

FINAL TRANSCRIPT

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GSIT - Q2 2012 GSI Technology Inc Earnings Conference Call

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CORPORATE PARTICIPANTS

Lee-Lean Shu

GSI Technology, Inc. - Chairman, President, CEO

Douglas Schirle

GSI Technology, Inc. - CFO

Didier Lasserre

GSI Technology, Inc. - VP - Sales

CONFERENCE CALL PARTICIPANTS

Daniel Marquardt

Robert W. Baird & Company, Inc. - Analyst

Mike Crawford

B. Riley & Co. - Analyst

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to GSI Technology's Fiscal 2012 Second 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 have also been asked to advise you that this conference is being recorded today, October 27, 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 over to Mr. Shu. Please go ahead, sir.

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

Good afternoon everyone. Thank you for joining us today. This afternoon we reported financial results for the second quarter of our 2012 fiscal year. We are pleased to note that it was our thirty-second consecutive quarter of profitability. Gross margin of 43.6% was within our target range, but operating margin of 9.2%, and net income of \$1.7 million, were lower than expected.

Part of the explanation lies in the lower-than-anticipated net revenues. Three months ago we projected that second-quarter net revenues could be in the range of \$22.8 million to \$23.8 million. In fact, second-quarter net revenues were \$20.8 million. The shortfall of \$2 million versus the lower end of our guidance was due primarily to a persistently sluggish economy that has adversely effected demand for our memory devices. As we noted in today's press release, the shortfall does not appear to be the result of any issues unique to GSI.

Rather, we believe it is largely a reflection of a global economy that, with few exceptions, has simply not performed as well as we and many others had expected. At this point we side with those who do not expect to see any significant pickup in economic



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activity in the fourth calendar quarter. Consistent with this view, we currently expect that fiscal third-quarter net revenues will be in the range of \$18.2 million to \$19.2 million.

Given that R&D expenses were essentially flat at \$2.7 million, the greater reason for the lower-than-expected second-quarter net income lies in a \$1.0 million increase in SG&A, most of it attributable to legal expenses of \$1.9 million rather than the \$1.5 million we had anticipated, and more than double legal expenses of approximately \$800,000 in the prior quarter were associated with a previously announced patent infringement lawsuit filed against GSI by Cypress Semiconductor Corporation on March 30, 2011 and a related proceeding before the United States International Trade Commission that was instituted on July 21, 2011.

Also included in second-quarter legal expenses were costs associated with GSI's filing of an antitrust lawsuit filed by GSI against Cypress on July 22, 2011. We do not believe that this litigation has impacted our net revenues in the second quarter.

We have said it before, but it is worth repeating. In our view, not only has Cypress illegally sought to monopolize the market for SRAMs, they have provided no credible evidence that GSI or any of its customers infringed any valid Cypress patent. That said, we fully expect to prevail on the merits of our case. But this will require patience and, no doubt, additional legal expenses. These costs are difficult to predict with any accuracy, but at this time we expect third-quarter legal expenses related to the Cypress litigation to be similar to those of the second quarter. With that, I will now turn the call over to Doug.

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

Thank you, Lee-Lean. Today we reported GSI's thirty-second consecutive quarter of profitability. We reported net income of \$1.7 million, or \$0.06 per diluted share on net revenues of \$20.8 million in our second fiscal quarter ended September 2011, compared to net income of \$5.2 million, or \$0.18 per diluted share on net revenues of \$26.7 million in the comparable period a year ago. In the prior quarter ended June 30, 2011, we earned \$3.3 million, or \$0.11 per diluted share on net revenues of \$23 million.

Second quarter direct and indirect sales to Cisco Systems were \$7.9 million or 38% of net revenues, compared to \$9.6 million or 31.6% of net revenues in the prior quarter. Second quarter fiscal 2011 sales to Cisco Systems were \$10.4 million or 39.1% of net sales. Sales to Huawei Technologies were \$774,000, or 3.7% of net revenues, compared to \$1.4 million or 6% of net revenues in the prior quarter, and \$2.7 million or 10.1% of net revenue a year ago.

In dollar terms, military defense sales were flat. They comprised 10% of shipments, compared to 8.9% of shipments in the prior quarter, when net revenues as a whole were higher. In the comparable period a year ago, military defense sales were 7.7% of shipments.

SigmaQuad sales were 35.4% of shipments, compared to 32.5% of shipments in the prior quarter, and 33.2% of shipments in the second quarter of fiscal 2011. Total second quarter fiscal 2012 pre-tax stock-based compensation expense was \$515,000, compared to \$510,000 in the prior quarter, and \$430,000 in the second quarter of fiscal 2011.

At September 30, 2011, we had \$56.6 million in cash, cash equivalents and short-term investments, \$31.5 million in long-term investments, \$87.6 million in working capital, no debt, and stockholder's equity of \$131.8 million.

Operating expenses are expected to be approximately \$7.3 million in the third quarter of fiscal of 2012, and include approximately \$2 million in legal fees related to the defense of the patent infringement lawsuit filed against us by Cypress Semiconductor Corporation on March 30, 2011, and the subsequent complaint filed by Cypress with the US International Trade Commission, as well as the antitrust complaint that we filed against Cypress on July 22, 2011.

We currently expect our effective tax rate to approximately 21.6% in fiscal 2012. Accounts payable at September 30 is \$5.3 million, down from \$5.6 million at March 31, 2011. Net inventory was \$23 million at September 30, up from \$21.4 million at

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March 31. Inventory turns at September 30 are two times, compared to 2.3 times at March 31. Depreciation and amortization expense was \$1.4 million in the six months ended September 30, 2011.

During the quarter we purchased 44,699 shares of our common stock at an average price of \$4.92. Since September 30, 2011, we have repurchased an additional 221,153 shares at an average price of \$4.83. We still have approximately \$4.6 million remaining of the \$10 million approved by our Board of Directors on November 6, 2008 to repurchase our common shares.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Daniel Marquardt with Robert W. Baird.

Daniel Marquardt - *Robert W. Baird & Company, Inc. - Analyst*

Listening to Cypress call, they talked about Samsung, and I was wondering if you had any comments in terms of Samsung leaving the SRAM business.

Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

So, certainly. We got the news weeks ago, and we've actually seen a copy of the EOL notice. The notice mentioned all synchronous SRAMs at a last-time buy of the end of June with the last-time ship of the end of December of 2012. I did read the transcripts from Cypress in [ISSI], and personally I think they've underestimated the Samsung share of market. Certainly, if you add up the suppliers who are left in the market, I believe Cypress had mentioned Samsung was 15%, and ISSI said they were 15% to 20%.

And certainly, if you add up the Cypress share which is 40%, which I think we all agreed to, and our sales in ISSI are roughly 10%. The numbers that are looked at for Samsung just don't make sense. If you add up [RAC] and the very little SRAM market that IDT remains in. And so, we personally think that Samsung is closer to 25% of the current market share.

Daniel Marquardt - *Robert W. Baird & Company, Inc. - Analyst*

Okay. It is greater than 25%? And then as far as Huawei, can you comment on why Huawei was down so much in the quarter?

Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

Certainly, there's weakness in general in China telecom. We saw that just in Huawei and other providers for that market space. So, there was that general weakness, and then there was also one device that we were supposed to ship in the last quarter that actually got pushed into this quarter. So, that helped give us a bit of a hole at Huawei.

Daniel Marquardt - *Robert W. Baird & Company, Inc. - Analyst*

Alright. And then in terms of the legal expenses, do you expect those to remain at the \$2 million level in outer quarters?

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Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

It's hard to say. The attorneys can't even give me a good estimate. I guess, at this point, I'm expecting it to be at that level in our third quarter, probably the fourth quarter. This quarter's heavy with depositions. They'll be starting soon and going through near the end of November, so I wouldn't expect them to necessarily be less this quarter. And then the trial is currently expected to be in March of our fourth fiscal quarter.

Daniel Marquardt - *Robert W. Baird & Company, Inc. - Analyst*

All right. And then just one more question on LLDRAM. Just wanted to see where you guys are with that and when should we expect revenue there?

Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

So, we've sampled our customer base, and we've gotten a few qualifications. We have a very minor couple of orders that have come in, very pro-type orders. Really, the large impact to revenues for that to the LL family will come from the majors. And the majors are holding back full qualification until our part is internally fully qualified, and so we anticipate that to be sometime early- to mid-quarter of the calendar first quarter. So, sometime in the January, February time frame we expect to have full internal qualification. At that time, they'll go through their process. So, if I have to guess, the earliest would be mid-year for some of those majors to start kicking in.

Daniel Marquardt - *Robert W. Baird & Company, Inc. - Analyst*

Alright, thank you.

Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

Your welcome.

Operator

(Operator Instructions)

The next question comes from Mike Crawford with B. Riley & Company.

Mike Crawford - *B. Riley & Co. - Analyst*

Thank you. Didier you mentioned that one part to ship to Samsung got pushed. Was that an internal issue, or what happened there?

Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

To Huawei, you mean.



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Mike Crawford - *B. Riley & Co. - Analyst*

To Huawei, sorry.

Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

Yes. It was an internal -- it was a newer part that we were getting into the system. It was actually a dye rev, and for some reason they had some issue on the board with the dye rev, and so, unfortunately, by the time we worked through that issue, we had missed some of the revenues.

Mike Crawford - *B. Riley & Co. - Analyst*

Okay. What other development efforts are you working on now? Are there any mask sets this quarter, any new products coming out in the near-term horizon?

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

Right now, I think we pretty much completed the development of all 65-nanometer products. We have a [fixed product] in the 65-nanometer. And right now, we're working on the next generation with our 40-nanometer design.

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

If you're talking about P&L exposure, there's nothing that we're currently working on that we consider R&D related in terms of how we expense it in the P&L. Everything currently being worked on is production related, and when mask sets come out they'll be charged cost goods sold over year.

Mike Crawford - *B. Riley & Co. - Analyst*

Okay. And then regarding the LLD RAM and beyond opportunity, have your thoughts changed at all there regarding what size of market you're addressing?

Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

No, we're still anticipating that certainly once we get up and running, and get the full spectrum of customers qualified, that's certainly the number we've thrown out in the past. It's certainly still our goal.

Mike Crawford - *B. Riley & Co. - Analyst*

Okay. Thank you. And then final question relates to military. So, that's been flat. Is there any specific electronics program that you're more tied to than others, given that there could be what is some uncertainty regarding future defense budgets?

Didier Lasserre - *GSI Technology, Inc. - VP - Sales*

So, that market [so far] for us has been quite lumpy. What I mean is, we have several of the large defense folks, I'm sure you know the names. They'll pop in for a quarter or two, and then they'll disappear for a quarter or two, and so on. And so, if you look on a customer-by-customer basis, it's certainly not consistent. But the spend is.

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As far as addressing which segments, a few of those lumpy segments related specifically to wars in Iraq and so on. We've already seen those programs disappear, and been replaced with more homeland security type applications. Now, we are hopefully, going to see an uptick in military in the next couple quarters. We are in a significant program that is just waiting for some government funding, and once that happens it's going to be a fairly quick build, and GSI is the chosen memory supplier on this particular program, and it's a high-end, high-density, high-speed. And so it could be -- it will certainly put this customer in top ten, for sure, and possibly, top five if they hit any of the target quantities they've shown us.

Mike Crawford - B. Riley & Co. - Analyst

Ok. Thanks, Didier. Last question relates to distribution channel. So, Doug, thanks for talking a little bit about the impact of litigation. So, there's been one school of thought that it's been more of a marketing ploy, and to scare away your customers or distributors. But you say you haven't seen much revenue effect. Is that true? Has there been effect of any changeover in your distribution channel, at all? What's the dynamics there?

Didier Lasserre - GSI Technology, Inc. - VP - Sales

So, yes, we do have a change in the United States. We, up until this past Monday, we had Arrow, New Horizons, and Avnet in the United States. And we're only talking about the United States. There really hasn't been any changes outside of the United States. This is where the real major changes has happened. And so Arrow and New Horizons are no longer franchise distributors as of this past Monday. We say that, although we certainly anticipate having some shipments throughout the rest of this quarter to December, but going forward Avnet will be our sole distributor in the United States.

Douglas Schirle - GSI Technology, Inc. - CFO

And we expect them to take over some portion of that business.

Didier Lasserre - GSI Technology, Inc. - VP - Sales

The majority portion of that business, correct.

Mike Crawford - B. Riley & Co. - Analyst

Okay. Thank you very much.

Didier Lasserre - GSI Technology, Inc. - VP - Sales

Your welcome.

Operator

(Operator Instructions)

Mr. Schirle, there are no further questions. Do you have any further remarks?

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

Thank you all for joining us. We look forward to speaking with you in January when we will report our third quarter fiscal 2012 results. Thank you.

Operator

That does conclude today's GSI Technology Fiscal 2012 Second Quarter Conference Call. You may now disconnect.

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