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Greg Anderson
The LGL Group, Inc.
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Operator: Good morning, everyone, and welcome to The LGL Group Q3 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 any time by pressing the * and 1 on your touchtone phone. You may withdraw yourself from the queue by pressing the # key.

This call also has a visual PowerPoint component in addition to the conference call. To view the PowerPoint, please click the “Join the Meeting” link you received in your invitation and included in the press release announcing today’s call. If you need assistance seeing the presentation, please press *0 on your touchtone phone and an operator will assist you. I will be standing by if you should need assistance.

It is now my pleasure to introduce LGL’s Vice Chairman, Michael Ferrantino. Please go ahead, Sir.

Michael Ferrantino: Good morning, everyone, and thank you for joining us today. As some of you know, I joined the company on October 1st of this year as Vice Chairman of LGL and Executive Chairman of MtronPTI. With me today is Greg Anderson, our Chief Executive Officer; LaDuane Clifton, our Chief Financial Officer; Jim Williams, our Corporate Controller.

I will now turn the call over to LaDuane who will go over our agenda for today’s call. LaDuane?

LaDuane Clifton: Thank you, Michael, and good morning, everyone. As the operator mentioned, we prepared a slide presentation for your reference that may be viewed as part of today's web conference. Presentation materials are also available from our website at lglgroup.com. We ask that you locate these and use them as a reference for today's call.

Please note that this call will also be recorded and available for playback later on our website. Other financial information and recent press releases are posted on the website, and please note that our comments are covered by our Safe Harbor Statement.

If at any time you need assistance during the call on the web conference, please press *0 for the operator.

At this time, I'd like to introduce our CEO, Greg Anderson.

Greg Anderson: Thank you, LaDuane, and good morning, investors. Again, thank you for joining our third quarter call this morning. I will start with the first slide, 3 in your deck, which really talks about a snapshot just a reminder of who we are as a company. Been around the long time; we have one operating subsidiary, MtronPTI. Our trailing 12 revenue is about $28 million. Our mix is about 50-50 within the U.S. and outside of the U.S. stock price as of yesterday was in the 5.80 range. A strong balance sheet, strong cash position over $9 million in cash, and we serve a very large market.

Some of our highlights, today, the subsidiary has a balance demand, about two-thirds of our revenue though comes from the aerospace and defense industry, about one-third from the internet communications industry. Where we drive our IP is we have crystal technology that really is still the base for a lot of core precise timing through our networks as well as control systems; with that goes some oscillator technology. Then, of course, in the RF and microwave arena, we have some filtering capability and we have some IP in that area, and that really is why our clients come to us for really engineering.

We have enabling platform. We have a global footprint, offices around the world, manufacturing around the world, a couple of U.S. sites. We can leverage some cost. Our margins – most of what we do is performance related and sort of in a corner of a niche of a very large market, things that provide value either in performance or in a harsh environment, so that helps really protect us on the margin side, if you will. Long product life cycles and we strive to invest or put our engineering where we can get some repeat revenue streams for many, many years. We've been in the supplier management business for a long time as well. We leverage that into our clients as well as our supply stream.

Our growth is really to hook our wagon, so to speak, with industry leaders, major OEMs. We do business with these large B2B kinds of companies and we do that directly. So as a small player, that's pretty critical and we try and choose those kinds of opportunities and growth where OEMs – frankly, we can grow with them.

So the results of the third quarter, revenues were $6.1 million year-to-date. They're $20 million. Obviously, we're disappointed; that's certainly a downtrend and down notably from a year ago and down 7% as we look at the first nine months of this year.

When we talk about margins, gross margin was 22.4% and, frankly speaking, it was all driven by the volume. Our previous quarter was $7 million and we dropped down to $6.1 million and really it's just all volume and all volume-related. In fact, we probably would have outperformed quarter-on-quarter had we had that revenue.

Year-to-date margins are actually up over 2012 by a few percent. We have a pre-tax loss of $0.46; that's notably worse than last year as well. We had a NOL that we announced at the end of the second quarter, and so that was really – that's why we are stating in this row a pre-tax basis.

Backlogs at the end of the third quarter were down 7% at $8.4 million. Really, that's sequentially and really just a soft market condition is what I would say. With the weak margins and the weak top line, EBITDA is down notably and you've seen the numbers. We'll talk about that a little bit more in the bar chart. I'm not sure about positive sort of the quarter, but certainly our ability to manage some cash in the third quarter, in light of the weak income statement, we were able to put off some cash, and cash is our focus at present.

Again, just to restate the economic environment, we certainly are no different than others today. We are struggling in these structural, infrastructure kinds of electronic markets. We've talked about these macro effects going back to 2011; certainly, no different than our major OEMs and our competitors, this U.S. budget uncertainty and sequestration. There are just lots of cautious infrastructure spending and it's affecting us.

There is always that it seems that newer technology never takes off as fast as we'd like. Pricing pressures in a soft market, they're certainly probably as severe as they've been at least in the recent number of years. Our key competitors, they're impacting as well; many, many changes around our competitors and those companies well making some strategic change.

Our financial snapshot, this is a 12-week – our 12-quarter rolling and the bars of revenue. You can look at margins in the grey line and then the red, green are certainly the EBITDA percentages. So as we talked about revenue is down notably at $6.1 million, margins followed. EBITDA followed. At the end of the third quarter, if we drop down, we got assets of $22.6 million. Working capital, cash and cash equivalents of $9.4 million. A little bit of debt and shareholder equity at $18.7 million. It should note that we had a book value of about $7.20 per share as of 9/30.

Backlogs for the quarter closed at $8.4 million, down a little bit sequentially, but probably frankly not out of line with where we've been and a little bit of bounce, but we've been hanging in that $8.5 million to $9 million for the past eight or nine quarters, so not a lot of change there. It was not a strong quarter for new orders, obviously.

A couple of reminders, our capital position is strong. We do have these key components and major client systems. When they back to wanting to have sales, well, our designs aren't going away. They're just not being ordered at present. We are getting some notable feedback in some of our of our R&D investments. We've talked to you investors many times about our investments in the software-defined radio market around our new filtering modules. At this point, it's certainly not driving the business fundamentals, but we are getting some notable feedback from our clients where we've sampled, done some engineering. We believe that, at least in the mid to long-term, that still is a viable revenue stream and a growth element for the company.

And we do have a strong position in commercial avionics. If we have any bright spot with the company at present, orders that go into the backlog of commercial airlines is certainly a positive for us. We supply those maybe not directly to those large OEMs, but indirectly in some cases we do do it directly, but that's certainly a growth driver for us.

GAAP to non-GAAP reconciliation, I'll let you take a look at that on your own and field any questions to LaDuane. When we think about trying to get this company back to growing, the negatives are certainly our major clients. They're reporting market softness. Even, frankly, as of last night, Cisco reported their revenues are expected to decline. They were up, I think, 2% quarter-on-quarter but, frankly, they're talking 8% to 10% decline. It's probably not a lot different when you get over to the aerospace and defense side so really, frankly, it's a tough market for us.

Repeat orders, which are things that we have designed in previously, we are expecting those orders and, frankly, they've just been sluggish coming from our OEMs and, of course, every time they come up now, they're pushing on price. If there are positives, we do have some healthy new product revenue streams in both sides of our business and really, we're actually probably decent with regard to new product revenues. It's really the repeat orders that have been holding us back.

We do have a strong working capital position. Some of our competitors don't have that; we do. We did generate some cash from ops in the third quarter and we still are in that kind of a position where margins and operating efficiencies, if we can get the revenues back up, they do remain favorable for us.

I talked earlier about our investments in software-defined radio and avionics. We have seen some gains on the aero-defense side of our business, not enough to offset all that is taking place in the market, but we have seen some gains. We continue to press and position ourselves around Indian sales and offset in what that could actually mean from a growth potential down the road, always looking for IP investments and joint venture opportunities. We continue to be exploring those when they present themselves.

The competitive landscape, this is actually the same slide that I shared at the end of the second quarter and I think it still holds, and so we haven't made any change. Just to remind all, the frequency control products industry, including us, is undergoing some pretty dramatic change. Many of our key competitors and even a couple of those – there are a couple of new ones that hadn't made announcement in this past quarter who have formally announced what we'll call strategic change in action. Those things include spinoffs, restructuring, sales, some goodwill write-down. All those are still correct statements. Companies larger than us are certainly all in the mix when it comes to these strategic changes.

Our commercial product lines are probably a step-up, pricing pressures as they've never been under. We are making gains on the factory cost side so we're trying to get that offset as much as we possibly can and maintain share. Certainly then, these macro factors regarding what's going on around the world, as well as within the U.S government, they just create this uncertainty in asset at our OEM level and that certainly is a trickle down to us as well.

If we talk about the company's strategic announcements back in June, the company made announcements about the - they were press releases around external interest in acquiring the company and a company then went ahead formed a strategic committee in July and August, issued a warrant dividend. Throughout that process, a couple of more steps took place in October.

The company announced that Michael Ferrantino joined as Vice Chairman of LGL and Chairman of MtronPTI. Michael comes to the company and to the board with – I'll just use these words – 40 years of experience in the electronics specialty business, and so we welcome his expertise and his leadership and, certainly, his knowledge as we try and navigate our way through the strategic process and set the strategy for the company and reset. We understand that we need to make change and Michael will certainly aid in leading us and helping us with those decisions.

We also announced in mid-October our management's initiatives to restructure the company. We plan to reduce and are reducing about 10% of the structural costs, and then there are some one-time charges that go with that as well. Essentially, what that means is in the near-term, we think that's the strongest way to return some shareholder value. We think there is chance to grow this company with our new product in organic investments, but those are probably mid-to-long term kinds of returns. At present, we chose to go into restructuring and try and get us through the short-term until we get to see those returns from those organic investments turn in the revenue and margin.

As a reminder of who we are, we still have a strong capital position. We do have an experienced management team. We are open to JB and M&A. The subsidiary, MtronPTI, again, not much has changed there. We've maintained all of our blue chip clients through this difficult time. We certainly have a team in place and we're trying to get the company positioned for growth.

At this time, I'd like to ask the operator to open for questions any of you may have.

Operator: At this time, if you would like to ask a question, please press the * and 1 on your touchtone telephone. You may withdraw your question at any time by pressing the # key. Once again, to ask a question, please press the * and 1 on your touchtone phone.

We'll go first to the site of [Darren Mueller]. Please go ahead.

[Darren Mueller]: Hi. Last time we spoke back in June, it sounded like you had about three to 10 parties that were interested in acquiring the whole company or part of the company. I think you mentioned around three to 10, and it sounds like the focus has moved off of that and more into restructuring. I was wondering why that is.

Also, you mentioned that there's some restructuring in order to save some money, but we've been seeing this difficulty in the market through the last two to three years already. Why haven't those initiatives been in place years ago?

Greg Anderson: Both fair questions. I'll take them one at a time.

So the first one about the expressions of interest from external parties about acquiring all our portions of the company, certainly, we have those. The strategic committee took those into consideration. Frankly speaking, I don't believe that they probably matured at least at this point to where they felt that was the best action to take. So it doesn't mean that they are off the table. It just means that - but they just frankly never materialized to a maturity that, at least at present, the Board chose to move forward.

So in the meantime, we just took some additional steps when it came to restructuring probably, and it leads into your second question. Why weren't those – I'll call it restructuring changes - made two years ago? I think the reality is that things change. So two years ago, we saw some strength in parts of our business that we don't see today, and so we are just restructuring and pointing us towards where we have our strengths and where we think we can get the chance to grow. If that makes sense, we're probably reducing structure where we didn't think we could grow and that is different than two years ago, or profitably grow. That's - I would say - the answer to your second question.

[Darren Mueller]: Okay, thank you. It's frustrating to see every quarter the revenue is declining, margin is decreasing, and backlog decreasing. I think there is some hope as an investor that we would see some sort of sale, and it's frustrating to see this continued weakness.

Greg Anderson: Yes, I understand.

Operator: Once again, if you'd like to ask a question on today's call, please press the * and 1 on your touchtone telephone.

We'll go next to the site of Hendi Susanto.

Hendi Susanto: Good morning, Greg and LaDuane. First question is for LaDuane. Gross margin dropped to 20% level, lower than my expectation, and this is the level that we have not seen since Q1 2012. You mentioned that the weak gross margin was primarily driven by volume. How should we think of gross margin levels going forward, given your costs of restructuring improvement and like weak markets out there?

LaDuane Clifton: Yes. Hendi, I will reiterate what Greg said. The change in gross margin sequentially was completely related to volume in this case. We continue to have favorable operating efficiencies and contribution margin has been – actually, it was flat. Looking ahead, we don't give very much guidance, of course, but I think that these circumstances will continue and then we expect that as we get into 2014, we should begin to see continuous improvement as we go to each quarter.

Hendi Susanto: Then Greg, where do you see share gains in aerospace and defense?

Greg Anderson: Well, the picture is – well, we've actually seen some gains up and down the line. I'll start with some contracts that we bid in one in what we call - they would be timing products and they go into – essentially, they are the clocking signal for microcontrollers and things that go on planes. They would be controlling various aspects of functions that are on planes, anything you think from cabin pressure control to - I'll call it flight and wing kinds of moves to wheels up and down to maybe even engine fuel controls.

So we've got a fairly strong offering there. We believe we're undersold in that area. Even though we've got a decent business, we think we can grow it. It's not quick in a lot of ways because the design cycle is long, but we are seeing some notable gains on what I would call the timing aspect for digital controls for avionics. Really, up and down the filtering line. We're positioning ourselves either in both navigation communication, and we've got a number of offerings there where we just think we have a compelling advantage and we are gaining some share of those accounts.

So the time to revenue from when you do the engineering to when you actually realize notable revenue is two to three years, and so it's not a fast process but we believe internally that our business planning and forecasts are pointing up really from share gains where we're taking some position or some share away from competitors either by engineering it or bringing new products in ourselves that we didn't have before.

Hendi Susanto: Greg, you often talk about software-defined radio excitedly. I'm wondering whether the current external market may push out the opportunities of software-defined radio. What is your insight on that?

Greg Anderson: Well, the answer to that is certainly yes. I think the question is how much, Hendi. The only thing - I'm trying to measure my enthusiasm as well. We've been in the design cycle with several major clients in the software-defined radio market for - I'll just say well over a year. I will confidently tell you we have not received negative news, which is a good thing. On the other hand, orders have pushed to the right, probably a quarter more than we were expecting. We are expecting some of our first orders in the fourth quarter of this year and now it appears that that's going to slide into 2014.

We're still pretty optimistic. Measuring when we'll actually get that business is just hard for me to commit publicly. I can tell you that with high confidence, we're having success on the engineering front. We're having success when we actually make the prototypes, and the client interest remains high. So we do think that's a growth engine. It's certainly not a near-term but certainly mid-to-long term. It can have an impact in the company.

Hendi Susanto: Then would you be able to elaborate more on the restructuring target of reducing structural costs by at least 10%? Where should we see cost saving in terms of cost of goods sold versus OPEX, and how much of that will go toward reinvestment versus how much will go to the bottom line?

Greg Anderson: I'm not sure I can – I would say, LaDuane, can you talk about the split between COGS and OPEX and structural cost and then...?

LaDuane Clifton: Yes. The fixed cost portion of cost of goods sold is going to benefit some from that reduction, but there is a fair amount that will come from the OPEX line. I'd say the majority is going to come out of OPEX. We intend to still reinvest though. Places that you'll continue to see investment will be in engineering and in our sales efforts, and so that's going to continue to be a place where we have a focus. I'll just support what Greg is saying. We have some very strong engineering opportunities in front of us that we're working to invest. The design cycles are long but we're committed to that reinvestment.

To the extent how much of that comes to the bottom line, our intent is that we're reducing the breakeven level of the company by doing this restructuring, and so a part of it will fall to the bottom line, obviously.

Hendi Susanto: Would you be able to share what's the new breakeven target for the company?

LaDuane Clifton: Well, we're at a run rate of about $28 million here. If you take this quarter and you project that out at $6 million a quarter, that might – six times four is 24. We need to break even at prevailing business levels.

Hendi Susanto: Okay. Greg, do you have updates on strategic review? Are you at the point where you can share expected timeline of how long the strategic review may take to complete, considering that there can be concern that the strategic review process may be an open-ended one and lengthy? Furthermore, does the board have any specific timeline target for that strategic review?

Greg Anderson: I don't know that we've talked about a hard timeline. Once you open the strategic review process, it tends to link, and I'll just use those words. I think we started in May and I'd like to say within a calendar year or maybe a calendar year in a quarter, we would close up. So with Mr. Ferrantino joining the board, certainly his experience will play into the steps that we intend to take. I'll just leave it like that, Hendi.

Hendi Susanto: Like a calendar year and a quarter?

Greg Anderson: Yes. So we started last or this May and it probably puts us into mid next year sometime.

Hendi Susanto: Okay, so it's like five quarters? Got it, okay. Thank you.

Operator: Again, if you'd like to ask a question on today's call, it is the * and 1 on your touchtone telephone.

At this time, we have no further questions. I'd like to turn the call back over to Greg Anderson. Please go ahead.

Greg Anderson: Well, I'd like to thank the investors for joining in on the call. I appreciate the questions. A very difficult quarter for the company. I hear the frustration and management feels that as well. There is still some goodness in the company. We're going to extract that. In the meantime we're going to be very focused on conserving cash and investing where we think we can grow.

We appreciate you – I guess I'll use the word "patient" as we look to transform the company as well as get it back on a growth plan. We'll look forward to making public any changes that we've got. Coming forward, we also have our Annual Meeting and Stockholders Meeting in New York in the 10th of December?

LaDuane Clifton: December 12th.

Greg Anderson: December 12th, and we certainly welcome you to attend that and, of course, the tough questions can be asked at that time as well.

We look forward to seeing you there and look forward to your attendance in future calls. Thank you.

Operator: This ends The LGL Group's Q3 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. Have a great day.

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