

LGL GROUP INC  
Form 10-Q  
November 13, 2015  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q  
(Mark  
One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the quarterly period ended September 30, 2015  
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-106

THE LGL GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware 38-1799862  
(State or Other Jurisdiction of (I.R.S. Employer Identification No.)  
Incorporation or Organization)

2525 Shader Rd., Orlando, Florida 32804  
(Address of principal executive offices) (Zip Code)  
(407) 298-2000  
(Registrant's telephone number, including area code)

(Former name, former address, and former fiscal year if changed since last  
report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at November 12, 2015
Common Stock, \$0.01 par value	2,652,779

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THE LGL GROUP, INC.

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PART I  
FINANCIAL INFORMATION  
Item 1. Financial Statements.

THE LGL GROUP, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED  
(Dollars in Thousands)

	September 30, 2015	December 31, 2014
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 5,941	\$ 5,192
Accounts receivable, less allowances of \$38 and \$43, respectively	2,201	3,266
Inventories, net (Note C)	3,747	4,198
Prepaid expenses and other current assets	217	278
Total Current Assets	12,106	12,934
Property, Plant and Equipment:		
Land	633	633
Buildings and improvements	3,928	3,922
Machinery and equipment	16,590	16,314
Gross property, plant and equipment	21,151	20,869
Less: accumulated depreciation	(17,841 )	(17,322 )
Net property, plant, and equipment	3,310	3,547
Intangible assets, net (Note D)	488	528
Other assets, net	213	253
Total Assets	\$ 16,117	\$ 17,262
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 1,021	\$ 1,719
Accrued compensation and commissions expense	814	681
Accrued warranty expense	146	242
Other accrued expenses	337	383
Total Current Liabilities	2,318	3,025
Commitments and Contingencies (Note K)		
Stockholders' Equity		
Common stock, \$0.01 par value - 10,000,000 shares authorized; 2,732,443 shares issued and 2,652,779 shares outstanding at September 30, 2015 and 2,696,201 shares issued and 2,616,485 shares outstanding at December 31, 2014	27	27
Additional paid-in capital	29,042	28,901
Accumulated deficit	(14,737 )	(14,163 )
Treasury stock: 79,664 and 79,716 shares held in treasury at cost at September 30, 2015 and December 31, 2014, respectively	(572 )	(572 )
Accumulated other comprehensive income	39	44
Total Stockholders' Equity	13,799	14,237
Total Liabilities and Stockholders' Equity	\$ 16,117	\$ 17,262

See Accompanying Notes to Condensed Consolidated Financial Statements.

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## THE LGL GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

(Dollars in Thousands, Except Per Share Amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
REVENUES	\$4,796	\$5,581	\$15,671	\$17,562
Cost and Expenses:				
Manufacturing cost of sales	3,209	3,849	10,497	12,869
Engineering, selling and administrative	1,741	2,094	5,822	6,750
Restructuring expense	—	47	—	444
OPERATING LOSS	(154 )	(409 )	(648 )	(2,501 )
Other Income (Expense):				
Interest expense, net	(16 )	(5 )	(25 )	(21 )
Other (expense) income, net	(23 )	(78 )	112	(48 )
Total Other Income (Expense)	(39 )	(83 )	87	(69 )
LOSS BEFORE INCOME TAXES	(193 )	(492 )	(561 )	(2,570 )
Income tax provision	(2 )	—	(13 )	—
NET LOSS	\$(195 )	\$(492 )	\$(574 )	\$(2,570 )
Weighted average number of shares used in basic and diluted net loss per common share calculation	2,652,779	2,594,730	2,635,794	2,594,752
BASIC AND DILUTED NET LOSS PER COMMON SHARE	\$(0.07 )	\$(0.19 )	\$(0.22 )	\$(0.99 )

See Accompanying Notes to Condensed Consolidated Financial Statements.

THE LGL GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS - UNAUDITED

(Dollars in Thousands)

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
NET LOSS	\$(195)	\$(492)	\$(574)	\$(2,570)
Other Comprehensive (Loss) Income:				
Unrealized loss on available-for-sale securities, net of taxes	(4 )	(7 )	(5 )	(4 )
TOTAL OTHER COMPREHENSIVE LOSS	(4 )	(7 )	(5 )	(4 )
COMPREHENSIVE LOSS	\$(199)	\$(499)	\$(579)	\$(2,574)

See Accompanying Notes to Condensed Consolidated Financial Statements.

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THE LGL GROUP, INC.  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - UNAUDITED  
 (Dollars in Thousands)

	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2014	2,616,485	\$ 27	\$ 28,901	\$ (14,163 )	\$ (572 )	\$ 44	\$14,237
Net loss	—	—	—	(574 )	—	—	(574 )
Other comprehensive loss	—	—	—	—	—	(5 )	(5 )
Stock-based compensation	36,294	—	201	—	—	—	201
Warrant dividend issuance costs	—	—	(60 )	—	—	—	(60 )
Balance at September 30, 2015	2,652,779	\$ 27	\$ 29,042	\$ (14,737 )	\$ (572 )	\$ 39	\$13,799

See Accompanying Notes to Condensed Consolidated Financial Statements.

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THE LGL GROUP, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS – UNAUDITED

(Dollars in Thousands)

	Nine Months Ended September 30,	
	2015	2014
<b>OPERATING ACTIVITIES</b>		
Net loss	\$(574 )	\$(2,570)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	607	621
Amortization of finite-lived intangible assets	51	83
Stock-based compensation	201	213
Impairment of note receivable	43	—
Gain on disposal of assets	(67 )	—
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable, net	1,065	(245 )
Decrease in inventories, net	424	298
Decrease in other assets	42	88
(Decrease) increase in trade accounts payable, accrued compensation and commissions expense, accrued warranty expense and other accrued liabilities	(767 )	418
Net cash provided by (used in) operating activities	1,025	(1,094)
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(370 )	(164 )
Asset acquisition	—	(748 )
Other	94	—
Net cash used in investing activities	(276 )	(912 )
<b>FINANCING ACTIVITIES</b>		
Net repayments on note payable to bank	—	(1,181)
Restricted cash	—	1,500
Net cash provided by financing activities	—	319
Increase (decrease) in cash and cash equivalents	749	(1,687)
Cash and cash equivalents at beginning of period	5,192	7,183
Cash and cash equivalents at end of period	\$5,941	\$5,496
Supplemental Disclosure:		
Cash paid for interest	\$—	\$32
Cash paid for income taxes	\$11	\$—

See Accompanying Notes to Condensed Consolidated Financial Statements.

THE LGL GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

A. Subsidiaries of the Registrant

The LGL Group, Inc. (together with its subsidiaries, the "Company"), incorporated in 1928 under the laws of the State of Indiana and reincorporated under the laws of the State of Delaware in 2007, is a holding company with subsidiaries engaged in the design and manufacture of highly-engineered, high reliability frequency and spectrum control products.

As of September 30, 2015, the subsidiaries of the Company are as follows:

	Owned By The LGL Group, Inc.
M-tron Industries, Inc.	100.0 %
M-tron Industries, Ltd.	99.9 %
Piezo Technology, Inc.	100.0 %
Piezo Technology India Private Ltd.	99.0 %
M-tron Asia, LLC	100.0 %
M-tron Services, Ltd.	100.0 %
Lynch Systems, Inc.	100.0 %

The Company operates through its principal subsidiary, M-tron Industries, Inc., which includes the operations of M-tron Industries, Ltd. ("Mtron") and Piezo Technology, Inc. ("PTI"). The combined operations of Mtron and PTI and their subsidiaries are referred to herein as "MtronPTI." MtronPTI has operations in Orlando, Florida, Yankton, South Dakota, and Noida, India. MtronPTI also has sales offices in Sacramento, California and Hong Kong.

During 2007, the Company sold the operating assets of Lynch Systems, Inc., a subsidiary of the Company, to an unrelated party.

B. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2015, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2015.

This interim information should be read in conjunction with the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

C. Inventories

Inventories are stated at the lower of actual cost (determined using the first-in, first-out method), or market (estimated realizable value), with adjustments being recorded in the reserve for obsolescence, which was \$2,991,000 and

\$2,802,000 as of September 30, 2015 and December 31, 2014, respectively.

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Inventories are comprised of the following (in thousands):

	September	
	30,	December
	2015	31, 2014
Raw materials	\$1,437	\$ 1,588
Work in process	1,425	1,572
Finished goods	885	1,038
Total Inventories, net	\$3,747	\$ 4,198

#### D. Intangible Assets

Intangible assets are recorded at cost less accumulated amortization. Amortization is computed for financial reporting purposes using the straight-line method over the estimated useful lives of the assets, which range up to 10 years. The intangible assets consist of intellectual property and goodwill. The net carrying value of the amortizable intangible assets was \$448,000 and \$488,000 as of September 30, 2015 and December 31, 2014, respectively. Goodwill, which is not amortizable, was \$40,000 as of September 30, 2015 and December 31, 2014.

The estimated aggregate amortization expense for each of the five succeeding years and thereafter is as follows (in thousands):

2015	\$ 13
2016	54
2017	54
2018	54
2019	54
Thereafter	219
Total	\$448

#### E. Stock-Based Compensation

The Company estimates the fair value of stock options on the grant date using the Black-Scholes-Merton option-pricing model. The Black-Scholes-Merton option-pricing model requires subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. There is no expected dividend rate. The fair value of grants was calculated using historical volatility as the Company believes that the historical volatility over the life of the option is indicative of expected volatility in the future. The risk-free interest rate is based on the U.S. Treasury zero-coupon rates with a remaining term equal to the expected term of the option. Accounting Standards Codification ("ASC") 718, Stock Compensation, also requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based upon past history of actual performance, forfeiture rates ranging from zero percent to ten percent have been assumed for options granted. Restricted stock awards are granted at a value equal to the market price of the Company's common stock on the date of the grant.

On May 8, 2015, the Board of Directors granted 37,296 restricted shares of the Company's common stock to Michael J. Ferrantino, Sr., pursuant to the Company's 2011 Incentive Plan. These shares vested in full on the grant date. Total stock-based compensation expense for this grant was \$160,000.

On March 12, 2015, the Board of Directors granted a total of 32,000 options to purchase shares of the Company's common stock to members of executive management pursuant to the Company's 2011 Incentive Plan. These stock

options have an exercise price of \$4.15, a five-year life expiring on March 12, 2020, and vest as follows: 30% on the first anniversary of the grant date; an additional 30% on the second anniversary of the grant date; and the remaining 40% on the third anniversary of the grant date. These stock options have a grant date fair value of \$1.03 per option.

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Compensation expense related to share-based compensation is recognized over the applicable vesting periods. As of September 30, 2015, there was approximately \$60 of total unrecognized compensation expense related to unvested share-based compensation arrangements.

#### F. Net Loss Per Share

The Company computes net loss per share in accordance with ASC 260, Earnings Per Share ("ASC 260"). Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share adjusts basic loss per share for the effects of stock options, non-participating restricted common stock, and other potentially dilutive financial instruments, only in the periods in which the effects are dilutive. Shares of restricted stock granted to members of the Board of Directors as a portion of their director fees are deemed to be participating as defined by ASC 260 and therefore are included in the computation of basic loss per share.

Unexercised stock options to purchase 189,023 shares and 221,635 shares of the Company's common stock for the three and nine months ended September 30, 2015 and 2014, respectively, were excluded from the diluted loss per share computation because the impact of the assumed exercise of such stock options would have been anti-dilutive during the respective periods.

#### G. Stockholders' Equity

On August 29, 2011, the Board authorized the Company to repurchase up to 100,000 shares of its common stock in accordance with applicable securities laws. This authorization increased the total number of shares authorized and available for repurchase under the Company's existing share repurchase program to 540,000 shares, at such times, amounts and prices as the Company shall deem appropriate. As of September 30, 2015, the Company had repurchased a total of 79,664 shares of common stock at a cost of \$572,000, which shares are currently held in treasury.

On August 6, 2013, the Company distributed warrants to purchase shares of the Company's common stock as a dividend to holders of the Company's common stock on July 29, 2013, the record date for the dividend. Stockholders received five warrants for each share of the Company's common stock owned on the record date. When exercisable, 25 warrants will entitle their holder to purchase one share of the Company's common stock at an exercise price of \$7.50 per share (subject to adjustment).

The warrants are "European style warrants" and will only become exercisable on the earlier of (i) their expiration date, August 6, 2018, and (ii) such date that the 30-day volume weighted average price per share, or VWAP, of the Company's common stock is greater than or equal to \$15.00 (subject to adjustment). Once the warrants become exercisable, they may be exercised in accordance with the terms of the warrant agreement between the Company and the warrant agent until their expiration at 5:00 p.m., Eastern Time, on the expiration date.

The warrants are traded separately from the Company's common stock on the NYSE MKT under the symbol "LGL WS".

#### H. Fair Value Measurements

The Company measures financial and non-financial assets and liabilities at fair value in accordance with ASC 820, Fair Value Measurements and Disclosures. These measurements involve various valuation techniques and assume that the transactions would occur between market participants in the most advantageous market for the Company.

## Fair Value Hierarchy

The three levels of inputs that may be used to measure fair value are as follows:

Level 1. Quoted prices in active markets for identical assets and liabilities.

Level 2. Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in less active markets, or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities. Level 2 inputs also include non-binding market consensus prices that can be corroborated with observable market data, as well as quoted prices that were adjusted for security-specific restrictions.

Level 3. Unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of assets or liabilities. Level 3 inputs also include non-binding market consensus prices or non-binding broker quotes that we were unable to corroborate with observable market data.

The following is a summary of valuation techniques utilized by the Company for its significant financial and non-financial assets and liabilities as of September 30, 2015 and December 31, 2014:

## Assets

To estimate the fair value of its equity and U.S. Treasury securities, the Company obtains current market pricing from quoted market sources or uses pricing for identical securities. Assets measured at fair value on a recurring basis are summarized below (in thousands).

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total September 30, 2015
Equity securities	\$ 54	\$ —	\$ —	\$ 54
U.S. Treasury securities (cash equivalents)	\$ 4,089	\$ —	\$ —	\$ 4,089

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total December 31, 2014
Equity securities	\$ 60	\$ —	\$ —	\$ 60
U.S. Treasury securities (cash equivalents)	\$ 4,089	\$ —	\$ —	\$ 4,089



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The Company also has assets that may be subject to measurement at fair value on a non-recurring basis, including goodwill and intangible assets, and other long-lived assets. The Company reviews the carrying value of these assets whenever events and circumstances indicate that the carrying amounts of the assets may not be recoverable. If it is determined that the assets are impaired, the carrying value would be reduced to estimated fair value.

### I. Foreign Revenues

For the three and nine months ended September 30, 2015 and 2014, significant foreign revenues from operations (10% or more of foreign sales) were as follows (in thousands):

	Three Months Ended September 30, 2015    2014	
Significant Foreign Revenues:		
Malaysia	\$451	\$674
China	213	539
All other foreign countries	416	1,068
Total foreign revenues	\$1,080	\$2,281

	Nine Months Ended September 30, 2015    2014	
Significant Foreign Revenues:		
Malaysia	\$1,749	\$2,354
China	678	2,155
All other foreign countries	1,729	3,014
Total foreign revenues	\$4,156	\$7,523

The Company allocates its foreign revenue based on the customer's ship-to location.

### J. Income Taxes

The Company has a total federal net operating loss ("NOL") carry-forward of \$9,471,000 as of December 31, 2014. This NOL carry-forward expires through 2034 if not utilized prior to that date. The Company has total state NOL carry-forwards of \$21,780,000 as of December 31, 2014. These NOL carry-forwards expire through 2034 if not utilized prior to that date. The Company has research and development tax credit carry-forwards of approximately \$1,285,000 at December 31, 2014, that can be used to reduce future U.S. income tax liabilities and expire principally between 2020 and 2034. The Company has foreign tax credit carry-forwards of approximately \$359,000 at December 31, 2014, that are available to reduce future U.S. income tax liabilities subject to certain limitations. These foreign tax credit carry-forwards expire at various times between 2018 and 2020. Additionally, the Company has federal alternative minimum tax (AMT) credits of approximately \$111,000 at December 31, 2014, that are available to offset future U.S. federal tax liabilities, and have no expiration.

Based on the Company's assessment of the uncertainty surrounding the realization of the favorable U.S. tax attributes in future tax returns in accordance with the provisions of ASC 740, Income Taxes, the Company has determined that a full valuation allowance against its otherwise recognizable U.S. net deferred tax assets is required. The Company has recorded a full valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized. When assessing the need for valuation allowances, the Company considers future taxable income and

ongoing prudent and feasible tax planning strategies. Should a change in circumstances lead to a change in judgment about the ability to realize deferred tax assets in future years, the Company will adjust related valuation allowances in the period that the change in circumstances occurs, along with a corresponding increase or charge to income.

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K. Commitments and Contingencies

In the normal course of business, the Company and its subsidiaries may become defendants in certain product liability, patent infringement, worker claims and other litigation. The Company records a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. The Company is not involved in any legal proceedings other than routine litigation arising in the normal course of business, none of which the Company believes will have a material adverse effect on the Company's business, financial condition or results of operations.

L. Related Party Transactions

At September 30, 2015 and December 31, 2014, approximately \$4,089,000 was invested in United States Treasury money market funds managed by a related entity (the "Fund Manager") which is related through a common director. One of the Company's directors, who is also a 10% stockholder, currently serves as a director and executive officer of the Fund Manager. The fund transactions during the nine months ended September 30, 2015 and for the year ended December 31, 2014, were directed solely at the discretion of Company management.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward-Looking Statements

This interim information should be read in conjunction with the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission on March 31, 2015 (the "2014 Form 10-K"). Information included or incorporated by reference in this Quarterly Report on Form 10-Q may contain forward-looking statements. This information may involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different than the future results, performance or achievements expressed or implied by any forward-looking statements. Forward-looking statements, which involve assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words "may," "should," "expect," "anticipate," "estimate," "believe," "intend" or "project" or the negative of these words or other variations on these words or comparable terminology.

Examples of forward-looking statements include, but are not limited to, statements regarding efforts to grow revenue, expectations regarding fulfillment of backlog, future benefits to operating margins and the adequacy of cash resources. Actual events or results may differ materially from those discussed in forward-looking statements as a result of various factors, including, without limitation, the risks outlined under "Risk Factors" in the 2014 Form 10-K, and as may updated in our subsequent Quarterly Reports on Form 10-Q. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this Quarterly Report on Form 10-Q will in fact be accurate. Further, we do not undertake any obligation to publicly update any forward-looking statements. As a result, you should not place undue reliance on these forward-looking statements.

Results of Operations

Three months ended September 30, 2015 compared to three months ended September 30, 2014

Consolidated Revenues, Gross Margin and Backlog

Consolidated revenues for the three months ended September 30, 2015 were \$4,796,000, as compared to \$5,581,000 for the three months ended September 30, 2014, a decrease of \$785,000, or 14.1%. Price compression from offshore manufacturers has continued to reduce the number of economically feasible opportunities in the Internet Communications Technology ("ICT") segment. The Company has moved away from such low margin commodities business and focused on achieving revenue growth through the development of more complex products, particularly in the Aerospace and Defense ("Aero/Defense") market segment.

Consolidated gross margin, which is consolidated revenues less manufacturing cost of sales, as a percentage of revenues increased to 33.1% from 31.0% for the three month period ended September 30, 2015, compared to the same prior year period. The quarter over quarter improvement in gross margin was primarily due to a favorable product mix and continued margin improvement initiatives. The favorable product mix is due to engineering investments the Company has made that have resulted in the development of more complex products that are producing higher margins.

Order backlog has remained consistent for the last four quarters. Order backlog as of September 30, 2015 was \$8,783,000, as compared to the order backlog as of June 30, 2015, which was \$8,857,000, and to the order backlog as of September 30, 2014, which was \$8,693,000.

Order backlog is adjusted quarterly to reflect project cancellations, deferrals, revised project scope and cost, and sales of subsidiaries, if any. The Company expects to fill its entire backlog within the next 12 months, but cannot provide assurances as to what portion of the order backlog will be fulfilled in a given year.

#### Operating Loss

The Company had an operating loss of \$154,000 for the three months ended September 30, 2015, compared to an operating loss of \$409,000 for the comparable period in 2014. The improvement in operating loss was due to a 2.1 percentage point increase in gross margin, and a decrease in engineering, selling and administrative expenses of \$353,000 resulting from our 2014 restructuring plan that realigned sales, general and administrative activities and customer support operations across all of our locations in an effort to gain efficiencies.

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## Stock-Based Compensation

Stock-based compensation expense was approximately \$14,000 and \$27,000 for the three months ended September 30, 2015 and 2014, respectively. Compensation expense related to stock-based compensation is recognized over the applicable vesting periods and included in engineering, selling and administrative expenses in the accompanying Condensed Consolidated Statements of Operations. As of September 30, 2015, there was approximately \$60,000 of total unrecognized compensation expense related to unvested share-based compensation arrangements.

## Income Taxes

The Company maintains a full valuation allowance against its deferred tax assets under the provisions of ASC 740, Income Taxes, based on the Company's assessment of the uncertainty surrounding the realization of the favorable U.S. tax benefits in future tax returns. When assessing the need for valuation allowances, the Company considers future taxable income and ongoing prudent and feasible tax planning strategies. Should a change in circumstances lead to a change in judgment about the ability to realize deferred tax assets in future years, the Company will adjust related valuation allowances in the period in which the change in circumstances occurs, along with a corresponding increase or charge to income.

## Other (Expense) Income, Net

For the three months ended September 30, 2015 other expense, net, was \$23,000 compared to \$78,000 for the three months ended September 30, 2014. The current period expense consists of foreign currency transaction losses. The prior year period consists of approximately \$59,000 of expense related to a legal settlement and a net loss of approximately \$28,000 realized on the disposal of assets, partially offset by foreign currency transaction gains.

## Net Loss

Net loss for the three months ended September 30, 2015 was \$195,000 compared to a net loss of \$492,000 for the comparable period in 2014. The improvement in net loss was primarily due to a 2.1 percentage point increase in gross margin and a decrease in engineering, selling and administrative expenses of \$353,000 resulting from the restructuring plan completed in 2014 that realigned sales, general and administrative activities and customer support operations across all locations in an effort to gain efficiencies. Basic and diluted net loss per share for the three month periods ended September 30, 2015 and 2014, was \$0.07 and \$0.19, respectively.

Nine months ended September 30, 2015 compared to nine months ended September 30, 2014

## Consolidated Revenues, Gross Margin and Backlog

For the nine months ended September 30, 2015 consolidated revenues were \$15,671,000 as compared to \$17,562,000 for the nine-month period ended September 30, 2014, a decrease of \$1,891,000 or 10.8%. Price compression from offshore manufacturers has continued to reduce the number of economically feasible opportunities in the ICT segment. The Company has moved away from such low margin commodities business and focused on achieving revenue growth through the development of more complex products, particularly in the Aero/Defense market segment.

For the nine months ended September 30, 2015 consolidated gross margin, which is consolidated revenues less manufacturing cost of sales, as a percentage of revenues increased to 33.0% from 26.7% for the comparable period in 2014 primarily due to a favorable product mix and continued margin improvement initiatives. The favorable product mix is due to engineering investments the Company has made that have resulted in the development of more complex products that are producing higher margins. The gross margin in 2014 was also negatively impacted by an increase in warranty expense of \$366,000 related to two isolated product defects.

Order backlog has remained consistent for the last four quarters. Order backlog as of September 30, 2015 was \$8,783,000, as compared to the order backlog as of December 31, 2014, which was \$8,793,000, and to the order backlog as of September 30, 2014, which was \$8,693,000.

## Operating Loss

The Company had an operating loss of \$648,000 for the nine months ended September 30, 2015, compared to an operating loss of \$2,501,000 for the comparable period in 2014, an improvement of \$1,853,000. The improvement in operating loss was due to a 6.3 percentage point increase in gross margin, and a decrease in engineering, selling and administrative expenses of \$928,000 as a result of the restructuring plan completed in 2014 that realigned sales, general and administrative activities and customer support operations across all of our locations in an effort to gain efficiencies. Operating loss for the nine months ended September 30, 2014, also included \$444,000 of restructuring expense.

## Stock-Based Compensation

Stock-based compensation expense was approximately \$201,000 and \$213,000 for the nine months ended September 30, 2015 and 2014, respectively, and is included in engineering, selling and administrative expenses in the accompanying Condensed Consolidated Statements of Operations.

On May 8, 2015, the Board of Directors granted 37,296 restricted shares of the Company's common stock to Michael J. Ferrantino, Sr., pursuant to the Company's 2011 Incentive Plan. These shares vested in full on the grant date. Total stock-based compensation expense for this grant was \$160,000.

On March 12, 2015, the Board of Directors granted a total of 32,000 options to purchase shares of the Company's common stock to members of executive management. These stock options have an exercise price of \$4.15, a five-year life expiring on March 12, 2020, and vest as follows: 30% on the first anniversary of the grant date; an additional 30% on the second anniversary of the grant date; and the remaining 40% on the third anniversary of the grant date. These stock options have a grant date fair value of \$1.03 per option.

## Other (Expense) Income, Net

For the nine months ended September 30, 2015, other income, net was \$112,000 compared to other expense, net of \$48,000 for the nine months ended September 30, 2014. The current period consists of approximately \$159,000 of net insurance proceeds received for damaged equipment and inventory, partially offset by foreign currency transaction gains. The prior year expense consists of foreign currency transaction losses.

## Income Taxes

The Company maintains a full valuation allowance against its deferred tax assets under the provisions of ASC 740, Income Taxes, based on the Company's assessment of the uncertainty surrounding the realization of the favorable U.S. tax benefits in future tax returns. When assessing the need for valuation allowances, the Company considers future taxable income and ongoing prudent and feasible tax planning strategies. Should a change in circumstances lead to a change in judgment about the ability to realize deferred tax assets in future years, the Company will adjust related valuation allowances in the period that the change in circumstances occurs, along with a corresponding increase or charge to income.

## Net Loss

For the nine-month period ended September 30, 2015, the Company had a net loss of \$574,000 compared to a net loss of \$2,570,000 for the comparable period in 2014. The improvement in net loss was primarily due to a 6.3 percentage point increase in gross margin and a decrease in engineering, selling and administrative expenses of \$928,000 as a result of the restructuring plan completed in 2014 that realigned sales, general and administrative activities and customer support operations across all locations in an effort to gain efficiencies. Net loss for the nine months ended September 30, 2014, also included \$444,000 of restructuring expense. Basic and diluted net loss per share for the nine



month periods ended September 30, 2015 and 2014, was \$0.22 and \$0.99, respectively.

## Liquidity and Capital Resources

Cash and cash equivalents increased by \$749,000, to \$5,941,000 at September 30, 2015, from \$5,192,000 at December 31, 2014.

Cash provided by operating activities was \$1,025,000 for the nine months ended September 30, 2015, compared to cash used in operating activities of \$1,094,000 for the same period in 2014. The \$2,119,000 improvement was primarily attributable to a \$1,996,000 reduction in year over year net losses and a reduction in working capital adjustments.

Cash used in investing activities for the nine months ended September 30, 2015 and 2014 was \$276,000 and \$912,000, respectively. The decrease was primarily due to the January 31, 2014 acquisition of certain of Trilithic, Inc.'s filter product line assets for cash consideration, including acquisition costs, of \$748,000, partially offset by an increase in current period capital expenditures of \$206,000.

Cash provided by financing activities was \$0 for the nine months ended September 30, 2015, compared with \$319,000 for the comparable period in 2014. The change was due to net repayments on the note payable to our credit facility provider of \$1,181,000 offset by a decrease in restricted cash during the comparable period in 2014.

As of September 30, 2015, the Company's consolidated working capital was \$9,788,000 compared to \$9,909,000 at December 31, 2014. As of September 30, 2015, the Company had current assets of \$12,106,000, current liabilities of \$2,318,000 and a ratio of current assets to current liabilities of 5.22 to 1.00. At December 31, 2014, the Company had current assets of \$12,934,000, current liabilities of \$3,025,000 and a ratio of current assets to current liabilities of 4.28 to 1.00. Management continues to focus on efficiently managing working capital requirements to match operating activity levels.

On September 30, 2014, MtronPTI entered into a Loan Agreement (the "CNB Loan Agreement"), with City National Bank of Florida ("City National"). The CNB Loan Agreement provides for a revolving line of credit in the amount of \$3.0 million (the "CNB Revolver"), which bears interest at a variable rate equal to 30-day LIBOR plus 200 basis points to be set on the first day of each month. Under the terms of the CNB Loan Agreement and the CNB Revolving Promissory Note (as defined below), MtronPTI may borrow under the CNB Revolver until September 30, 2016, unless the term of the CNB Revolving Promissory Note is extended.

The Company's obligations under the CNB Loan Agreement are secured only by cash collateral and do not require any other liens. The CNB Loan Agreement provides that MtronPTI will pay City National a fee equal to 0.75% per year on the daily unused amount of the CNB Revolving Promissory Note. In connection with the CNB Loan Agreement, MtronPTI also entered into a Cash Collateral Agreement with City National (the "CNB Cash Collateral Agreement") and delivered a Revolving Promissory Note in the principal amount of \$3.0 million to City National (the "CNB Revolving Promissory Note"). The CNB Cash Collateral Agreement provides that MtronPTI will hold cash collateral equal to any amounts outstanding under the CNB Revolver in a non-interest bearing deposit account with City National. Provided that MtronPTI is not in default of any of its obligations under the CNB Loan Agreement, the CNB Revolving Promissory Note or the CNB Cash Collateral Agreement, the funds collateralizing the CNB Revolver are restricted only to the extent of the outstanding principal amount under the CNB Revolver. As of September 30, 2015 and December 31, 2014, there was no balance outstanding under the CNB Revolver and no associated restricted cash.

The CNB Loan Agreement, the CNB Revolving Promissory Note and the CNB Cash Collateral Agreement provide for customary events of default, including but not limited to payment defaults, breach of other obligations under the CNB Loan Agreement, the CNB Revolving Promissory Note and the CNB Cash Collateral Agreement, bankruptcy or insolvency, material default with respect to any obligation owed to City National and default with respect to other material indebtedness.

The Company believes that existing cash and cash equivalents and cash generated from operations will be sufficient to meet its ongoing working capital and capital expenditure requirements for the next 12 months. However, the Company may seek additional capital to fund future growth in its business, to provide flexibility to respond to dynamic market conditions, or to fund its strategic growth objectives.

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The Board has adhered to a practice of not paying cash dividends. This policy takes into account our long-term growth objectives, including our anticipated investments for organic growth, potential technology acquisitions or other strategic ventures, and stockholders' desire for capital appreciation of their holdings. No cash dividends have been paid to the Company's stockholders since January 30, 1989, and none are expected to be paid for the foreseeable future.

#### Critical Accounting Policies

Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of such statements requires us to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period and the reported amounts of assets and liabilities as of the date of the financial statements. Our estimates are based on historical experience and other assumptions that we consider to be reasonable given the circumstances. Actual results may vary from our estimates.

The Company's most critical accounting policies include revenue recognition, accounts receivable allowance, valuation of inventories, accounting for warranty obligations, accounting for income taxes, and accounting for stock-based compensation.

#### Revenue Recognition

The Company recognizes revenue from the sale of its product in accordance with the criteria in ASC 605, Revenue Recognition, which are:

Persuasive evidence that an arrangement exists;

Delivery has occurred

The seller's price to the buyer is fixed and determinable; and

Collectability is reasonably assured.

The Company meets these conditions upon shipment because title and risk of loss passes to the customer at that time. However, the Company offers a limited right of return and/or authorized price protection provisions in its agreements with certain electronic component distributors who resell the Company's products to original equipment manufacturers or electronic manufacturing services companies. As a result, the Company estimates and records a reserve for future returns and other charges against revenue at the time of shipment consistent with the terms of sale. The reserve is estimated based on historical experience with each respective distributor. The amount of the reserve at September 30, 2015 is not material to the financial statements.

The Company recognizes revenue related to transactions with a right of return and/or authorized price protection provisions when the following conditions are met:

The seller's price to the buyer is fixed or determinable at the date of sale;

The buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product;

The buyer's obligation to the seller would not be changed in the event of theft or physical destruction or damage of the product;

The buyer acquiring the product for resale has economic substance apart from that provided by the seller;

The seller does not have obligations for future performance; and

The amount of future returns can be reasonably estimated.

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### Accounts Receivable Allowance

Accounts receivable on a consolidated basis consists principally of amounts due from both domestic and foreign customers. Credit is extended based on an evaluation of the customer's financial condition and collateral is not generally required. In relation to export sales, the Company generally requires letters of credit supporting a significant portion of the sales price prior to production to limit exposure to credit risk. Certain credit sales are made to industries that are subject to cyclical economic changes.

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Estimates are based on historical collection experience, current trends, credit policy and relationship between accounts receivable and revenues. In determining these estimates, the Company examines historical write-offs of its receivables and reviews each client's account to identify any specific customer collection issues. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payment, additional allowances might be required. The Company's failure to estimate the losses for doubtful accounts accurately and ensure that payments are received on a timely basis could have a material adverse effect on its business, financial condition and results of operations.

### Inventory Valuation

Inventories are stated at the lower of cost (based on a first-in, first-out method), and market value (net realizable value).

The Company maintains a reserve for inventory obsolescence based on estimated losses that result from inventory that becomes obsolete as of period end. In determining these estimates, the Company performs an analysis on demand and usage for each inventory item over historical time periods. Based on that analysis, the Company reserves a percentage of the inventory amount within each time period based on historical demand and usage patterns of specific items in inventory.

### Warranties

The Company offers a standard one-year warranty. The Company tests its products prior to shipment in order to ensure that they meet each customer's requirements based upon specifications received from each customer at the time its order is received and accepted. The Company's customers may request to return products for various reasons, including but not limited to the customers' belief that the products are not performing to specification. The Company's return policy states that it will accept product returns only with prior authorization and if the product does not meet customer specifications, in which case the product would be replaced or repaired. To accommodate the Company's customers, each request for return is reviewed, and if and when it is approved, a return materials authorization ("RMA") is issued to the customer. Each month the Company records a specific warranty reserve for approved RMAs covering products that have not yet been returned. The Company does not maintain a general warranty reserve because, historically, valid warranty returns resulting from a product not meeting specifications or being non-functional have been immaterial.

### Income Taxes

Significant management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. The future recoverability of the Company's net deferred tax assets is dependent upon the generation of future taxable income prior to the expiration of the loss carry forwards. The Company maintains a full valuation allowance against the Company's net deferred tax assets. The valuation allowance was calculated in accordance with the provisions of ASC 740, Income Taxes, which requires an assessment of both positive and negative evidence when measuring the need for a valuation allowance. We intend to maintain a valuation allowance until sufficient positive evidence exists to support its reversal.



## Stock-Based Compensation

The Company measures the cost of employee services in exchange for an award of equity instruments based on the grant-date fair value of the award and recognizes the cost over the requisite service period, typically the vesting period.

The Company estimates the fair value of stock options on the grant date using the Black-Scholes-Merton option-pricing model. The Black-Scholes-Merton option-pricing model requires subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. There is no expected dividend rate. Historical Company information was the basis for the expected volatility assumption as the Company believes that the historical volatility over the life of the option is indicative of expected volatility in the future. The risk-free interest rate is based on the U.S. Treasury zero-coupon rates with a remaining term equal to the expected term of the option. The Company also estimates forfeitures at the time of grant and revises, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based upon past history of actual performance, forfeiture rates ranging from zero percent to twenty percent have been assumed for options granted.

Stock awards are made at a value equal to the market price of the Company's common stock on the date of the grant.

## Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

## Item 4. Controls and Procedures.

### Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company's principal executive officer and principal financial officer evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on their evaluation of the Company's disclosure controls and procedures, the Company's principal executive officer and principal financial officer, with the participation of the Company's management, have concluded that the Company's disclosure controls and procedures were effective as of September 30, 2015, to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is (a) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (b) accumulated and communicated to management, including the Company's principal executive officer and principal financial officer, as appropriate to allow for timely decisions regarding required disclosure.

### Changes in Internal Control Over Financial Reporting

During the fiscal quarter ended September 30, 2015, there were no changes in the Company's internal controls over financial reporting, or in other factors that could significantly affect these controls, that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

None.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following is a list of exhibits filed as part of this Form 10-Q:

Exhibit

No. Description

- 31.1 Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document\*\*
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE LGL GROUP, INC.

Date: November 12, 2015 By: /s/ Michael J. Ferrantino, Sr.  
Michael J. Ferrantino, Sr.  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 12, 2015 By: /s/ Patti A. Smith  
Patti A. Smith  
Chief Financial Officer  
(Principal Financial and Accounting Officer)