and EBITDA as we go forward.

Our drivers, we talk a lot about organic growth in places where we invest our engineering. We're in there fighting for share gains in aero/defense clients. Maybe it's a smaller pie. Maybe it's a same-size pie but we have good positions with our clients and the top six or eight, so to speak, and we're always trying to position for share gains and in some cases are.

India is certainly an investment for us. We're continuing to look at ways where we can enhance that investment. There are some local Indian indigenous sales I'll call that. We're certainly always looking at operational investments for that particular facility and how we can leverage that into the Mtron subsidiary.

IP investments, any way we can have more of what we have, the broader offerings, additional componentry that that we can bring in to the fold of MtronPTI and really get us to where we have greater barriers and really eventually, we'd like to get to the point where we've got these sort of integrated sub-assemblies or integrated levels for our OEMs. To do that, we have a strong offering today but it would be advantageous for us if we could bring a few additional types of technologies into the company that would enable that.

Acquisitions and joint ventures, we're going to talk about the Trilithic acquisition in just a minute. Having that capital structure, having the ability to move quickly, it's a key part in this kind of a market when companies are deciding to divest and we're going to be able to be there and move quickly and certainly being able to acquire when we feel it's a good value and we can integrate well into our strategy, that's a key part of our growth initiatives.

I'd like to announce that we've completed our strategic review process and really the results are that we're going to continue to pursue our own engineering and acquisitions really for our core business and we've made a number of changes in how we allocate our capital. Of course, we're going to be – we've talked a lot about transforming our company into these long and sticky revenue streams and getting to where we've got more differentiated product positions that are large OEMs.

A number of significant actions took place in late 2013 and end of 2014. We announced the distribution of warrants back in August. Our Vice Chairman, Michael Ferrantino Sr. joined us in October. We announced an initiative to restructure our company which was really getting these capital allocations in line of where we really can create the greatest value for you shareholders and that took place in October. We began those efforts at the end of January.

We announced the acquisition of the filter assets of Trilithic and from that we've got a couple of pieces of intellectual property. We certainly got some long and sticky revenues we believe or a chance for those, added a couple of new aerospace clients to us and so those all sort of fit the strategy of where we'd like to go and then early March, we announced the appointment of Conrad Jordan. He joined us and he is the Vice President of our Timing Products Division for all of our timing offerings that we have and really, he's a seasoned 20-year RF, a microwave veteran, really in the R&D space, marketing, business kind of a background so we're looking forward to Conrad's experience. He comes to the Company not only with a component understanding but a good sense of subsystem level understanding in this RF and microwave marketplace.

Our strategy is clear. We're going to reinvigorate our intellectual property. We're going to invest in our own roadmap where our clients – where we think we have a number of opportunities to serve the same clients with technologies. Obviously, we're going to enhance that with acquisitions and joint ventures. We can leverage where we're at today. We've got great client positions and if we bring these additional capabilities to them, we think we have a nice return on investment for the company and our shareholders and really our focus is to invest and really differentiate it in broader RF and microwave kinds of products and portfolios.

In the bottom, I just have a couple of simple statements where we talk about transforming our product portfolio, really this thing towards longer lifecycles, higher competitive barriers, better margins. That's a journey that we began – it probably began before last year but we're certainly laser focused on it now. That'll take a couple of three years probably to really get the wheels going. We have long product lifecycles, long incubation periods with many of our OEMs and so it's not something that you do overnight but we believe that that's really a differentiator when it comes to long-term financial performance. If we can take some of the cycle out of it, get into these longer backlog kinds of business models, that's where we're pointing the Company.

I have one slide on the Trilithic assets acquisition. I expect questions on this so I thought I would share some of the details, the whys and what-fors. It's public. We purchased it for $700,000.00. Really what we were after was the intellectual property and the print positions. It's an active business. It probably was a – I will say this that it wasn't the largest portion of Trilithic and that was probably the primary reason for divesting but it has an active backlog and we've been – we've had good success for early on here yet. We're less than 60 days into it but we're really transitioning those open orders and backlog over to MtronPTI.

I talked about some new product IP especially in the tunable filter area. We've got a couple of different offerings that really enhance the ones that we've worked on. There's an offering called tubular filters and we've got a couple of top-tier clients and really some real good client positions or applications positions in this UAV market space which we know is predicted to grow. This fits the model of being – what we'll call asset-light so we're able to acquire frankly and integrate it fully into our existing – essentially our existing overhead structure. It's a pretty exciting time for us to be able to find that kind of target and hopefully integrate very quickly. With less than a couple of months into it, we are on plan and we've actually begun shipments so it was accretive immediately and certainly we expected to have a favorable impact on 2014. So the key takeaway is there were a couple of pieces of IP, a couple of new clients and really a limited – what we call structural cost adds.

So once again to recap our investment considerations at the LGL level, strong capital, experienced management team and board. We're always interested in this joint venture, M&A and where it really fits in with our strategies. MtronPTI remains a strong brand, lots of experience, some terrific clients. I mentioned there diversity of markets, lots of the certifications that these difficult – I'll call it harsh high rel kinds of certifications but we're actually able to do some of that in our worldwide manufacturing location in Delhi, India. We're really known as an industry leader in both technology and reliability and customer service. So at this time, I'd like to entertain your questions.

Operator: Great. Thank you. At this time, if you would like to ask a question, please press the "star" and "one" on your touchtone telephone. You may withdraw your question at anytime by pressing the "pound" key. Once again, to ask a question, please press "star" and "one" on your touchtone telephone now. We'll pause momentarily to allow questions to queue. We'll take our first question from Hendi Susanto. Please go ahead. Your line is open.

Hendi Susanto: Good morning LaDuane and Greg.

LaDuane Clifton: Good morning.

Greg Anderson: Good morning.

Hendi Susanto: Greg, what is your current expectation on software-defined radio in terms of timing of sampling by customers in your shipment and outlook for 2013? It will be great if we can learn like how many customers are evaluating your software-defined radio products?

Greg Anderson: Good question, Hendi. I know I've talked a lot about in these calls about our software-defined radio offerings. I would say at present, we have sampled I'm going to say maybe not quite a half dozen, maybe five specific applications with several more on the drawing board today that are variants of the initial samples that we have in the marketplace. With confidence, we're getting good feedback on the performance. It's difficult to predict revenue and I wish I could but the time it takes for these products to get through the qualification and the incubation period and gain the client's confidence are two things that I would probably talk about in this call. It's no less than one year and sometimes it can be three and so at this point, we do expect some impacts in 2014. I would say that I'm not going to quantify that as being notable at present.

Hendi Susanto: Okay and then by healthy growth in the commercial aerospace market, would you be able to share percentage or the amount of revenue coming from aerospace and how was the number in 2013 compared to 2012?

Greg Anderson: I'll verbalize that. Yes, I can, Hendi. So I mentioned our company is about 65% aerospace and defense. I would expect of that 65%, 22% to 25% is commercial avionics. We certainly saw a double-digit growth in that in 2013 and we've just got strong backlog again for 2014 and that's split largely between radio and radar communications for things that fly as well as this flight control kinds of applications for our timing devices. So it's an area that we're certainly focused on. We do a lot of prototyping. We've got good client positions and we are growing. I would say we're growing that segment equivalent to what that industry overall is growing.

Hendi Susanto: Then LaDuane, how should we think of operating expenses in 2014 considering the benefit of the restructuring in Q4? The restructuring is supposed to reduce your operating expenses by 10%. I'm wondering how much of that savings may go to reinvestment and how much is like pure reduction. Furthermore, how should we think of gross margin in 2014?

LaDuane Clifton: Okay. Thank you. Operating expenses, we were on track and did reduce probably a little better than 10% of our operating expenses based on 2000 – or run rate through Q3. Coming into 2014, of course, that will improve. We will reinvest some of those savings. As an example, the addition of Conrad Jordan which is notable to improve our – lift up our R&D efforts but I still believe that we'll end up being at a 10% reduction so it's an improvement of almost

$2 million to operating expenses as we go into 2014. In terms of margins, gross margin will benefit as well from the restructuring but frankly, most gains in gross margins will have to come on higher volumes. We've already, as Greg mentioned, been operating pretty lean. We had 26% gross margin in 2013 which was just flat versus '12 and so we've been managing that as well as we can going into 2014. We might see some gains, maybe a few points above 26 perhaps but that's going to be tied primarily to volumes I believe.

Hendi Susanto: Okay. Greg, you have been talking about sales opportunity in India for quite some time. May I inquire what markets you're targeting, the current status and expectation for 2014?

Greg Anderson: Most of it is defense-related. Indirectly of course, we do business as avionics where the Boeings and those folks are selling airplanes to the country of India so I don't know but I would call that quite so much indigenous content. So most of our indigenous content is really at this time on the defense side, we are continuing to work on the offset opportunities with our major OEMs, to provide them some relief in that regard and we hope that that could end up leading us to some share gains. So it all ends up frankly as goods into that country really between some defense and certainly some avionics as well.

Hendi Susanto: Greg, would you be able to share some new products that are in your R&D?

Greg Anderson: Oh, it's probably a little bit early on some things but we are working on some very sensitive – we'll call it G-sense and vibration-sensitive oscillators and I'm not going to quantify that for you other than the market potential is large compared to a company like ours and really what that would do would enhance things like radar and things that might be moving around so airplanes or UVs are moving around and they're really trying to get a clear image. The noise of the oscillator is just extremely inherent to the value add that the performance of the radar can see. So we've got a couple of three offerings there that we're – I'll call it looking at strongly for a large investment, a number of new filter offerings as well. We have one that's called switched filter banks. We actually have begun the sampling of that and essentially you're getting into this sort of high power kinds of filtering and lot of times things that fly as well. So that market potential looks real as well and we've got that technology available for sampling. So those are probably two of the very ones at present besides the number of the tunable filter offerings that we have and are working on.

Hendi Susanto: Okay. My last question, would you be able to share the revenue run rate that you are expecting from the acquisition of Trilithic's assets?

Greg Anderson: Well, we knew that was coming, Hendi, from someone. At this point, I think obviously, we've publicly shared the purchase price and I think at this point, I'll stay away from giving revenue expectations. I would say certainly, it's probably even slightly ahead of our initial business plan that when we acquired the assets so it's at present running strong. It's certainly been – as I mentioned, it's accretive immediately and it appears that it's going to fit this asset-like kind of model so it appears that we're going to be able to get in and use our existing structure, retain these clients and build these products inside of our existing facilities without really having to make lots of additional either people or machine investments. So we do expect it to have the kind of contribution margin that maybe is even the equivalent to what our existing filter line has or maybe even has the potential to outdo that. So probably for this call, Hendi, I'm going to probably stay away from revenue expectations other than saying it's on plan from the internal plans that we put together and modeled when we look to acquire.

Hendi Susanto: If I may approach it differently, may I ask like what the historical run rate of the Trilithic assets?

Greg Anderson: They're bouncy like we are.

Hendi Susanto: Okay.

Greg Anderson: More than one and less than three, Hendi.

Hendi Susanto: Okay. That's helpful.

Greg Anderson: Okay?

Hendi Susanto: Yes.

Operator: Thank you and once again, if you'd like to ask a question, you may do so by pressing the "star" and "one" on your touchtone telephone now. We'll pause momentarily to allow additional questions to queue. It appears we have no further questions at this time.

Greg Anderson: Okay. Well, thank you all for joining our call this morning. 2013 was certainly a difficult year and it led us into this strategic review process. We made a number of changes within the company primarily really on how we allocate our capital, some leadership changes. We're sharpening our focus on where we can create greater value with these RF and microwave kinds of offerings. We like our start to 2014. I'm not going to proclaim victory yet but we certainly like our start. We got the restructuring behind us. We're able to identify the acquisition early on in the year and execute. We've got a couple of notable leadership adds, one of the board directors, Mike Ferrantino, as well as Conrad Jordan joining us as VP of our timing products area and he's just got a real strong RF and microwave kind of background. So we like our start. We look forward to sharing those results as we work through the year and appreciate you joining the call this morning. Thank you.

Operator: Thank you. This ends the LGL Group's Full Year and Q4 2013 Earnings Report Call. If you have any further questions, please send an email to Greg Anderson at ganderson@lglgroup.com or to LaDuane Clifton at lclifton@lglgroup.com. Once again, thank you for your participation. This does conclude today's conference. You may disconnect at anytime and have a great day.

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