Zacks Small-Cap Research

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Ken Nagy, CFA

www.zacks.com
111 North Canal Street, Chicago, IL 60606

LGL Group Inc (LGL-AMEX)

LGL: Weak Quarter, Still Very Cheap; OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/02/2010
Current Price (08/05/11)	$7.79
Target Price	**$20.00**

OUTLOOK

LGL Group, through its subsidiaries manufactures custom-designed highly engineered electronic components. Beyond its blue chip customer base the firm has significant opportunity for growth in specialty products in the military instrumentation and space avionics market (MISA) as well as high growth emerging areas such as India and China. Further the firm's long-term goals include plans to diversify away from strictly selling components and to be included higher in the value chain through strategic partnerships.

SUMMARY DATA

52-Week High	**$33.93**
52-Week Low	**$7.79**
One-Year Return (%)	**-37.08**
Beta	**1.31**
Average Daily Volume (sh)	**11,890**
Shares Outstanding (mil)	**3**
Market Capitalization ($mil)	**$20**
Short Interest Ratio (days)	**4.78**
Institutional Ownership (%)	**22**
Insider Ownership (%)	**16**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-3.0**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**4.9**
P/E using 2011 Estimate	**9.4**
P/E using 2012 Estimate	**4.2**
Zacks Rank	**3**

Risk Level	**Moderate**
Type of Stock	**Small-Blend**
Industry	**Elec-Misc Compn**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	7.5 A	7.2 A	7.3 A	9.2 A	31.3 A
2010	10.7 A	12.5 A	12.4 A	11.0 A	46.7 A
2011	9.0 A	9.6 A	11.0 E	11.5 E	40.5 E
2012					50.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	-$0.44 A	-$0.43 A	-$0.44 A	$0.15 A	-$1.16 A
2010	$0.47 A	$0.97 A	$0.88 A	$0.46 A	$2.78 A
2011	$0.10 A	$0.13 A	$0.28 E	$0.32 E	$0.83 E
2012					$1.85 E

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WHATS NEW

On August 3, 2011, LGL Group, Inc., reported financial results for its fiscal 2011 second quarter, ended June 30, 2011.The second quarter performance resulted in a 23 percent year over year decrease in revenue, with revenue dropping $2.889 million to $9.646 million from $12.535 million for the three months ended June 30, 2010.

Net income came in weak as well, falling $1.485 million year over year to $346,000. This compares to net income of $2.177 million for the comparable quarter of 2010.Still, LGL's net earnings result for the 2011 second quarter extends the Company's trend to seven consecutive quarters of net earnings.

The decrease in revenue for the three months ended June 30, 2011 was mainly due to reduced order activity for the Instrumentation, Military, and the Space and Avionics market segments. However, it should be noted that while demand for the Space and Avionics market segment has softened, the Company has seen improved strength in the Avionics segment.

While year over year gross margin fell 4.5 percent during the quarter, the decrease in net income was likewise the product of a de minimis tax expense in 2010 due to a full valuation allowance against its deferred tax assets resulting in an increase to the Company's income tax provision for the quarter ended June 30, 2011. Gross margin fell from 36.3 percent, in the second quarter of 2010, down to 31.8% for the three months ended June 30, 2011.

This decrease in gross margin was mainly a result of spreading fixed infrastructure costs over a reduced revenue base.Management confirms that its cost structure remains in alignment with revenue levels through the close monitoring of variable costs and the maintaining of structural cost discipline.

The Company's backlog decreased modestly due to decreased repeat orders from existing customers in the Space and Avionics market segment as well as extended order request dates that are greater than the twelve-month time frame reflected in the order backlog. Still, the Space and Avionics market segment's reduction of repeat orders was offset by sustained demand in the Telecom market segment.

LGL's backlog, as of June 30, 2011, fell 1.2 percent sequentially to $12.093 million compared to $12.238 million as of March 31, 2011. Nevertheless, cash from operations for the first half of 2011 increased $0.925 million year over year to $1.733 million and working capital improved by $6.5 million to $19.3 million as compared to $12.8 million as of December 31, 2010.

Furthermore, cash-adjusted working capital, as of June 30, 2011, improved by $0.517 million to $9.179 million from $9.696 million as of December 31, 2010.

The decrease in cash-adjusted working capital was due to a decrease in accounts receivable which was offset by an increase in inventories and trade accounts payable. Additionally, total debt as of June 30, 2011, was decreased by $133,000 to $536,000 compared to $669,000 at December 31, 2010.

For the third quarter and second half of 2011, the Company continues to expect growth in the Semi-conductor industry, with the progress being driven by end consumer application.

However, LGL remains cautious regarding its outlook for repeat orders during its second half as major electronic manufacturing service companies and original equipment manufacturer's report mixed market conditions. The Company believes its customer positions remain strong across its target market segments.

Likewise, LGL expects to see growth in revenue and earnings over the next two years through the expansion of its product portfolio through continued investment in product development.

Along the same lines the Company anticipates new opportunities with new and existing customers through its active pursuit of joint ventures and synergistic acquisitions as well as investments in greenfield opportunities.

INVESTMENT SUMMARY

LGL Group, through its subsidiaries manufactures custom-designed highly engineered electronic components. Beyond its blue chip customer base the firm has significant opportunity for growth in specialty products in the military instrumentation and space avionics market (MISA) as well as high growth emerging areas such as India and China. Further the firm's long-term goals include plans to diversify away from strictly selling components and to be included higher in the value chain through strategic partnerships. We feel the stock will outperform the overall market.

Growth Initiatives

LGL is committed to four strategic growth initiatives in order to build shareholder value.

The Company intends to generate increased shareholder worth through incremental investments into its core business. This organic growth is anticipated through investments into higher level value chain products that will result in both higher average sales prices as well as increased margins. Organic growth would be accomplished through maximizing positions with existing customers through investments that would leverage opportunities with those customers.

Management also believes joint venture opportunities could further increase shareholder desirability by allowing the Company to secure access to intellectual property. Likewise, joint venture opportunities that would expand and improve LGL's capacity would allow the Company to be more reactive to its customers' supply chain requirements.

Similarly, management believes that synergistic mergers and acquisition opportunities may escalate shareholder appeal. The LGL Group intends to focus on acquisitions with high value added engineering complements as well as those that would improve customizations levels and extend OEM cycles.

The Company's subsidiary, M-tron Industry's October 2002 acquisition of Champion Technologies allowed entry to the timing modules market while the subsidiary's September 2004 acquisition of PTI provided LGL with its family of oven-controlled crystal oscillators and its electronic filter products.

Finally, LGL is also committed to growth through opportunities with new customers, fresh markets and new products. Approximately 10% of the Company's MtronPTI subsidiary's revenue has come from major new designs or new product platforms that have been introduced in the preceding three years.

1.) Enterprise Multiple

The enterprise multiple looks at a firm as a potential acquirer would, because it takes debt into account - an item which other multiples like the P/E ratio do not include. Enterprise value is calculated as market cap plus debt, minority interest and preferred shares, minus total cash and cash equivalents. The Firm's Enterprise multiple is 1.43x compared to 6.29x for the industry. **According to the enterprise multiple INTT appears undervalued compared to industry.**

$$\text{Enterprise Multiple} = \frac{\text{Enterprise Value}}{\text{EBITDA}}$$

Metric	LGL	Industry Average
EV/EBITDA	1.43	6.29

2.) Two Stage Free Cash Flow to Equity Model

FCFE = Net Income - Net Capital Expenditure - Change in Net Working Capital + New Debt - Debt Repayment

Assumptions

- The firm is expected to grow at a higher growth rate in the first period.
- The growth rate will drop at the end of the first period to the stable growth rate.
- The free cash flow to equity is the correct measure of expected cash flows to stockholders. (rather than dividends)

Rationale for using the Model

As the firm adds potential partners we expect the firm to grow at a higher overall rate than the industry. As These products mature and the firm faces more competition we expect the growth rate to level off.

Weakness of the Model

As you add more layers to the model it is more sensitive to the assumptions you make. The growth may look more "lumpy" than we have it in the model.

Output

The intrinsic value is essentially a sum of the company's future earnings, minus any long-term debt. Dividing the intrinsic value by the number of shares outstanding yields an intrinsic stock price. We used the following inputs:

- A 5-year period with an earnings growth rate of 8.0% (average forecast) and a discount rate of 13.5%.

- A continuing period assumed to go on forever, with earnings growing at 5% and a discount rate of 13%.

With these inputs we arrive at a target price of $24.75.

According to the model, the firm appears undervalued.

3.) Price to Earnings Multiples/ Price to Sales Multiples

Due to its simplicity the Price/Earnings ratio is easily the most widely used metric in all of finance. The first strength of the model is that it is intuitive. It is simply the price paid for current earnings. It can also act as a proxy for other firm characteristics such as risk and growth. There is a downside to the P/E ratio in that it has the potential to reflect investor's mood rather than the fundamentals of the firm. It also eliminates assumptions about risk, growth, and retention ratio (something discounted cash flow models account for.)

While not as popular as Price/Earnings or Price/BV, Price/Sales is not influenced by accounting decisions in depreciation, inventory and extraordinary charges. P/S multiples are much less volatile than P/E multiples. However if the problem with the firm lies in cost control the P/S ratio will not reflect this flaw.

The firm appears undervalued compared to the industry.

Metric	LGL	Industry Average
P/E TTM	4.96	14.62
P/E 2011 (E)	9.38	14.13
P/E 2012 (E)	4.21	14-16
P/S	0.48	0.82

*source for background on valuation models: Investment Valuation, Aswath Damodaran

A look at the firm's balance sheet shows significant strength as well. The Company's cash and cash equivalents as of March 31, 2011 was $11,052,000, compared to $4,147,000 on December 31, 2010. As of March 31, 2011 and December 31, 2010, MtronPTI had $0 outstanding and available borrowing capacity of $4,000,000 under the FNBO Revolving Loan.

On March 31, 2011, the Company's consolidated working capital was $19,250,000, as compared to $12,829,000 at December 31, 2010. On March 31, 2011, the Company had current assets of $23,838,000 and current liabilities of $4,588,000. The ratio of current assets to current liabilities was 5.19 to 1.00 as of March 31, 2011, compared to 3.75 to 1.00 on December 31, 2010. The industry average is approximately 3.13 to 1. The increase in net working capital is primarily due to the increase in the Company's cash and cash equivalents balance as a result of the net proceeds of $6,404,000 from the Company's public offering of 350,000 shares of its common stock completed on February 4, 2011.

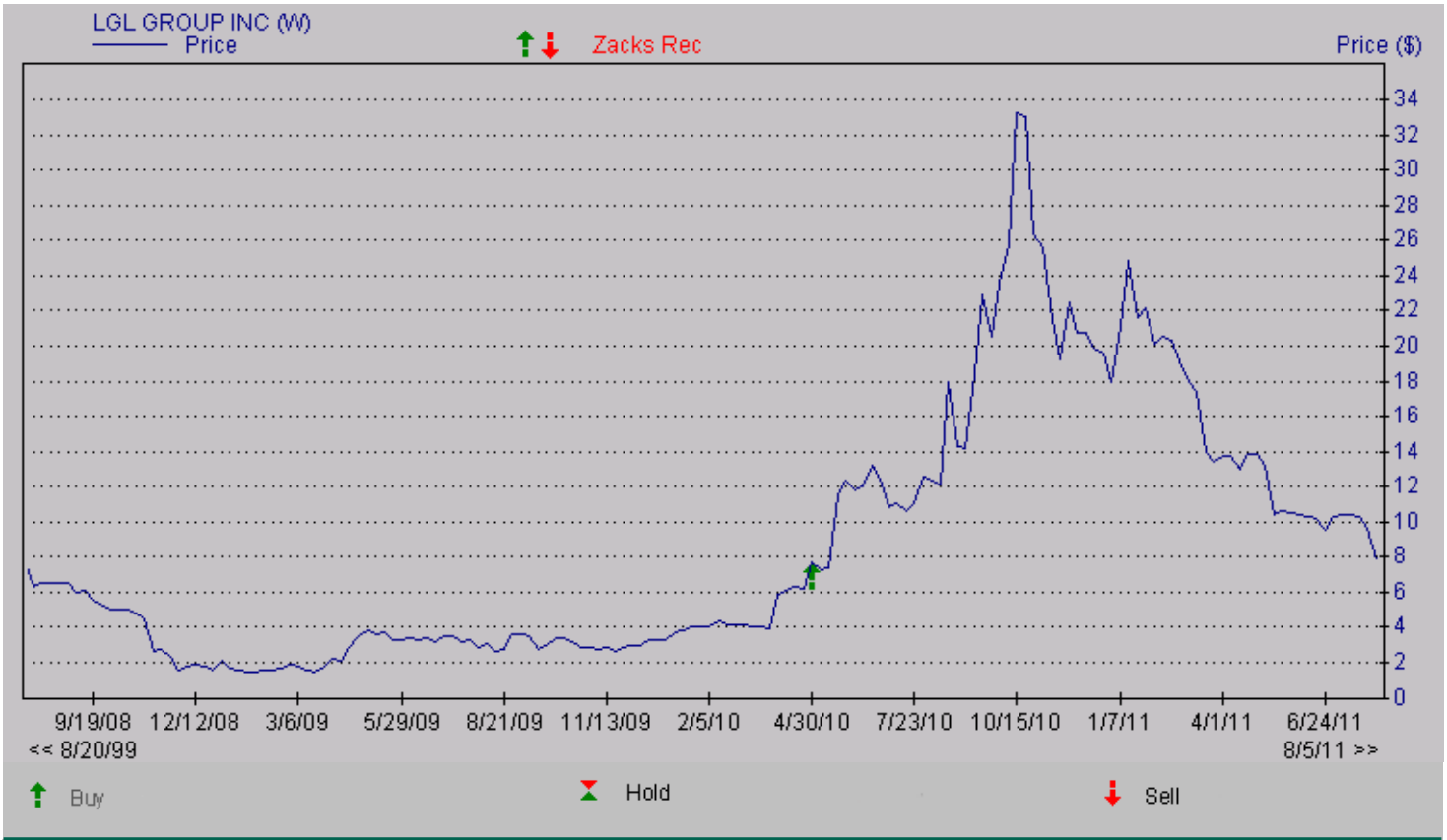
We value the firm based on the on the average of 18.3x 2011 estimated earnings and our two stage intrinsic model. The scientific & technical instruments group average P/E is between 15x-20x depending on the size of the firm. We would add shares at these levels.

PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Jun-10 Q2 10	Sep-10 Q3 10	Dec-10 Q4 10	Mar-11 Q1 11	Jun-11 Q2 11 E	Sep-10 Q3 11	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 E	FY 2012 E
REVENUE												
Net Revenue	**12.5**	**12.4**	**11.0**	**9.0**	**9.6**	**11.0**	**39.5**	**40.2**	**31.3**	**45.0**	**40.5**	**50.0**
Sequential Growth		*-1%*	*-11%*	*-18%*	*7%*	*14%*						
OPERATING EXPENSES												
Cost of Revenues	8.0	7.7	7.5	6.1	6.6	7.3	29.4	29.8	23.9	29.3	25.0	33.0
% of Revenue	*64%*	*62%*	*68%*	*70%*	*70%*	*66%*					*67%*	*64%*
Gross Profit -	**4.5**	**5**	**3.5**	**2.9**	**3.1**	**3.7**	**10.2**	**10.4**	**7.4**	**15.6**	**14**	**17.0**
Proforma Gross Margin	*36.3%*	*38%*	*31.7%*	*32.6%*	*31.8%*	*33.6%*	*25.7%*	*25.8%*	*23.7%*	*34.8%*	*33%*	*36.0%*
R&D + Engg	2.2	2.5	2.5	2.6	2.5	2.9	11.0	11.2	9.3	9.7	11.1	12.0
% of Revenue	*17.5%*	*19.8%*	*22.5%*	*28.4%*	*25.9%*	*26.4%*	*27.8%*	*27.9%*	*29.8%*	*21.6%*	*27.3%*	*24.0%*
SG&A	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0	0	0.0	0.0
% of Revenue	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*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	2.2	2.5	2.5	2.6	2.5	2.9	10.98	11.20	9.34	9.70	11.1	12.00
% of Revenue	*17.5%*	*19.8%*	*22.5%*	*21.9%*	*21.9%*	*26.4%*	*27.8%*	*27.9%*	*30%*	*22%*	*27.3%*	*20.4%*
Operating Income -	**2.4**	**2.2**	**1.0**	**0.38**	**0.56**	**0.8**	**-0.810**	**-0.830**	**-1.910**	**5.947**	**2.5**	**5.000**
Operating Margin	*18.8%*	*17.7%*	*9.2%*	*7.6%*	*7.6%*	*7.3%*	*-2%*	*-2%*	*-6%*	*13%*	*6.1%*	*15.5%*
NON-OPERATING ITEMS												
Non operating Income/Expense	-0.08	-0.12	0.03	0.00	-0.02	0.00	0.39	-0.36	-0.57	0	0.02	0.09
% of Revenue	*-0.61%*	*-0.97%*	*0.26%*	*0.19%*	*0.19%*	*0.00%*	*0.99%*	*-0.90%*	*-1.82%*	*-0.36%*	*0.06%*	*0.19%*
Tax Provision	0.10	0.1	-3.16	0.1	0.19	0.10	0.1	0.1	0	-3	0.4	0.5
Effective Tax Rate						*13%*					*15%*	
Net Income -	**2.18**	**2.00**	**4.20**	**0.25**	**0.35**	**0.70**	**-0.55**	**-1.31**	**-2.49**	**8.63**	**2.13**	**4.59**
Net Income Margin	*17.4%*	*16.1%*	*38.1%*	*6.3%*	*6.3%*	*6.4%*	*-1.4%*	*-3.3%*	*-8.0%*	*19.2%*	*5.2%*	*12.6%*
Stock Based Comp	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
EARNINGS PER SHARE												
EPS - Basic	$0.97	$0.88	$1.87	$0.10	$0.13	$0.28	-$0.25	-$0.61	-$1.16	$3.82	$0.83	$1.85
EPS - Diluted	$0.97	$0.88	$1.87	$0.10	$0.13	$0.28	-$0.25	-$0.61	-$1.16	$3.82	$0.83	$1.85
EPS - (EXCL Charges)	$0.97	$0.88	$0.46	$0.10	$0.13	$0.28	-$0.29	-$0.60	-$1.16	$2.41	$0.83	$1.85

Ken Nagy, CFA Zacks Investment Research 8/5/2011

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