Zacks Equity Research

November 16, 2010
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LGL Group Inc (LGL-AMEX)

LGL: Solid Quarter-

Foreign Sales Beginning to Contribute.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/02/2010
Current Price (11/15/10)	$20.55
Six- Month Target Price	**$30.00**

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 $30.00

SUMMARY DATA

52-Week High	**$33.95**
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	**8.9**
P/E using 2010 Estimate	**6.7**
P/E using 2011 Estimate	**5.5**
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 A	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	$0.88 A	$0.95 E	$3.27 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

LGL makes Operating and Non-Operating Gains

On November 11, 2010 LGL announced results for the third quarter of fiscal year 2010 ending September 2010. Revenue for the period was $12.4 million falling slightly sequentially from $12.4 million and up 69.3% year over year. 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.

Foreign Sales Increase

Increase in demand continued to be reflected in foreign sales, primarily to Asia, which grew 52.0% to approximately $5,724,000 for the quarter ended September 30, 2010, compared to approximately $3,765,000 for the comparable period in 2009. The Company's new sales office in Shanghai, China was fully registered with the Chinese government during the quarter.

At quarter end the company's backlog was $11,973,000, which was a decrease of 16.7% compared to the backlog of approximately $14,373,000 as of June 30, 2010. The reduction in backlog was primarily due to softer short-term demand in repeat orders from customers in the Telecom market segment combined with strong shipments from production facilities during the third quarter 2010.

Looking at the balance sheet working capital increased to $10,904,000 as of September 30, 2010, compared to $5,466,000 as of December 31, 2009, an increase of 99.5%. The increase in working capital was primarily due to increases in accounts receivable and inventory balances. In addition, on September 30, 2010, the Company repaid the remaining $2,282,000 of principal and interest due under its term loan with RBC Bank and terminated the related loan agreement. Also, the Company's balance under its revolving credit facility with First National Bank of Omaha was $0 as of September 30, 2010.

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:

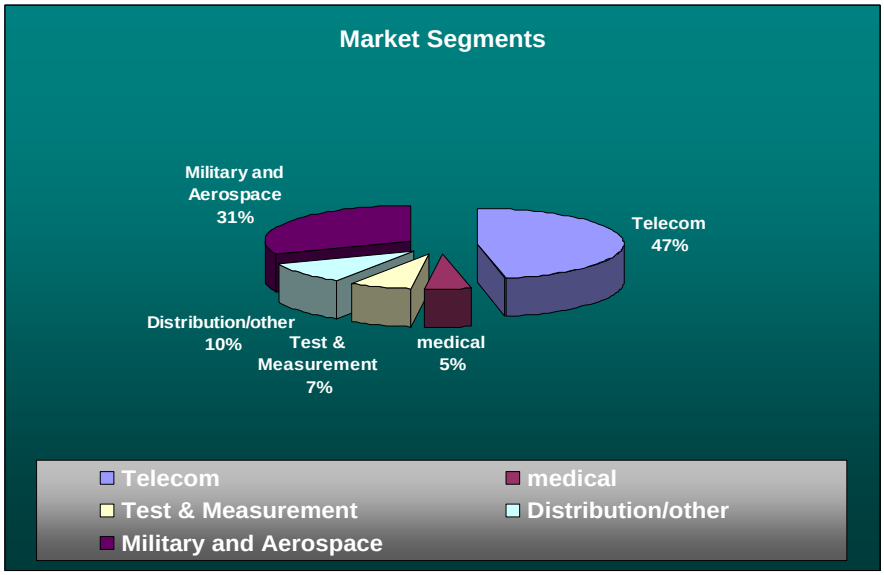
- Accuracy -the frequency of the signal does not change significantly over a period of time
- Stability -the frequency of the signal does not vary significantly when the product is subjected to a range of operating environments
- Low electronic noise -the signal does not add interfering signals that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

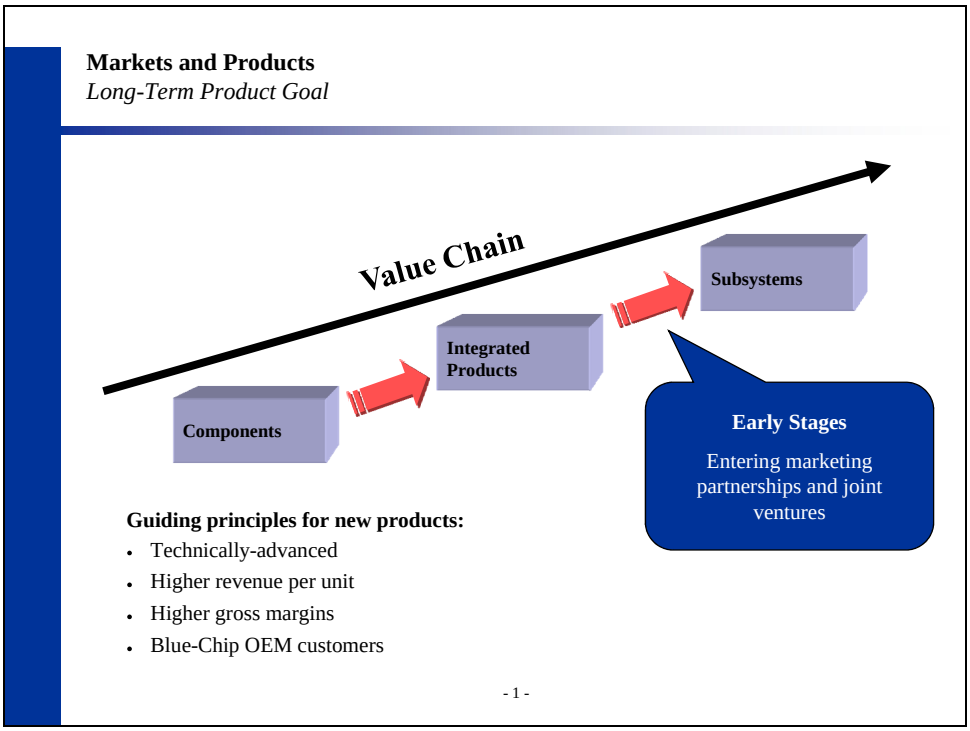
Networking infrastructure segments

- 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

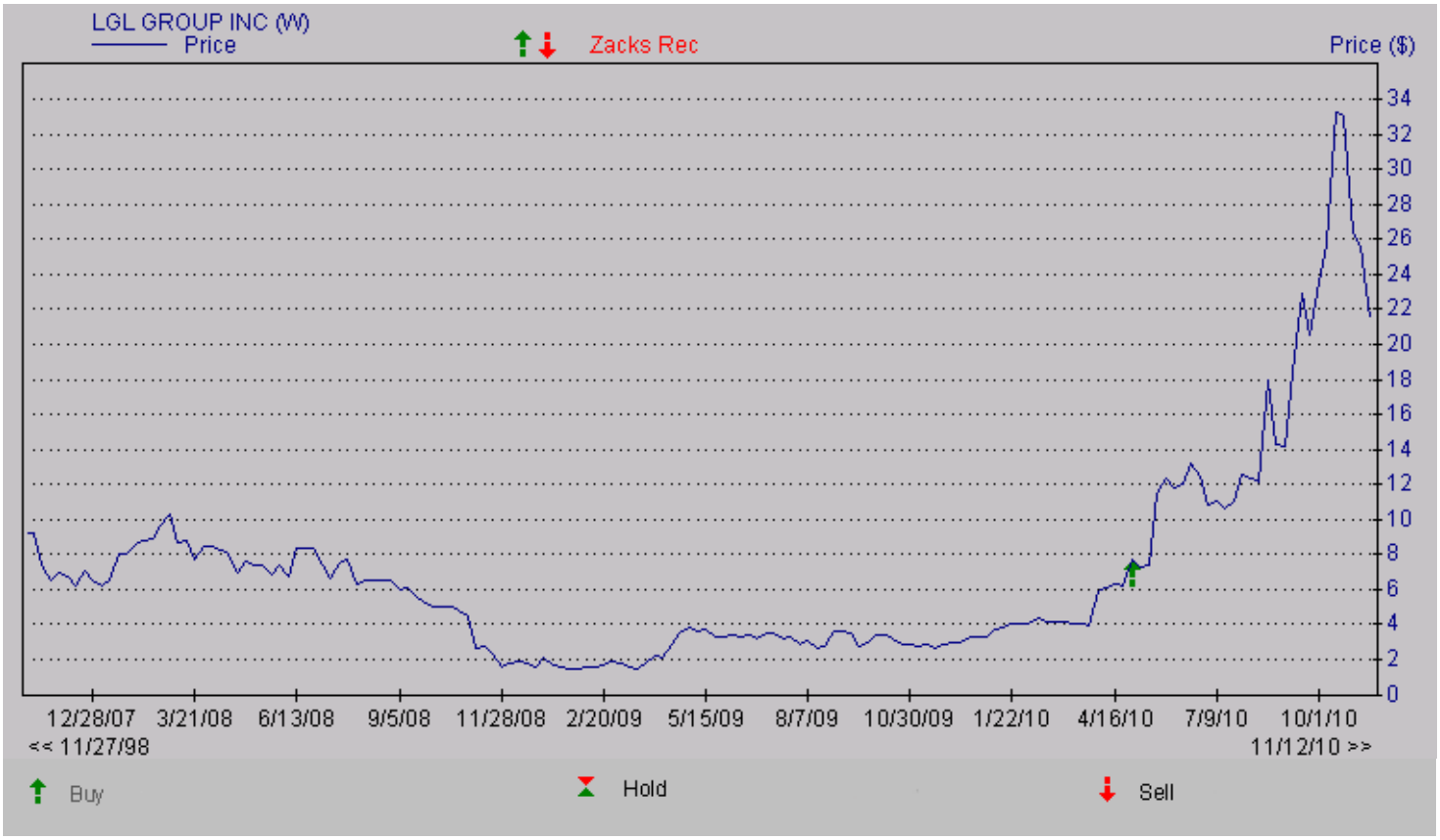
New MISA contracts won in the second half of 2009 should begin to contribute significantly to revenue over the next two quarters. The contracts deal with military personnel protection and homeland security.

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.

HISTORICAL ZACKS RECOMMENDATIONS



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