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Greg Anderson
The LGL Group, Inc.
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Operator: Good morning, everyone, and welcome to the LGL Group Q2 2013 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 * then 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. You may begin, sir.

LaDuane Clifton: Good morning, everyone and thank you for joining us today. Greg Anderson is with me as well and will be our presenter. We prepared a slide presentation for your reference that may viewed as part of today's web conference and the presentation materials are also available at our website, lglgroup.com. Please refer to these and use them as we go through the call. Our call will be recorded and available for playback later today on our website. Other information such as financial information and recent press releases are posted on our website as well and please note that our comments are covered by the Safe Harbor Statement. If at any time you need assistance during the call in the web conference, please press *0 for the operator. At this time, it's my pleasure to introduce Greg Anderson.

Greg Anderson: Thank you, LaDuane, and good morning. Welcome to our second quarter earnings call. I'll start with just a short snapshot of corporate overview. We've been around for a long time. The company was formed in 1917. Today, we are traded on the NYSE market. Our trailing 12 revenue is $29 million. About half of our revenue gets booked outside the United States. Yesterday's closing stock price was just a little over $0.6. We've got a market cap of just under $16 million cash and cash equivalents of $9 million and we're a small player in a very large market.

From a highlight perspective, LGL currently has one subsidiary, goes to market under the brand name of MtronPTI. Primarily specialty components supplier for electronic communications and we serve large B2B clients. We provide solutions both to primarily the internet communication technology market as well as into the aerospace and defense market. So we have a nice balance demand. About two-thirds of our revenue today is booked into aerospace and defense clients, about one-third is into what we call ICT, or Internet Communications. From a technology perspective, our value propositions, we are very much crystal based in at least probably half of our revenue. We tend to participate in really the precision on what we call the low noise environment, things that really require a great deal of precision and performance. We're not just a timing company, we have nice balance of filtering as well and that becomes very important to our clients especially in radio applications. The platform itself is a global footprint in a number of US sites, some international sales, certainly some international supply. Know we have an India manufacturing facility and really that provides us a cost advantage even for some of these high performance products. Margin protection - again, we participate in more of the precision end. Often times our components are designed into products and platforms of long life cycles, so they generate those repeat revenue stream and certainly we've got an experienced management team as well as a supply stream that really helps manage our cost. Growth opportunities - we've got a number of very long standing relationships with very large companies and as the market is pressured today for reduced supply base, it's never ever been more present than what's taking place today in the frequency control industry. We believe that presents some sure gain opportunities as well as our organic new product development activities.

We look at second quarter results as certainly a step backwards for us, as compared to the first quarter. Well, probably with the exception of backlog. So real quick, revenue was $7 million. It was down 8% as compared to a year ago. Sequentially, it was down 3%. Margins were about flat as compared to a year ago and is sequentially down almost 7%. We had a pre-tax net loss of $0.32 and that really add some favorable to a year ago. I think a year ago we had a $0.13 loss and really, the decrease or the increase loss was due to a revenue drop and as well as a change in product mix. We reported a onetime non-cash charge of $1.59 on evaluation allowance for deferred tax assets coupled with our pre-tax that gets us to $1.91 on a net loss. As I mentioned, the positive for the quarter frankly, is a positive book to bill and backlog’s up 9% sequentially.

Taking a look at the first half, where our revenues are down just a few percent as compared to the first half of last year. Margins frankly, are up nicely almost 5%. We lost less - if we can use that word - by a few cents as compared to the first half of last year, so maybe operated just a little bit more effectively. Again, we talked about the backlog being up sequentially 9% quarter on quarter, down just a few percent if we look at a comparable periods of last year. EBITDA says we operated about a 1% better in the first half of this year versus last year.

Our typical financial snapshot that has – in the bars – is our revenue, the gray line is our margin, and then EBITDA performance is the green. Unfortunately, red colors at the bottom. You can see our revenue trend in the rolling 12. $7 million is the low point in that rolling 12 quarters. Margin's a bit noisy and EBITDA is a bit noisy as we move through mix. I think overall, revenue is the challenge. Cash and cash equivalents at the end of June were $3.50. If we look at our capital position, assets dropped notably and that was really for the valuation allowance of the tax asset. Working capital – cash adjusted working capital, which was actually slightly more efficient. Debt was reduced. Then, of course, the shareholder equity was again, down, primarily driven by the valuation. Book value at the end of the quarter was $7.60.

Where are we trying to position for growth? Because that's the challenge before the operating business at present. Well even though with our struggles of our business unit, our capital position does remain strong and in some cases, that actually is different than some of our competitors. So we are able to make investments organically, as well as some of these other investments and sales and e-commerce and those kinds of things that help reach out and touch our clients. I want to remind our investors that a lot of our components are quite sticky and they have long product life cycles especially in the aero defense market. It's not uncommon for those products to run 10 years. Even though we live in the cyclical business, eventually – and when they need that equipment again, sales will rebound for those long sticky revenue streams.

Our R&D investments today are really pretty targeted. We've got a number of new products being launched in what we call software defined radio market, primarily for aero defense applications. Some low noise radar timing devices and a number or products in what we call harsh environment timing again, aero defense directed. We have a strong position in commercial avionics. Similar to last year, that is a shiny spot with inside of our product offerings and our client position, and really seeing double-digit growth as the industry has predicted. We're feeling that as well with inside of our company. Below is the order backlog trend, the rolling 12, and we mentioned that quarter on quarter we're up 8% with backlogs at just over $9 million. GAAP to non-GAAP reconciliation for earnings as well as adjusted working capital. Some of this is repeat, but I'll share it again. We are towards growth. Some of clients reporting market softness. In some cases we know that because frankly speaking, we have sole source design positions and when business is down there, we can track pretty readily how well our major clients are doing. In some cases, it's just part of a cycle. Repeat orders against existing contract especially in the ICT market has been tough. Of course, we're under price pressure really everywhere in the soft market like we're in. Really, our client demand in this networking business has been the toughest part in the first half of this year. On the positive side, our new product revenue stream is sort of the percentage of new products as a percent of the total revenue remains what we believe healthy; near at 15% to 20% mark, and so that says we are replenishing or refreshing our revenue streams. Again, our working capital position, although it has slid, we did generate cash from ops in the second quarter. Really in the first half, margin and operating efficiencies, they remain favorable. Revenue remains our challenge. We talked about our organic growth investments. Software defined radios are really the avionics market. We are seeing repeat orders and share gain with our top seven or eight aero defense clients; strong in the double-digit category. We still think there's opportunity for indigenous sales in India. Anyway, we are continue to pursue how to grow within that market especially via some our larger clients. We are making investments and modules and sub systems. That's a slow process. You have to develop the technology and convince your clients that this is an entry point for you. We are gaining some success. Of course, as we've talked in a number of announcements, joint ventures and M&A - those types of activities are certainly present for LGL.

I added a slide that spoke generally but pretty plainly to the competitive landscape. Some of these are comments about the industry and the competitors. Some of them are a little bit more internal, but I'll just trying to walk through those. I've been in this industry now more than 10 years and the frequency control products industry, I can speak most closely to the environment that I see frankly, in North America, but I also have a number of touches in the Asia as well and it's certainly undergoing change. There's been a number of our key competitors that have formally announced - I'll call them strategic actions. Companies have formally announced spin-offs, so divisions of larger companies are now going to become divisions of smaller companies which are competitors that have announced major restructuring. We've seen a couple of complete sale of a portion of their assets. Goodwill write downs are common amongst all of that. So there is a fair amount of change today within the frequency control industry. I just wanted to share with our investors that LGL and MtronPTI are not standing alone when it comes to the state of the business.

For us, our commercial product lines are under notable pricing pressures. When you have a soft market like this, frankly speaking, pricing pressures are ever present and of course competitors that are struggling financially will dig deeper and work harder on margin. So that's probably just a factor of today's commercial market. On the macro economic effects, we talked about those often on these calls. Everybody reads about them. And it creates uncertainty. I'll try and share some specific example where we have been notified by clients of orders that we have frankly, booked or been awarded and yet the process of actually delivering the purchase order to us might lag by 60 days. So I think that's just a matter of - I'll call it a good example of where the market is still tentative and it creates this uncertainty and nobody really books or buys until they absolutely have to, so that same uncertainty is reflected in our backlog and then of course our revenue.

We've had a number of recent announcements here at LGL in the past 60 days and I just want to recap those for our shareholders. On June 13 we announced that LGL had received more than one and received some interest regarding acquisition of a portion of the MtronPTI. At the same time, our board of directors announced the formation of a special committee to really lead that review process. The board also took action to announce a warrant dividend to our shareholders. We also reviewed our stock repurchase program. On July 17th we stepped forward and announced the finalization terms of the warrant dividend and we also made additional commentary about the consideration of strategic options like streamlining operations, what would it mean if we reviewed the segmentation of the business, possible discontinuation, and of course, the interest regarding acquisition as well. On August 5th the warrants were distributed to our shareholders and they are now traded separately on the

NYSE market. I just want to comment and below the board of directors are actively exploring these strategic options. Today, there's not a lot of detail that I can share. I think our listeners would be appreciative of the fact that we can't share it until it's public. At this point, all I can say is it's an active process between management and the board of directors as we take a look at these options.

One last slide before we recap and ask for your questions. Capital position does remain strong. We do have an experienced management team. We are taking a look at JV and M&A and restructuring and all those kinds of things just like many of our key competitors are going through at this time in the industry as well. The brand itself, it's got some long standing value. It's been around a long time. It's got great client positions, some good technology, a worldwide platform, and known to be frankly, a high rail product line out there in the marketplace. So at this time, operator, I would open to our listeners that may have questions.

Operator: Certainly. At this time if you would like to ask a question, 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 will first go to the site of Sam Muller, who's a private investor. Your line is now open.

Sam Muller: Hi. I was wondering if you could speak to the idea of the dividend of the warrant and about how you came up with the pricing of those warrants.

Greg Anderson: Okay. I'll let LaDuane handle that question.

LaDuane Clifton: Good morning, Sam. Thanks for joining us. Yes. So the warrant dividend - we listed a number of ways and we're always looking for ways to bring value to our shareholders. The warrant dividend has a nice feature in the sense that it's a means of returning a portion of the company's future value to stockholders while preserving the company's balance sheet. We are active in our stock repurchase program as we've disclosed in our press release and in our 10-Q. So this was just another way to continue doing that. We need to preserve the cash obviously in this business cycle. We continue to look for ways to deploy that. So the warrant dividend kind of made a lot of sense. With regard to the pricing, the strike price or whatever related in the warrant dividend, I'd say the company - it analyzed a variety of factors in determining the terms of the warrants and we're really trying to maximize value to stockholders but balance that against some terms that could make sense in the long term. So we think we accomplished that but obviously, we had to apply a lot of judgment in trying to really strike the right balance.

Sam Miller: Okay. Thank you.

Operator: Our next question comes from David [Minkoff] with DCM Management. Your line is now open.

David [Minkoff]: Hi. Good morning, gentlemen. I also have a question on the warrants. The company issued five warrants but you need 25 warrants to buy share of stock at $7.50, sets the five to one ratio. Why didn't the company just issue one warrant and require the five warrants to buy a share of stock?

LaDuane Clifton: Well thanks for the question, David. It's nice to hear from you. Really, there's a balance of the exchange ratio, which is the rate that can be exercised for and then the distribution ratio. We were trying to balance between providing sufficient liquidity. Since the warrants will be traded separately, we wanted to provide sufficient liquidity for that separate trading as well as sort of have an exchange ratio that was meaningful, that the number of shares that can exchanged was sort of a function of what was available under our shelf registration frankly, and so we were balancing between those two ratios.

David [Minkoff]: Right. Well, but still a five to one ratio. It seems the math would've been easier would it not have if it was just one to five?

LaDuane Clifton: I understand that. We modeled that option. We thought the way we did the terms would provide more liquidity or better liquidity for the separate trading of the warrant.

David [Minkoff]: Okay. On August 6, the day before the X dividend day. I think the stock closed at $6.40 and on August 7th, the X dividend date, the stock was indicating $3.90 and the warrants were indicating $0.50 or thereabouts. So in other words, $2.50 had come off the price of the stocks, so I guess either they were valuing the warrants at $0.50 for five of them $0.10 for 25. I'm not sure which. Who imputed that value of $2.50 on the warrants? They never traded at $3.90 and the stock is trading about the sixth like you indicated, but the warrant is trading at $0.10, not $0.50. So how is that initial $2.50 off the price as the next dividend amount come about?

LaDuane Clifton: Well, I'm sure you realized those sort of pricing decisions, particularly around the first day of trading, really are outside the company's control. We're not part of that process. I'd say between the NYSE markets -

looking at the trading, how the stock traded with due bills between the record date and coming up to the first day of trading - I know they do an analysis of the due bills to see how things were trading during that time. Then of course, the market maker has a role as related to whatever activity you're seeing as well. So those events you described, we were looking at them anxiously as well. Wondering ourselves. All I can tell you is I think that now that they're trading actively in the market, the market decides the pricing albeit those first few estimates that came out of those decision makers, maybe I had the same question as you did. I wasn't sure, but those things are outside of us. Although we were speaking to them to understand after the fact. We saw it the same time you did.

David [Minkoff]: All right. The intention of this of course was to be an enhancer for shareholders. I know it's early but at this time, the amount that the stock is selling less than it was plus the dividend is about a wash really, right? The value of the warrant is what would come off of the stock price, so it's a pure X dividend so there's been no value created just yet admittedly it's early?

LaDuane Clifton: Yes. No, I appreciate your comments.

Greg Anderson: Yes. I think it's a fair statement. That's about as simply as we can say it as well.

David [Minkoff]: Just finally, I think you talked mainly about, in the releases, that there is a party that's interested in part of Mtron. I seem to recall in a prior release - I can't find it just now - but there was another party interested in the entire company. Is that true? Are there several interested parties or just the one? How many are we talking about?

Greg Anderson: I think they are at different levels of interest being expressed. I would say more than one and less than ten, and pieces are all certainly the board would take into consideration those kinds of interests.

David [Minkoff]: All right. Thank you very much for your answers.

Operator: We will now have the side of Hendi Susanto with Gabelli & Co. Your line is now open.

Hendi Susanto: Good morning. LaDuane, first question. I would like to inquire more insight into gross margin. The magnitude of the decline in gross margin in the quarter was deeper than my expectation. Can you describe how much impact came from product mix and whether there are certain variables that we need to be aware of?

Greg Anderson: Hendi, this is Greg speaking. I would say that the contribution between mix as well revenue decline’s probably split fairly evenly. Okay?

Hendi Susanto: Okay. Then let's say when you talk about mix like which mix has a lower gross margin?

Greg Anderson: Today, I can tell you that, and it's historically not always been the case, but today in our current operating business model, there are lines within our commercial products or networking group that run at less margin in today's environment for all the kind of reasons that I spoke to in the presentation.

Hendi Susanto: So let's say it is commercial [unintelligible] I believe, it is in ICT business then, which is well with a third of your revenue so it was big enough to impact the gross margin?

Greg Anderson: Yes.

Hendi Susanto: Okay. Just like to confirm that. Then second question is among the options of the strategic review process, what did you mean by segmenting some or all and from PTI's operations?

Greg Anderson: Okay. Fair question. Segmenting - well, we obviously have - half of our sales are foreign, so there is some regional - I'll call it options, if that's the right word, considerations is probably a better one. There's certainly market considerations - how we participate in those market, and there's considerations that we could segment along those lines. There's also various kinds of businesses. Largely, some of our businesses are what I would say more like customer service and distribution base when we have contract factories doing work for us. Then of course we have some parts of our business that are almost what I would call more manufacturing based and then we have some that are extremely custom and almost very specialized. So maybe the right word is there could be a consideration on the kind of business model as well. To recap, I would view it as regional market and possibly business type, if you will, inside of there.

Hendi Susanto: Okay. Then may I know how long the strategy review process especially the review of the third party [unintelligible] portions of that from PTI?

Greg Anderson: I'm sorry. I didn't hear that, Hendi. Could you repeat?

Hendi Susanto: How long does the strategy review process may take for let's say, like [unintelligible] considerations and also reviewing the third party influence in part of the company?

Greg Anderson: Yes. So you're questioning what the length of timeframe that will be in the strategic review process?

Hendi Susanto: Yes.

Greg Anderson: Well that's again, a good question. I'd say at this point it's undefined. I can just tell you that it's active. You can't do anything quickly within a public company. So, I would just say it's active. Obviously, we just had a board meeting in different kinds of options and proposals. At least some of those were discussed and under consideration, so decisions are not just made yet. I would say that we understand the urgency in the operating business. It's likely not going to recover quickly in this kind of market. The board of directors understands that. We understand the cash burn situation and there are pieces of the business that are performing well, others are not and all that certainly creates a sense of urgency. I'm not going to give you a horizon. I'll just say it creates a sense of urgency. Our management and board understands that.

Hendi Susanto: [unintelligible] I meant rather than having you do like an open ended review. Is it reasonable to assume that it should be completed [unintelligible] like one year?

LaDuane Clifton: Completed by when, Hendi?

Hendi Susanto: Like within a year?

LaDuane Clifton: So within a year - that’s as reasonable an estimate as any, Hendi, I'd say.

Greg Anderson: Yes.

Hendi Susanto: Then Greg, could you elaborate on sales opportunities in India and what timeline or horizon you are looking at?

Greg Anderson: For India investments or growth?

Hendi Susanto: Yes.

Greg Anderson: Okay. Well, it's active. So in particular, we've constantly made investment there to really manufacture a number of our products lines. As I mentioned in the presentation, a number of those end up being the high performance products as well. Probably of note, and I've spoken to it in previous calls, is being eligible for what is called the offset dollars. We are actively working with two clients trying to bring that to reality and that may end up providing them benefits and a way for us to grow. It's probably less about manufacturing infrastructure, Hendi, and more about, if you want to say, getting the right approvals within the company – within our clients, as well as getting positioned within the - I’m going to use these words - list their certifications within the Indian government to become eligible. We believe that that has the potential of steering business our way. So at this point, it's not like the factory expansion so much per se as it is getting positioned for that eligibility.

Hendi Susanto: Greg, would you talk about product groups within LGL? I think what I would like to understand better is that say, you have like a number of product groups within LGL. In my - of the third party of interest, I think one may think that under some potentials, you may be able to sell like certain product groups or certain segments but at the same time, one would like to know if it's like legacy business, gross business, product selling development, or etc. because if you [unintelligible] like a strong product group, then there's some indications on the company’s road maps as you pick out some legacy business [unintelligible] some indication that it may be of like smaller value?

Greg Anderson: Okay. All right. It's a first statement. So from a product grouping perspective, I'll start with filtering. We have a number of filtering offering and primarily, they are an aero defense applications either in radios, avionic communications, and they tend to be, I'll just say, using applications that are close to the antenna. Not always, but they're certainly part of what's called the RF signal path. It's also an area where we've done a fair amount of R&D investment in the past and certainly most - in the last 18 months, it's been our heaviest area for R&D investment. That particular kind of business - could it stand alone and be segmented? Yes. It’s tucked inside the infrastructure. It's certainly part of the aerospace and defense marketplace. We are not really a commercial products filtering company. Okay?

Hendi Susanto: Okay.

Greg Anderson: From a timing device perspective, there's really two parts to it. There is really network timing - the things that going backhaul, switches, routers, all those kinds of devices. There is timing that goes into base stations as those pieces of equipment convert signals, move packets of information around. That business itself - there's probably four or five kinds of products that make up network timing and I would say that those could be grouped together. Then there's timing that goes into aero defense applications and some of that actually - it also goes into the radio frequency signal path and some of that actually goes into digital controls used in a lot of avionic applications. Could that be segmented? The answer is yes. I think it probably most cleanly segments between the two markets - either network timing or aerospace and defense and the reason for that, Hendi, is clients, they buy that whole suite of products from us on aero defense. So first instance, Rockwell would be quite interested in having a front-end filter as well as timing devices that could be used in the RF signal path as well as timing devices that could be used in various kinds of avionics control applications. So I think it would probably best fit less on a product than maybe on a market, but there's probably potential either way.

Hendi Susanto: Then can you characterize the third party interest, whether they are like legacy products or whether they are let's call it like productive product groups?

LaDuane Clifton: Meaning growth product groups or…?

Greg Anderson: I would say that they tend to be legacy more mature. I think that's what we're - sensitive question. I'm not sure.

Hendi Susanto: Okay. That's [unintelligible]. Then last question is for LaDuane. Despite the tough markets that you're facing, where are we in terms of the company's ability to produce [unintelligible] for the year?

LaDuane Clifton: We don't tend to give a lot of guidance, but forward look, I'd say the backlog show some growth there and we're glad to see that, but I would simply say sort of second half is going to continue to sort of a tough go. That's probably all I can say on that. We don't tend to get too much forward guidance.

Hendi Susanto: Then if I may add one more, what is the estimated CapEx for the year?

LaDuane Clifton: We have a target CapEx rate we've shared publicly of around 1.5% of revenue that can fluctuate depending on what opportunities we have in front of us. I will say that if you look at where we come out on Q2, CapEx was down relative to Q1. That's a combination of things. Primarily, we're trying to work to get certain projects into production, but we're also trying to be prudent and make sure that we're investing in places that give us the best potential for growth in terms of product investment or CapEx to support product investments. So yes, that's probably I'd say we are.

Hendi Susanto: Okay. Thank you. Good luck for the second half.

Greg Anderson: Thank you.

LaDuane Clifton: Thank you.

Operator: Once again, if you'd like to ask a question, it is * then 1 on your touchtone phone. We'll pause for just a moment to allow additional questions to queue. Once again, that is * then 1. At this time, there seems to be no additional questions. I'd like to turn the program back over to our presenters.

Greg Anderson: Listeners, thank you for joining our call this morning. I would just finalize a couple of comments. In the core operating business, it was nice to see the backlog tick up. We have some bright spots in the aero defense in the first half as shown some nice growth in our largest clients. The top spot for us has been in our networking business. Management understands and the board of director understands we're not delivering the kind of performance that our investors would expect. Frankly speaking, that's why the review process is underway. We're not really able to comment on that very broadly as I've stated, but it is an active process with the board of directors and management. So once again, thank you for listening in this morning and as decisions are made, we'll obviously bring those forward to you. Thank you.

Operator: This ends the LGL Group's Q2 2013 Earnings 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. That is ganderson@lglgroup.com or lclifton@glggroup.com. Thank you and have a wonderful day.

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