LGLIR328
Greg Anderson
The LGL Group, Inc.
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Operator: Good morning, everyone, and welcome to the LGL Group FY 2011 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 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 touch tone phone and an operator will assist you. I will be standing by if you should need any assistance. 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 everyone and thank you for joining the call today. Joining us well as our host will be our President and CEO, Mr. Greg Anderson. We've prepared a slide presentation for your reference to may be viewed as part of today's web conference. The materials are also available on our website at lglgroup.com. We ask that you use these as a reference for today's call. Please note that our call will be recorded and will be available for playback later today on our website. Other financial information and recent press releases are posted there as well. Please note that our comments today are covered by the Safe Harbor Statement. As a reminder, if at any time you need assistance, 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 agenda for this morning's call, we will touch on our typical business highlights and financial highlights. We've got one market outlook slide that I'd like to share and then of course take your questions. So from a business highlights perspective, we were frankly disappointed with the back half of 2011 and notably the fourth quarter. From our perspective, we had good start to the year. We just didn't finish strong. In summary, our revenues finished at just under $36 million, and that's more than 23% down in revenue as compared to the previous 2010. From a positive perspective, we were able to finish the year with gross margins of 30%. I think that speaks to a lot of the cost work and the operational efficiencies that went into the company and the organization and our operations in 2009 and 2010, so we continue to reap those gains. It is a decrease over 2010 that's primarily the volume effects. We had pre-tax diluted earnings per share of $0.22. We had a positive EBITDA margin for the year of 4.2% and we did generate some solid cash from operations of $2.3 million. Our customer positions - I've spoken to this in the past and I'm speaking frankly to it again today - they do remain strong throughout the year. We did not lose any of our major customer positions. We've got about ten of those that we hold in our strategic category and frankly, they all remain very strong. In fact, one of those major accounts we actually had some fairly notable market share gains and so we feel good about where we're at from a customer perspective. When we look at the quarter specifically itself, fourth quarter revenues were $7.4 million; again, down almost a third as we compare that to the fourth quarter of 2010. Really, not a lot of capital spending in either one of our markets, so orders really were soft for both Telecom and what we call our MISA Market. Backlogs had a modest decline over where they were the previous quarter of about a half a million. They ended the Q4 at $8.6 million. Gross margin for the fourth quarter was just under 28% and again, a decrease as compared to fourth quarter of last year; again, really volume driven. So as we work through this cycle and get back to a plan growth, several of our customers are reporting the same kind of market softness. Really, what's been our struggle has been getting a repeat order, is what we call a repeat order, from our existing contracts really in both markets. So essentially we have these designed positions one out there and lots of platforms, whether it's in Telecom or MISA, our customers give us a forecast and they say, "Hey, we believe we're going to buy this quantity of these particular devices from you." Those orders are just not materializing. We do not believe that it's from notable market share losses, but rather the fact that they're just not receiving orders and not selling that equipment. So our repeat orders has really been our notable gap and it's just, to say it politely, it's been sluggish. The semiconductor industry, they're becoming a bit more bullish as they look at into the second half of this year. That's typically a leading indicator. Semis and all sectors doesn't have an impact on us, but it does notably speak to the business level in the specialty electronics field, but they are predicting at least single digit growth in the back half of 2012. Of course, our capital position does remain strong. It gives us a great amount of flexibility and so we're in a very strong position there. Frankly, our engineering backlogs in the first half of this year are – to use words, they're very good and they're quite promising. Those are in order of today, but that's certainly the pipeline that builds our orders for a future, back half '12, '13, and '14, and so the engineering activity is very good. We take a look at our financials. This is our quarterly income chart, and if you look at the most recent quarter, you can see where our revenues came in at $7.4 million. Gross margins were at $28 million and again, the positive EBITDA of 4.2%. The real driver there when it comes to margins and EBITDA is really the volume. If we look back, this is about a three year look. So we look back 12 quarters when we were achieving, I'll say it, these low revenues of the cycles in the $7 million to $7.5 million range. Previous back in the first three quarters of ’09, clearly we were driving negative EBITDA and we’ll just say we had a gross margins in about the 20% range. So if there is some confidence in our performance, it’s the fact that when we do receive our experience these down quarters like this, we’re certainly maintaining and reaping the benefits from all the work of our operational efficiencies and our cost performance. The backlogs itself - modest decline from the third quarter. I think it’s fairly indicative of what our book to bill is/was during the quarter. I won’t speak to that clearly, but I think you can draw some inference there. It’s down about a half million to $8.6 million. When we look at our capital position as of the end of the year, we had total assets of over $32 million and networking capital of $18 million; that’s up over almost $7 million as compared to a year ago. We also provide a non-GAAP cash adjusted working capital number; nearly $14 million of cash. We did exercise our line of credit, and so we do hold a balance there at the end of the year of $3.4 million and we do have an open line of credit yet at $2.4 million, so notably strong on the balance sheet and we do now have the flexibility, if we choose to make some investments, to be able to do that in a prudent and I’ll call it flexible and quick manner. A couple of GAAP and non-GAAP reconciliations that we provide pre-tax earnings - I won’t spend much time on it as a computation of this adjusted working capital. Questions on those, we’ll be happy to answer. I did put in a slide. When we talk about the next cycle, and it’s from a marketing perspective - where we see our technology/where we see these markets going and I’ll speak at least in this slide specifically to what’s taking place in 4G and LTE. So in the upper right hand corner, I’ll call it the stacked [align] chart. That’s really US expenditures and CapEx by the carriers. Again, in the US market only. The source for that is JP Morgan and analyst research report, so it’s not our numbers, but you can see that there’s expected to be, all things hold true, a fairly rapid growth in this area for 4G and LTE and again, that’s just the US market. I think that computes to more than 25% [CATR] and really, it's driven by the things that we all talk about, which is really the shift to smart phones, all the content, everything's wireless. It's basically installing that wireless 4G front end for all the data use that's taking place today. Of course what isn't spoken here is all the back call requirements. Once you load up all that information, you've got to get it back done to fiber and that also plays to our strengths. All the front end activity as well as the back end activity of putting in bandwidth, all that means is more data, more sells, and really, more precise timing devices. Down in the lower right hand corner, you can see a pie chart and that's just a snapshot today of where we are doing our engineering. So in the past we've typically said we've probably been about 50-50 between the Telecom market and the MISA market. This pie chart today says we're engineering a little bit more than 50% towards Telecom and again, for all the reasons that we talked about, lots of different sells and coverage and 4G LTE kinds of investments. This is frankly the engineering demand has been very strong in that area for us and so that's where the majority of our focus is today. We've talked to you before about laying the foundation for growth. In 2011 we obviously significantly improved our capital structure. We've now achieved profitability in solid cash flow for two sequential years. Our balance sheet is quite strong. I think we've demonstrated that even in a down quarter, we can still put off cash and have decent margins as well as EBITDA performance and because of that, we do believe we are positioned to weather the cycle. We do think that frankly we still have good growth opportunities like I reflected in the previous slide for both timing devices and filters as this communications infrastructure continues to be deployed. Then notably, we do believe we have a manufacturing cost advantage when it comes to the MISA market itself. As we look towards our investments for growth, organic investments, essentially where we put our engineering, these are where we're poking at today. We think that they can provide, in the future as we get through this cycle and the investments come back into equipment infrastructure, we believe there's a strong opportunity to grow in the wireless infrastructure as well as the backhaul. Then in the MISA market, we're doing a lot of engineering pointed directed at the software defined radio market and we continue to get good customer pull as well as sizing that market as a good opportunity for top line growth for us. We continue to work on joint ventures. We continue to have good candidates. At this time, we're not far enough that we can share that with you, but that's still an active process. From an M&A perspective, this industry has been active in the past several months. We remain out there active and looking, trying to find those right fits. Some of the larger companies in our sector have done acquisitions and of course, they're bigger and larger and more capitalized and what we are. We're trying to be thoughtful about our M&A making sure that it really does provide those kinds of engineering compliments that we're after as well as positions that can strengthen our existing OEMs. We'd like to have products in engineering that make us wider and deeper where we're at today and we're frankly, looking for M&A targets that don't have a high degree of overlap. We do continue to look at investments for Greenfield opportunity. Again, nothing today that we'll share that has materialized but that's out there and it's always an option especially for adjacent or near markets to where we operate today. So at this time, operator, we'd like to entertain questions that our attendees may have.

Operator: Certainly. At this time if you would like to ask a question, please press the * and 1 on your touch tone 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 touch tone phone. We'll go first to Ian Gilson with Sacks Investment. Your line is open. Please go ahead.

Ian Gilson: Hey. Good morning. Can you hear me okay?

Greg Anderson: We can.

Ian Gilson: Good. A question on the backlog. What I track as revenue has a percentage of the prior quarter ending backlog.

Greg Anderson: Yes, that could be a methodology.

Ian Gilson: Oh, it's one of the few that I've got, so it's a- use what you can.

Greg Anderson: Okay. Right.

Ian Gilson: It is actually for the last few quarters in fact, the last three quarters, had there been less than it was and through '10. [Crosstalk] '10 which to me suggests that you had a certain component of your backlog, which is a longer term horizon now than you did in the prior year. [Comment] on what you're using on your backlog and second question relating to the same thing. Basically, the rate of decline in the backlog is moderated significantly. Are we looking now at a more stable environment as far as the back log is concerned?

Greg Anderson: Well, I'll tell you that a couple of questions here and I'll try and speak to those. The character of the backlog - which is one of the reasons frankly why we don't provide guidance, we rather let you do your own charting like you've notably done - the changes that can take place inside of our backlog, they're fairly dynamic and we can't always predict them and really, it's related to the different kinds of markets that we're in. So we have some customers that will come in, and in some cases in the military sector, they might give you a year's worth of orders at any one time for a particular, let's say, timing device and that can change and they can come in midstride and do that as well, so that can have what I'll call a long term horizon effect component inside the backlog. Telecom - I don't think that would be new news to many of us in this business - tends to be they buy frankly when they need it. So you can draw your own inference on the character and the nature of the backlog and what that book to bill might be, but for us, it does change a lot especially when new contracts – so can get kind of lumpy as we try and predict when we'll actually turn that to revenue. Now, as far as the amount of dollars in the backlog and is it stabilizing? We'd like to think so. I think that speaks clearly to where we're at in this cycle. We know the kind of components that we have and where they're used, they're not easily substituted. So I think it's fairly indicative of what takes place out there either in collapsing the inventories in the supply chain for our customers as well as their order activities. So I'm not going to give any leading comments that while we've hit bottom, but it's certainly slowing the amount or decline of backlog, and so we're hopeful that we are now beginning to move up hill. So I hope that speaks to both of your questions.

Ian Gilson: Good. Regarding the so-called 4G, I believe that the only true 4G is in fact from Verizon.

Greg Anderson: I'm not an expert on that. I will comment that there are various flavors of 4G and LTE in performance that are out there. I honestly can't speak to who has the most - I'll call it peer by specification compliance. I believe you may be correct, but I really don't want to come across as an expert on that. For us, it's really – I want to be careful how I say this. As long as they're putting in new front ends, that's the main driver for us. So a lot of the stations today go in and there, they go in in what's called multimode capability. So essentially, the carrier can turn them on to what they want to have turned on in that tower.

What that really means is whether we provide a timing device for the purist or highest echelon of 4G or LTE kind of capability, to us, as long as we're in that new tower, they can use that any way they'd like. I hope that makes sense. So if there's new capital going in and the carrier buys equipment, they're putting in essentially their latest and greatest design and frankly, a lot of the equipment folks are going to multimode towers and essentially, it drives timing device demand for us regardless of which way they turn that tower on.

Ian Gilson: Okay. So the fact that AT&T and Sprint are both changing their technology away from what they used to call LTE; closer towards 4G, that does not make any difference to you?

Greg Anderson: No. What makes a difference is who they're buying the gear from and are we designed in with those folks.

Ian Gilson: Okay. Good. Margins.

Greg Anderson: If you do a lot of research in that area, please send me the report. I'd like to know. [Laughter]

Ian Gilson: I used to. I used to follow a number of software companies in that area. I still do follow one. Gross margins.

Greg Anderson: Yes.

Ian Gilson: Again, looking at a year ago, you've got some pretty good control on all of your costs.

Greg Anderson: Thank you.

Ian Gilson: So basically, is it end of business or are you generally – well, of course you're paying closer attention, but do we see, as revenue flattens out and then picks up, could we see an increase in your gross product margins?

Greg Anderson: I think the simple answer to that is yes. We believe pretty strongly in our platform that we went through a lot of change in '09 and '10 to really get our cost structure and our operations structure, if you will, right sized and put in the right places. I believe now we're reaping the benefits of that. So yes, if we can maintain these kind of margins, which we are demonstrating - we'll call it at the low point of the cycle - then when we get back to, we'll just say a stronger market, people really spending the capital as they say they're going to, we believe that we can leverage that very well and maybe frankly, better than most of our competitors in the industry. That's my own personal opinion. So we're pretty bullish on the platform itself and we do believe we've got a firm amount of upside when the cycle returns.

Ian Gilson: Okay. My last and probably the most obscure question is we have seen over the past six or eight months considerable amount of discussion about restructuring of the armed forces to move - and I know when McNamara talked about this a few years ago. Nothing much happened when the government changed, but as we're looking at it now and they're talking about the so-called smaller, more mobile, etc., etc., etc., as you look at potential changes in the defense budget, the structure of the defense budget, could you sort of outline what you see and whether this may be of benefit to you?

Greg Anderson: Okay. Well, how about if I speak to our actions? We've obviously been notably impacted already today by military spending and government spending, so we felt a lot of that in our numbers already today. It's just opinion, but I'd like to think that we've reached a level there that is sustainable. When it comes to new engineering for the military sector, certainly that's got an impact and notably, all of our engineering for military - not all, but the good portion of it - is going into the radio systems or EW kinds of UAV applications, anti-IED. We believe that there'll still be some spending in those areas and frankly, those kinds of applications fit our products quite well. So we are pursuing new design applications with our major customers, but they're probably far more over in that area than they are in ammunition side, if that makes sense. So we actually believe that overall cutbacks and sizing in the military certainly has had an impact in our company. We're just being thoughtful about where we are putting our engineering capital, so to speak, as we look forward to areas that we believe will be investments for the military.

Ian Gilson: Okay. Great. Thank you very much.

Greg Anderson: Thank you.

Operator: We'll take our next question from the site of Hindi Susanto with Gabelli & Company. Your line is open. Please go ahead.

Hindi Susanto: Good morning.

Greg Anderson: Good morning, Hindi.

Hindi Susanto: First question is I would like to revisit the questions whether we have seen the market bottom in Q1 or not considering that we are almost at the end of Q1 2012. Would you be able to share what your markets look like in Q1 - whether you are seeing sequential growth, but fast growth or sequential. Then a lot of major companies and semiconductor have expressed their view that they're expecting sequential growth in Q1 2012 and I'm wondering whether you share similar opinion?

Greg Anderson: Well, Hindi, that's a hard question. That's a leading question. The way I'm going to answer it is we have had, in the past, really four to five months. We've had months with notable positive book to bills. I'm not going to say in this call whether we've got the consistency in that that can be reported and say that, "Well, we've now hit the bottom and we do expect sequential growth." We're just still, in my opinion, too bouncy. We've had, in the last five months, more positive book to bills than negatives. I'll say that. I'm not going to give you a number in total and that's probably as much as I'll speak to it. I do believe in just by watching all the analysts work, whether they're contract manufacturers or whether they're semi-analysts, they're all speaking to a better second half. If they're going to have a better second half. They're going to start buying now. CMs, the electronic manufacturing sector – also, if you read closely in a lot of the major ones who really buy a lot of our components, they'll speak to the sectors themselves explicitly the Telecom sector, data sector, and they are talking about sequential growth and even some of the major OEMs are speaking that way. Recently [Siena] came out and talked about what they were expecting even though the revenues were down. They were reporting a positive book to bill and that they expected future revenues to climb. So they are a number of indicators out there at least from the commercial side that it's pointing upwards whether that's modest or rapid, we certainly can't tell that yet.

Hindi Susanto: Okay. Then I believe that your 4G LTE timing device products are designated for cell towers.

Greg Anderson: Yes, and also a lot of them – similar technology goes into this – if you follow it closely. I know you do this IEEE 1588 protocol that's used in backhaul or they're expected to be the backhaul or are they expected to be the backhaul standard for essentially 4G and LTE. The same types of timing devices are used in the backhaul application as well as they do on the tower aspects. So in the network itself, as they go to upgrade, that same sort of precise timing is needed is there. So we're doing a lot of engineering in complement to the towers. It's similar in performance but it's really two different parts of the network.

Hindi Susanto: Yes. Then looking at those end devices, what is the approximate dollar content of your 4G LTE timing devices?

Greg Anderson: Well, I'm trying to figure out how to answer that question. It's a notable portion of our engineering right now, let me put it that way. so that pie chart that I showed you on the market, when I talk about more than 60% Telecom right now, nearly all of that is into front end or backhaul kinds of engineering. How that turns into revenue, we believe the market potential there is tens of millions and what we capture for us – we started to win some of that business last year. I don't think I'm going to give you any forward kind of number, but the market there is tens of millions and frankly, we're a pretty small player there yet, so we believe we've got notable upside.

Hindi Susanto: Then looking at those like tens of millions market, who will be your competitors?

Greg Anderson: We see companies that are traded publicly like – there's a company called – well, if you would go to the top 15 in frequency and timing device sector, three or four of those are large Japanese companies. At least one of those will be in there. There's a company that's traded on the New Zealand exchange by the name of [Rakon]. They're likely in there. I know they're our competitor in some places. We've spoken ultimately about a company called Vectron, which is a division of Dover. I'm sure they're a player in there. Companies like CTS have those offerings as well. What we do here in the market is most of the China growth is being given to – I'll call it indigenous Chinese suppliers – again, that's just commentary so I want to be careful with that, but as the rest of the world and certainly the US installs that infrastructure, we think we have the right kind of OEMs and the positions that we can participate in that growth.

Hindi Susanto: Okay. Then will you share more insight into software defined radio, what those markets look like in the market opportunity, competitions, and the timing of when new products sell from this organic investment can materialize?

Greg Anderson: Well, the purpose for them, as – and essentially it's really driven in the military market. As the military radios, instead of having a number of radios with defined bands to use that language frequency ranges, what they really want to have is sort of a universal radio that can cover a wide range of frequencies. For that then they either have to have a huge radio or they've got to have a pretty smart filter in the inside to help find the frequencies that they want to listen to, so that's really the next generation or even current generation radio technology. So we've been invited by our customers to participate in developing that technology that's a new product for us in the filtering area. I have a tough time sizing the whole market. I can again, tell you with confidence, that inside the customer sets that we know if, it's tens of millions and our current revenue is zero. So what we capture and perform at and win contracts is all ahead of us. It is a large engineering effort for us and I think we have demonstrated in the past that when we have developed new filtering platforms, we've had pretty good success in the market place with our customers. I can tell you that these latest might even have been early this week, I talked with our VP filter engineering and he had just gotten off a call with one of our major customers and again, it's all words, but they had also invited us to look at another opportunity in that area. So we're getting some pull. We believe the market for us is tens of millions and today we're not a player. We're brand new in it kind of competitors. Pretty notable, maybe. I'm not quite as knowledgeable in that area, but you might find some of those divisions of Dover in there as well.

Hindi Susanto: In terms of timing when we can see like new products, is it years?

Greg Anderson: Oh no, no. It's months. It's months and then when we win contracts – we're expecting to deliver that technology to the market to here in the next several months when we win contracts, those kinds of things, I'm not going to provide insight to that, but we expect to be providing working prototypes in the next 90 days.

Hindi Susanto: Then it might [unintelligible] call it radio backhaul I'm not sure I know what the existing product base that you are having now. [Crosstalk]

Greg Anderson: We have some in radio. I want to be careful about what customers I say, but we have filtering technology today and micro array radio backhaul, so there's a lot of commentary out there that it's more cost effective today to radio it as long as you've got spectrum than it is to try and drop it down on fiber. So that speculation has been out there for a while. All I can say is primary in the filtering side, and I guess in the timing device side as well, that would fit us nicely.

Hindi Susanto: Okay. Then there's also like ongoing discussion about the 700MHz spectrum for public safety. I would like to know whether LGL has some product footprints in that area as well.

Greg Anderson: The answer is yes. I believe on the chart that I – the answer is yes, and so we're doing filtering there already. I think public safety is about we estimate to be about 6% of our total engineering right now, so it's not a huge portion, but it is a portion. When we had won contracts back in '10, it really helped our swing up in 2010, Hindi, one of those in public safety sector in frequency.

Hindi Susanto: Okay. Then last question. Could you share what the 5% in Avionics entail?

Greg Anderson: That's a mix of both filtering as well as timing devices. So we have an offering of products that goes into digital controllers of various kinds of airplanes and then we have a number of filtering offerings and that can go anywhere from navigation to communications kinds of applications. So we're kind of mixed there as well and in fact, one of our US factories, really, the company became what's called AS9100 certified for aerospace in February of this year. So that's a market that we continued to invest in, grow in, and deploy our resources towards.

Hindi Susanto: Thank you, Greg and all the best for 2012.

Greg Anderson: Thank you, Hindi.

Operator: I show we have no further questions in queue at this time.

Greg Anderson: Well in closing, I'd like to thank our listeners and our investors for attending. We're certainly humble and I'll say even disappointed in how we finished 2011. We do remain strong and confident that we have the pieces in place both operationally and engineering wise. We've made some recent investments in the marketing side; brought on a director of marketing so we continue to strengthen our knowledge base there as well as our talent pool. We continue to have some JV prospects in the pipe line and we are judiciously looking at the M&A candidates out there as well. So we still believe strongly in the LGL platform and that we can leverage that as the cycle rebounds. Again, thank you for attending our call today and look forward to our future discussions.

Operator: This ends the LGL Group's FY 2011 earrings 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. You may disconnect at this time. Thank you and have a wonderful day.

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