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IRF - Q2 2012 INTERNATIONAL RECTIFIER EARNINGS CONFERENCE CALL

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OVERVIEW:

IRF reported 2Q12 revenues of \$230.1m and net loss of \$6.3m or \$0.09 per fully-diluted share. Expects 3Q12 revenues to be \$230-250m.



CORPORATE PARTICIPANTS

Chris Toth *International Rectifier Corp - Executive Director, IR*

Ilan Daskal *International Rectifier Corp - CFO*

Oleg Khaykin *International Rectifier Corp - President and CEO*

CONFERENCE CALL PARTICIPANTS

Gabriela Borges *Goldman Sachs - Analyst*

Brian Piccioni *BMO Capital Markets - Analyst*

Terence Whalen *Citigroup - Analyst*

Stephen Chin *UBS - Analyst*

Craig Berger *FBR & Co. - Analyst*

Ramesh Misra *Brigantine Advisors - Analyst*

Steven Smigie *Raymond James & Associates - Analyst*

PRESENTATION

Operator

Good afternoon. My name is Carrie and I will be your conference operator today. At this time I would like to welcome everyone to the International Rectifier second-quarter fiscal-year 2012 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session.

(Operator Instructions)

I would now like to turn the conference over to Mr. Chris Toth with the International Rectifier. Thank you Mr. Toth, you may begin your conference.

Chris Toth - *International Rectifier Corp - Executive Director, IR*

Thank you Carrie good afternoon. If you have not already read through our press release issued earlier today, it can be found on our website at investor.irf.com in the investor relations section. Our quarterly report on Form 10-Q is expected to be filed with the SEC tomorrow, Friday, February 3, 2012 and can be accessed using the same web address. A conference call replay will also be available through February 9, 2012. After our prepared comments, we will open the line for questions.

Our discussion today will include some forward-looking statements made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. We caution that such statements are subject to a number of uncertainties, and actual results may differ materially. Risk factors that could affect the Company's actual results are included in our press release issued today, and the Company's filing with the SEC, including the most recent Forms 10-K and 10-Q.

Before we begin, I would also like to mention the following upcoming events. On Tuesday, February 7, we will be attending the Stifel Nicolaus 2012 Technology and Telecom conference in Dana Point, California. Then on February 15, we will be attending the Goldman Sachs Technology conference in San Francisco, and on Tuesday, February 28, we will be attending the UBS One-on-One Symposium in Boston. Now, Ilan will discuss our most recent financials. Ilan?

Ilan Daskal - *International Rectifier Corp - CFO*

Thank you, Chris, good afternoon and thank you all for joining us. For the second quarter of fiscal 2012, IR reported a revenue of \$230.1 million, which was a 24% decrease from the prior quarter and an 18.3% decrease from the second quarter of fiscal year 2011. Revenue over the last quarter's significantly decreased due to a



economic uncertainty and macroeconomic concerns that resulted in broad market inventory reductions across nearly all of our end markets. Further we reduced our channel inventory as our shipments to distributors were well below their sell-through shipments. The largest percentage revenue decrease among our end-market segments was in our Power Management Devices business unit, which felt the most impact from the channel inventory reduction.

During the December quarter our IP segment revenue decreased to a negative \$900,000, the negative royalty revenue was due to a \$1.5 million over reporting and overpayment in prior periods by our largest licensee. Excluding these effects our IP revenue would have been a positive \$500,000. Gross margin for the December quarter was 35.4%, down 2.5 percentage points from the prior quarter mainly due to lower factory utilization during the quarter. We reported a net loss of \$6.3 million or \$0.09 per fully diluted share for the quarter. Excluding the effect of the prior period royalty revenue over reporting and overpayment of \$1.5 million and an investment impairment charge of \$1.5 million, net loss would have been \$3.3 million or \$0.05 per share. This compares with a net income of \$22 million or \$0.31 per fully diluted share in the September quarter.

R&D expenses were \$32.2 million compared with \$33 million in the prior quarter. R&D expenses represented 14% of revenue for the quarter. SG&A expenses were \$50.6 million, up from \$49 million in the prior quarter, due to ERP implementation cost primarily depreciation of about \$2 million. SG&A expenses represented 22% of revenue for the quarter. Amortization of acquisition related intangibles was \$1.9 million. Operating loss was \$3.3 million for the quarter. Other expense net was \$2 million in the December quarter, primarily due to an investment impairment charge of \$1.5 million. Income tax for the December quarter was a \$1.1 million expense primary due to a tax accruals in our foreign jurisdictions.

The total cash, cash equivalents, and investments at the end of this quarter were \$398.6 million, which included \$1.4 million of restricted cash. During the quarter, inventory increased \$26 million, to \$308.9 million. Weeks of inventory increased 8 weeks to 27 weeks. We used \$19.4 million in cash from operating activities in the quarter, mainly due to changes in working capital. Cash capital expenditures for the quarter were \$26.6 million and represented about 11.6% of revenue. Depreciation and amortization expense was \$20.7 million, and stock-based compensation was \$4.3 million. During the quarter, we did not purchase any shares of our stock. We are at about 69 million shares outstanding at the end of the December quarter.

Moving on to our outlook. We currently expect revenue for the March quarter to be between \$230 million and \$250 million. For this projected revenue range, we currently estimate gross margin in the March quarter to be between 31% to 32%, primarily due to lower plant factory utilization. Going forward we are working to balance utilization and inventory reduction but overall expect that our gross margin will likely trough in the March quarter through this cycle.

We expect R&D expenses to be about \$33 million and SG&A expenses to be about \$53 million. For the March quarter, amortization of acquisition related intangibles is expected to be about \$2 million. Other expense net is expected to be about \$1 million and interest income net is expected to be negligible. For tax we expect an expense of about \$3 million, due to foreign jurisdiction tax accruals. In the June quarter we anticipate a net tax benefit as we believe we will be able to release reserves.

And finally for the March quarter, we expect our cash capital expenditures to be about \$30 million. For the full 2012 fiscal year, we expect capital expenditures to be between \$110 million and \$120 million. Now Oleg will give you the latest update on our Business. Oleg?

Oleg Khaykin - International Rectifier Corp - President and CEO

Thanks, Ilan. December quarter revenue came in much weaker than expected. As the quarter progressed, we observed weakening demands driven by a [growth] end-market inventory reduction (inaudible) slow down in several end-markets particularly appliances in Asia and industrial in Europe. Geographically for the quarter, Asia was down sharply as distributors reduced inventory in the appliance end-market in China weakened dramatically. The Americas and Europe also came in weaker than expected as customers worked to reduce inventories. In particular we saw significant weakness in industrial demand in Europe. On the positive side, we saw modest growth in Japan as recovery from the Japanese earthquake continues.

Moving onto our business units. The Enterprise Power business unit revenue decreased 15% from the prior quarter mainly due to weakness in the computing end-market as a result of recent flooding in Thailand. Server shipments were flat as the industry slowly shifts to the new Romley platform. Also as a result of the slow ramp, we continue to see persistent demand for prior-generation platform products in the near-term. We continue to be well-positioned for the future as future growth of tier 1 customers accelerate adoption of our Digital Power Management solutions, our latest generation products deliver industry-leading performance in efficiency, thermals, and density, while offering compelling cost performance value proposition. Customer activities is robust and we believe we are well-positioned for the future growth in next-generation servers, ultrabooks, and other computing platforms.

Due to normal seasonal weakness, particularly in computing we expect March-quarter revenue to be flat to slightly up. Our Power Management Devices business unit revenue decreased 35% from the prior quarter, this drop was mainly driven by customer inventory reduction and weaker computer sales due to the Thailand floods. The majority of our PMD products are sold through distribution and we significantly undershipped POS during the quarter. For March we are starting to see customers



beginning to replenish inventory and we expect our PMD business unit to grow modestly. Our Energy-Saving Products business unit revenue decreased 23% compared to the September quarter. Overall demand was weak in the industrial and appliance end-markets. China was particularly hard-hit as overall industrial production fell through the end of the year. Initial projections for the March quarter indicate revenue trending flat to slightly up as customer demand is expecting to recover.

Our Automotive Product business unit revenue decreased 15% from the prior quarter, mainly due to holiday shut down and timing of shipments. As a result we expect to see Automotive bounce back to the \$28 million to \$30 million run rate level in March, we continue to see Automotive as one of our long-term growth drivers at IR and our design activity and product introductions remain robust. Lastly, our HiRel business unit decreased 9% compared to the September quarter. The decrease was due to manufacturing delays as a result of tax acceptance criteria and a weather-related fab closure at the end of October. For March, we expect revenue to be between \$48 million to \$50 million. Bookings and our overall backlog continue to be strong in our HiRel market segments.

Now an update on channel inventories. During the December quarter even though our total Company revenues declined 24%, we saw our POS decline only in single-digits percentage points compared to the prior quarter. As a result, we significantly undershipped end-market demand and reduced our channel inventory to below 11 weeks. During the December quarter, internal inventory increased to 27 weeks. Several factors drove the increase. First our expectations of seasonally strong September and December quarters did not materialize as customers aggressively reduced their inventories. Thus our pre-build earlier in the year ended up contributing to the inventory.

Secondly, we made the decision not to pursue highly-discounted spot-market business during the quarter. Clearly 27 weeks of internal inventory is too much. However we are comfortable that we will be able to unwind the inventory throughout the year on our terms rather than taking deeply-discounted spot-market opportunities today. Lead times remain below normal for the majority of our products and overall factory utilization came down from 90% in September to 70% in the quarter. In summary despite weak industry conditions and in the last two quarters our design-win activity remains robust and we are starting to see some improvements in orders as customers demand returns. We remain committed to our strategy and our long-term growth objectives.

In the December quarter we also launched our new ERP system, the new system promises to deliver automation to many of our business processes and we fully intend to capture these productivity gains. As a result we have started to review our SG&A structure and over the next two quarters we expect to begin benefiting from the automation delivered by our new ERP system. Our goal remains to reduce SG&A expenses down to about \$50 million level by the end of June quarter or early in the September quarter. We believe we are on track to realize this goal.

In R&D we continue to take advantage of the lower-fab utilization to accelerate the development and introduction of new products. Last cycle we maintained our R&D investments during the downturn and as a result captured significant market share during the upturn. As the Company continues to grow, we expect to maintain our quarterly R&D expenses in the \$33 million to \$34 million range. Finally, we continue to make good progress on our GaN projects and we remain on track to make initial shipments to customers during 2012 calendar year. We are approaching completion of 100-volt rated devices and have sampled several key customers.

In addition we have developed high-voltage GaN power devices and sampled 600-volt GaN rectifier switch prototypes to tier 1 customers; the feedback on both has been very positive. Next week at the Apex Trade show in Orlando, Florida we are planning to present three GaN demonstrations, showing superior GaN performance in efficiency and density from 20 volts to 600 volts. The launch of 600-volt GaN devices will significantly expand IR's available market in high-voltage Power Management Products beyond the IGBT products today, and we remain confident in the opportunities presented to us by GaN.

In closing, the market continues to show promising signs that a bottom has formed and that demand is starting to recover. As demand returns, we believe we are well positioned with new products and capacity for the future. This concludes our prepared remarks, we will now open the lines to your questions. Operator?

QUESTION AND ANSWER

Operator

(Operator Instructions)

James Schneider, Goldman Sachs

Gabriela Borges - Goldman Sachs - Analyst



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This is Gabriela Borges on behalf of Jim. I understand that it's only been a week since Chinese New Year but any new insight into whether ordering patterns have picked up in PC and consumer since that time?

Ilan Daskal - International Rectifier Corp - CFO

Last week, well it's not even last week, we only had I'll say 3 days so clearly the Chinese New Year just ended on the Sunday and we've seen some orders coming in but at this point, it's hard to discern whether these orders are just catch up for the two weeks or snap back, but nevertheless we've seen order activity pick up.

Gabriela Borges - Goldman Sachs - Analyst

That's helpful, thank you. As a follow-up if I may, you mentioned your expectations for gross margins to trough off in the March quarter. With the guide up in sales from March could you provide any color on how high you think March-quarter utilization will be versus the December quarter? Thank you.

Oleg Khaykin - International Rectifier Corp - President and CEO

So, I believe it is a little bit too early to tell you now what the exact utilization or even a range that I can point out, at the end of the day it is going to be a combination of the utilization rate and the level of inventory that we will end up the quarter at that time. So due to the higher than normal inventory that we have right now it will be a mix of both of those factors.

Gabriela Borges - Goldman Sachs - Analyst

That's helpful, thank you very much.

Operator

Brian Piccioni, BMO Capital Markets

Brian Piccioni - BMO Capital Markets - Analyst

So couple of questions, actually I have a whole bunch of questions, but there was some signs that the Chinese appliance market was slowing down, if I recall from your preannouncement comment and I was wondering whether there was any sense that that was some sort of an inventory rebalancing or some sort of a longer-term type impact?

Oleg Khaykin - International Rectifier Corp - President and CEO

Well, Brian, actually, if you may remember in the summer of last year, Chinese government was getting very nervous about the rapidly escalating inflation so they slammed hard on all the lending and available liquidity in the markets. These measures had a desired effect. And probably more so than they expected and by about October timeframe, we literally saw all of the orders get pushed out or get canceled. So on the appliance manufacturers as they found themselves in a very tight liquidity crunch and also I guess it is kind of perpetrated all the way through the Chinese supply chain all the way down to the consumers since you couldn't get any liquidity.

From my understanding is in early December the Chinese government reopened all of these tickets and the funding began to flow and now we are seeing return towards consumption and orders. So, really, I don't think there was so much of the inventory correction in this thing, maybe there was excess inventory at the finished goods level that the manufacturers were expecting to sell, but it clearly put big brakes on new builds.

Brian Piccioni - BMO Capital Markets - Analyst



Okay, and as I'll drop back into the queue to ask my GaN question but with respect to the comments regarding the commodity type devices, is that, in your mind representative to let's say strategic discounting by a small number of players or it is reflective of a significant supply demand imbalance in the industry?

Oleg Khaykin - *International Rectifier Corp - President and CEO*

Well, I think I wouldn't say it is a small number of players, but as you know the stupidity does not come in small portions in this industry. (laughter) It's been broader, but the way we look at it is if it was purely an inventory correction, if you do a discount and you get into the right customers or commodity products it is great, because then you still move the product. Judging where we were seeing last quarter, it didn't matter how much you discount, your end customers did not want the product because they were trying to reduce their own inventories. So, most likely where your products would end up is with the speculative broker segment which always going to do is just take the air out of your sales. Later through the year as those products pop up all over the world through gray-market channels and undermine your pricing in various segments.

So we consciously decided not to play this game because clearly discounting gives you increased market share and they displaces somebody at the point of consumption, it is great then you actually pick up market share, but if by doing discounting all you're doing is placing it into a gray-market channel or some broker speculative channel, then you are really just hurting your future quarters. We thought that the December quarter was more of the latter.

Brian Piccioni - *BMO Capital Markets - Analyst*

Okay, great, so go back into the queue, then. Thank you.

Operator

Terence Whalen, Citi.

Terence Whalen - *Citigroup - Analyst*

This when relates to a comment Oleg that you made about the decision to hold inventory on your balance sheet versus in the channel. In terms of your experience over the past couple of years coming out of the recession, what have you learned that you might change differently? In other words are we going to see a structural change in between the balance of what you hold in the channel and what you hold on hand? And the reason I ask that is I am trying to understand how you and Ilan think about balancing, improving utilization in gross margin with working down inventory to an acceptable level. Thank you.

Oleg Khaykin - *International Rectifier Corp - President and CEO*

Okay, well let me kind of address it from a couple of points. So as I said, it is okay to give customers a discount if you pick up market share, right? How are we going to be very careful and you say hey am I actually going to is actually going to create the demand, is there now elasticity of demand. Well we felt the last quarter there was really no elasticity of demand in the end market. Just like I asked, all of our customers who were also under orders from their CEOs to reduce inventories, so it's behold the poor procurement guy who was buying more product even with some discount and increased his inventories, right? So we've seen clearly that channel [shop] for us so we didn't feel that giving any kind of discount would move the product in the right direction.

Secondly, it is always more preferable for me to keep inventory on my shelf than put it into a particular distributor because when demand recovers, maybe the distributor A will not see demand for that product but distributor B be will see it and if all the product is sitting at distributor A all you're doing is -- the product is not moving from the channel. But if it's sitting on my shelf, I can more efficiently reallocate the product to where the demand appears first. And lastly, you've got to think of inventory as cash. From my perspective, if you have so many dollars on deposit, and you decide to move it and you take a loss on it, well you just reduced your return on your cash, right? So you take cash and you build a product and when you sell it you get a return on cash. If you dump it at a significant discount you take a very low return. My view was given the current situation, is that by unwinding this inventory over the next several quarters we are getting a heck of a lot better return on our cash than we would be just by dumping it into the channel, especially since all it is going to do is sit out there and cannibalize my revenue in the coming quarters.



And lastly, doing this kind of deep discounts you can destroy your pricing strategy in one quarter that may have taken you eight quarters to create. And this is just plain stupid. You look at any industry, outside of semiconducting industry they seem to understand pricing, but in this industry we still have very unsophisticated view of inventory and elasticity of demand.

Ilan Daskal - International Rectifier Corp - CFO

Terence, I would add also to that that if you recall our strategy of internal utilization versus the external of 70% versus 30%. When you look at the inventory, a lot of the incremental inventory was manufactured through the foundries and not internally. And that is part of the overall consideration. So, if it's a time shift then the foundries will suffer probably more than the internal utilization but at the end of the day it will be the same balancing effect for everyone because the demand is at the same demand over the context of a few additional quarters.

Terence Whalen - Citigroup - Analyst

Okay, very helpful points and then as my follow, this follow-up relates specifically to the PC Power Management. Just want to gauge your overall ambition there. Given that Ivy Bridge is a process change to synthetic 22 nanometer but the following platform has (inaudible) actually have architectural shifts in vCore Power Management. To what degree does this process and then this architectural shift create a window of opening to increase your market share in vCore controllers? Thank you.

Oleg Khaykin - International Rectifier Corp - President and CEO

That is a very good question. As you probably seen in my script I had some language indirectly addressing it, but it is actually very very good news for us because effectively all these new technology platforms, ranging from ultrabooks they are going to be benefiting from these advanced nodes. They are all pretty much adopting universally digital power control and with our all digital power control and integrated power stage solution we are extremely well positioned and we are getting very strong traction in the market for these new applications.

Terence Whalen - Citigroup - Analyst

Great. Thank you very much.

Oleg Khaykin - International Rectifier Corp - President and CEO

It actually represents a significant market expansion for our Enterprise Power business unit, these are the areas where we have not played before and we are seeing very strong traction there.

Operator

Stephen Chin, UBS

Stephen Chin - UBS - Analyst

First one I had was related to your European industrial exposure. I guess, Oleg, if you could first please help us better understand what some of your European customers may be seeing out there now in terms of demand? Is it still largely macro-related concerns that they are leading to the current relatively low order rates or are you seeing some improvements based on the pickup in certain areas of European markets?

Oleg Khaykin - International Rectifier Corp - President and CEO



Well, let me talk about Europe and sales in part of semiconductors. You can read through it very simply, it is predominantly Germany with a sprinkle of France and Northern Italy. So that is pretty much the European extent of the power semiconductor where most of the market is. What we saw in Europe, I guess the drop in demand was driven by two things. One, is there was a big continuous concern over the European economy and as a result we saw a lot of customers from OEMs to distributors working hard to reduce their inventories. But furthermore, we also saw a lower level of consumption, not only in this inventory reduction but also due to build and part of it is December is a very big holiday month in Europe, so clearly, it was a shorter quarter. But also, remember a lot of European capital goods and industrial goods are exported into Asia, and with China being particularly slow in the December quarter, a lot of these orders got either delayed, pushed out, or canceled so that further exacerbated the European demand.

And luckily, when you think about industrial, industrial has always been a very slow-growth market. In the last few years it has been seen as a new-growth market and mainly driven by solar and wind power deployment. Some of those deployments or rates of deployments have slowed down, especially in Europe where they have -- with the appearance of government incentives and credits clearly the dynamics have changed somewhat. So that is kind of our view where we see Europe today.

Stephen Chin - UBS - Analyst

Okay great that is very helpful. The other question I had was on gross margins. I'm guessing that a good portion of your gross margin recovery going into next quarter, or sorry into like Q2 period was based on appreciable recovery in your capacity utilization rates. I guess whatever the reason that you could at this point -- how much of an effect do you think lower pricing and also maybe mix would have an effect on gross margin recovery? Thanks.

Ilan Daskal - International Rectifier Corp - CFO

So, Steve, you referred to the mix versus utilization?

Stephen Chin - UBS - Analyst

Right, so basically in terms of as we look forward beyond March quarter as how you're gross margins might trend, understanding that capacity utilization rates will probably be a very big factor in driving margin improving, how about other factors such as pricing and also mix?

Ilan Daskal - International Rectifier Corp - CFO

So, I believe for the shorter term, when gross margin will start to recover it will be more utilization driven than mix. But then it is going to be a combination of both, but if you look at the June and the September quarter it will be more utilization driven.

Oleg Khaykin - International Rectifier Corp - President and CEO

Especially as PMD in later quarters gets back to its run rate levels. There you are going to see more of a mixed factor because it's a below Company average market segment, but in early quarters clearly utilization will drive leverage in the model.

Stephen Chin - UBS - Analyst

Perfect. Thank you.

Operator

Craig Berger, FBR Capital Market

Craig Berger - FBR & Co. - Analyst



One question I have is when you look at your peak revenues over the last cycle, \$317 million and your trough revenue is now \$230ish million, where do you think true consumption is and when you look out at your design-win funnel over the next year, where do you think revenues can recover to?

Oleg Khaykin - International Rectifier Corp - President and CEO

Well, I think if we go back to business as usual a steady state I think we are probably, the demand was more than a \$290 million type of thing. I think with the Japanese earthquake and some expectations of a strong September demand, we can push to maybe over \$300 million and there probably get some overconsumption by the channel. But I would say probably \$290 million was the rate, I don't know how much, how lasting effect is going to be from the economic weakening at the end of the year, what it's going to be. But I would expect as things recover it needs to go back at least to that level.

In terms of the peak to trough, I don't actually think about it the same way that you are Craig, I think the right way to look at it would be trough-to-trough and peak-to-peak because how you do in any one quarter dropped from peak to trough it really comes down to how you choose to play in the channel game. I could've gotten a higher revenue last quarter, but I would have done some significant discounting and taking a lower margin, and then my peak to trough would have been smaller, but it also would have implied that the next few quarters my recovery would be also shallower. They probably would have stopped the channel. But I think if you really the best way to look at it is the way I look at it I look at it much longer term I look at it cycle-over-cycle. Previous peak was \$212 million our latest peak was \$317 million so we grew about \$100 million, it's about 50% increase peak-on-peak and our previous trough was \$133 million and our current trough -- we hope it's a current trough, \$230 million and that is over 70% increase. So to me that is a more relevant comparison because how you managed the drop-off over one or two quarters is really a function of how you want to play the channel inventory game.

Craig Berger - FBR & Co. - Analyst

Oleg, these cycles are always good for some self reflection. Is there anything you would have done differently over the last cycle and as part of that can you guys still do 41% gross margins at \$1,250 a year and what do you need to do in order to get there? Thanks so much.

Oleg Khaykin - International Rectifier Corp - President and CEO

So, I think I would say in the retrospect, everything is 20/20. I mean had I known that the economy would be so heavily in the December, September quarter clearly in the retrospect us pre-building some inventory in the first half of last year was not the best decision, but let's look at it this way. 9 out of 10 times over the last 50 years it would have been a pretty good bet. So had I been sitting again would I do in the future, I think I probably would be more cautious as to how much I would grow, but still I think it is a good idea to take advantage of available capacity in the expectation of strong September quarter to do a little bit of the build ahead. We probably got a little bit ahead of ourselves. In terms of the gross margin at \$250 million, I think given over that our current mix and significantly greater pro rata presence of our PMD business today, probably it 40% of \$250 million is not a viable model unless we really the other business units recover quickly and PMD stays lower than obviously the mix will give you the to 40% margin. But I think really that as things recover it will go more towards the mix we were running at the \$290 million level which really kind of puts us at the high 30% gross margin.

Operator

Ramesh Misra, Brigantine Advisors.

Ramesh Misra - Brigantine Advisors - Analyst

First some bookkeeping, in regards to inventory Ilan do you anticipate any write-downs and also what was the utilization level last quarter?

Ilan Daskal - International Rectifier Corp - CFO

So there was about \$3.1 million write-down in the last quarter. And it was in the 70% s.

Ramesh Misra - Brigantine Advisors - Analyst



Okay, and do you anticipate any further or major inventory write-downs with this large inventory last quarter?

Ilan Daskal - International Rectifier Corp - CFO

So far, obviously on the write-downs it depends on two factors. The immediate forecast that we have and analysis of the overall inventory. Since the inventory, the incremental inventory is a recent one, it still has a pretty long life shelf unless the entire macroeconomic situation would change and the focus cannot substantiate to keep the inventory which for now we don't see it.

Oleg Khaykin - International Rectifier Corp - President and CEO

Well, the other thing, what we have done is when we did do pre-builds last year we picked the high-volume runners and those things have very long life cycles so at least from my perspective I see very little risk that a lot of this inventory will get impaired.

Ramesh Misra - Brigantine Advisors - Analyst

In regards to CapEx, so clearly that has come down very sharply and you will be running at fairly low levels at least for the next few quarters. What is happening over there or is it basically you've got the production capability that you needed and now you are done for some time?

Ilan Daskal - International Rectifier Corp - CFO

So, on the CapEx Ramesh, First the ERP is alive now so maybe as a comparable, it's smaller but we tried to stick to our strategy of having the CapEx between 10% to 12% of revenue and it is pretty much fits to the strategy.

Ramesh Misra - Brigantine Advisors - Analyst

Okay, on the SG&A side, you said that you plan to get it below the \$15 million mark by the June quarter September quarter, when looking back just last year, you were well below those \$15 million mark while your revenues were around the \$280 million to \$290 million level. So when -- do you view this as kind of a new SG&A run rate or did you anticipate being able to come down to below prior levels with the ERP system implementation.

Oleg Khaykin - International Rectifier Corp - President and CEO

One of the things you've got to remember is when we say \$50 million that includes actually \$2 million depreciation that we are now including on SAP, right? So when we're saying to going back down it means effectively offsetting the \$2 million increase in SAP. The other thing is that over the last few quarters, even though most of the SAP implementation was capitalized we are still going through a learning curve and there are as you can imagine teething pains with all these programming so we continue to rely a lot on additional -- incur additional expense and give up the new applications and doing some things to stabilize the system. As the system becomes stable, that's where we're going to look to take advantage of the productivity it offers and start taking costs out of the SG&A to more offset or more than offset the increase due to SAP.

Ilan Daskal - International Rectifier Corp - CFO

And Ramesh I will add to that the \$50 million that we kind of guided for, we'll be able to support a much higher revenue level. I mean it easily can support a \$350 million level at the quarter, if not even higher and if it's a higher revenue the scalability is going to be -- the incremental SG&A is going to be much lower than what it used to be. That is obviously due to all the efficiencies that we will be able to gain here.

Ramesh Misra - Brigantine Advisors - Analyst



Okay, thanks. Just a final one if I may. On the industrial side, at least in North America, with ISM data looking actually pretty good in recent months, what is your tops in terms of the normal cyclical or seasonality in the industrial side? Do you see that coming back up nicely in the first two quarters of this year or do you think it will be somewhat subdued? Thanks.

Oleg Khaykin - International Rectifier Corp - President and CEO

You're talking about in North America specifically?

Ramesh Misra - Brigantine Advisors - Analyst

Yes, industrial especially in North America.

Oleg Khaykin - International Rectifier Corp - President and CEO

Yes, the North American industrial, clearly there is a little bit of lag between the attitude and the actual orders being placed. That said, the US did undergo inventory correction last quarter. I think it is too early to see how strong it's going to bounce back, but all that said, industrial is not a very big number for us in North America. Now, military and space, now some people put military, space, and industrial; that segment we track separately in our HiRel and that segment remains to be very strong for us and we've seen expended bookings and very strong demand profile there.

Ramesh Misra - Brigantine Advisors - Analyst

Okay. Thanks very much guys.

Operator

Steve Smigie, Raymond James

Steven Smigie - Raymond James & Associates - Analyst

I wanted to follow up on the issue here with the SG&A expense and that coming off, I think you mentioned there is \$2 million of amortization and we've been seeing \$2 million over the last couple quarters so is that already the amortization in there? Or should I be backing in extra \$2 million per quarter out of whatever SG&A? So if I was trying to do a pro forma number backing out amortization would it be a \$48 million number in either June or September or is it still --?

Ilan Daskal - International Rectifier Corp - CFO

So on a net basis, Steve, it's a bit lower than that for the new ERP system it is about \$2 million but there was some old system residual depreciation that we no longer depreciate. So on a net basis it is a bit less than \$2 million.

Oleg Khaykin - International Rectifier Corp - President and CEO

And also we started depreciating SAP only in December so September did not have SAP in it.

Ilan Daskal - International Rectifier Corp - CFO

In the December quarter.



Oleg Khaykin - *International Rectifier Corp - President and CEO*

Just in the December quarter. December is the first quarter where we are carrying SAP.

Steven Smigie - *Raymond James & Associates - Analyst*

Okay. Oleg R&D has been relatively high over the past couple of quarters, as the revenue has fallen off and you indicated that was to run some R&D wafers, I was wondering if you could talk a little bit about when we will see the benefit of that investment and does it show up in GaN or does it show up in other product categories?

Oleg Khaykin - *International Rectifier Corp - President and CEO*

It is actually going to show up across the board, clearly GaN is one of them, but our new generation of IGBT use the new generation of MOSFETS. Our new high-voltage IT processes are coming online and probably one of the bigger elements of it was the digital power controller development that we will start seeing benefits as early as this summer as these new products start ramping up in the computing and server space.

Steven Smigie - *Raymond James & Associates - Analyst*

Okay and so if I look at say PMD given investments you've made there, let's say 2012 is a 10% growth year for the industry as a whole. How much faster do you think you would grow given your investment, would be 12%?

Oleg Khaykin - *International Rectifier Corp - President and CEO*

12% for the discrete is expected growth in 2012.

Steven Smigie - *Raymond James & Associates - Analyst*

Yes just wondering do you get an extra 20% bump above the market for your investment do you think?

Oleg Khaykin - *International Rectifier Corp - President and CEO*

I think in generally in the discrete I mean we put a target to grow 50% faster than the market so if market grows let's say 12% than we want to be 18%, if market grows 5% we want to be 7.5%. That is kind of how we look at it.

Steven Smigie - *Raymond James & Associates - Analyst*

Okay, great. Thank you very much.

Operator

Brian Piccioni, BMO Capital Markets

Brian Piccioni - *BMO Capital Markets - Analyst*

Okay, so, on the GaN product offering, do you expect the same sort of delay in customer interest or whichever in the higher-voltage parts because there was some hesitancy as you introduced the new technology amongst customers they wanted to make sure that it worked okay and that it was stable and all the rest of it. Does the same -- will the same apply with the higher-voltage parts?



Oleg Khaykin - *International Rectifier Corp - President and CEO*

Well, I don't believe so. There is a little bit difference in the lower-voltage parts you're dealing with a lot of the standards, like motherboards or server architecture and in those architectures, the frequency at which you are switching is pretty much set by the standard, or by the whatever the prevailing rules of thumb that manufactures are using. Really in the lower-voltage, again the main value for a position is a higher frequency, so you have to change the way you design the product to use a higher frequency.

At the higher-voltage we effectively do a swap and effectively the way we are also approaching is a little bit differently than a low-voltage. We are approaching it with the way where you can just swap an existing product with footprint compatible or from the point of view of the consumer or the user, they can just put a GaN switch from outside it is going to look just like a regular MOSFET but it will give you the GaN performance, because at the high-voltage the primary value of the GaN is the lower -- not only faster switching but also much lower resistance. So, actually, GaN in the high-voltage applications, it does not require rethinking the network topologies and things like that. All you're getting is immediately a much higher efficiency part by swapping conventional MOSFET with the GaN. So in fact we believe the adoption will be much faster.

Brian Piccioni - *BMO Capital Markets - Analyst*

Okay. Wouldn't you hope that over time the customers would design for both the all the improved -- all the benefits of GaN, higher frequency and lower resistance and so on and so forth?

Oleg Khaykin - *International Rectifier Corp - President and CEO*

Absolutely, in fact we are trying to help them think through it but what we've learned is it's a heck of a lot easier to drive adoption when they initially just plug it into an existing circuit and immediately get percentages worth of improved efficiency over the best solution out there. And then of course if they want to go even further, and shrink the form factor, shrink the footprint of the design then they can take advantage of the higher frequency.

Brian Piccioni - *BMO Capital Markets - Analyst*

Okay, great. Thank you.

Oleg Khaykin - *International Rectifier Corp - President and CEO*

Because I think what we want to do is be able to plug the part into existing designs and not wait for the whole new development cycle.

Operator

At this time there are no further questions. Gentlemen are there any closing remarks?

Oleg Khaykin - *International Rectifier Corp - President and CEO*

I would like to thank everybody for joining us today and we look forward to speaking with you in the coming months. Thank you.

Operator

This concludes today's conference. You may now disconnect.



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