Zacks Equity Research

June 9, 2010
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Lgl Group Inc (LGL-AMEX)

LGL: Zacks Company Report - Outperform

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/02/2010
Current Price (06/08/10)	$11.17
Six- Month Target Price	**$15.00**

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. We feel the stock will outperform the overall market and set a six month price target of $15.00

SUMMARY DATA

52-Week High	**$7.91**
52-Week Low	**$2.63**
One-Year Return (%)	**132.65**
Beta	**1.51**
Average Daily Volume (sh)	**11,557**
Shares Outstanding (mil)	**2**
Market Capitalization ($mil)	**$18**
Short Interest Ratio (days)	**0.10**
Institutional Ownership (%)	**10**
Insider Ownership (%)	**29**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-7.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2010 Estimate	**N/A**
P/E using 2011 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**Small-Blend**
Industry	**Elec-Misc Compn**
Zacks Rank in Industry	**N/A**

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	9 E	9 E	10 E	11 E	39 E
2011	10 E	11 E	11 E	12 E	44 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	$0.15 E	$0.15 E	$0.16 E	$0.16 E	$0.62 E
2011	$0.17 E	$0.17 E	$0.18 E	$0.18 E	$0.70 E

Zacks Projected EPS Growth Rate - Next 5 Years %	**N/A**
N/A	**N/A**

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KEY POINTS

- The global market for frequency/timing components is approximately $4.0 billion. LGL draws it's revenue from the less commoditized higher margin segment of the market.
- The 2009 recession has been weathered. Costs have been cut and backlog is rising.
- Military instrumentation and space avionics market (MISA) should drive LGL top-line growth.
- The firm passed on a strategic combination opting for its own strategic path.
- LGL has a solid portfolio of blue chip clients.

OVERVIEW

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

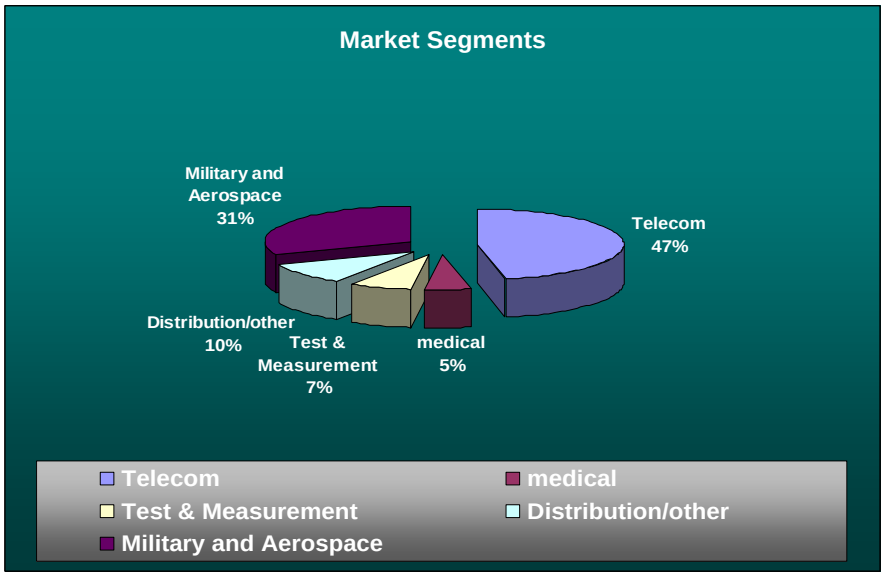
LGL, which dates back 40 years, has an impressive portfolio of blue chip global OEM customers. These customers include Cisco, Raytheon, GE, Honeywell and Agilent Technologies among others. Revenues from MtronPTI's 10 largest customers accounted for approximately 57.4% of revenues in 2009, compared to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

As of December 31, 2009, MtronPTI's order backlog was $13.9 million, which was an increase of 70.6% compared to a backlog of $8.1 million on December 31, 2008. The growth in backlog is primarily due to increased repeat orders from existing customers.

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)

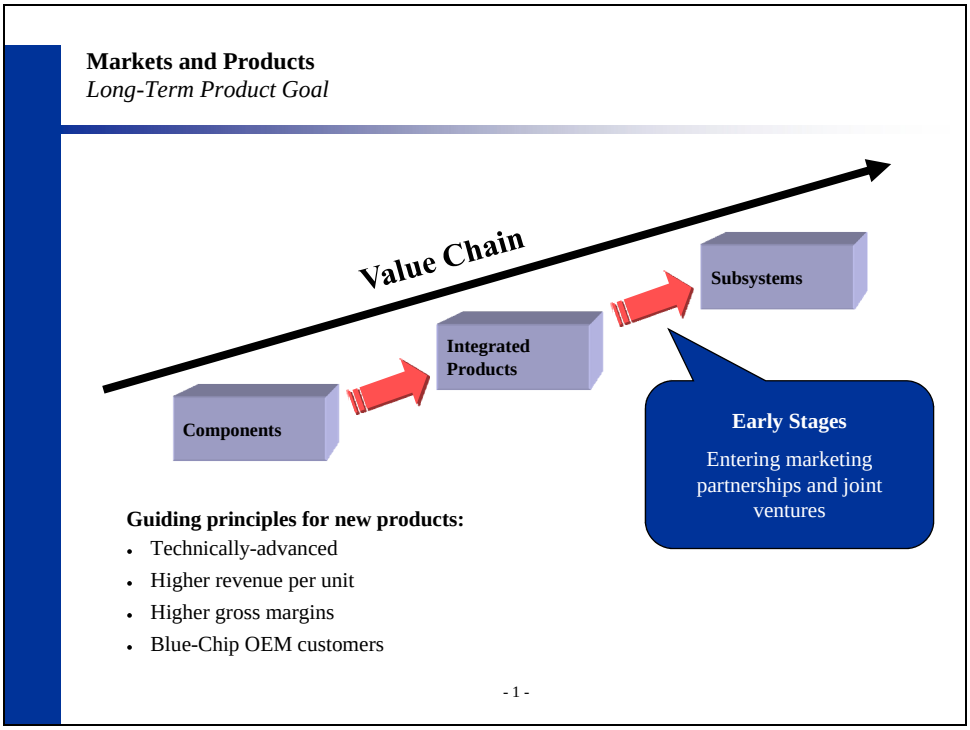
Networking infrastructure segments

- 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 CTS 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 of 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.

INDUSTRY OUTLOOK

The outlook for the Electronics Industry is about average relative to the S&P 500. After enduring a significant slump--the worst ever--there are some signs of stabilization. Inventories are no longer much of a concern and more than a few companies have begun to generate at least modest sales growth. Nevertheless, the weak demand environment means that the industry may be saddled with excess capacity for some time to come as firms race to cut costs and shutter plants.

The industry includes manufacturers and distributors of a wide range of electronic parts, as well as the electronics manufacturing services (or EMS) firms who contract out with original equipment manufacturers (OEMs) like Cisco to build subassemblies and finished products. Throughout the economic downturn, demand for consumer-oriented items like cell phones, digital cameras, and printers have held up relatively well. On the other hand, spending by corporations on computers and communications infrastructure has been particularly hard hit. Companies that depend on these areas have taken it on the chin.

Given the persistent industry over-capacity, electronic OEMs have been successful in obtaining pricing concessions from their contract manufacturers and electronic component suppliers further down the food chain. Electronic component suppliers have responded by shuttering plants and moving more production to low cost regions like China. While the moves make sense, a number of companies have been forced to take large restructuring charges that have hurt their returns.

While the fragile economy makes it difficult to predict when a recovery will take hold, long-term growth prospects are above average, in our opinion, due to the proliferation of electronic applications and the ongoing trend toward outsourcing. What's more, given the amount of cost cutting that has occurred, profit margins should respond quickly to a pick up in key end markets.

INDUSTRY POSITION

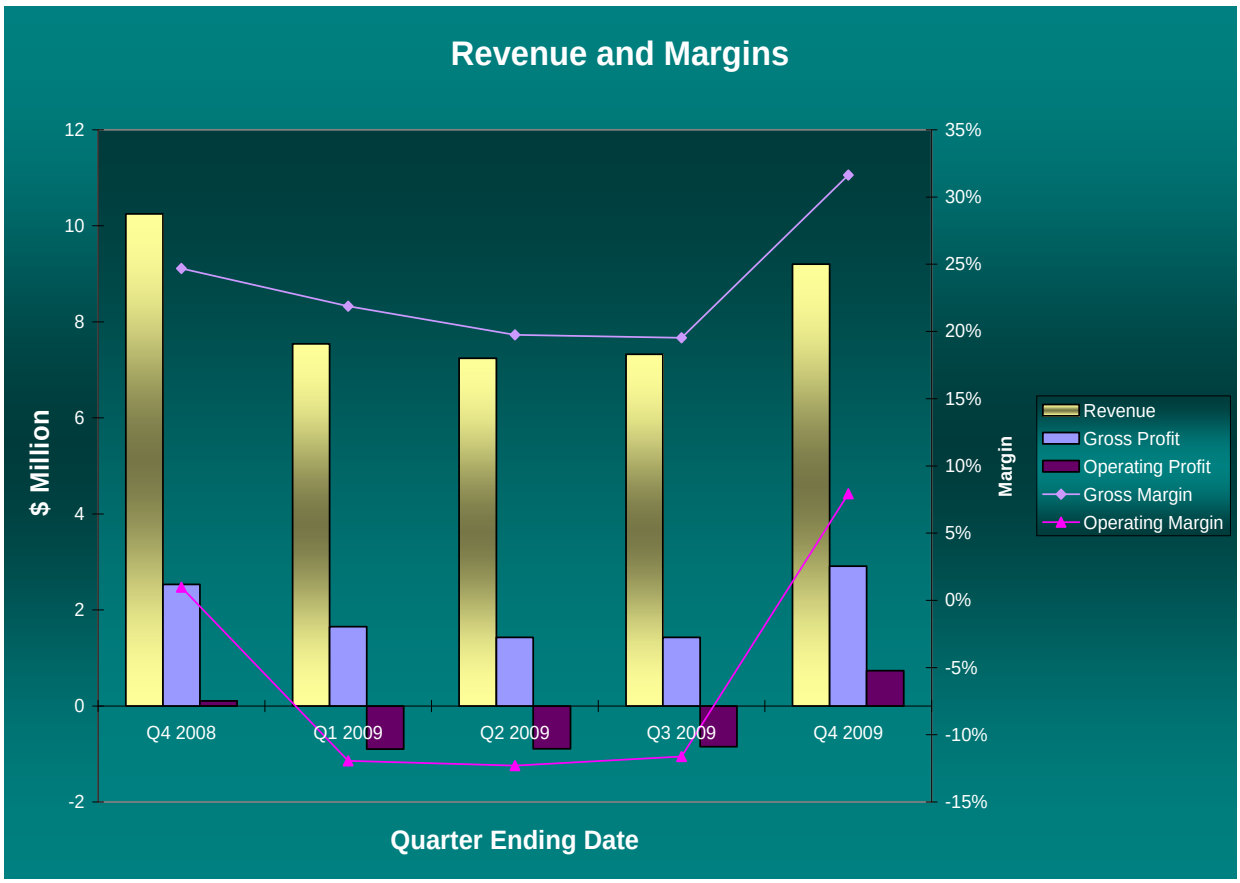
LGL sells its frequency control devices in an extremely competitive industry. There are several domestic and international manufacturers who are capable of providing custom designed quartz crystals, oscillators and electronic filters comparable in quality and performance to MtronPTI's products.

Competitors include Vectron International (a division of Dover Corporation), CTS Corporation, K&L (a division of Dover Corporation) and Saronix (a division of Pericom Semiconductor Corporation). MtronPTI does not operate in the same markets as high volume manufacturers of standard products; rather it follows a niche strategy manufacturing lower volumes of more precise, custom designed frequency control devices. A number of MtronPTI's competitors and potential competitors have substantially greater financial, engineering, manufacturing and marketing resources than MtronPTI.

MtronPTI seeks to manufacture custom designed, high performance crystals and oscillators, which it believes it can sell competitively based upon performance, quality, order response time and a high level of engineering support. MtronPTI believes that its main competitive advantage rests in its ability to bring to its customers new product designs as well as final manufactured products faster than its competitors, thus being more responsive to its customers' supply chain requirements.

RECENT NEWS

On May 17, 2010 LGL announced results for the first quarter of fiscal year 2010 ending March 2010. Revenue for the period was $10.7 million rising 16.3% sequentially from $9.2 million and up 41.9% year over year. Foreign sales grew 37.3% to $5.1 million for the quarter ended March 31, 2010, compared to $3.7 million for the quarter ended March 31, 2009. The Company is continuing its efforts to grow revenue by expanding into new geographic regions and into additional segments of the timing and frequency equipment market, such as alternative energy management, energy exploration, military personnel protection and homeland security. Further LGL introduced new product line of cavity filters into production during the quarter ended March 31, 2010.



Gross margin for the period significantly increased sequentially to 34.1% from 23.7% and 21.2% in the year ago quarter. The gross margin gain was primarily a function of the increase in revenues which improved gross margin by spreading fixed infrastructure costs over a larger revenue base, and the Company's implementation of its plan to effect permanent structural cost reductions in overhead, engineering and administrative expenses.

As of March 31, 2010, the Company's order backlog was $14.3 million, which was an increase of 2.2% compared to the backlog of the previous year. The growth in backlog is primarily due to increased repeat orders from existing customers, as well as orders from new customers obtained through the Company's ongoing efforts to expand within its target markets.

Engineering, SG&A expenses for 2009 decreased by $1.8 million from $11.2 million for 2008 to $9,3 million for 2009. This decrease in expense is primarily attributable to reductions in head count, a decrease in professional fees, and a reduction in the costs of continuing to comply with the Sarbanes-Oxley Act of 2002 This was offset by an impairment of $235,000 recognized on the assets of Lynch Systems in 2009 compared to an impairment loss of $0 recognized in 2008 for the same assets. The Company expects that its sales focus combined with its resizing efforts will result in improved operating performance in the future.

VALUATION

LGL trades at a reasonable valuation of 12.8x our 2010 estimated earnings per share. We feel LGL presents a unique investment opportunity based on the fact that LGL has a solid blue chip customer portfolio, a high growth potential segment in MISA, and a strategic plan for higher margins (value Chain). The firm emerged from the economic downturn with a significantly lowered cost structure and should continue to ride the momentum of Military Instrumentation, Space and Avionics segment or MISA. The MISA segment should lead the global economy out of recession and will do so with higher margins.

LGL competes in the specialized and higher margin component segment area of the frequency /timing components market. This has the effect of higher margins and stickier revenue which is less likely to be cancelled or sourced elsewhere.

Industry Comparables

	Pr Chg YTD	P/E CurrFY	EPS Gr 5Yr Est	Price/ Book	Price/ Sales	Price/ CF
LGL GROUP INC	115.8			1.7	0.5	
Industry Mean	30.4	21.7	18.5	2.0	2.8	16.0
Industry Median	8.2	17.7	15.0	1.5	0.9	11.3
S&P 500	8.2	15.1		4.3	2.4	14.4
ENER1 INC	-32.8			4.4	15.4	
ELTEK LTD	17.7			1.5	0.2	31.5
BLONDER TONGUE	7.9			0.4	0.3	13.7
ORBIT INTL CORP	-4.7			0.9	0.6	27.0

We value the firm based on the on the average of our P/E multiple and our two stage intrinsic model. The scientific & technical instruments group average P/E is between 20x-40x.

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 10-year period with an earnings growth rate of 10.0% (average forecast) and a discount rate of 10%.
- A continuing period assumed to go on forever, with earnings growing at 6% and a discount rate of 12%.

With these inputs we arrive at a target price of $15.00.

RISKS

- MtronPTI's market is highly competitive, and it competes with larger and better-financed competitors.
- LGL is dependent on a single line of business.
- LGL's high fixed cost infrastructure requires scale.

INSIDER TRADING AND OWNERSHIP

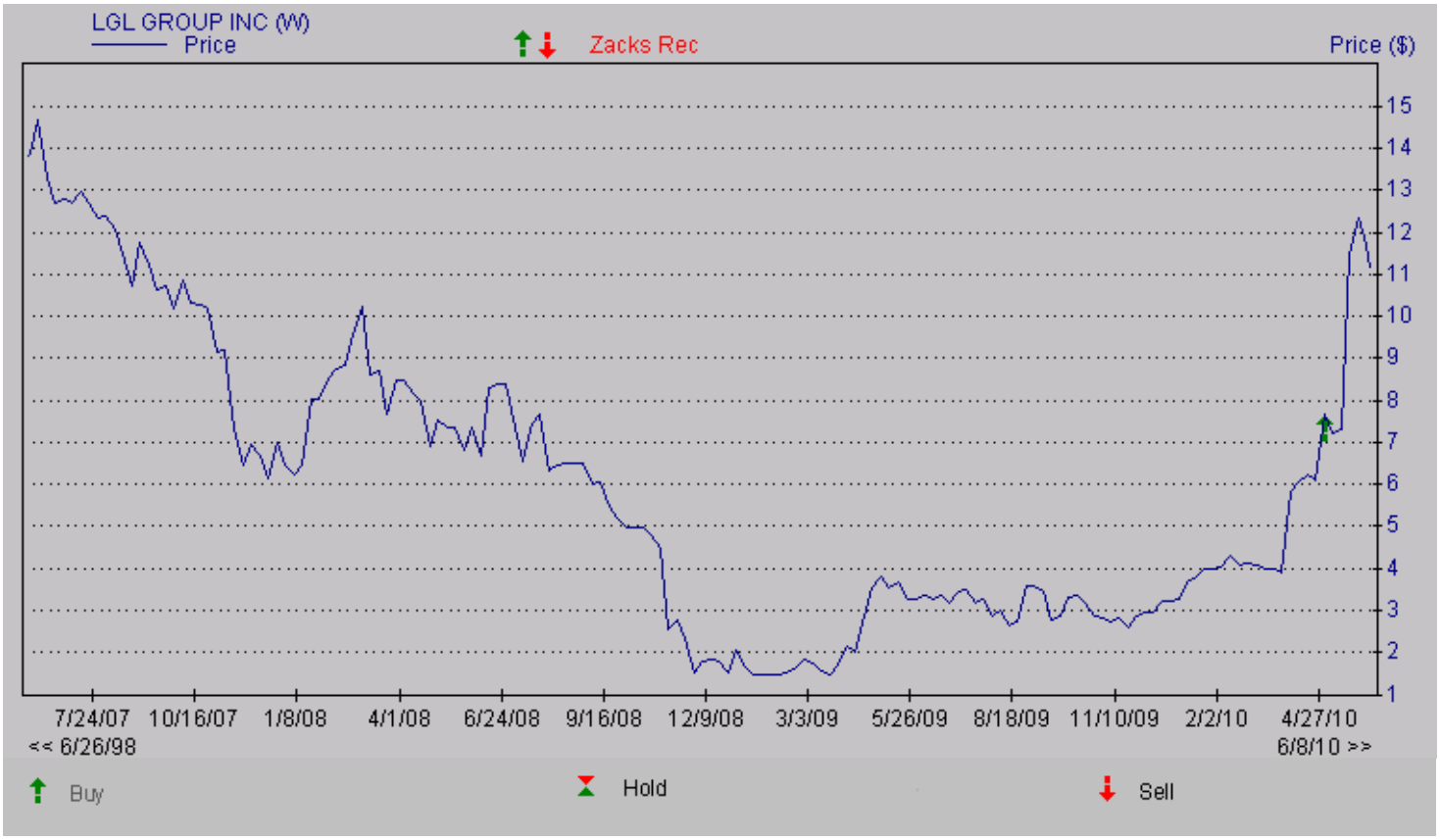
Institutional holders hold 9.2% shares outstanding. The top five institutional holders are Dimensional Fund Advisors Inc (with 4.51% of the total shares outstanding), Mcintyre Freedman & Flynn Investment Advisers Inc (1.68%), Renaissance Technologies (1.56%), Gamco Investors, Inc (1.43%) and Grt Capital Partners (1.43%). All of the top five holders with the exception of Dimensional Fund Advisors added shares in the last quarter. Dimensional shed 500 shares.

PROJECTED INCOME STATEMENT & BALANCE SHEET

INCOME STATEMENT ($ Millions)	Dec-08 Q408	Mar-09 Q109	Jun-09 Q209	Sep-09 Q309	Dec-09 Q409	Mar-10 Q110E	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 E
REVENUE											
Net Revenue	**10.0**	**7.5**	**7.2**	**7.3**	**9.2**	**9.5**	**49.3**	**39.5**	**40.2**	**31.3**	**39.0**
Sequential Growth		*-25%*	*-4%*	*1%*	*26%*	*3%*					
OPERATING EXPENSES											
Cost of Revenues	7.5	5.9	5.8	5.9	6.3	6.4	35.7	29.4	29.8	23.9	28.1
% of Revenue	*75%*	*78%*	*80%*	*80%*	*68%*	*67%*					
Gross Profit -	**2.5**	**1.7**	**1.4**	**1.4**	**2.9**	**3**	**13.6**	**10.2**	**10.4**	**7.4**	**10.9**
Proforma Gross Margin	*25.1%*	*21.9%*	*19.9%*	*19.5%*	*31.6%*	*33%*	*27.5%*	*25.7%*	*25.8%*	*23.7%*	*27.9%*
R&D + Engg	-5.7	2.6	2.3	2.3	-7.2	2.4	0.0	0.0	0.0	0.0	0.0
% of Revenue	*-57.1%*	*33.8%*	*32.2%*	*31.1%*	*-77.8%*	*25.3%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
SG&A	8.1	0.0	0.0	0.0	9.3	0.0	14.1	11.0	11.2	9	9
% of Revenue	*81.2%*	*0.0%*	*0.0%*	*0.0%*	*101.5%*	*0.0%*	*28.6%*	*27.8%*	*27.9%*	*29.8%*	*23.1%*
GW Amort, Restructuring, other	-	-	-	-			-	-	-		
% of Revenue											
Total Operating Expenses	2.4	2.6	2.3	2.3	2.2	2.4	14.10	10.98	11.20	9.34	9.00
% of Revenue	*24.1%*	*33.8%*	*32.2%*	*31.1%*	*23.7%*	*25.3%*	*28.6%*	*27.8%*	*27.9%*	*30%*	*23%*
Operating Income -	**0.1**	**-0.9**	**-0.9**	**-0.8**	**0.7**	**0.7**	**-0.540**	**-0.810**	**-0.830**	**-1.910**	**1.900**
Operating Margin	*1.0%*	*-11.9%*	*-12.3%*	*-11.6%*	*7.9%*	*7.4%*	*-1%*	*-2%*	*-2%*	*-6%*	*5%*
NON-OPERATING ITEMS											
Non operating Income/Expense	-0.29	-0.07	-0.05	-0.10	-0.35	-0.30	1.18	0.39	-0.36	-0.57	-1
% of Revenue	*-2.90%*	*-0.93%*	*-0.69%*	*-1.37%*	*-3.80%*	*-3.16%*	*2.39%*	*0.99%*	*-0.90%*	*-1.82%*	*-1.49%*
Tax Provision	-0.05	-0.03	-0.01	0.01	0.05	0.1	-0.2	0.1	0.1	0	0
Effective Tax Rate											
Net Income -	**-0.14**	**-0.94**	**-0.93**	**-0.96**	**0.33**	**0.34**	**0.86**	**-0.55**	**-1.31**	**-2.49**	**1.29**
Net Income Margin	*-1.4%*	*-12.5%*	*-12.8%*	*-13.1%*	*3.6%*	*3.6%*	*1.7%*	*-1.4%*	*-3.3%*	*-8.0%*	*3.3%*
Stock Based Comp	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
EARNINGS PER SHARE											
EPS - Basic	-$0.05	-$0.44	-$0.43	-$0.44	$0.15	$0.15	$0.40	-$0.25	-$0.61	-$1.16	$0.62
EPS - Diluted	-$0.05	-$0.44	-$0.43	-$0.44	$0.15	$0.15	$0.40	-$0.25	-$0.61	-$1.16	$0.62
EPS - (EXCL Charges)	-$0.04	-$0.44	-$0.43	-$0.44	$0.15	$0.15	$0.40	-$0.29	-$0.60	-$1.16	$0.62

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HISTORICAL ZACKS RECOMMENDATIONS



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