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Greg Anderson
The LGL Group, Inc.
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Operator: Good morning, everyone and welcome to the LGL Group Q4 and FY 2012 earnings report. At this time all participants are on 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 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 turn the conference over to the company's Chief Financial Officer, Mr. LaDuane Clifton. Please go ahead, sir.

LaDuane Clifton: Good morning and thank you for joining the call today. With me is our President and CEO, Mr. Greg Anderson. We have prepared a slide presentation for your reference that can be viewed as part of today's conference. The materials are also available from our website at www.lglgroup.com. We ask that you locate these and use them as a reference for today's call. This call will be recorded and available for playback later today on our website. Other financial information and recent press releases are posted there as well and please note that our comments 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. Welcome you to our fourth quarter call this morning. Just a quick corporate snapshot of who we are. The LGL Group is a publicly traded on the New York Stock Exchange formed back in the early 1900s, had an IPO in 1946 and today we have one operating subsidiary known as MtronPTI. The financial profile listed here in the outline is that of MtronPTI 2012 revenues. As you can see, we're just under $30 million. We've got a nice mix of both being in the US and outside of the US. Stock price as of this week was $5.60 with a 52 week high of just under $8.00. A market capital $14.1 million. Cash and cash equivalents just above $10 million. We operate in a very large market of, we estimate, more than $2 billion.

From an investment highlight perspective, and I'll speak to LGL's subsidiary MtronPTI first here, the sub serves really, we serve large B2B clients and really, we provide them very smart parts. Those parts go into internet communication technology as well as many military, aerospace, and instrumentation types of applications. I mentioned previously we've just got a nice balanced demand also not only between around the world, but between these two target markets. So today we're about 50% internet communications and about 50% of this military aerospace and instrumentation. We really engineered these high valued components - I call them, "smart parts," and it's really got technology that's based on crystals, low noise oscillators, and really filtering and all that is around signal management and electronic systems. We have an enabling platform. It's global. We have multiple US sites. We have international sales. We have international supply especially from our India manufacturing location and it should be noted that we can even produce some of the more difficult types of specifications and needs from that particular facility.

From a margin perspective, the kinds of applications that we seek and the kinds of products that we provide to our clients are really high performance, high rel, harsh environment. They tend to have high switching costs, so they've got long product lifecycles. We've been in business a long time, so we've got an experienced supplier management team as well as system that really helps drive our costs as well as service these large OEMs from this global platform.

Our growth opportunities again, we've got these long standing relationships with industry leaders, primarily we've got eight large clients and they're sort of the who's who in these various markets, and so these relationships are longstanding and in some cases are decades long. We've got share gain opportunities with new product development, and we'll speak to those as we get through our presentation here this morning and really in today's sort of economic uncertainty, there's an awful lot of work going on by our clients around I'll say consolidation of the supply base and we believe because of who we are and where we've been and the kinds of solutions that we provide, we also have a compelling opportunity to grow in that regard.

So if we speak specifically to the fourth quarter, we did see some - we'll call it positive execution throughout the quarter. A modest uptick in revenues, both as we look at year on year as well as sequentially, and those are in the low single digits kinds of growth. Gross margins for this level of business we were pleased with in the fourth quarter. It was 30.7% and that's up almost 3% year over year and up 6% quarter on quarter. We did have a net loss for the quarter of $0.08 per share and that was an improvement over the third quarter. Essentially at the end of fourth quarter our backlogs remain unchanged at just $8.7 million and really, order patterns are just not where we want them to be for both our ITT market as well as our MAI market. We did turn the quarter in a corner I should say, in this corner for EBITDA. So we just [inked] out some positive EBITDA in our fourth quarter and relative to where we were earlier in the year. We felt that was a nice positive sign going into 2013.

Full year 2012, as I mentioned, revenues just overall macroeconomic climate and factors. Revenues were down 16.7%, and we'll speak to that earlier but essentially in the second half of 2011 our target markets really took a notable decline and essentially we haven't really recovered from that and there's a number of factors and we'll speak to those earlier. So our revenues are now settled in at the year at just under $30 million. Gross margin is 26%, that's down 4% as compared to 2011. Really all volume driven. I think you can see that we can still execute in the fourth quarter, so our operating leverage is still there. We'll speak a little bit to some of the new product work that we have going on. For the year, it was a loss of $0.51 and essentially backlogs have been unchanged now for approximately one year, so they're very comparable to where they were a year ago as well. Full year EBITDA was -3.2 and that's certainly down from 2011. Again, just did [ink] out some positive EBITDA in the fourth quarter.

So as I speak more clearly to the economic environment, we just had some I'll call it continuation of the overall week macroeconomics and I mentioned previous just have not seen any notable structure recovery in our target market. As we look back and reflect and look at our booking pattern really starting in the second half of 2011 things started out earlier in ’11 with the Japanese natural disaster and we all know what kind of interrupts that cause to the overall supply chain and electronics industry. We coupled out with US budget uncertainty and then certainly I’ve laid all the discussion surrounding sequestration. We’re on a long period of uncertainty in the Euro zone. Even as of late year with the discussions around Cyprus, so it’s just been an awful lot of uncertainty and these sort of compounding factors we feel are preventing really our target market from recovering from where they were previous. As a result, our major clients, they appear to be sitting on the sidelines with their spending, likely not giving the orders that they’re after. They’re certainly more conservative and all that means delayed microelectronic spending and that has a direct impact on us. In addition, we hear a lot about 4G and LTE and we are positioned in those markets. We just don’t see the kind of investment that we were expecting at this point and again, that’s I would say probably more of a delay than whether that’s going to happen for sure. If you see or read about our comps - some of those are public - they’ve certainly been impacted as well and there may be a few spots out there that smaller companies are doing well or areas within a company but overall, most comps that we see are also down in the same kind of numbers that we’re reflecting here today. Our operating leverage remains. I think even at these reduce business levels, our fourth quarter demonstrates that we can frankly, have the kind of margins and performance and even look at having some EBITDA in those kind of levels, so I think that’s management’s commitment to shareholders that we are going to provide consistent oversight of costs. We’ve done a nice job in 2012 of reducing our public company and admin costs and those are all mixed in there to achieve our performance.

This slide is a 12 quarter role of our quarterly income statement. So it gives you I'll call it a nice view of the kind of cycle that we are now facing. So for this particular quarter, I mentioned gross margin was up to 30.7%. You can see that's the highest quarter since second quarter 2011. Revenues were $7.6 million, maybe up slightly but now sort of unchanged for five quarters. EBITDA just turning slightly green as we got back some of our factory cost and reduce some of these overhead and structural costs, so we're pleased with that. Our capital position the last few months, shareholder equity really nearly unchanged. A few notable at the bottom of this slide that cash and cash equivalents of just under $4.00. We have a non-GAAP cash adjusted working number down there of $2.78 and our book value at the end of the year was just under $9.50.

Why do we think we can grow? Well, our cash position or our capital position remains strong. So we take this opportunity, even though we don't have strong repeat orders in our target markets, we are investing in organic opportunities. We've identified places where we think we can gain share in the market and bring some new products, having some success in that regard. We continue to look for those strategic opportunities either with joint venture M&A with the kind of balance sheet that we have. We have that opportunity in front of us. I mentioned earlier the kinds of smart parts or components that we make that go into very important applications that we call them sticky and it's just high cost to our clients to be able to switch them. So in some cases it's not that the business is gone away. They just don't have the orders for that particular piece of equipment and as a result, we don't get the orders. When that returns, we believe that we have the distinct possibility of getting that business back. During all this cycle in these macro effects that we talked about around the world, we have retained all of our major clients. In fact, added one in the last couple of years and so we're happy we're able to serve them in a way that they consider us a good partner. Probably one notable - a significant portion of our revenue serves commercially avionics, and I think from an analyst report perspective, we know that companies like Air Bus and Boeing are in their strongest backlog positions. We don't do a lot of business with them directly. Indirectly we do do business with them and that particular industry is predicting double digit growth both in revenues and earnings, and so that's been a strength for us in 2012 when we expect that to be a strength going forward as well.

GAAP to non-GAAP - just we've got to take a quick snapshot of both EBITDA as well as this adjusted working capital. So as we look forward and we're working towards growth, our major clients are reporting market softness as well for these equipment purchases as I've mentioned. We've got some strong new product revenue streams, but frankly, it's been our repeat orders that have been sluggish, and so we're actually quite pleased with the percent of new product revenue that we've got across our core business. I mentioned many times we've got that solid working capital position and how can we leverage that either with internal investments or strategic investments and I believe our fourth quarter demonstrates that we still have those margins and operating efficiencies that keep us favorable even in this level of business.

As we look at the growth drivers for 2013 where we are making investments and new products - I've mentioned a number of times on this call to our investors that investments in RF filtering in the software defined radio markets we think that's a nice opportunity for us. We believe the overall [PAM] there is let's just say $30 million and that's a new entry for us. We do expect to launch those products later this year somewhere around our show at - the microwave show MPT in Seattle in June. We still think that the rollout of 4G and LTE is going to bring some CapEx spend and increased CapEx spend later this year and we hope that we'll be a recipient of some of that increase.

I mentioned earlier our repeat orders with clients have served commercial avionics. We've got a number of designs there, anywhere from things that go in the cockpit around communication and navigation out to various aspects of flight control whether that's wings or wheels or pumping. We just got a number of applications there where we've got existing business and we've seen nice repeat orders in 2012 and we expect those to continue in '13. We continue to look at India sales opportunities and operational investments. We think that's still a core piece of where we can grow shareholder value. That's an active part of frankly, our operations team as well as my time. We are making investments in modules and subsystems. Our revenue streams there are small today but we are making progress and we have begun sampling at least one new format. As I mentioned, we are active in joint venture and M&A. So from an investment consideration perspective, LGL itself has a strong capital position. Management team has been in and around this business now for quite a number of years. We've got essentially our operations and our sales and our senior management team - many of those have been in the industry for frankly more than 20 years, so we're not new to the business. We've been through some M&A experience in the past, so we do have that experience as well. Our subsidiary, Mtron, has been around a long time. I mentioned the kind of clients that we serve very diverse markets. Frankly, a world class team as well a world platform to work from. We're known as an industry leader for both reliability and support. So at this time we'd like to hear your questions.

Operator: At this time if you would like to ask a question, please press the * and 1 on your touchtone telephone. You may withdraw yourself from the question queue by pressing the # key. Once again, to ask a question please press the * and 1 on your touchtone phone. I'll pause to allow those questions to enter the queue. We'll take our first question from Hendi Susanto with Gabelli & Company. Please go ahead.

Hendi Susanto: Good morning, Greg. Good morning, LaDuane.

LaDuane Clifton: Good morning, Hendi.

Greg Anderson: Good morning.

Hendi Susanto: Congratulations on strong gross margin in the fourth quarter. How sustainable is your gross margin that you have gained in that quarter? Furthermore, could you share qualitatively how much of gross margin improvement came from product makeshift and how much came from the cost structure improvement that you have been doing?

Greg Anderson: Well Hendi, why don't you let me take that question? Is it sustainable? It's certainly product mix sensitive. I can tell you that we have contributions in the fourth quarter that both came from improving our operating cost structure and I can also tell you that we have gross margins improvements frankly, from some new products. So I'm going to give you the answer as being combined. Our new product, what we call our MPI revenue as a percent of our total revenue was very healthy in the fourth quarter and healthy to me is I'll use a number like better than 20% and so that was nice to see. The sustainability is definitely mixed and order pattern related. If our clients continue to buy these I'll call it newer products that we've introduced, I think we have a good chance of sustaining that kind of margin. If not, I think it's going to be pressured. From a cost structure perspective, I believe the changes that we've made really in the third quarter/in the fourth quarter I think those are sustainable and frankly, they are permanent. So I'm going to conditionally answer that. It's sustainable as long as these new design wins that have - these new contracts essentially that we've won are going to continue to be purchased.

Hendi Susanto: Okay. Then on slide nine you posted information that commercial avionic is predicted to grow at double digit. How much exposure to commercial avionics does LGL have? Perhaps you can say as a rough percentage of your total sales?

Greg Anderson: Okay. I'll take an estimate at that as well. It's hard to get a pure number and very little of it, as I mentioned earlier, we don't do a lot of direct business frankly with the Boeings and the Air Buses also we do do some, but oftentimes we are a components supplier to their subs whether that be a Rockwell or a Honeywell, those kind so of companies. I'm going to estimate in 2012 that our avionics commercial revenue was approximately 20% of total and we did experience nice growth in 2012. We like to think as that market continues to I'll say at least receive good press from the analysts and the market reports so that we participate - we remain in good standing is what I can tell you with our clients.

Hendi Susanto: Okay. Greg, you always sound excited every time you talk about new product development. Could you share more about software defined radio and 4G LTE, what products you are developing and where they are in the process are now? Specifically, I'm interested in hearing more about your 4G LTE product development.

Greg Anderson: Okay. Well, that's my job to sound excited, Hendi and it's not just a game. I got some passion for the business. I'll start with software defined radio market. We have been investing research or engineering dollars for about 12 months now, maybe slightly more, to bring some offerings to the market and our clients have - I'll just say expressed interest to us that they have that need. It's not a new market. There are a number of players out there, although not that many. So I would say the number of competitors, just because of the difficulty of the technology, is limited. So that particular market, we have begun sampling prototypes and we have received positive feedback from at least one of our clients. I will say we haven't - if I was shipping notable revenue against that, I would certainly share that with you but we're just early on in the qualification phase, but I can say that it's been positive thus far at least at our entry point there. Again, that total market - we can point our finger pretty clearly at $30 million and that kind of technology, there's also an additional portion of that that's actually done by the OEMs themselves and their own engineering department, so it's not just a clean number like you might point out a particular component. So what I'm saying is $30 million really might have a potential market of more than that. How much of that we can win, that's really up to us and how well we execute in what programs and who we partner with. For the LTE market, I can tell you right before this call I had a meeting with our sales team in Europe and it was specifically about new offerings for one of our clients that provides an awful lot of equipment to that market and as far as I would put that more in a sustaining core components kind of opportunity. Nevertheless, we are constantly engineering new components for additional applications for those clients. As those clients change their - I'll call it portfolio of equipment, well that brings us opportunities and we are then asked to participate, so we've got a number of new designs in play there as well. So today, that's still a small portion of our revenue. I'll just say probably less than 10% and it certainly has chance to grow also a double digit depending upon what kind of capital gets spent.

Hendi Susanto: Okay. With regard to the IP investment in module and subsystem, what product are you targeting and how will it impact your avoiding expenses in 2013?

Greg Anderson: Well at present those products are really around, as I mentioned earlier, the software defined radio market. So they're really - we'll call them filtering modules more than they are just a component. So as far as operating expenses and margins, I would expect revenues from those kinds of products when they hit. I expect those to have higher contribution margins and probably our average today. So there'll be a net positive when we actually turn that work into revenues. As far as OpEx engineering expenses, today we've largely shifted cost across the enterprise if I can use that language from other parts of the P&L or the income statement over to our engineering area. So at this point it's really not been a large - I'll call it engineering increase. So at this point it has not been. On the other hand, if the opportunities bring themselves to us, we will make some additional engineering investments as that unfolds for this year. So at present I'm going to say that we've held the cost line. What we're certainly willing and committed to make those investments should our clients show the kind of interest that we hope they do.

Hendi Susanto: Okay. Greg, I would like to understand more about sales opportunities in India. What potential sales do you see in India?

Greg Anderson: The indigenous market in India - last year I've frankly spent a fair amount of time understanding that market and today what we believe in the commercial applications there is still, at least for our kind of technology, is still an attempt to see. Not the kind of dollars being sourced there that I'll call it get us terribly excited. There is some. So we've got a sales team there and so we're beginning to explore that. On the other side, in the defense and aerospace side, we think that's quite interesting and India has a government offset program for both of those classes of materials and we know that our existing clients today participate in sales that go into the country of India and as a result, we believe that we can create some value both for our clients and our shareholders by frankly, additionally building some products there that can be used and then become eligible for those offsets. So what could that be? That could be as much as a 20% increment in revenue as well. I can't speak today about how quickly we can materialize that. It's certainly an active process within the company.

Hendi Susanto: Okay. LaDuane, what tax rate and capital spending do you anticipate for 2013?

LaDuane Clifton: The tax rate is going to be very similar to the prior year. We're kind of right around the 30% - 32% range roughly as an effective rate worldwide. For us on capital expenditures, we have a target sort of maintenance of sort of existing product line and capacity of around 1.5%, kind of some of the opportunities that Greg has mentioned - materialize and we have to see how those things go - we're willing to position ourselves for additional investment, but initially I think we're going to stay conservative as they materialize. So you can expect similar rate this year as to last.

Hendi Susanto: Okay. Last question for me, Greg. I know it's a bundle of questions. Considering that we are close toward the end of March quarter, would you be able to share some insight on what you are seeing into your markets and at your customers quarter to date?

Greg Anderson: Frankly speaking, I'm not going to give you any numbers, but I would say that we have seen some highs and lows, Hendi. So I remain cautious as we look at 2013. I just can't predict these macro effects, and so we've had some pretty notable swings within the quarter and I won't give you numbers. So I remain cautious, frankly. I'm just concerned about what could be had in the euro crisis and what that means to our clients as well as the buzzword on the mil and aero side is sequestration. Our clients themselves are uncertain what it means. I've talked to them personally and just in the last few weeks so for us, I'm uncertain and I'm cautious.

Hendi Susanto: Okay. Thank you, Greg. Thank you, LaDuane. I appreciate all the insight you gave.

Greg Anderson: Thank you, Hendi.

Operator: Just as a reminder, it is * and 1 if you would like to ask a question. We'll pause to allow any final questions to enter the queue. We have a question in queue. We'll take our next question from David Mankoff with PCEM Asset Management. Please go ahead.

David Mankoff: Good morning, gents. I believe we have a share repurchase authorization of about 500,000 shares of which we purchased 15,000 past two quarters. Have we bought any more shares on that repurchase in the last quarter?

LaDuane Clifton: During Q4 it'll be in - you'll see our 10-K here shortly, but we did not initiate any additional repurchases during Q4. We have a number of interesting investment opportunities - Greg has mentioned - where we're putting some R&D and so we kind of continue looking at how we allocate our capital. Recently we've been looking at these new product opportunities and so for Q4 that's kind of where our focus was.

David Mankoff: Okay. I think the early approaches were in the $6.00 range or $6.01. Stock has been under that basically. It was a book value close to $10.00, that's a pretty good return if the thing would achieve book value. It's doubled, so are your opportunities better than that potentially?

LaDuane Clifton: You know what? We think so. We think that there's some interesting markets that these products could bring us entry into. No, but we're making that same judgment as you are to compare where we can best allocate. No, these are some pretty good opportunities that we're in the process of.

David Mankoff: Okay. Fair enough. Okay. That's all I have. Thank you.

LaDuane Clifton: Actually, I'd like to follow up for Hendi. A moment ago he asked me about tax rate and I just want to clarify. I kind of defined a single year tax rate in this 30% effective rate, but I want you to remember we have a number of net operating loss deferred tax assets from prior years such that the actual amount of cash we pay for taxes is zero. So if we come out positive during the year, those would be shielded in the near term as we use up those deferred tax assets. So sort of a cash effective rate of tax would be zero and I just want to make sure I clarified that for Hendi.

Greg Anderson: Thank you for your question, David.

David Mankoff: Thank you.

Operator: Just as a reminder, it is * and 1 if you'd like to ask a question. I'll pause to allow the questions to enter the queue. We have no further questions at this time.

Greg Anderson: Okay. Well, we'd like to thank you for attending this morning's call. We're obviously disappointed in 2012. We are somewhat pleased with our fourth quarter performance, so I think it's a good example that Mtron and LGL really do have that operating leverage that we talk about. We're certainly going to remain cautious, as I've mentioned several times in these call, with these macro effects. We just can't predict very far in this kind of climate what our - I'll call it a repeat order business - is really going to materialize as. On the other hand, we do remain optimistic that we are positioned to grow. We've got clients. We've got a good balance sheet. We've got some new products and frankly, we've got a lot of will and so our intent is to stay the course, return value to our shareholders, and get back to a healthy business. So thanks for your time this morning.

Operator: This ends the LGL Group's Q4 and FY 2012 earnings report call. If you have any further questions, please send and email to Greg Anderson at ganderson@lglgroup.com or to LaDuane Clifton at lclifton@lglgroup.com.

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