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LaDuane Clifton
The LGL Group
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Operator: Good morning, everyone and welcome to The LGL Group Q3 2012 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 on the Join 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 * and 0 on your touchtone phone and an operator will assist you. I will be standing by if you should need assistance and it's now my pleasure to turn the conference over to the company's Chief Accounting Officer, Mr. LaDuane Clifton. Please go ahead, sir.

LaDuane Clifton: Good morning, everyone and thank you for joining this call. With me as well is our President and CEO, Mr. Greg Anderson. We've prepared a slide presentation for your reference that may be viewed as part of today's conference call. The presentation materials are also available at our website at www.lglgroup.com. We ask that you locate these materials and use them as a reference for today's call. To let you know, this will be recorded and will be available for playback later today on our website. Other financial information and recent press releases are also posted there.

Please note that our comments today are covered by our Safe Harbor statement. If at any time you need assistance during the call and web conference, please press *0 for the operator. At this time I will turn it over to Greg Anderson.

Greg Anderson: Thank you, LaDuane and good morning. The first slide that I'd like to speak to just gives a corporate snapshot of who the LGL Group is and our subsidiary, MtronPTI. Yes, we're publicly traded on Amex. We've been around frankly a long time. The subsidiary itself has been in operation for more than 40 years. Some of the current financials: Our trailing '12 is at $30 million. About half of our revenue comes from outside of the United States. Stock price is in the low $5.00 range. Got a market cap of $14.5 million and we have $11 million of cash and cash equivalents. We're a niched player in a very large market that we believe is over $2 billion. The investment highlights: LGL's MtronPTI brand - we really serve large B2B clients and those clients provide solutions either to internet communications technology or mil, aero, and instrumentation applications. We've really got a balanced demand. About half of our revenue come from this ICT sector and about half from mil, aero, and instrumentation. We've got a long history of IP really built around crystal technology. We are experts in the crystal making business, so to speak, and that really remains core to precision timing. Of course those crystals then often used in our low noise oscillator technology which is again, a very, very precise timing application. In addition, we have a very nice filter offering that can go up into the microwave range. The LGL platform is enabling. It's a global foot print. We have multiple U.S. sites. We've got some international sales locations and supply locations. So for a small company, we're able to service our large B2B clients frankly, the way that they expect. We also have an India manufacturing operation that we think is a differentiator; provide some low cost especially in some of these precision applications. From a margin perspective, we protect our margins really though performance and value and reliability and really focusing on applications it requires sort of these harsh high rel environments. Our products have long product lifecycles with repeat revenue streams. We estimate that about half of our products have lifecycles of greater than five years and in many cases, create those call them repeat annuity streams. We have an experienced supplier management team and frankly we're good, we believe anyway, at driving lower cost structures throughout our supply chain as we deliver our products across the world to these large OEMs. From a growth perspective, we have some very long standing relationships with some very large clients and we know and believe that they are the industry leaders really, across both of our markets. So from our perspective, that's the core of our business model, is really to stay attached to those very large clients. We also believe we're positioned to gain share as the requirements for precision timing and filtering really actually are increasing as the demand for this information across our markets continues to go up, so we believe we are positioned to gain share and grow.

When we look specifically at the third quarter, it wasn't a good quarter for us and I'll just recap some of the highlights. Revenues were $7.3 million. They're down notably from a year ago, went down sequentially about 3.5%, just really overall softness in our markets. From a gross margin perspective, we finished the quarter at 24.5%, 3.5 points down from a year ago and a couple of points down from the second quarter. Really, the variable operating costs of our products for the quarter we were satisfied with. Really, we felt a revenue effect. So we're not happy with 24.5% points of gross margin, but frankly, what we consider our variable cost in our contribution margin were in line with our expectations; always trying to improve that number. Our loss for the quarter ends up being just a little over $300,000.00 or $0.12 per share. Our backlog closed at the end of the third quarter at $8.7 million, approximately a 4% decrease on a sequential quarter basis and really, driven - we just had a soft quarter for both ICT and mil, aero, and instrumentation. I can't speak to either one sort of who was worse if you will, so to speak, but really they were just both soft markets for that particular quarter.

In a positive sense, our major clients are all there. We're actually increasing our position at some. We're sort of in that final swing of our contracts for 2013, so we remain positive from that perspective. Our engineering backlog is actually quiet active and our [quote] activity is especially for the mil, aero, and instrumentation markets has been strong in these past couple of months. The business cycle - obviously like many of our clients as well as our competitors, we're caught up in the over a weak macroeconomics. Basically, the new technologies are the capital's not being deployed and not being expensed. There are some encouraging signs out there. I think we all can read and hear some of the reports that consumer confidence is improving. That certainly will, if you will, improve the confidence of our clients as they look to secure orders from their service providers. I think we'd all agree that the U.S. political landscape has now been decided and that will bring with it some stability that we've not had at least in recent quarters. We know our key competitors are impacted as well so we believe we've held share during these difficult times. A couple of spots maybe even gained some. We continue to have strong operating leverage. We give our cost oversight a great deal of scrutiny. We've been successful in reducing some of our administrative costs in 2012 and so as a result, really have been we'll call it prudent in our spending.

As a financial snapshot, we often show this call it rolling 12 quarters. The blue bars represent our revenue. The gray line represents our gross margin and the lower line represents our EBITDA percentage. As you can see where we ended up at 24.5 points gross margin, $7.3 million in revenue, and EBITDA just under -3%. During the quarter we did reduce our line of credit to $1.5 million again, just being prudent about spending interest dollars. This small repurchase on shares and I'd just like to note that what we term our tax adjusted working capital, which really is the amount of money that we believe from ARAP - an inventory that really takes to run the business, we were able to reduce that by $800,000.00 sequentially quarter on quarter. We remain positive that we are positioned for growth. I think you all agree that for a company of our size that our capital position is strong. We've got some very sticky revenue streams and I mentioned earlier about half of our backlog in our designs today we believe will extend past five years, and so they've got some good life and cash generation to them yet our major client positions remain intact and in fact growing and in some cases we've actually added new major clients. We are disappointed that our backlog took a step down but I think if you'd see from the recent trends, it's typical from the noise that we've seen from the last four to five quarters. Page nine is just a GAAP to non-GAAP reconciliation. You can take a look at that and field questions if you have any.

So as we work through the cycle towards getting back to a growth oriented company, obviously our major clients are reporting market softness. Just last week I had one of our largest clients into our headquarters for - we'll call it a business review and they were down 17% year on year and so frankly our business with them sort of mimics or echoes that as well. So a lot of our repeat orders from our existing contracts is what's really been sluggish. Again, I mentioned that modest decline in backlog. Positives - a solid working capital position. We're about break even from cash from ops for the first nine months of this year, so we consider that quite positive as we work to manage our cost structure. We are continuing to make further improvements to our cost structure and we like the quote activity and we like our engineering backlog, so we believe all those are positives as we look to move ahead into 2013. We speak cleanly to the growth drivers. At The last meeting in August I spoke about a couple of organic investments to use that terminology. One is we spoke clearly to the software defined radio market. We've got clients asking us to participate in that market. We think that's a nice win business opportunity for us and I think we've mentioned frequently our investments in the 4G LTE market as that capital gets deployed and that technology gets built out. We also think there are some incremental sales that we can get out of country of India, so we're going to continue to make some sales investments there as well as operational investments. So for us, obviously it's a region that's going to grow. Is growing. Going to grow. We've already got a foothold there. We've had a presence there for 15 years, so we're going to continue to build out around that presence and use that as a driver as we look towards next year. We are continuing to make IP investments and modules in subsystems. We're always trying to improve our relevance to our major clients in OEMs, and that's just some organic investment as well as we are active in M&A and any kind of opportunities there that we think can improve our relevance to our OEMs is really what we're after. I spoke about M&A in our August meeting as well. What I would say is we're active. Solar pricing is better today than it's been and what I would comment on our process is we are being patient and prudent shoppers but it is an active part of what our management team spends time on.

So a bit in summary, our investment considerations. From an LGL perspective, strong capital position, experienced management team, really looking at investments outside of the core business; as well JV and M&A opportunities. The subsidiary MtronPTI - long business existence, large B2B clients, diverse markets, got a world class team and platform, recognized as an industry, and technology leader. So at this time I would be happy to answer any questions that you may have.

Operator: Thank you. 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 pause momentarily to allow questions to queue. We'll take our first question from Orin Hirschman with AIGH. Please go ahead. Your line is open.

Orin Hirschman: Hi. How are you?

Greg Anderson: Good morning.

Orin Hirschman: Good morning. So I guess one of the things I would ask you to provide a little bit more color on is just in terms of orders. As I kind of looked at month to month type of orders, what would I see? We're about halfway through this quarter. What would I see in terms of trends?

Greg Anderson: Well, I'll try and speak to that plainly, Orin. A bit of a leading question. So I think I tried to share some color but I really don't want to frankly, dollarize it as we look at the fourth quarter bookings. It's really not out in the public domain, but I did comment that our [unintelligible] activity and our engineering activity, I was pleased with it especially in our mil, aero, and instrumentation markets, so I'm just going to leave it at that. I won't dollarize it during this conversation, but it is encouraging and it's an encouraging sign. We're halfway through the quarter. If it maintains well, hopefully we'll have some good information to share.

Orin Hirschman: Would that quantify more than you want to, would you expect we could have a positive bookings quarter?

Greg Anderson: Yes.

Orin Hirschman: Okay. I know it's coming off a reduced bookings quarter.

Greg Anderson: Yes. The answer to that is yes.

Orin Hirschman: In terms of what's going on on the 4G side of the business, it sounds like still running in place. Is that an accurate description or are there signs of finally breaking the long [gen]?

Greg Anderson: Let's just say with recent conversations with those clients, I saw some near term but I didn't really hear a lot of what I would call very strong comments about that long [gen]. I believe we remain positioned to participate in that, Orin, maybe even improving, but some of that information is again, a leading statement by myself, but we're not all down with our contract cycles for next year basically and so I don't see a huge - at least not what I'm being told - a huge uptick in the near term. Definitely delayed spending is the way I'd report that.

Orin Hirschman: You have a number of customers on that side of the business that compete with each other. Are you seeing strength in certain customers compared to other customers?

Greg Anderson: Yes. So I would say yes. I would say the outlook for a lot of our what I would call base station stuff versus backhaul stuff looks stronger at this point.

Orin Hirschman: Okay. That's because it's specifically of customer manufacture specific?

Greg Anderson: I believe that's correct, yes.

Orin Hirschman: Just in terms of looking forward as things may or may not turn there, if the base station stuff is going to look better versus the backhaul, how does that translate into rough percentage of business give or take in any particular period of time between base station versus backhaul from that piece of [crosstalk]?

Greg Anderson: I would say the incremental aspects - I would guess but it's more than 5% and probably less than 15% of total revenue, but it's probably somewhere in that range if it materializes.

Orin Hirschman: Which one is backhaul or…?

Greg Anderson: Base station aspects.

Orin Hirschman: Backhaul?

Greg Anderson: Probably close to being the same, maybe a little stronger in backhaul. I would actually expect them to be a bit sequential. Base station would go first and backhaul would come after.

Orin Hirschman: Okay. Thank you.

Operator: Thank you. Once again to ask a question, you may do so by pressing the * and I on your touchtone telephone. Meanwhile we'll take our next question from Hendi Susanto with Gabelli & Company. Please go ahead. Your line is open.

Hendi Susanto: Good morning.

Greg Anderson: Good morning, Hendi.

Hendi Susanto: My first question. In light of the number of cost restructures/initiatives that you have engaged in the past, what kind of gross margin range that can we expect in the near term?

Greg Anderson: Well, it's certainly tied to revenue, Hendi. We believe our leverage can be as high as 50% depending upon the mix of products that we sell. So from my perspective, we're running at our lowest fixed cost or structural cost that we've been able to achieve in the company today and so if we can return to previous revenue levels, I believe that we have a chance of frankly, meeting or exceeding where we've been in the past. Very revenue dependent at this point.

Hendi Susanto: Then do you have any updates on potential M&A or joint venture? On the other hand, like looking on your cash positions, you have about $11 million in cash and then $1.5 million line of credit. How should we think of like potential deal size that you are currently looking for?

Greg Anderson: Well, I'm not sure it's size on the M&A front as much as it is about strategy. So when we think about the frequency control division or subsidiary MtronPTI, I think we think clearly about making sure that any acquisitions we do, obviously there's the valuation piece, but then there's certainly the IP piece. In other words, if we can bring the right IP into the company to complement our existing IP as well as our client base, that's frankly much more exciting than frankly just bringing on some volume at least at this point in the company's journey. So when I look to acquisitions or M&A activity in the frequency control aspects, most of those are smaller deals. I'll say that a lot of those are under $10 million although we have looked at some that are more than that. We have a completely unleveraged balance sheet, so how much cash do we need? Well, we haven't structured those deals yet, so I can't speak to it, but I think we've got a lot of room there. If we look outside the industry, I'm not sure that deal size is as specific. Right now when it comes to frequency control, we're pretty pointed on what we're looking for and what I mentioned earlier, I believe valuations and pricing are becoming a little maybe more favorable for buyers, and so we actually think we're in a good position to - we'll call - be the smart shoppers.

Hendi Susanto: Could you indicate whether there are any like active discussions?

Greg Anderson: The answer is we're under NDA oh, in about five places at places, Hendi. So the answer is yes, they're active. None have been disclosed at this point.

Hendi Susanto: Okay. Greg, people are talking about fiscal cliff and then potential reductions in government budget and considering that LGL has exposure to military, aerospace, and consequently, government as well. If somehow [unintelligible] happen and the government budget got reduced, how would you anticipate that situation?

Greg Anderson: it's hard to monetize, but I will just give you what I think is my professional judgment. Certainly, we felt the impact by much of the military cutbacks already, so that's' not new to where we're at. As we look forward, we see our clients, our large clients, spending a lot of time working on their supply base and we believe that the number of suppliers that they're able to have online to service them is frankly got to be a challenge. In the past, I think there's a great number of small suppliers that maybe had unique technology who were able to get in and win some contracts. I frankly believe that that's going to be more difficult in the days ahead, and that's not just my personal or professional opinion, that actually is the opinion of many of those mil, aero kinds of clients. So I think they will pressure their supply base to have fewer. I think that's a positive for us. I believe that we're big enough and large enough so to speak that we could be the recipient of business that maybe was spread elsewhere to a smaller supplier in previous. So obviously, we're trying to attach ourselves to the right kind of platforms that we think have some growth to it, so the electronic warfare, the EW kinds of platforms we believe are probably in the strongest position to continue to be funded and so we're again, trying to be smart engineers in that regard in that we are pointing our investments towards platforms that maybe support things like UAB markets and those kinds of things that we believe will be continued investments by the U.S.

Hendi Susanto: Thank you.

Operator: Thank you. Next we'll go to [Mario Rousseau] with GSIL. Please go ahead. Your line is open.

[Mario Rousseau]: Hello? Would you please explain the cash restriction shown in the balance sheet?

Greg Anderson: Okay. I'll have LaDuane comment on that.

LaDuane Clifton: Good morning, Mario. Simply put, the cash restriction is tied to the line of credit we have. Given our recent - the business cycle effects there, some of the covenants were challenging so we simply put up the cash. I think it's important to note the reason we keep the line of credit open is because we have good relationship with JP Morgan Chase and it offers us flexibility as we go forward. So we've kind of maintained that line of credit so that we have more capital flexibility.

[Mario Rousseau]: Yes. The question now is what could be - if the cycle becomes more favorable to the business and then this covenant with the bank would increase. Would the balance sheet be affected by this and also your cash capacity in order to push your M&A activities as you previously mentioned?

LaDuane Clifton: We could pay the line of credit off today and take it to zero and still have very strong balance sheet for our operating needs. Frankly, we utilized the line of credit by $1.5 million. Changes in working capital in the last several quarters has been - they're modest at best as we continue to manage the adjusted amount we need if we keep managing it down. To be honest, I think we have the flexibility we need to make…

Greg Anderson: If I could just add in, LaDuane. If the business cycle improves, I don't believe we'd have to restrict more cash, frankly speaking. Business improves, there's maybe a quarter or so before we really turn that into cash generation - at the most two quarters - and so it'd be a very short time period if we really had to restrict more cash and then after the cash starts to come out of the business, oh obviously, the covenants improve and frankly, the bank will be able - just call it more cooperative in looking at our [government's] needs. So I think there is a potential in maybe very short term - one, maybe two quarters if the business turned real strong that we would restrict more cash, but I really wouldn't consider it a concern because that's the good part. Eventually we have a history that the cash comes out of the business within one to two quarters as well.

[Mario Rousseau]: Thank you.

Operator: Thank you. Just as a reminder. To ask a question, you may do so by pressing the * and 1 on your touchtone telephone. Next we'll move to David Mankoff with PCEM Asset Management. Please go ahead. Your line is open.

David Mankoff: Good morning, gents.

Greg Anderson: Good morning, David.

David Mankoff: I think you had indicated you had acted on the buyback this quarter. Can you tell us how many shares you bought and at what price?

LaDuane Clifton: We actually bought back about 15,000 shares repurchased under the prior board authorization we have still outstanding. We spend about $90,000.00 to buy this back, so this price was about $6.00 roughly.

David Mankoff: Right. So you do have quite a large authorization. I think it's $540 million which you bought relatively small amount, maybe 10% or something like that. Do you plan to get more aggressive in that stance in light of the large cash position and with stock is - I think it's half a book value at this point?

LaDuane Clifton: No. You're right about book value. It's certainly LGL's compelling investment in that sense. We continue to look at - we have the authorization there. It's part of our overall capital allocation scheme that we're looking at. Greg mentioned a few - there are a few M&A activities there that are continuing, and so we kind of look at it in the balance of all these things at once, but you're right, we do have a continuing authorization and expect that we would act on it as we think is prudent over time.

David Mankoff: Okay. Thanks very much.

Operator: Thank you. It appears we have no further questions at this time.

Greg Anderson: Well once again, thank you for joining our call this morning. We are disappointed with our third quarter results. I hope we conveyed the message the management remains diligent and focused to work through this business cycle. Obviously, our intent is to grow our core business and get back to being considered a growth company. We also remain very focused on our strategic objectives. Our long term goal, we're committed to having the LGL platform be leveraged for long term shareholder value. So I appreciate your questions this morning. I appreciate your attendance. We look forward to speaking to you again in a quarter. Thank you.

Operator: Thank you. This does end the LGL Group's Q3 2012 earnings report call. If you have any further questions, please send an email at Greg Anderson at gansderson@lglgroup.com or LaDuane Clifton at lclifton@lglgroup.com. Thank you and have a great day.

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