

FINAL TRANSCRIPT

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GSIT - Q4 2011 GSI Technology Inc Earnings Conference Call

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CORPORATE PARTICIPANTS

Lee-Lean Shu

GSI Technology, Inc. - Chairman, President and CEO

Douglas Schirle

GSI Technology, Inc. - CFO

Didier Lasserre

GSI Technology, Inc. - VP, Sales

CONFERENCE CALL PARTICIPANTS

Jeff Schreiner

Capstone Investment - Analyst

Ben Axler

Spruce Point Capital - Analyst

Jeff Meyers

Cobia Capital - Analyst

PRESENTATION

Operator

Welcome to GSI Technology's Fiscal 2011 Fourth Quarter Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. At that time, we will provide instructions for those interested in entering the queue for the Q&A.

Before we begin today's call, the Company has requested that I read the following Safe Harbor statement. The matters discussed in this conference call may include forward-looking statements regarding future events, and the future performance of GSI Technology that involve risks and uncertainties that could cause actual results to differ materially from those anticipated.

These risks and uncertainties are described in the Company's Form-10K filed with the Securities and Exchange Commission. Additionally, I've also been asked to advise you that this conference call is being recorded May 5, 2011 at the request of GSI Technology.

Hosting the call today is, Lee-Lean Shu, the Company's Chairman, President and Chief Executive Officer. With him are, Douglas Schirle, Chief Financial Officer and Didier Lasserre, Vice President of Sales.

I would now like to turn the conference call over to Mr. Shu. Please go ahead, sir.

Lee-Lean Shu - *GSI Technology, Inc. - Chairman, President and CEO*

Welcome, everyone. Thank you for joining us. Today, for the fiscal year ended March 31, 2011, we reported the strongest operating results in GSI's history. Net income for the 12 months was a record \$18.9 million, or \$0.64 per diluted share, on net revenues of \$97.8 million, compared to net income of \$10.4 million, or \$0.38 per diluted share, on net revenues of \$67.6 million in the prior fiscal year. This represents an increase of 45% in net revenues, and 82% in net income.

We also ended the year with the strongest balance sheet in the Company's history; \$52 million in cash, cash equivalents and short-term investments; \$31 million in long-term investments; \$80 million in working capital; no debt; and stockholders' equity of almost \$125 million.



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Less easily quantified, but no less important as we look to the future, we ended the year with the broadest and the most promising line of product offerings in GSI's [15-year] history. Some of these, like our first-generation SigmaQuad devices, have already proven themselves in the marketplace. Others, like the second- and third-generation SigmaQuad and SigmaDDR devices, have attracted considerable interest and are expected to drive top line growth for years to come.

Equally exciting is our family of 576-megabit LLDRAMs. As we announced earlier this week, these are now available for sampling and customer evaluation, with volume shipments expected not later than the first quarter of calendar 2012. The market for low-latency DRAMs is currently estimated to be as much as \$300 million a year, most of it now controlled by Micron Technology.

The addition of a supplier with GSI's credibility as a second source will, we believe, contribute to the growth of the low-latency DRAM market as a whole. We expect to get our share of it and believe that by the end of calendar 2012, LLDRAMs could be contributing as much as \$10 million per quarter to GSI's net revenues.

As we noted in today's release, fourth-quarter net revenues were below expectations, due primarily to lower-than-expected sales to Cisco Systems, our largest customer. As we explained three months ago, we were expecting a sequential decline in the fourth-quarter revenues, driven largely by excess inventory at some of Cisco's contract manufacturers.

However, the decline in direct and indirect sales to Cisco to \$6.8 million from \$9.8 million in the third quarter was greater than we had anticipated, and it had a predictable effect on margins and the net income.

To a considerable extent, then, financial results for the quarter just ended reflect inventory adjustments among a number of customers, notably Cisco, following stronger-than-expected shipments in the preceding two quarters.

Longer term, of course, the demand for GSI's products will continue to be a function of the global demand for memory devices. Here the outlook is clearly positive. But in the shorter term, as was apparent throughout fiscal 2011, when in two out of four quarters we under-estimated net revenues. It is more immediately a function of customers' and their contract manufacturers' success in predicting their requirements and managing their inventories accordingly.

It is for this reason, among others, that we, as a supplier, do not attempt to forecast financial results beyond the current quarter. There are simply too many variables. Add to the mix the effects of the recent earthquake and the tsunami in Japan, which have raised questions regarding the pricing and availability of some raw materials, and the visibility regarding the coming 12 months is somewhat more limited than it was at this time a year ago.

I would emphasize, however, that we are an extremely nimble organization with among the shortest lead times in the industry, tight control of our own inventory, and a proven ability to respond quickly to any unforeseen increase in demand.

All that said, at this point our best estimate is that first-quarter 2012 net revenues will be between \$22 million and \$23 million. Built into this projection are slightly higher sales to Cisco, with the rest of our business expected to be essentially flat versus the prior quarter. Gross margin is expected to be only slightly higher than the 44.1% reported in the current quarter.

In closing, let me comment briefly on a recently announced complaint lodged by Cypress Semiconductor against GSI which alleged patent infringement principally related to our SigmaQuad and SigmaDDR products.

I do this with your understanding that beyond these remarks, we will for the time being have nothing further to say on the matter. While it is of course impossible to predict the outcome of such litigation, at this point we believe that our position is strong and that Cypress' claims are without merit. We intend to defend the lawsuit vigorously.

I will now turn the call over to Doug.



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Douglas Schirle - GSI Technology, Inc. - CFO

Thank you, Lee-Lean. For the fiscal year ended March 31, 2011, we reported net income of \$18.9 million, or \$0.64 per diluted share, on net revenues of \$97.8 million, compared to net income of \$10.4 million, or \$0.38 per diluted share, on net revenues of \$67.6 million from the prior fiscal year. Gross margin was 45.8% compared to 43.3% in fiscal 2010.

Total operating expenses of \$21.4 million were \$2.8 million higher than in fiscal 2010, reflecting increases of \$1.6 million and \$1.2 million, respectively in research and development and selling, general and administrative expenses. Operating margin was 23.9% in 2011, compared to 15.7% in 2010.

For the quarter ended March 31, 2011, net income was \$3.4 million or \$0.11 per diluted share, on net revenues of \$21.9 million, compared to net income of \$3.8 million or \$0.14 per diluted share, on net revenues of \$21.2 million in the comparable quarter a year ago.

Pre-tax income was slightly higher at \$4.8 million, compared to \$4.5 million in the same period a year ago. The lower fourth quarter 2011 net income reflects a \$1.4 million provision for income taxes compared to \$700,000 in the fourth quarter of 2010.

Product lines acquired in the Sony acquisition completed in August, 2009, contributed approximate \$3.9 million to fourth quarter net revenues, compared to \$4 million in the third quarter and have now contributed a total of approximate \$20 million.

Fourth quarter direct and indirect sales to Cisco Systems were \$6.8 million or 31.5% of net revenues, compared to \$9.8 million or 37.2% of net revenues in the third quarter and \$8.7 million, or 41.1% of net revenues in the same period a year ago. For the full year, sales to Cisco were 37% of net revenues, compared to 34.7% in fiscal 2010.

Sales to Huawei Technologies, our second largest customer, were \$2.2 million or 10.1% of net revenues, compared to \$2.8 million or 10.7% of net revenues in the prior quarter. In the fourth quarter of fiscal 2010, sales to Huawei were \$2 million or 9.5% of net revenues. For the full year, sales to Huawei were 9.7% in net revenues, compared to 9.9% in fiscal 2010.

Military/defense sales were 8.3% of shipments compared to 8.8% of shipments in the third quarter and 6.7% of shipments in the comparable period a year ago. For the full year, military/defense sales were 8.2% of sales, compared to 11.6% in fiscal 2010. SigmaQuad sales were 27.3% of shipments in the fourth quarter of 2011, compared to 33.4% a year ago. For the year, they were 31.7% of shipments, compared to 23% in fiscal 2010.

Total fourth quarter pre-tax stock-based compensation expense was \$408,000, compared to \$428,000 in the third quarter and \$395,000 in the comparable period a year ago. For the year, pre-tax stock-based compensation expense was \$1.7 million, compared to \$1.5 million in fiscal 2010.

Operating expenses are expected to be approximately \$5.6 million in the first quarter of fiscal 2012. The increase over the fourth quarter of fiscal 2011 is primarily due to expected legal fees to be incurred related to Cypress' patent litigation. We currently expect our effective tax rate to be approximately 23.8% in fiscal 2012, compared to 20.9% in fiscal 2011.

Accounts payable at March 31st is \$5.6 million, down from \$7.4 million at December 31, due to decreased wafer purchases and manufacturing expenses. Net inventory was \$21.4 million at March 31st, down from \$22.5 million at December 31st. Inventory turns at March 31 are 2.3 times. Depreciation and amortization expenses was \$2.8 million in fiscal 2011.

Operator, at this point, we'll open the call to Q&A.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We do have a question from Jeff Schreiner with Capstone Investment.

Jeff Schreiner - Capstone Investment - Analyst

Yes, good day, gentlemen. Thank you very much for taking my question. Doug, I was wondering, maybe you could comment on this a little bit, but can you help us understand, maybe how your late year entrance into the low latency kind of DRAM market is really any different than what current competitor ISSI is doing?

Are you targeting different segment of the market, or what are you doing to differentiate? Or, are we seeing both of you now kind of gravitate to the low latency DRAM markets as well?

Douglas Schirle - GSI Technology, Inc. - CFO

So, it's correct. So certainly, anybody who's entering this market today is going in as a second source to Micron. So, we are certainly following what Micron has started. The market has been a bit hampered because it has been single sourced to-date and so if you enter additional sources; it should help enable the market.

At this point, our advantage override the size effect that we believe would be to market before them. And then also if you look at who the large users are for this technology, it tend to be the large OEMs in the networking and telecom space which we feel we have a strong relationship with -- than ISSI.

Jeff Schreiner - Capstone Investment - Analyst

Okay. And was there any ASP erosion with the low revenues in the quarter?

Douglas Schirle - GSI Technology, Inc. - CFO

No. There was a mix change from some of the higher density devices to lower density devices, but it wasn't so much as a result of price erosion.

Jeff Schreiner - Capstone Investment - Analyst

Okay. So, is it more a mix issue?

Douglas Schirle - GSI Technology, Inc. - CFO

Correct.

Jeff Schreiner - Capstone Investment - Analyst

And then, why was there -- I know you guys attribute a lot to the revenue and that's understandable, the upside there. But why was so much leverage, if you could help me understand that losses in the model during the quarter?

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Douglas Schirle - *GSI Technology, Inc. - CFO*

You mean on the gross margin?

Jeff Schreiner - *Capstone Investment - Analyst*

Yes. Just on the margin and just on the overall gross margin.

Douglas Schirle - *GSI Technology, Inc. - CFO*

Well, it wasn't that much. We were looking at -- our guidance was, I believe, 45% for the quarter and we are less than 1% below that.

Jeff Schreiner - *Capstone Investment - Analyst*

Okay.

Douglas Schirle - *GSI Technology, Inc. - CFO*

And that's really attribute of the fact we have fewer revenue dollars working against the same, essentially fixed cost and operation expenses are up, cost of good sold type expenses.

Jeff Schreiner - *Capstone Investment - Analyst*

Right. But then, when you look at kind of the EBIT margin, you are down quite substantially on a sequential basis. I'm just wondering was there maybe ability to pull back expenses given on the timing of knowing this. Or, how you would have normally been able to see EBIT margin closer to 25% or higher, and now they are 21%.

And it's simply -- yes, there is a big revenue gap between the two, but I'm just wondering what was the moving part that maybe added to that, if any, from the revenue?

Douglas Schirle - *GSI Technology, Inc. - CFO*

Yes, I think the \$25 million we have, all that -- we have 45% gross margin, a lot of that falls through to pre-tax, because when our revenues go down, really the one thing that changes is well, we pay our outside [rep] commissions.

Jeff Schreiner - *Capstone Investment - Analyst*

Okay. Thank you very much for your time, gentlemen.

Operator

(Operator Instructions)

We do have a question from Ben Axler with Spruce Point Capital.

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Ben Axler - *Spruce Point Capital - Analyst*

Hi, gentlemen. Thank you for taking my question. I was wondering if you could reiterate what you said you expected to spend on legal expenses next quarter and if you foresee that being a or kind of a recurring expense throughout the year or just a one-time orange, charge for the coming quarter? Thank you.

Douglas Schirle - *GSI Technology, Inc. - CFO*

Yes, sure. It's very preliminary at this point. We don't have a lot of good information on what our expected costs are, but I have in there in the first quarter in the range of \$400,000 to \$500,000 right now. Depending on how long this goes, I would expect -- again, I don't have a lot of information, but probably somewhere in the \$0.5 million range per quarter.

Ben Axler - *Spruce Point Capital - Analyst*

Okay.

Douglas Schirle - *GSI Technology, Inc. - CFO*

We'll fine-tune it as we get more information from our attorneys.

Ben Axler - *Spruce Point Capital - Analyst*

Thank you.

Operator

(Operator Instructions)

The next question will come from Jeff Meyers with Cobia Capital.

Jeff Meyers - *Cobia Capital - Analyst*

Great. Well, let's see, first question, could you guys talk a little bit about the SigmaQuad-III and the ramp that's going on, I guess, with the OEM and how that's progressing?

Douglas Schirle - *GSI Technology, Inc. - CFO*

So, the design win you are talking about, one of our large customers, is going into a 100-gig switch. And so, certainly, they are in the process of doing some of the deployment today out in the field. And so, it's kind of a bit of a lull right now as far as before the ramp happens.

So, if you look at what we expect this quarter, we actually expect the shipments of these SigmaQuad-III to be down a little bit from the last quarter before it comes back up. So, right now, certainly on this equation of how quickly they can get the systems out to the service providers and how quickly they can ramp from there. So, at this point, we expect it to be down this quarter and then coming back up in the future quarters.

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Jeff Meyers - Cobia Capital - Analyst

Got it. And then, maybe perhaps a little bit about the guidance for this coming quarter and I mean, is there an extra dose of conservatism in there, given what happened in Q4, or I guess how would you characterize it?

Douglas Schirle - GSI Technology, Inc. - CFO

I try to make the forecast as realistic as possible. Our model isn't always predictable. As we've talked about in the past, we usually turn at least 40% of our quarter throughout the quarter. And then we also have a fair amount of our business, goes through distribution, which is not always easily predictable.

And then Cisco in general, they certainly are over 30% our number and they work -- and on a consignment model, and so, they are not (inaudible) in the system. We go into consignment models and when they need the devices, they pull them and at that point, we invoice them.

And so, we based our forecast on their forecast which are certainly only as accurate as they are when we receive them from Cisco.

So I try to make the forecast as accurate as possible, but there certainly are some factors that aren't always - it's not exact science, let's put it that way.

Jeff Meyers - Cobia Capital - Analyst

All right. Would you say -- I mean, would you say that your guidance at this point reflects end demand, or do you think there's still inventory being taken down in the system, and that's not kind of the end demand number?

Douglas Schirle - GSI Technology, Inc. - CFO

Right. So, in general, I think that we are in a better position now with inventory in our customers' channel than we were last quarter. There are certain part numbers [at] customers that haven't even shown up on forecast for a bid that are now showing up in the forecast again, which tells me that they are going to be back in an ordering mode.

So, certainly, we hope there would be most of the inventory correction is behind us, but certainly we feel that the recovery is going to be more of a U shape versus a V shape. So, that's why we are not bouncing back this quarter as much as we'd like to just because, again, that recovery, I think, is a little bit more U-shaped.

Jeff Meyers - Cobia Capital - Analyst

Okay, great. Thanks.

Operator

There are no further questions.

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Lee-Lean Shu - *GSI Technology, Inc. - Chairman, President and CEO*

Right. Thank you, all, for joining us. We look forward to speaking with you in another three months when we will report our first quarter fiscal 2012 results. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. You may now disconnect.

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