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Greg Anderson
The LGL Group
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Operator: Good morning, everyone, and welcome to the LGL Group Q2 2012 Investors Conference 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 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'll be standing by if you should need any assistance. It's now my pleasure to turn the conference over to the Company's Chief Accounting Officer, Mr. LaDuane Clifton.

LaDuane Clifton: Good morning, everyone, and thank you for joining the call. I have a number of people today with me. Greg Anderson, our CEO, will be our host, and then also I have Paul Dechen, Vice President of Sales for our Mil / Aero Group; Dick Thompson, Vice President of Sales for our Internet Communications Technology Group; and Phil Smith, our Director of Marketing. We prepared a slide presentation today for your reference that may be viewed as part of the web conference. The presentation materials are also available at our website, LGLGroup.com. We ask that you locate these and use them as a reference for today's call. This call will be recorded and will be available for playback later on our website. Other financial information and recent press releases are also posted there, and please note that today's comments are covered by the Safe Harbor statement. If any time you need assistance, you may press *0 for the operator and someone will help you. So at this time, I'll introduce Greg Anderson, our CEO.

Greg Anderson: Good morning and thank you for joining our second quarter call. Just to begin, a backdrop reminder of our overall company. LGL, we go to market under the brand of MtronPTI. We've got $32 million of our trailing 12 months revenue. About half of that comes from overseas, our international. Stock price is $5.60 as of yesterday. Market cap is modest at $14.6 million, and we really service the specialty electronics market that's over $2 billion. Essentially, our brand and our products are essential to high – I'll call them "communications applications" and our markets are really diverse between internet communications, as well as Mil / Aero and instrumentation. Our overall demand is balanced. We believe we're in the growth industries of internet communications and that's about half of our revenue, and the other half comes from the Mil / Aero and instrumentation sector. Our IT is really a long history of being a fundamental precision timing supplier using quartz technology. We also have a nice complement of filters. All of those are needed for the precise and precision and high performance communication industries. A number of enabling efficiencies, we like to think of ourselves as the big-small company. We've got multiple U.S. sites with the distributed engineering model. We've got manufacturing locations around the world to service our customers. We've got good margins, and the way that we protect those is really to stay in the performance end, the custom end, and the specialty end of harsh environments and tough performance specs. We've got a strong supply base to service our customers as we bring our products to market. Our growth opportunities are fairly simple. We're going to stay attached to some wonderful big B2B clients that we have. Essentially, they're industry leaders and we believe that we are positioned to gain share at those respective accounts. As we go through today's presentation, I'll touch on some of our engineering investments and the markets themselves and why we think we're positioned for growth. So Q2 results themselves, revenue was $7.6 million – certainly a modest quarter by our previous standards in '10 and early '11. Down notably compared to second quarter '11 but if there's a bright spot, up almost 6% as compared to the first quarter of this year. Gross margins were 26.5%. Sequentially, that's up 4.2%. Really, we had some notable improvements on what we call "variable cost" which is nice to see, and certainly any small increase in revenue that we have between Q1 and Q2 also helped the gross margin performance. Earnings per share was a loss but notably improved over the first quarter. Just to speak clearly about our markets and their performance, our internet communications market really remains soft in the second quarter. We did see some what we call "notable improvements" in what we call the Mil / Aero space and avionics segment. We had a nice new quarter of bookings there, and really that's what drove our backlog up. So our backlog was up 7% sequentially. It is now at $9.5 million, and so it showed at least some positive movement in what's a pretty tough economy out there. During the quarter, we really held all of our positions that are major clients. Actually, frankly, continue to press hard to gain positions. Our engineering backlog was very good for the first half and it remains quite active. We did see some pulling activity, and what that means is we've got a backlog and our customers asked for that earlier. We saw that fairly notable in what we'll call the Mil / Aero and instrumentation market. So the overall factors affecting our business, we're really in a down cycle and we're not the only ones attacked that way. Our customers are that way. They're reporting softness in their hardware pieces, and so we're no different than they are.

Our major clients, they're just not spending the money that they had predicted. In a lot of cases, newer technologies like 4G that we believe we're positioned to grow in, those kinds of investments aren't happening as fast as we earlier predicted. Our competition is impacted as well; we know that and we believe it's a nice time to remain targeted to try and gain share in the down market. The semiconductor folks are talking about some growth in the second half. It's single digit, but nevertheless it is some positive news out there that can be a leading indicator for our market. We don't obviously participate in all that, but it can be a leading indicator as communications demand goes up. If we take a look at where we're engineering today and specifically where we're making those kinds of investments, there is the obvious front-end aspects of 4G and LTE as they roll out but in the backhaul aspect, there's a significant amount of engineering and investment going into what is called "IEEE 1588 Protocol." Essentially, it takes precision-timing devices and they're essentially needed as we get to this heterogeneous network that allows for voice data, video, all of those things to traffic through the same lines. To speak clearly, we believe for just the frequency control piece, we believe that that ham is just under $100 million as we look at it this year. We believe it's growing more than double digit and could double in a few years. Our engineering is focused on a performance kind of product called an "OCXO," and essentially it feeds all of these IEEE 1588 applications. The two pie charts you can see on the screen is the left one, if you will, is where we've made those investments and that you can see in the future as we view that to turn into the – we call them "new orders" and eventual revenue stream of opportunities that's also the majority of our engineering on the timing device side of our business. On the filtering side of our business, a good portion of our engineering today investments are going into what we call the "software defined radio market". We have some content in that market today, but most notably we are bringing forward a new piece of technology called a "tunable filter". It's used in these software defined radios. We'll call it an up-market kind of component with the number of complexities and a number of performance attributes that are needed as radios move away from fixed bandwidth, the multiband kinds of applications. Today, we are doing the engineering at the yellow sliver, if you will, at the left pie chart. As we move that over to the right and turn that into bookings, we think that that will – I'll call it "outperform" the other product lines where we're doing in engineering investments today. We just think that that could be a very nice growth driver for us. Today, we view that opportunity for that market that we can see with our customers at about $30 million and we believe that that's growing at – we'll just say 10%. Those are internal estimates. Today, we're new to that market so we really – when it comes to the tunable filter aspects, that's all upside for us. To give our investors a feel for the – what I would call the "expected return" on those kinds of investments, I would expect gross margins from the software defined radio and specifically the tunable filter projects to be richer than our historical gross margins which makes contribution margin better than that. So even if we could bring on a few million dollars of the revenue in the next couple of years, I think that would have a nice bottom line effect to earnings. This slide again is our quarterly income trend. You can see the past 12 quarters, the improvements in gross margin, as well as a modest improvement in revenue so, again, 26.5 for gross margin, 7.6 in revenue. It has got a trend line that says, "We're pointing back towards green and then changing the color," and that's our initiative. Some listings on our assets at the bottom, our capital position, we're remaining very strong from a balance sheet perspective. How are we positioned for growth? Capital strong, we are bringing a value-added component to our major client systems. We've got very strong customer positions. The majority of our customers are big B2B. Probably two-thirds of our revenue gets driven through eight or so very large companies, and so we're positioned well with our clients and in some cases, gaining share. Our backlog, we reported, is at 9.5 million and as a quarterly trend, you can see at the bottom of slide 10 that we are showing some incremental improvement. Slide 11 is our GAAP to non-GAAP, and I'll let you look that over. So as we work through this business cycle, clearly our major clients are reporting softness like we are. We see repeat orders, just really off of what we would call "contract norms," so they're pretty sluggish. Things just start happening as fast and the capital isn't being spent at the rate that it was predicted. The positives, we are starting to see some improvements that are backlog. Our working capital position is very strong, especially as we compare to companies, and some of our competitors that maybe our size, even slightly larger. Our backlog for engineering, I talked about the two areas where we're doing the most engineering investment. We think those are growth engines for us and as the market returns and those companies look to make those kinds of capital spends, we expect to participate in that. The semiconductor industry is making – I'll call them "frequent announcements" now that they're in single-digit growth for the second half of the year. So we are working through the cycle. The LGL is in a position of strong capital and a very experienced management team. We continue to pursue M&A and JB opportunities. In the past, in several months, we have been a finalist in a couple of those. For evaluation reasons, really chose not to participate. We are actively looking for companies that we think will be nice tuck-ins and really fit our evaluation expectations as well. The brand remains strong for all these reasons, lots of experience, blue chip clients, diverse markets. We've got a worldwide platform and we are known as an industry leader and got the kind of reliability and the longevity, if you will, in a tough market like this that our customers and our clients know that we're not going away. So at this time, myself as well as my colleagues here would be happy to field any questions that you may have.

Operator: At this time, if you'd 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 do have a question in queue. We can go to the site of Hendi Susanto with Gabelli & Company. Your line is open.

Hendi Susanto: Hi. Good morning, Greg. You mentioned the pricing pressure in Q2 was tough. How was pricing pressure in Q2 in July relative to historical patterns?

Greg Anderson: I would say pricing pressure in primarily the ICT sector is notable. I'm not sure that - largely we work off of contracts, Hendi, so we're – I'll call it "mid-contract cycle". We don't feel as many of those pressures as when we roll over our contracts into the next annual cycle, and that process is actually taking place today. We don't really know the outcome of that but certainly in a softer market, pricing pressures are more fierce. When it comes to off-contract bids, I would say that it's notable. It's at least single-digit kind of pressure across primarily our ICT market, but the Mil / Aero market also feels those pressures.

Hendi Susanto: Okay. Then you mentioned about contract. Could you remind us again how long average contract is?

Greg Anderson: Well, the majority of our contracts are annual and they essentially are fixed pricing in terms. We have a couple of contracts with our big B2Bs that are two-year. For the most part, we've done annually and we had a pretty good look at what our position is going to be sometime probably around mid fourth quarter, so we've got about three months before we have a real clear view of our contract positions and really mostly that's from a repeat order sense. When it comes to new engineering opportunities, most of the time we get into those mid-contract cycles and frankly, they're what I would say opportunistic and usually find their way onto a contract the following year.

LaDuane Clifton: Hendi, I would just add to that – this is LaDuane – when we talk about contracts, we're talking about set terms and pricing for that period, and then the customer gives us a forecast of their expected demand. I would say there's still some uncertainty around what they'll actually buy and there is limited visibility from our customers in that regard, but I just want to make sure to clarify that.

Greg Anderson: But it is the strongest indication of our upcoming business level.

LaDuane Clifton: Yes.

Hendi Susanto: Then how does pricing work in a contract? Does it base on – let's say like tier volume?

Greg Anderson: Yes, and the answer is volume and performance aspects of the part, certainly the competitive landscape. In some cases, it's us and one more; sometimes, it's us and a couple more. In some cases, it's only us and obviously, [still] source positions we favor nicely.

Hendi Susanto: Okay. Greg, you also reported that repeat orders from existing contracts are sluggish. When do you expect to see the recovery of those orders?

Greg Anderson: I wish I knew, Hendi.

Hendi Susanto: Okay, fair enough.

Greg Anderson: Our visibility is pretty limited. Our two sales VPs are sitting next to me and we go through that discussion often. Frankly, our sentiment for second half is to improve. I'm not going to give you a number and I'm probably not going to stay committed to that but we do see it. The "activity" is solid and the engineering activity is very good.

Hendi Susanto: Okay. Thank you.

Operator: Again, if you'd like to ask a question, please press the * and 1 on your touchtone telephone. We'll pause for a moment. I'm showing no further questions at this time.

Greg Anderson: Okay. Well, I'd like again to thank all of you for joining the call this morning. It's nice to see a little bit of movement in the business fundamentals for the second quarter. Certainly, we remain optimistic. We're not going away. Our capital position is strong. We still see opportunities to grow. We continue to invest in the platform organically as well as looking for these inorganic types of investments as well that are profiled in our evaluation expectations. Thanks for joining our call and we look forward to next quarter.

Operator: This ends the LGL Group's Q2 2012 Investors Conference 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.

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