Zacks Equity Research

August 27, 2010
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# LGL Group Inc (LGL-AMEX)

**LGL: Solid Quarter-**

**New Contracts Beginning to Contribute.**

| | |
|---|---|
| **Current Recommendation** | **Outperform** |
| Prior Recommendation | N/A |
| Date of Last Change | 05/02/2010 |
| Current Price (08/26/10) | $15.56 |
| **Six- Month Target Price** | **$20.00** |

## OUTLOOK

LGL Group, through its subsidiaries manufactures custom-designed highly engineered electronic components. On August 17th 2010 LGL reported second quarter of 2010 earnings. This marked the 3rd straight quarter of top and bottom-line growth. MISA contracts won in the second half of 2009 have begun to contribute significantly to revenue. The contracts deal with military personnel protection and homeland security. Despite record revenue back-logs improved slightly from $14.3 million to $14.4 million and have shifted from MISA to Telecom.

## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$19.06** |
| **52-Week Low** | **$2.63** |
| **One-Year Return (%)** | **590.58** |
| **Beta** | **1.04** |
| **Average Daily Volume (sh)** | **13,682** |
| **Shares Outstanding (mil)** | **2** |
| **Market Capitalization ($mil)** | **$43** |
| **Short Interest Ratio (days)** | **0.28** |
| **Institutional Ownership (%)** | **10** |
| **Insider Ownership (%)** | **29** |
| **Annual Cash Dividend** | **$0.00** |
| **Dividend Yield (%)** | **0.00** |
| **5-Yr. Historical Growth Rates** | |
| **Sales (%)** | **-9.2** |
| **Earnings Per Share (%)** | **N/A** |
| **Dividend (%)** | **N/A** |
| **P/E using TTM EPS** | **16.6** |
| **P/E using 2010 Estimate** | **8.7** |
| **P/E using 2011 Estimate** | **10.2** |
| **Zacks Rank** | **1** |

| | |
|---|---|
| **Risk Level** | **Above Avg.,** |
| **Type of Stock** | **Small-Blend** |
| **Industry** | **Elec-Misc Compn** |
| **Zacks Rank in Industry** | **5 of 39** |

## ZACKS ESTIMATES

**Revenue**
(in millions of $)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2008 | 10 A | 10 A | 10 A | 10 A | 40 A |
| 2009 | 8 A | 7 A | 7 A | 9 A | 31 A |
| 2010 | 11 A | 13 A | 12 E | 12 E | 48 E |
| 2011 | 13 E | 14 E | 15 E | 15 E | 57 E |

**Earnings per Share**
(EPS is operating earnings before non recurring items)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2008 | -$0.28 A | -$0.26 A | -$0.03 A | -$0.05 A | -$0.61 A |
| 2009 | -$0.44 A | -$0.43 A | -$0.44 A | $0.15 A | -$1.16 A |
| 2010 | $0.47 A | $0.97 A | $0.84 E | $0.95 E | $3.23 E |
| 2011 | $0.98 E | $1.01 E | $1.03 E | $1.04 E | $4.06 E |

Zacks Projected EPS Growth Rate - Next 5 Years % **15**

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## WHATS NEW

On August 16, 2010 LGL announced results for the second quarter of fiscal year 2010 ending June 2010. Revenue for the period was $12.5 million rising 16.8% sequentially from $10.7 million and up 73.2% year over year. Top-line growth was primarily due to increased demand from existing customers for existing products in the Telecom, Military, Instrumentation, Space and Avionics (MISA) market segments. Further new lines of cavity filters and double-oven oscillators, which entered into production during the first half of 2010, also contributed to the growth. Foreign sales grew 52.7% to $5.4 million for the quarter ended March 31, 2010, compared to $3.5 million for the quarter ended June 30, 2009.

The company's backlog grew by 0.8% sequentially from $14.3 million to $14.4 increased by 73.3% compared to the backlog as of June 30, 2009 of approximately $8.3 million. The growth was primarily attributed to increased repeat orders from the Company's existing customers, as well as orders received from new customers.

Working capital increased to $8.8 million as of June 30, 2010, compared to $5.4 million as of December 31, 2009. The increase in working capital was primarily due to increases in accounts receivable and inventory balances, offset by increases in accounts payable and accrued commissions expenses, which are the result of increased production activity commensurate with the increase in revenues. During the second quarter LGL negotiated a renewal of its revolving credit facility with First National Bank of Omaha, effectively extending its maturity date to June 30, 2011. The Company also has a term loan with RBC Bank, which matures on October 1, 2010.

On August 5, 2010 LGL announced that MtronPTI entered into an agreement with Jackson Labs Technologies Inc. to develop and market Global Positioning Satellite Disciplined Oscillator (GPSDO) modules. Jackson Labs, based in Los Gatos, CA, is a privately-held company that designs precision timing, testing and measurement instruments. According to Greg Anderson, LGL Group's President and Chief Executive Officer, the agreement will combine Jackson Labs' extensive technology portfolio with LGL's oscillator products and manufacturing expertise. The result should be state of the art timing and frequency solutions to customers in the multi-billion dollar telecom, military, security, space and avionics markets.

## INVESTMENT THESIS

Orlando based LGL Group manufactures custom-designed highly engineered electronic components. The Company operates through its principal subsidiary, M-tron Industries, Inc., which includes the operations of M-tron Industries, Ltd. ("Mtron"), and Mtron's subsidiaries Piezo Technology, Inc. and Piezo Technology India Private Ltd.

LGL's components are used primarily to control the frequency or timing of signals in electronic circuits. Its devices, which are commonly called frequency control devices, are used extensively in infrastructure equipment for the telecommunications and network equipment industries. Its devices are also used in electronic systems for military applications, avionics, earth orbiting satellites, medical devices, instrumentation, industrial devices and global positioning systems.

MtronPTI's products are employed in numerous applications within the communications industry, including computer and telephone network switches, high-speed gigabit Ethernet, modems, wireless transmitters/receivers, multiplexers, data recovery/regeneration devices, fiber channel networks, repeaters, data transceivers, line interface devices, communications satellites, and base station controllers. Its products are incorporated into end products that serve all elements of the communications industry.

The crystals, oscillators and filters intended for non-communications applications are found in military applications for remote sensing, personnel protection and armaments. Avionics applications include ground and flight control systems. Industrial applications are in security systems, metering systems, electronic test instruments and industrial control systems. MtronPTI's products are also used in medical instrumentation applications, as well as in various computer peripheral equipment such as storage devices, printers, modems, monitors, video cards and sound cards.

MtronPTI's frequency control devices consist of packaged quartz crystals, crystal oscillators and electronic filters. These products produce an electrical signal that has the following attributes:

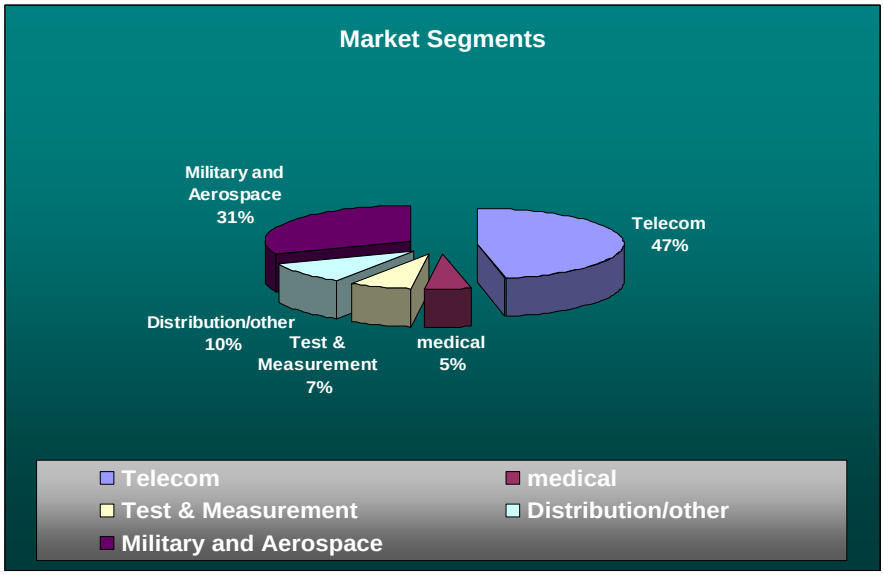
- Accuracy -the frequency of the signal does not change significantly over a period of time
- Stability -the frequency of the signal does not vary significantly when the product is subjected to a range of operating environments
- Low electronic noise -the signal does not add interfering signals that can degrade the performance of electronic systems

LGL, which dates back 40 years, has an impressive portfolio of blue chip global OEM customers. These customers include Cisco, Raytheon, GE, Honeywell and Agilent Technologies among others. Revenues from MtronPTI's 10 largest customers accounted for approximately 57.4% of revenues in 2009, compared to approximately 47.0% of revenues for 2008.

**Emerging from the global slowdown.**

The 2009 recession hit LGL as well as the industry hard. LGL, which relies on a single product line, was not immune to the weak economic environment as 2009 revenue fell 22.1% year over year. Despite the rough waters the firm emerged stronger and leaner as cost structure was realigned, manufacturing was tapered to three global manufacturing plants and more high-end jobs were transferred overseas.

U.S. electronic equipment orders and shipments performed better than most of the world in 2009 – thanks to the U.S.'s higher dependence on less volatile end markets (military, medical, instruments, and controls). These markets offer much lower volumes compared to computers, mobile communications, consumer electronics, and automotive sectors, which drive export dependent SE Asia.




The firm currently competes in a fragmented market which management projects to be somewhere in the area of $4.0 billion. Broken down by geography 26% of the business is aligned in North America, with 21% attributed to Europe and 50% in the Asia Pacific region. The majority of this market (80%) supplies to the low end standardized commodity market. What remains is the specialized components markets. This is where the firm competes, primarily in the Military Instrumentation, Space and Avionics market (MISA) and the telecommunications and Networking infrastructure segments.

**Military Instrumentation, Space and Avionics**

- Radar Navigation
- Communications
- Electronic Warfare
- Weaponry
- Instrumentation (test and Measurement)

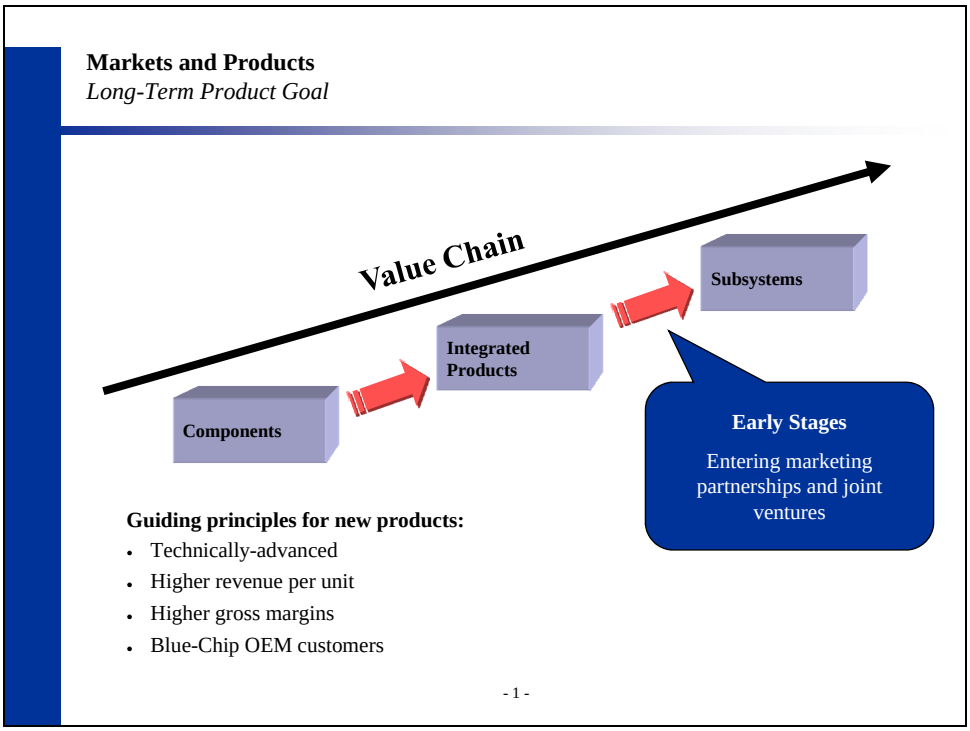
**Networking infrastructure segments**

- Cell Phone Base Stations
- Microwave Radios
- Switches and Routers

Growth of the internet should mean more switches and router orders. In our opinion the internet is still growing and has a relatively low 24.7% penetration rate compared to the population. Especially if one considers Asia which has approximately 56% of the world's population yet remains only 18.5% penetrated. Another trend to consider in assessing the LGL growth rate is the explosion of handheld devices such as IPhones and Blackberries. There are in effect more and more devices being connected and each new connection needs some type of access.

| WORLD INTERNET USAGE AND POPULATION STATISTICS | | | | | | |
|---|---|---|---|---|---|---|
| World Regions | Population ( 2009 Est.) | Internet Users Dec. 31, 2000 | Internet Users Latest Data | Penetration (% Population) | Growth 2000-2009 | Users % of Table |
| Africa | 991,002,342 | 4,514,400 | 65,903,900 | 6.70% | 1359.90% | 3.90% |
| Asia | 3,808,070,503 | 114,304,000 | 704,213,930 | 18.50% | 516.10% | 42.20% |
| Europe | 803,850,858 | 105,096,093 | 402,380,474 | 50.10% | 282.90% | 24.20% |
| Middle East | 202,687,005 | 3,284,800 | 47,964,146 | 23.70% | 1360.20% | 2.90% |
| North America | 340,831,831 | 108,096,800 | 251,735,500 | 73.90% | 132.90% | 15.10% |
| Latin America/caribbean | 586,662,468 | 18,068,919 | 175,834,439 | 30.00% | 873.10% | 10.50% |
| Oceania/Austraila | 34,700,201 | 7,620,480 | 20,838,019 | 60.10% | 173.40% | 1.20% |
| **World Total** | **6,767,805,208** | **360,985,492** | **1,668,870,408** | **24.70%** | **362.30%** | **100.00%** |

The firm see's significant potential for highly engineered value chain product. That is, be in the product life cycle not only for the sale of components but also later on in the advanced stages product life cycle through joint ventures and partnerships. This will lead to higher revenue per unit as well as higher gross margins and should serve as target for investors to consider.




**A footprint in the fast growing MISA**

New MISA contracts won in the second half of 2009 should begin to contribute significantly to revenue over the next two quarters. The contracts deal with military personnel protection and homeland security.

According to the market research firm Deloitte, "The Aerospace &Defense industry is likely to see opportunities based on troop increases, from supplying vehicles, generators, transport aircraft and helicopters to providing innovative new solutions to key problems, such as improvised explosive devices (IEDs) and energy use. Companies that can rapidly develop, test and deploy new technologies will likely be winners in 2010," said General Charles Wald (USAF Ret), director and senior advisor in Deloitte's A&D sector.

**Passing on a combination**

During the 4th quarter of 2009 the LGL Group was approached about a potential combination. Management, which stated no purchase offer was ever proposed, commented briefly during a January conference call to investors. The benefits of such a combination include cost savings with respect to sales expenses, engineering expenses, and administrative expenses. The board of directors dispatched a special committee to review the combination which concluded returns would be greater with the current business model.

## PROJECTED INCOME STATEMENT & BALANCE SHEET

| INCOME STATEMENT ($ Millions) | Jun-09 Q209 | Sep-09 Q309 | Dec-09 Q409 | Mar-10 Q1 10 | Jun-10 Q2 10 | Sep-10 Q3 10 E | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **REVENUE** | | | | | | | | | | | |
| **Net Revenue** | **7.2** | **7.3** | **9.2** | **10.7** | **12.5** | **11.5** | **49.3** | **39.5** | **40.2** | **31.3** | **48.3** |
| *Sequential Growth* | | *1%* | *26%* | *16%* | *17%* | *-8%* | | | | | |
| **OPERATING EXPENSES** | | | | | | | | | | | |
| Cost of Revenues | 5.8 | 5.9 | 6.3 | 7.0 | 8.0 | 7.5 | 35.7 | 29.4 | 29.8 | 23.9 | 31.0 |
| *% of Revenue* | *80%* | *80%* | *68%* | *66%* | *64%* | *65%* | | | | | |
| **Gross Profit -** | **1.4** | **1.4** | **2.9** | **3.7** | **4.5** | **4** | **13.6** | **10.2** | **10.4** | **7.4** | **17.3** |
| *Proforma Gross Margin* | *19.9%* | *19.5%* | *31.6%* | *34.2%* | *36.3%* | *35%* | *27.5%* | *25.7%* | *25.8%* | *23.7%* | *35.8%* |
| R&D + Engg | 2.3 | 2.3 | -7.2 | 2.4 | 2.2 | 2.1 | 14.1 | 11.0 | 11.2 | 9.3 | 8.8 |
| *% of Revenue* | *32.2%* | *31.1%* | *-77.8%* | *22.8%* | *17.5%* | *18.3%* | *28.6%* | *27.8%* | *27.9%* | *29.8%* | *18.2%* |
| SG&A | 0.0 | 0.0 | 9.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0 | 0 |
| *% of Revenue* | *0.0%* | *0.0%* | *101.5%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* |
| GW Amort, Restructuring, other | - | - | - | | | | - | - | - | | |
| *% of Revenue* | | | | | | | | | | | |
| Total Operating Expenses | 2.3 | 2.3 | 2.2 | 2.4 | 2.2 | 2.1 | 14.10 | 10.98 | 11.20 | 9.34 | 8.80 |
| *% of Revenue* | *32.2%* | *31.1%* | *23.7%* | *22.8%* | *17.5%* | *18.3%* | *28.6%* | *27.8%* | *27.9%* | *30%* | *18%* |
| **Operating Income -** | **-0.9** | **-0.8** | **0.7** | **1.2** | **2.4** | **1.9** | **-0.540** | **-0.810** | **-0.830** | **-1.910** | **8.500** |
| *Operating Margin* | *-12.3%* | *-11.6%* | *7.9%* | *11.4%* | *18.8%* | *16.5%* | *-1%* | *-2%* | *-2%* | *-6%* | *18%* |
| **NON-OPERATING ITEMS** | | | | | | | | | | | |
| Non operating Income/Expense | -0.05 | -0.10 | -0.35 | -0.11 | -0.08 | -0.12 | 1.18 | 0.39 | -0.36 | -0.57 | -1 |
| *% of Revenue* | *-0.69%* | *-1.37%* | *-3.80%* | *-1.03%* | *-0.61%* | *-1.04%* | *2.39%* | *0.99%* | *-0.90%* | *-1.82%* | *-1.45%* |
| Tax Provision | -0.01 | 0.01 | 0.05 | 0.02 | 0.10 | 0.1 | -0.2 | 0.1 | 0.1 | 0 | 0 |
| *Effective Tax Rate* | | | | | | | | | | | |
| **Net Income -** | **-0.93** | **-0.96** | **0.33** | **1.09** | **2.18** | **1.68** | **0.86** | **-0.55** | **-1.31** | **-2.49** | **7.48** |
| *Net Income Margin* | *-12.8%* | *-13.1%* | *3.6%* | *10.2%* | *17.4%* | *14.6%* | *1.7%* | *-1.4%* | *-3.3%* | *-8.0%* | *15.5%* |
| **Stock Based Comp** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** |
| **EARNINGS PER SHARE** | | | | | | | | | | | |
| **EPS - Basic** | -$0.43 | -$0.44 | $0.15 | $0.47 | $0.97 | $0.84 | $0.40 | -$0.25 | -$0.61 | -$1.16 | $3.23 |
| EPS - Diluted | -$0.43 | -$0.44 | $0.15 | $0.47 | $0.97 | $0.84 | $0.40 | -$0.25 | -$0.61 | -$1.16 | $3.23 |
| EPS - (EXCL Charges) | -$0.43 | -$0.44 | $0.15 | $0.47 | $0.97 | $0.84 | $0.40 | -$0.29 | -$0.60 | -$1.16 | $3.23 |

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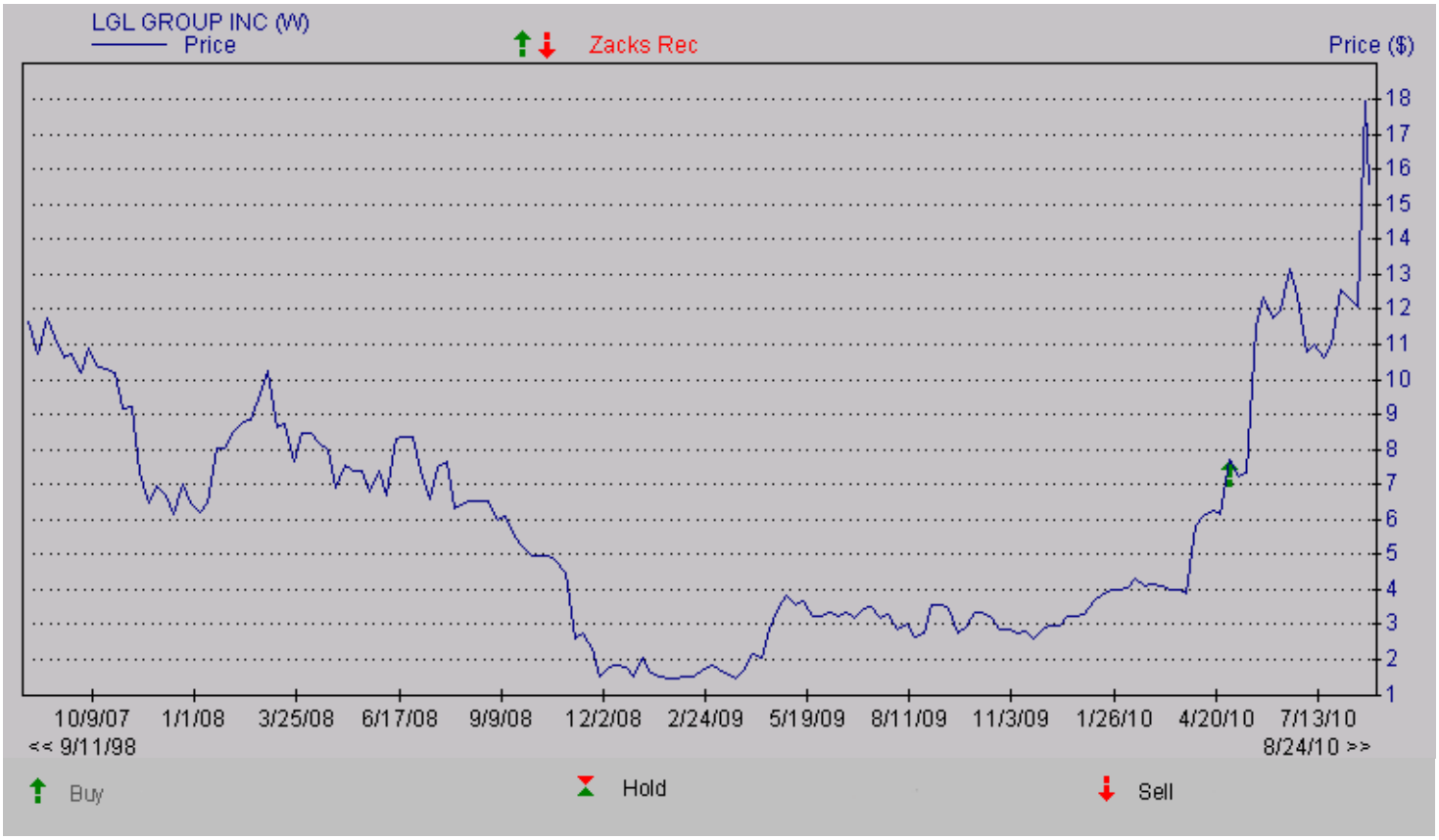
## HISTORICAL ZACKS RECOMMENDATIONS

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