

LGLIR316
Greg Anderson
The LGL Group, Inc.
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Operator: Good morning everyone and welcome to the LGL Group Quarter Four 2010 Earnings Call. 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 virtual 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 any assistance and it is 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 and welcome everyone for today's call. Joining me today as well is our President and CEO, Mr. Greg Anderson. Before we get started today, I'll point out as well that we've prepared a slide presentation for your reference that can be viewed as part of the web conference. Presentation materials are also available from our website at www.lglgroup.com. We ask that you locate these and use them as a reference as we go through the report. As the operator mentioned, the call will be recorded and will be available for playback later today on our website. Other financial information or press releases are also posted there and we welcome you to take a look and see. Please note that our

comments are covered by the Safe Harbor statement. During the call we may include certain forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, non-GAAP financial measures may be presented. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to changes in global, political, economic, business, competitive, market, and regulatory factors. More detailed information about those factors is contained in the LGL Group's filings with the Securities and Exchange Commission. If you need assistance during the call in the web conference, please press *0 for the operator. At this time I would like to introduce you to our President and CEO, Mr. Greg Anderson.

Greg Anderson: Thank you, LaDuane. Good morning and thank you for attending our call today. I'd like you to turn to slide three, which is really just an introduction and our agenda for this morning's call. Our typical topics of business highlights, some financials, we'll review our strategic growth initiatives and of course, take time for questions. On the business highlight section, we did complete our fifth consecutive quarter of positive earnings, so we're glad to share that. Obviously 2010 was a turnaround year for the company. We're excited that we're able to reach new revenue levels of \$46.7 million, that's up almost 50% from over 2009. We also achieved an annualized gross margin of 35%, that's up 11% over '09. We're going to talk a lot today about pre-tax earnings. Our earnings per share was \$2.88 and 2010 EBITDA of 16.1%. Again, our customer positions do remain strong, and we'll speak more to that as we go through today's presentation. Q4 itself, revenues for the fourth quarter were \$11 million, that's almost 20% increase over the same quarter of 2009. We do want to report today that new orders were softer in the last half of the

fourth quarter and that really was across both of our major markets, which we namely call telecom and MISA. Our backlogs at the end of the fourth quarter was \$10.7 million and our fourth quarter gross margin was \$31.7, and that's very comparable to what took place in the fourth quarter of 2009. For full year results, again I mentioned that revenues were \$46.7 million against 2009 revenues of \$31.3 million. We had a pre-tax net income that's a non-GAAP number of \$6.5 million and a pre-tax earnings per share of \$2.88. We had a net income on a GAAP basis of \$9.4 million and 2010 EPS of \$4.19 on a GAAP basis and we had the benefits and realizations of some net operating loss carried forwards and a reduction in those valuations, and we can answer those questions later in the call should you have them. As we look toward the first half of 2011, our customers are reporting some market softness. Many of the larger ones have talked about flat revenues in either the first quarter or the first half of the year and that really is what we're experiencing as well. Our repeat orders from exiting contacts have been sluggish. We fall in the semi-space for a lot the analysts and I think if you take a broad stroke at semis, you'll see that the first half remains fairly flat and they are predicting growth in the second half. Clearly, our cash position and our working capital has significantly improved as we finished 2010 and started 2011. The financial highlights section – the bars represent our historical revenues. Normalized here to the [Mtron] PPI business unit and you can see again, the \$46.7 - that is a high water mark as compared to the previous five years. Our quarterly income statements – again, revenue was 11%, margins were down at \$31.7 million - very comparable to a year ago, and EBITDA was 11.3%. Our backlog trends, we reported at the end of the year at \$10.7 million and again, I mentioned really a couple of reasons for that. One, obviously we've had some reduced order activity and that really began in the last half of 2004. This is kind of a number, a

\$10.7 million number, is really more of a normalized what I would call backlog for our business. A year ago it was much higher and I think we reported – we've discussed many times with you where we won some large contracts. They obviously loaded up early. We had some incubation time to those contracts and did those shipments in the second and third quarter of last year. At present, those repeat orders against those new product contracts really have what I would call a normal book to bill versus having a long incubation period to them. On the income statement trends, we've talked about revenue. You can see our gross profit. EBITDA for the year was \$7.5 million or 16%. We have pre-tax earnings of \$6.5 million or 14% and a non-GAAP number as well in our pre-tax earnings per share of \$2.88. Our capital structure as of the end of the year: Assets were up nicely. Networking capital was more than double where we were a year ago. Our cash on hand at the end of the year was a little over \$4 million. Our debt is primarily gone as we paid off the RBC loan as well as retired our revolver and our available line of credit stands open at \$4 million, so we've substantially improved the company's balance sheet. Free cash flow for the year was \$4.6 million. I mentioned previous that we did pay down the revolving line of credit as well as the paid off the RBC loan again, so we are essentially debt free at this time and in February of this year we did successfully go through a capital raise. We placed 350,000 shares at \$20.00 per share and that proceeds of that raise was \$6.5 million which further strengthens the balance sheet from the numbers shared on the previous page and really positions the company to utilize its equity and debt or cash to fund the many strategic initiatives that we have on our plate at present. Page sixteen is just a reconciliation of GAAP against non-GAAP, and that's provided for your reading and analysis. Our strategic growth initiatives. We talked to you a couple of times about those efforts. So today as we look forward to laying that

foundation for growth, really we have significantly improved our business fundamentals. We've talked a lot about that through the year. We've come to being a growth company. We achieved the profitabilities that we were after. We've improved our working capital position. Our framework, which are really are four pillars of things that we are focusing on as we look to deliver further growth to the business, so obviously we're going to re-invest in our organic business. We'll have a number of new products that are coming to market today and throughout the year. We're actively looking at joint ventures to either expand our IT position or our supply chain or anything that will enable the flexibility of our supply. We are looking at synergistic acquisitions and really, we're very focused on sort of this high value added engineering, complements to our existing business – anything where we can drive our ASPs, deepen our positions at our OEMs, anything to build those kinds of relationships and we've mentioned several times that we will remain open to Greenfield opportunities. We think there are a number of other businesses that are related that could potentially benefit from the strengths of the LGL platform and we'll look at those throughout the year as they present themselves. So at this time, we'd like to entertain your questions. So operator?

Operator:

Certainly. At this time if you do wish to ask a question, as a reminder, it is * and 1 on your touchtone phone. That's * and 1 to ask a question. Keep in mind you may withdraw yourself from the queue at any time by pressing the # key. Once again, it is * and 1 to ask a question. We'll go first to Krishna Shankar with ThinkEquity. Your line is open. Please go ahead.

Krishna Shankar: Yes. Congratulations, Greg and LaDuane, on an excellent 2010. I have a few questions in terms of the business segments and the outlook for 2011. You indicated that you would expect growth to resume in the second half in 2011. Can you give us some sense on what the seasonality and the process of inventory reduction and slow down in your customers - what were the typical seasonal revenue profile look like in Q1/Q2? With this current industry slowdown, how do you think we should be forecasting or modeling that?

Greg Anderson: Well, I'll go first Krishna, and good morning by the way. I happen to be in California, so I think if you're in California, we're on the same time.

Krishna Shankar: Yes.

Greg Anderson: When it comes to the seasonality - to speak to that, I just don't think there is much of a cycle to the business other than the lagging effects of what takes place at our major OEMs. So when they soften up, obviously there's a long supply chain that exists between the contract manufacturers all the way down to the component suppliers, namely ourselves. I believe we're still feeling the effects of some of that inventory [build] that took place in those supply chain lagging effects, if you will, that took place throughout 2010. A couple of our larger customers are - they've spoken openly about it. Of course they avoid being very definitive, as I will be as well on this call, but they have spoken hopefully that they do expect that normal business is expected to return and growth is expected in the second half. That's really all that I can speak to from the business cycle itself. Would LaDuane comment there as well?

LaDuane Clifton: Yes. Just to reiterate, I think that we went through the process of having the contract - really the older process – going through and getting the forecast from customers which took place October -November timeframe at that time, and we've mentioned before, customer growth was expected to be 5% - 8% over 2010. Today, we still hear that they expect that growth as a total percentage, being pushed more toward the back half of the year. It would probably be safe to say that that total growth forecast for the year might be impacted, but all the same, that's the message we continue to receive from our customers.

Krishna Shankar: So as you look at 2011 we should be looking at your customer or customer revenue growth sort of at the low end of that range - 3% - 5%, maybe 5%, something like that, for your customers?

LaDuane Clifton: I think that's right. It would seem to me that it's off to a slow start for them and so their original forecast, while probably still fairly accurate seeing as they made those later in 2010/fourth quarter timeframe, I do believe they may be starting slower than they expected but we should still have growth for the year over year.

Krishna Shankar: Okay. Are you seeing similar trends in both the MISA segment and the telecom segment? Can you highlight the key differences and key customers in each of those two segments?

Greg Anderson: Well, on the telecom sector side, the major players that we have there are companies like CISCO and Ericsson and [Sienna] and a number of what I would call the next level of telecoms. On the MISA side there are customers like Rockwell, Honeywell, Raytheon, Agilent Systems, [Harris], RF. Those are probably the majors, so we all can watch the dynamics that

are taking place in military spending and certainly there are some political aspects to that as well.

LaDuane Clifton: Of course with our MISA customers, and we've mentioned this before, we have some munitions type programs but to be honest, even in MISA, we're primarily in communications based applications and so that's helpful for us as we look forward and like you said, there's uncertainty at times in the political environment, so yes.

Krishna Shankar: Okay. Then based on this capital that you raised here early in 2011, can you give us some sense for where you stand in your discussions on strategic opportunities and whether this could be a joint venture or a small acquisition outright that you're looking at? What kind of an impact that might have on P&L on the second half of 2011 both in terms of revenues, margin impact, and operating expenses?

Greg Anderson: I'll take that one. As far as the capital raise they went through, and we had a number of reasons for that raise. Primarily the first aspect was really to get the flexibility that we wanted on the balance sheet. We've got a number of things ahead of us there all the way from we'd like to take a look at our commercial banking lines and make sure that we finance there with the more flexibility than we previously had in the past, obviously the strength in the balance sheet also gives us the confidence and the credibility to move forward on a number of our strategic initiatives. What I can tell you on the strategic initiatives, although we're not ready to disclose any of those today, we are really active in all areas. So when it comes to the organic business, we have hired a couple of engineers and brought them on, so we are early designing new products with those engineers. On the IP joint venture supply, we have two active discussions

on the IP side and one discussion on the increasing some flexibility in our supply chain. I can't disclose whether those would be homeruns or singles or nothing at present other than they're active. On the synergistic acquisition side, we have taken a look at a number of companies. Again, nothing today that I would disclose although we have been under NDA. We are actually spending some time on Greenfield. We think there's some nice fits that are extensions to our core components business, so we've spent some time in that as well. What I can tell you, Krishna, is in 2011, a great deal of my time along with key members of the board will be spent on those strategic initiatives.

Krishna Shankar: Okay. My final question is can you highlight some of the new products that you're working on and the potential for some of the new products that you're working on in-house for organic growth during 2011-2012?

Greg Anderson: Okay. Sure. On the timing side, we really have three new product actions right now. I will say we did launch another one in the fourth quarter and if you would go to our website, you'll see it's a timing device called an OCXO but really what that is is that one plays into 4G back call and we won some nice customer contracts and seeing some nice growth on that. If we look at this year, we have just recently launched two new GPS [deal] modules. Again, very specific timing applications and those are really targeted towards more the commercial markets, and those could go into anything from broadcast timing to radio systems. We're also expanding our offering of very small, miniaturized timing devices that are very precise. Again, those play both in commercial and the MISA, so we've got a couple of offerings today. We're really adding to those offerings and then we're also adding a timing device, and just for very technical explanation, it's called 100 Megahertz [SC]. but really again, that has

some very specific applications in instrumentation, the MISA market as well, as well as a number of commercial applications, so we like to do those kinds of new products that play across both of our markets. On the filter side, we are expanding our offering on what we call high power filters, which ends up being more on the transmission side of systems. We are expanding our offering on cavity filters, so we had some very nice wins in the cavity filter technology in 2010. We're adding a couple of new – I'll call it designs - to that portfolio and later this year we're hoping to launch what is called a tuneable filter, which will be more of probably a subsystem kind of an offering. We've got customers today asking for that and so we are deploying engineering resources at this time. So we're excited about those. In all cases there, we've got customers pulling on all of those items and we are eagerly trying to complete the engineering and provide those launches.

Krishna Shankar: Great. My final question is can you comment on the recent events in Japan and do you have any customers in Japan? Also how [unintelligible] through your supply chain in Asia-Pacific and the US?

Greg Anderson: Excellent question. It's pretty dynamic yet with that horrific event. What I can say is our customer base isn't so deep, so our revenues are really not terribly exposed. Our supply chains, more from a raw material perspective do have some exposure. Our early reports at this time is that we have fortunately escaped any major damages to either our raw material factories or potential supply factories that are in contract factories to us. Again, it's pretty dynamic yet as late as very early this morning and very late last night, I was answering emails and phone calls on that very topic just to try and understand the situation. At present, it appears that we have at least avoided any initial significant impacts to the business and as bad

as those kinds of items are, there may be ways that they could be opportunistic for some companies as well. Other suppliers or competitors may not have been so fortunate, and I'm not ready to comment on that, but we're certainly willing to help our customer base any way we can during that kind of a disaster.

Krishna Shankar: Great. Thank you very much and all the best for 2011.

Greg Anderson: Oh, thank you Krishna.

Operator: Once again as a reminder if you do wish to ask a question, it's * and 1 on your touchtone phone. We'll go next to Hendi Susanto with Gabelli and company. Your line is open. Please go ahead.

Hendi Susanto: Good morning, all. Thank you for taking my questions.

Greg Anderson: Good morning, Hendi.

Hendi Susanto: My first question is about the gross margin. The gross margin in the fourth quarter was impacted by a product mixed toward lower margin items. Could you refresh our memory and tell us which product groups have higher gross margin and which ones have lower gross margin?

Greg Anderson: Honestly, there's really not a lot of difference when it comes to the product families themselves, Hendi but there are certain, I'll call it part numbers, inside of those product families that can contribute differently. So I can't be very explicit just because we probably have frankly 3,000 active part numbers, so it's hard for me to grab any one and say, "Well, that one there is the one that caused the problem." I just want to comment

– we didn't see any significant inefficiencies in yields in those kinds of items and our fixed cost of sales was where it was supposed to be for the fourth quarter, so I'm happy to report that those kinds of consistencies were there. I really believe it was more of a variable cost aspect to the number – to the part numbers that were actually built and sold during that time period.

Hendi Susanto: Okay. How do you mitigate the impact of softness in your market on your gross margin in the first half of 2011? Any new initiatives on your part?

Greg Anderson: Well, it's difficult to mitigate everything that takes place in top line. So we are leveraged nicely and so any top line that we get really, from any product and any of those families that we've talked about, we just get some really nice lip to that, so we are certainly exposed to top line hits when it comes to spreading our fixed cost of sales against margin. I will say that as far as managing cost, we have not significantly added any structural cost to the company. We're still at what we feel is a very competitive and a very good cost structure. We're always trying to improve that. In fact, we have actions today that reduce our fixed cost base to help mitigate these top line swings and really, our getting ourselves positioned in 2011 to really continue to be at the lowest cost structure that we've ever been at in the company.

Hendi Susanto: Thank you.

Operator: We'll go next to the site of David Igel, a private investor. Your line is open. Please go ahead.

David Igel: Hello?

Greg Anderson: Good morning, David.

David Igel: Good morning. Congratulations. I didn't get a chance to go through the numbers very closely because I'm out on the West Coast, so it was a little –[unintelligible] a little late last night, but it seemed that you had a pretty, in terms of bottom line, an excellent fourth quarter if you were to break out by itself?

Greg Anderson: Yes. To be specific, I believe we reported \$0.46 pre-tax and a little over \$1 million of those pre-tax earnings.

David Igel: Any further comment on analysis of the fourth quarter by itself on profitability?

Greg Anderson: For us, it was a solid quarter. Second and third quarter were really our high water marks. We were pleased with it. We're working hard on revenue, frankly. We believe we now have the company where it can consistently make money, so we're spending a great deal of our energy now where we're trying to leverage the platform for growth.

David Igel: Okay. Then the other thing is in terms of the new products you announced in the fourth quarter, do you see them contributing significantly in the year ahead?

Greg Anderson: The answer to that is we have one – defining significant – in the past I've used the number of 10% of revenue and 10% impacts and I'm not going to go there with that. I can tell you that on the one that we announced in the fourth quarter, we have won some nice contracts and they are increasing in

volume and in fact, they're pulling pretty hard on our factories. So I would say that healthy and from a new product development standpoint, and we are reaping some of those benefits in the first quarter in light of some market softness.

LaDuane Clifton: I would add to that. 2010 was a bit unique to have two significant products come through that both individually would have been considered fairly sizeable, but then to have them both come out Q1-Q2 of last year really had a nice driver right there and like Greg has mentioned, we continue to receive repeat orders against those. New product launches today and it's just the nature of each customer what they need and require. They tend to be stretched out a bit so that their impact perhaps may not be quite as noticeable as having two come out at nearly the same time. All the same, as Greg has outlined, there's a lot of effort going into it and they're all very exciting, frankly, as we build towards higher level systems or integrated systems and modules as well as offering that play across our entire both telecom and MISA market segments.

David Igel: One thing you've mentioned in the annual meeting, was a lot of your product cycle, it's five and ten years to reap the benefits.

Greg Anderson: Yes. That part has not changed. Our revenue streams are very sticky, so we continue – the repeat order aspect of our business is where we're really sluggish, as I've mentioned earlier in the slides, but I don't believe at all that that's because those products have reached the end of their life cycle. It's just part of the – I'll call it the business cycle within those. So yes, they tend to be very sticky. Once they're designed in, they're very precise for very specific applications and they tend to have a long product life cycle.

David Igel: Thank you very much.

Greg Anderson: Thank you.

Operator: I'm showing we have no further questions in queue at this time.

Greg Anderson: Okay. Well listeners, thanks for joining this morning. 2010 was a great year for LGL. It was a good turnaround. In 2011, we are focused on leveraging the platform for growth. We've talked about that with you a number of times both organically as well as strategically. We certainly look forward to providing you more updates as we move throughout the year and we are actually presenting at the [Roth] Conference here this morning in just a few hours, so if any of you happen to be at the conference, we look forward for the chance to meet and shake your hands and get to know you, so thanks again for attending.

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