

LGLIR0514
Greg Anderson
LGL Group Inc.
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Operator: Good morning, everyone and welcome to the LGL Group Q1 2014 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 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.

LaDuane Clifton: Good morning, everyone and thank you for joining the call today. With me as well is our President and CEO, Mr. Greg Anderson and LGL's Chairman Michael Ferrantino. We prepared a slide presentation for your reference that may be viewed as part of today's web conference. Those materials are available on our website at lglgroup.com. This 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 are covered today by our Safe Harbor statement. If you need assistance during the call, please press *0 for the operator. At this time, I'd like to introduce Mr. Greg Anderson.

Greg Anderson: Thank you, LaDuane and good morning. I'll start by giving you a quick corporate snapshot overview of LGL just to refresh folks. It's publicly traded. Formed in 1917. Today we have one operating subsidiary that goes under the brand of MtronPTI. Trailing 12 is \$25 million. Cash and cash equivalents is approximately \$7.5 million. Our revenue is approximately 50% outside the United States. Our current stock price as of Monday was \$4.75. We had a market cap of \$12.3 and we're a small player in a very large market. When we look ahead to our investor highlights, LGL subsidiary MtronPTI, we really serve large B2B type of clients and we're really in primarily two market sectors, internet communications technology and more largely, based in defense. Today, approximately two-thirds of our business is aerospace and defense and about one-third internet communications. Our technology's core is based upon crystal technology in the timing arena. We tend to work and perform on the real low noise or what we call the performance aspects of the value chain in these kinds of products. The company's platform itself is enabling. We've got a number of US sites, international sales, and international supply. We do have a low cost manufacturing facility in India and we have the opportunity to even produce these high performance products from that particular facility. Our margins - we gained margin performance really just because of the high value and the high reliability of the kinds of applications that our products go into. We strive to have long product cycles with these repeat revenue streams and we certainly have an experienced supplier management team to help drive costs. Our growth opportunity - we've several long standing relationships with industry leaders. Some of these relationships go back tens of years and in all cases, we're really a fairly small market share and so we've got those share gain opportunities as we bring on new products.

Slide five. We can talk about our operating environment in the first quarter of this year. I mentioned on our previous call that we've completed the acquisition of a product line from Trilithic in the first quarter. We did reconvert those open orders and we actually began shipments during the first quarter. So we call that immediately accretive. In the first quarter of this year, we did realize some benefits from our restructuring that we announced in the fourth quarter. At present, that run rate is about a little over a million dollars a year annualized or \$300,000.00 in the first quarter. On the positive side of our business, we are reporting a positive book to bill and really even though it's single digits, it's actually been building for three quarters in a row. We knew the first part based upon backlogs at the end of last year. We knew the front half of 2013 was going to be difficult. We are positioning the company for better results in the second half of this year. Costs, new products, and I mentioned this favorable bookings trend.

Slide six. I'd just like to spend a moment commenting on some of the strategic transformation that we've gone through over these past several years as we try to strive to create this long term value. We continue to stay committed to organic R&D and really what we're doing is we're trying to revitalize or are revitalizing our intellectual property in the company. So our spend in R&D, we disclosed that in the K. It's running about \$2 million a year. I think I've talked to you and investors many times that it takes several years once we start a program with one of our OEMs till we turn that into revenue. So these R&D investments that have been going on these past years, we do expect those to reap new products and certainly increases in revenue. We're targeting the software defined radio market and many low noise applications around these sort of high rel performance areas like radar. We made a number of investments into our infrastructure and our company and really trying to improve our overall operating efficiencies. We've made

investments in our ERP system. Those have been notable and sizeable to CapEx. We've certainly gone through a number of changes in our structure as our product mix and as our transformation in the market has taken place to really try and maintain those variable costs which end up driving our gross margins. You'll see a slide or two where we talk about improvements in gross margin and those trends and that's really where we're aiming and then we mentioned earlier that we had acquired the assets in Trilithic's filter product line at the end of January. Very consistent with our investments strategy of moving upstream to more complicated or complex products with these long and sticky revenue streams and improved margins. So in essence, we're well underway with transforming our product portfolio towards these longer product lifecycles where we've got enhanced capability integration into our OEM systems and really provide better solutions for them. With that, we believe that provides a more stable business by which we will have improved margins and returns for you shareholders.

The first quarter financial results. Revenues were \$6.1 million. That's up almost 7% from the fourth quarter, down notably from last year's first quarter. I would like to say that last year's first quarter was certainly our strongest first quarter financially for the year. Gross margin was at 26%, that's sequentially up almost 4% on increased revenue. It is down from first quarter of again, last year, which was our strongest quarter. Net loss was \$0.31 and that's sequentially less than the \$0.50 we reported in the fourth quarter. On a positive note, backlogs are up almost 6% sequentially over the fourth quarter and with the margins, with the revenue, we're seeing some improvement in our adjusted EBITDA. Still not where we want it to be but a notable improvement as compared to the fourth quarter.

The next slide, eight. We have our typical rolling 12 quarter - I call it our bar chart, but essentially in the blue bars, we have the revenue for the quarter. In the gray we have the margins. The red-green line is really the adjusted EBITDA. The point that we spoke to, we can see revenue trending up slightly. Margins are up as well and part of that is our restructuring and part of that is our mix and part of that is our operating efficiency and you can see the trend line on adjusted EBITDA. Yes, it's still negative, but it is trending the right way. We talked about our cash position. Cash and cash equivalents is just under \$3.00 a share and book value at the end of March was \$6.18 per share. We continue to try and position the company for growth. We do have a strong capital position. I mentioned our R&D investments are running almost \$2 million a year. We're fairly targeted with our large OEMs of where we're trying to bring new products into the marketplace. Again, those adoption cycles are quite long in our business. On the other hand, once we do win those design positions, they can often run 10 years or longer. These kinds of components that we make are very sticky and they've got high barriers to switching and we're well under our way of transforming the company's backlog and product investments along these lines. We do have a strong position in commercial avionics, either in flight controls or communication systems, and that's certainly the strongest part of our portfolio at present. Amidst our backlog, is up to \$9.1 million, almost 6% sequentially.

Slide 10. When we talk about how we're working towards growth, it's been tough on the price side in the business. The networking business has seen a fair amount of price compression and certainly, that has an impact on our ability to maintain margins and grow. In the first quarter of this year, again, we talked about our Trilithic acquisition and certainly with that comes some onetime variable costs and so we expect those to improve as we look forward into the rest of the year with that acquisition, but that has certainly somewhat

challenged our financial performance in the first quarter. We still have strong new product revenue streams from - we measure that on a 36 month rolling basis. Certainly, we're going to get some benefits from the impacts of Trilithic I mentioned. We're beginning to see the improved cost structure and what that can do for our P&L and we remain having a strong working capital position. Our drivers again, we're investing for organic growth. We think we have a good chance to share gain inside of our existing clients. We're looking hard at opening up India sales opportunities and some additional operational investments. IP investments towards more functional or more highly integrated products especially along the RFM Microwave signal management area and of course, opportunistic and certainly looking always for synergistic and strategic kinds of acquisitions and joint ventures.

Slide 11, our strategy. Simply stated, to revitalize our intellectual property really to our organic investments as well as these acquisitions. We do have a strong brand with our OEMs and we're going to continue to leverage that as we bring on these new capabilities and diversify our product offerings. In any way we can, we're looking for ways where we can differentiate our offering and bring increased value to our OEMs. So we're very focused on that. While we're doing that essentially, we're transforming our product portfolio towards these offering that have longer lifecycles and higher switching costs or higher competitive barriers and better margins.

Slide 12. A recap of our investment considerations. Strong capital position at LGL, experienced management team, experience with joint ventures and M&A. Today we're trading at less than book. We've got 0.8 tier. Our brand itself has been our, along with MtronPTI. A great list of clients. A couple of key markets that we serve. World class team and platform to work from. Several of our quality standards are recognized. We've spent a lot of time

over the last couple of years working towards AS9100 and we certainly have that certification now worldwide for a company and we are certainly today recognized as an industry leader. So at this time, operator, I would entertain questions from our listeners.

Operator: At this time if you would like to ask a question, please press the * and 1 on your touchtone phone. You may remove your question from the queue by pressing the # key. Once again if you'd like to ask a question, please press the * and 1 on your touchtone phone. Our first question comes from Hendi Susanto. Please go ahead. Your line is open.

Hendi Susanto: Good morning, Greg and LaDuane. I hope you can hear me okay and pardon me for some background noise here.

LaDuane Clifton: We can hear you fine. Good morning.

Greg Anderson: I can hear you fine.

Hendi Susanto: So Greg, Q1 revenue declined by 7.8% on a year over year basis and then on the other hand, you reported that LGL continued to expand share gain in aerospace and defense. How would that show that your overall end markets declined at a lower rate than 7.8%. So how should we view that revenue decline relative to your overall end market trend?

Greg Anderson: Well, it's a thoughtful one. Honestly, I'm not sure that that is completely out of line within markets especially in the networking side. So a fair amount of price compression. I mentioned that, Hendi, and in that particular market space, double digit year on year is really not that hard. In fact, it's probably required in some of those networking products to maintain share. I think the

rest of it is really just been a compression really of the continuation of sequestering and softness. I don't really feel that we've lost share at many of our key accounts. We certainly have felt some price compression. I think through the - you want to call it the budget cycle - there's some signs in the electronic industry. A number of companies are reporting positive book to bill, so we're not the only one out there doing that. So maybe some of the budget - I'll call it program funding - is now beginning to come through. So yes, it was an aggressive step down but the markets that we serve at this time, they were under a fair amount of pricing pressure over this past year.

Hendi Susanto: How do you characterize the pricing pressure in Q1 compared to [unintelligible] numbers? I'm wondering whether you can share some insight whether like take over, below, or on par with like recent historical trends?

Greg Anderson: I'm not sure I heard that so clearly, Hendi. So the pricing pressure historically - can you restate that one for me?

Hendi Susanto: How do you characterize the pricing pressure in Q1 whether it's steeper, on par, or below recent historical trends?

Greg Anderson: Oh, I think it would be steeper this year. So typically, our contract - another aspect of it - our contract cycle typically follow the calendar as well, Hendi. So you know the stuff that we have in our revenue stream in the first quarter of this year versus the first quarter of last year would certainly be under a new contract cycle, which really means new pricing. So I think the last two years for certain in the networking space, pricing pressure has been steep and more aggressive than the previous certainly. In fact, I was on a call with one of our OEMs yesterday and he said - they had affirmed that. Will that stabilize? I

think the pricing pressure is certainly going to be tough through this year as well.

Hendi Susanto: Got it. LaDuane, would you be able to share what Trilithic's contribution in Q1 look like and what the revenue run rate and then perhaps whether you can share also like Trilithic customer profiles and the number of customers?

LaDuane Clifton: Okay. So margins in Q1, we came out with gross margins of about 26%. The Trilithic is going to help us in the margin area, but it's relatively a small component of it. However, we think that Q1- that rate will prevail. It could improve some as volumes improve. If we look across the year, the run rate - currently \$6 million over the last couple of quarters - that was largely expected, as Greg mentioned, based on where our backlog was at end of year. We've seen backlog improve as we reported and that will come out later in the year. So the run rate for revenue - we have some backlog to support that. It could improve but it's hard for us to predict or forecast that for you today. The last part of your question, Hendi, I didn't understand.

Hendi Susanto: [Crosstalk] share like Trilithic assets, customer profile, and the number of customers?

Greg Anderson: Okay. Well, let me take that one, Hendi. I'll just comment just a little bit more on the margin. So in the first quarter, Trilithic probably didn't have a positive impact because of our one time transition cost. So I would say it probably didn't hurt our margin profile in the first quarter. I do believe it will help our margin profile in the quarters ahead. We're taking a different structure than Trilithic did with those particular models. We're able to again, leverage some costs out of those products by largely, producing those from our India facility. I think that'll help frame the margins. Overall, I believe

Trilithic will be richer than our typical historical gross margin profile in the company for us anyway. From a customer profile perspective, they had a couple of exceptional customers. Companies like divisions at Boeing. So there were some very key designs here in UAB platforms. So what's coined in aerospace and defense, EW platforms, and so rather than probably giving you a detailed profile, there's probably in total dozens of clients. A few make up probably half of the revenue and they're the kind of companies and applications that I just mentioned. So that's certainly target areas for us. They're strategic areas for us. It blends nicely with the kinds of technology that we're developing and where we're trying to broaden our product portfolio. So there were several very good things - clients, margin, products. There were a few things there that we got from Trilithic that we think will pay strong dividends for our shareholders in the future.

Hendi Susanto: Okay. Great. Do you have updates on software defined radio and whether or not we should expect to see initial sales happening in 2014?

Greg Anderson: So the answer is yes. We have the prototype activity and the interest in the market is strong. So nearly every sales call that we're on, we find success in uncovering a - I'll call it a complex filtering opportunity for software defined types of applications. From a revenue perspective, we're seeing small hits at present and nothing that I would comment to that I'll call be notable in our financials. On the other hand - I'll be a broken record - it takes a long time in this business to turn it into revenue streams. It's not uncommon for it to take three years and on the other hand, once you are, the barriers and the switching costs are quite high. So we're active. We're active in the engineering aspect. We've taken some small orders. It's still an area of investment. It's providing a lot of I'll call it enthusiasm in the market for our sales and engineering folks and marketing folks when we're out selling. There is a lot of interest. It's

quite obvious a lot of our OEMs do that kind of work inside on their own bench. It's not just competing with other folks that have these types of complex components. A lot of times that kind of engineering is done inside of our OEM, so we're trying to bring a nice I'll call it compelling market reason for them to be able to move that engineering over to us. So yes, feel excited about it. I wish I could report 10% compare growth on it but I can't yet, Hendi, but we're still investing there.

Hendi Susanto: Okay. Then last question for me. Greg, do you have updates on new product pipeline? In the last earnings call you mentioned about the G-Sense and [unintelligible] such as [unintelligible] oscillators and then [unintelligible] power filters?

Greg Anderson: The answer is yes. We are making inroads and bringing some G-Sense products to market. We did take an order and I'm probably not going to mention that as being material, but we have taken it for one of those very sensitive G-Sense kinds of applications. So we will be shipping revenue with inside of 2014 on those kinds of products. So we're pleased with that and that's just actually happened recently in the month of April actually. So yes, we are developing there. We're actually going to have revenue this year and as I mentioned, that's probably work we started a couple of years ago. So that's probably our largest areas for investment, is really this software defined things of filtering applications and really vibe shock, G-Sense kind of timing applications is where we're spending most of our R&D dollars.

Hendi Susanto: Okay. Thank you.

Greg Anderson: Thank you, Hendi.

Operator: Again, if you'd like to ask a question, please press the * and 1 on your touchtone phone at this time. It appears we have no further questions.

Greg Anderson: All right. Thank you, investors for joining our call this morning. A couple of positive trends. Still a tough financial quarter for us but certainly an improved backlog, improved margins, a better cost structure. Those are all somewhat positive. We're obviously pressing hard for a better performance in the second half of this year. Thank you for attending. Okay, operator?

Operator: This ends the LGL Group's Q1 2014 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. Thank you and have a wonderful day.

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