Vishay Intertechnology NYSE: VSH
Q1 2018 Earnings Call Transcript
Tuesday August 7, 2018 9:00 a.m. ET

Operator:
Good day. My name it (Shelby), and I will be your conference operator today. At this time, I would like to welcome everyone to the Q2 2018 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. If you would like to ask a question during this time simply press star then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key.

Thank you. Mr. Peter Henrici, you may begin your conference.

Peter G. Henrici:
Thank you, (Shelby). Good morning, and welcome to Vishay Intertechnology's Q2 2018 Conference Call. With me today are Dr. Gerald Paul, Vishay's President and Chief Executive Officer; and Lori Lipcaman, our Executive Vice President and Chief Financial Officer.

As usual, we'll start today's call with the CFO, who will review our second quarter financial results. Dr. Gerald Paul will then give an overview of our business and discuss operational performance as well as segment results in more detail. Finally, we'll reserve time for questions-and-answers.

This call is being webcast from the Investor Relations section of our website at ir.vishay.com. The replay for this call will be publicly available for approximately 30 days. You should be aware that in today's conference call, we will be making certain forward-looking statements that discuss future events and performance.

These statements are subject to risks and uncertainties that could cause actual results to differ from the forward-looking statements. For a discussion of factors that could cause results to differ, please see today's press release and Vishay's Form 10-K and Form 10-Q filings with the Securities and Exchange Commission.

In addition, during this call, we may refer to adjusted or other financial measures that are not prepared according to generally accepted accounting principles. We use non-GAAP measures, because we believe they provide useful information about the operating performance of our businesses and should be considered by investors in conjunction with GAAP measures, that we also provide.

Additional factors are described in our earnings release for second quarter of 2018. Our estimates may change, and the company assumes no obligation to update forward-looking statements to reflect actual results, changed assumptions or other factors except as required by law.

This morning, we filed a Form 8-K that outlines the various variables that impact the diluted earnings per share computation. On the Investor Relations section of our website, you can find a presentation of the specific second quarter 2018 information the CEO and CFO will be discussing on the call.

Now I turn the call over to Chief Financial Officer, Lori Lipcaman.

Lori Lipcaman:
Thank you, Peter. Good morning, everyone. I am sure that most of you have had a chance to review our earnings press release. I will focus on some highlights and key metrics. Vishay reported revenues for Q2 of $761 million. EPS was $0.65 for the quarter. Adjusted EPS was $0.54 for the quarter.

During the quarter, we executed certain transactions in response to U.S. tax reform. First, we issued new convertible notes and used the proceeds to repurchase some of our outstanding convertible debentures, which were no longer tax efficient under the new U.S. tax law.

Additionally, we began to repatriate some of our foreign earnings to the United States. All of the reconciling items between GAAP EPS and adjusted EPS are related to these transactions, or tax reform generally. There were no reconciling items impacting gross or operating margins. The repatriation transactions resulted in the payment of $92 million of foreign withholding and other taxes.

Additionally, we made the first transition tax payment of $14 million as required under U.S. tax reform. These taxes have been accrued at the enactment of the U.S. tax reform in Q4 2017. The payment of these taxes is reflected as an operating cash flow on the statement of cash flows. I will elaborate on these transactions in a few moments.

Revenues in the quarter were $761 million, up by 6.2 percent from previous quarter and up by 18.3 percent compared to prior year. Gross margin was 29.9 percent. Operating margin was 16.2 percent. There were no reconciling items to read – right at adjusted operating margin. EPS was $0.65. Adjusted EPS was $0.54. EBITDA was $144 million or 18.9 percent. Adjusted EBITDA was $161 million or 21.2 percent.

Reconciling versus prior quarter, operating income quarter 2, 2018, compared to operating income from prior quarter, based on a $44 million higher sales or $51 million higher, excluding exchange rate impacts. Operating income increased by $19 million to $123 million in Q2 2018 from $104 million in Q1 2018.

The main elements were: average selling prices had a positive impact of $5 million, representing a 0.7 percent ASP increase; volume increased with a positive impact of $21 million, equivalent to a 6.4 percent increase in volume, which includes the UltraSource contribution; fixed cost increased for the negative impact of $7 million, including increases in incentive compensation, expenses for dismantling at our were vacated Santa Clara manufacturing facility, acquisitions and in general, our higher level of activity.

Reconciling versus prior year, operating income Q2 2018 compared to adjusted operating income in prior year, based on $118 million higher sales, or $98 million higher, excluding exchange rate impacts, adjusted operating income increased by $38 million to $123 million in Q2 2018 from $86 million in Q2 2017.

The main elements were: average selling prices had a positive impact of $5 million, representing a 0.7 percent ASP increase; volume increased with a positive impact of $45 million, representing a 13.6 percent increase, again, including the UltraSource contribution; fixed cost increased with a negative impact of $16 million, primarily due to wage increases, incentive compensation, legal and other fees, acquisitions, R&D expenses and, in general, a higher level of activity.

Selling, general and administrative expenses for the quarter were $104 million. For quarter 3, 2018, our expectations are approximately $103 million of SG&A expenses and approximately $412 million for the full year at constant exchange rates. As mentioned in my opening remarks, we completed debt issuance and repurchase transactions in June.

Our convertible debentures had certain tax attributes, which were no longer efficient after U.S. tax reform. We issued new convertible notes, principal amount of $600 million, due in 2025. The new notes have a cash coupon of 2.25 percent. We recognized interest expense at the comparable yield of 5.5 percent of net book value for U.S. GAAP purposes. We use the proceeds to repurchase 80 percent of the convertible debentures due in 2040 and 46 percent of the convertible debentures due in 2042.

In addition to be more tax efficient going forward, the transactions also allowed us to significantly increase the average conversion price of our outstanding convertible debt, thus reducing the diluted effect on EPS. Even though net earnings will decrease slightly as a result of the increased interest expense, partially offset by the lower tax expense, the ongoing impact of the transactions is neutral-to-slightly accretive on a per share basis, after the reduction in potentially diluted shares.

Both the proceeds of the new convertible notes and the repurchase price of the old debentures were bifurcated between the respective debt and equity attributes. The retirement of some of the existing convertible debentures resulted in a pretax extinguishment loss of $17 million, which was primarily the result of reduced market interest rates since the initial issuances, which is a key assumption in bifurcating between the debt and equity attributes.

We recognized a U.S. GAAP tax benefit of $4 million related to the pretax extinguishment loss, which is also a reconciling item to arrive at the adjusted EPS.

Furthermore, we recognized a tax benefit of $34 million resulting from the extinguishment, reflecting a reduction in deferred tax liabilities related to special tax attributes of the debentures. As also mentioned in my opening remarks, we've been evaluating the potential repatriation of the cash to the United States after the enactment of U.S. tax reform.

While such amounts are no longer subject to federal taxes, they are subject to foreign withholding and other taxes and some state income taxes. We have accrued about $225 million of taxes on approximately $1.2 billion of foreign earnings available for eventual repatriation, most of which was accrued on enactment of U.S. tax reform in the fourth quarter of 2017.

During the second quarter, we began the process of repatriation, which included movement of cash from second or third tier subsidies to higher tier subsidiaries. In total, we received approximately $274 million in the United States, which was primarily used to pay down the outstanding balance in our credit facility and to repay certain company indebtedness. As a result of these transactions, we paid approximately $92 million of foreign withholding and other taxes.

Additionally, we paid the first installment of the U.S. transition tax of $14 million. These tax payments are reflected as operating cash flows on our statement of cash flows, thus explaining the negative free cash flow for quarter 2. Because we utilized most of the repatriated cash to repay outstanding debt, substantially all of our cash and short-term investments continue to be located outside of the United States.

We continue to evaluate additional cash repatriation transactions and have adjusted the provisional amount of taxes related to the enactment of U.S. tax reform during Q2, as permitted by the SEC Staff Accounting Bulletin No. 118.

We had a total liquidity of $1.7 billion at quarter end. Cash and short-term investments comprised $1.15 billion, and unused capacity on the credit facility was $540 million. The carrying value of our debt of $680 million is net of unamortized issuance cost of $18 million and includes $96 million outstanding on our credit facility, $113 million remaining in the convertible debentures, net of unamortized discount and issued in 3 tranches and due in 22, 23 and 24 years, respectively; and $489 million of the new convertible notes, net of unamortized discount, due in 2025.

The principal amount or face value of the converts totaled $886 million. $600 million related to the new notes and $286 million related to the remaining debentures. No principal payments are due until 2020. However, the convertible debentures may be redeemed if certain stock price thresholds are met.

At the end of Q2, 2018, the convertible debentures due in 2040 and 2042 are redeemable for the next quarter. Accordingly, for those tranches, we have reclassified the difference between the carrying value and the principal amount from stockholders equity to a separate line between liabilities and equity on our consolidated balance sheet.

If the debentures are converted, we would fund the principal amount with borrowings on our revolving credit facility and net share settled amount in addition to the principal amount. This criteria is measured quarterly and measured separately for each tranche and the amounts represented as temporary equity will revert to regular equity, if the criteria are not met for that particular tranche of debentures.

We expect to repatriate an additional approximately $450 million to the United States in Q3, net of withholding in non-U.S. taxes of about $72 million. We utilized some of these amounts to further paid on our revolving credit facility and to fund interest and our recently enhanced dividend payments. This will leave about $300 million of cash available for repatriation with taxes accrued. We are still evaluating the timing of such repatriation, but they are not expected to be in 2018.

Going forward and on a full quarter basis, interest expense on the old convertible debentures would be $2.3 million per quarter, about half of the current run rate. Interest expense on the new debt is expected to be about $6.8 million, about half of which is noncash accretion. Interest expense on the revolver, specifically commitment fees, are expected to be about $0.4 million per quarter, once fully reduced to 0.

Amortization of issuance cost was approximately $0.9 million per quarter, thus total interest expense is expected to be $10.4 million per quarter going forward, split approximately $5.5 million cash and $4.9 million noncash.

For quarter 3, we expect interest expense to be about $11 million, assuming about $100 million outstanding on the revolver for most of the quarter, until the repatriation can occur. As previous highlighted, we took steps in this quarter in response to U.S. tax reform and may continue to evaluate with the effect of the tax reform on Vishay.

The actions taken during the quarter, related to our convertible debentures, have a favorable impact on our tax rate going forward. Due in large part to the unusual tax benefit related to the settlement of some of the convertible debentures, our GAAP tax rate was negative 6 percent for quarter 2 and 12.5 percent year-to-date.

As we disclosed at year-end, 2017, we changed our permanent reinvestment assertion regarding unremitted earnings in certain key countries and have accrued appropriate incremental foreign taxes to repatriate those amounts. As a result of additional analysis completed in the second quarter, we revised the amount available to be repatriated from $1.1 billion to $1.2 billion, and recorded $12 million additional provisional tax expense to be accrued in incremental foreign income taxes, withholding tax payable to foreign jurisdictions.

Additionally, our U.S. GAAP tax expense for the quarter and year-to-date periods includes adjustment to remeasure the deferred tax liability related to those incremental foreign taxes payable on repatriation, such as foreign currency effects. A similar remeasurement will occur quarterly until such amounts have been repatriated. That remeasurement adjustment, with a benefit of about $9 million in Q2, and an additional expense of about $1 million in Q1, 2018.

Our normalized effective tax rate, which excludes these unusual tax items, was approximately 28 percent for the year-to-date period. This mathematically yields a rate of 25 percent for quarter 2. We now expect a normalized effective tax rate for the year to be about 28 percent.

We continue to be impacted by the new GILTI tax and the limitation on deductibility on some of our interest expense. We continue to evaluate the provisions of the new U.S. tax law, and we may further adjust our financial and capital structure to reduce our effective tax rate.

Our consolidated effective tax rate is based on an assumed level and mix of income, among our various taxing jurisdictions. A shift in income could result in significantly different results. Total shares outstanding at quarter end were 144 million. The expected share count for EPS purposes for the third quarter 2018, based on the average stock price third quarter to date, is approximately $154 million.

This reflects the reduction of potentially dilutive shares after the settlement of some of our convertible debentures in Q2. For a full explanation of our EPS share count and variables that impact the calculation, please refer to the 8-K we filed this morning.

Cash used in operations for the quarter was $9 million. Capital expenditures for the quarter were $48 million. Free cash for the quarter, negative $49 million. For the trailing 12 months, cash from operations was $278 million. Capital expenditures were $198 million, split approximately for expansion, $105 million; for cost reduction, $24 million; for maintenance of business, $69 million.

Proceeds from the sales of property and equipment were $9 million for the trailing 12 months. Free cash generation for the trailing 12 months was $89 million. Both the quarter and trailing 12 months include about $106 million of cash taxes paid related to U.S. tax reform and cash repatriation.

Vishay has consistently generated am excess of $100 million free cash in each of the past 12 years. Cash flows from operations were greater than $100 million for the last 23 years, and greater than $200 million for the last 16 years. Backlog at the end of quarter 2 was $1,595,000,000 or 6.3 months of sales.

Inventories increased quarter-over-quarter by $30 million, excluding exchange rate impacts. Days of inventory outstanding were 80 days. Days of sales outstanding for the quarter were 46 days. Days of payables outstanding for the quarter were 34 days, resulting in a cash conversion cycle of 92 days.

Now I will turn the call over to our Chief Executive Officer, Dr. Gerald Paul.

Gerald Paul:
Thank you, Lori, and good morning, everybody. First of all, there is no change to prior quarters. Vishay continues to enjoy very excellent business conditions in virtually all of its markets and there is no sign of a slowdown. Record volume and good efficiencies supported the further substantial increase of revenues and of profitability. As we continue expanding critical manufacturing capacities.

Vishay, in the second quarter, achieved a gross margin of 30 percent of sales, an operating margin of 16 percent of sales, GAAP EPS of $0.65 and adjusted EPS of $0.54. And we continue to be a reliable generator of free cash. However, the year 2018, will be burdened by approximately $164 million of foreign cash taxes related to our announced cash repatriation.

Let me talk about the economic environment. The economic environment in the second quarter continue to be very friendly in practically all aspects. In particular, our key markets, automotive and industrial, keep growing fast. The market demand continues to exceed available manufacturing capacities in several product areas, leading to shortages of supply. High order levels continue to be driven by distribution in all regions. The economic environment allows more stable pricing, also selective price increases.

Commenting on the regions. In fact, all regions continue to do very well. In the Americas, the economic outlook is strong and looks favorable for the quarters to come. Many industrial segments like robotics, lighting and energy metering continue to enjoy healthy growth.

The European market remains very strong and continues to be driven by the automotive and industrial segments. We also see very strong Asian markets for industrial equipment, energy infrastructure and automotive electronic equipment.

Concerning distribution, worldwide distribution, also in the second quarter, enjoyed quite excellent business conditions. POS increased by 1 percent quarter-over-quarter, but by 14 percent year-over-year. Despite an inventory increase of 7 percent in the quarter, inventory turns of distributors remained at a quite excellent level of 3.7 in the second quarter as compared to 3.8 in the prior quarter and to 3.9 in prior year.

In the Americas, 2.4 turns after 2.2 in the first quarter and 2.3 in prior year. In Asia, 4.7 turns after 5.1 in the first quarter and 5.3 last year. In Europe, 4.3 turns after 4.5 turns in prior quarter and 4.3 in prior year. The general confidence of our distributors remained unchanged. For sure, in view of their continued high order rates with a book-to-bill of substantially above 1.

Coming to the various industry segments. Automotive continues to be the main driver of growth in our industry, with general electrification of the vehicle driving new programs in many several sectors. No change to prior quarters. Also industrial markets remained strong across all regions and across a wide range of product segments, also here, no change to prior quarters.

Fixed telecom shows some signs of recovery and starts to be supported by 5G projects. AMS and medical continue to look positive, with steady growth expected for 2018 and beyond. Concerning our business at Vishay, sales in the second quarter, excluding exchange rate impacts came in slightly above the midpoint of our guidance.

We achieved sales of $761 million versus $717 million in prior quarter and $643 million in prior year. Excluding exchange rate effects, sales in the second quarter were up versus prior quarter by $51 million or by 7.2 percent, and up versus prior year by $98 million or 14.8 percent. Book-to-bill of 1.17 in the second quarter, again, was strong across the board.

We had book-to-bill of 1.23 for distribution after 1.28 in Q1, and 1.08 for OEMs after 1.16 in the quarter 1. 1.06 book-to-bill rate for actives after 1.26. 1.29 for passives after 1.18. 1.29 for the

Americas after 1.25 in the first quarter. 1.09 for Asia after 1.22. And 1.18 for Europe after 1.23. So altogether, it's a strong, but very strong for passives in U.S. and European distribution.

Despite our increased manufacturing output, backlog remained at an extremely high level of 6.3 months, 6.9 months in actives and 5.7 in passives. Selling prices went up in total, 0.7 percent up versus prior quarter and also 0.7 percent up versus prior year. Same picture more or less for actives and passives. For actives, 1.1 percent up versus prior quarter and 1.0 percent up versus prior year. For the passives, 0.3 percent up versus prior quarter and 0.3 percent up versus prior year.

Some highlights concerning operations. Also in the second quarter, we were able to more than offset the negative impact of inflation on the contributive margin by cost reduction and innovation. SG&A costs in the quarter came in at $104 million, slightly above our expectations. Manufacturing fixed costs in the quarter were $128 million according to expectations.

Total employment at the end of the second quarter was 23,720, 1.3 percent up from the prior quarter of quote, of course, the consequence of ongoing capacity increases for most of our product lines. Excluding exchange rate impacts, inventories in the quarter increased by $30 million, $9 million in raw materials and $21 million in (weapon) finished goods, again the consequence of further increased productions outputs.

Despite inventory increase, inventory turns in the second quarter remained at a very satisfactory level of 4.6. Capital spending in the quarter was $48 million versus $32 million in prior year, $32 million for expansion, $7 million for cost reduction and $9 million for the maintenance of business. For the entire year 2018, we continue to expect CapEx of approximately $225 million.

In Q2, we used cash from operations of $9 million versus the generation of $85 million in prior year and we generated $279 million on a trailing 12 months basis. Cash from operations in the second quarter was burdened by cash taxes, paid related to cash repatriation and to the U.S. tax reform of $106 million, $92 million and $14 million, respectively.

We used, in the second quarter, free cash of $49 million versus the generation of $53 million in prior year. We generated $89 million on a trailing 12 months basis, again, also free cash generation was burdened by $106 million of cash taxes paid.

Let me come to our product lines and I'll start with resistors and inductors. Vishay's traditional, and since years, most profitable business continues to grow steadily. With resistors and inductors, we enjoy a very strong position in the industrial, auto, military and medical market segments.

Sales in the second quarter were $252 million, whereby $5 million came from the recent acquisition, UltraSource, up versus prior quarter by $10 million or 4 percent, and up versus prior year by $35 million or 16 percent, when excluding exchange rate impacts.

The book-to-bill ratio in the second quarter for resistors and inductors, was 1.16 after 1.15 in prior quarter, highlighting continued growth, strong growth and ongoing need for increasing manufacturing capacities. Backlog grew further to 5.4 months from 5.1 in the first quarter. Supported by higher sales and better prices, gross margin in the quarter increased to 34 percent of sales from 32 percent in prior quarter.

Inventory turns in the second quarter were at the very satisfactory level of 4.4. Prices are starting to increase, 0.4 percent versus prior quarter and on the same level as prior year. We continue to invest in manufacturing capacitors – capacities of power inductors, metal strip resistors and thin film resistor chips as well as MELF Thin Film Resistor. Our new acquisition, UltraSource is solid and profitable.

Coming to capacitors. Our business with capacitors is based on a broad range of technologies with a strong position in American and European market niches. We enjoy increasing opportunities in the fields of power transmission and of E-Cars, namely in Asia, especially in China. Sales in Q2 were at $112 million, 7 percent above prior quarter and 17 percent above prior year, again excluding exchange rate effects.

Strong book-to-bill ratio in the quarter at 1.59 after 1.26 in previous quarter. The backlog increased substantially to 6.4 months from 5.1 months in prior quarter. Gross margin in the quarter decreased slightly to 22 percent of sales from 23 percent in prior quarter. There has been some negative impact of metal prices.

Inventory turns in the quarter were at 3.7. Also for capacitors, selling prices were increasing by 0.3 percent versus prior quarter and by 0.9 percent versus prior year. We feel that the business starts to see tailwind from the economy, also capacitors.

Coming to Opto products. Vishay's business with Opto products consists of infrared emitters, receivers, sensors and couplers as well as LEDs for automotive applications. Sales in the quarter were $76 million, 7 percent above prior quarter and 1 percent above prior year, again without exchange rate impacts. We see continued strong book-to-bill ratio of, in Q2, of 1.20 after 1.24 in prior quarter.

The backlog for Opto products increased to 5.4 months from 5.2 months in the first quarter. The gross margin in the quarter came to a normal level of 35 percent of sales after 38 percent in the first quarter. The previous quarter had benefited from some inventory builds.

The inventory turns at Opto are quite excellent, they are 5.3. Prices are stable to slightly up. There was some minus (0.1 percent) versus prior quarter and the plus 0.6 percent of prices versus prior year. We remain confident for this line growing steadily and profitably also in future.

Coming to the diodes. Diodes for Vishay represents a broad commodity business, where we are the largest supplier worldwide. Vishay offers virtually all technologies as well as the most complete product portfolio. We in particular are leading in power applications. The business has a strong position in the automotive and industrial market segments and keeps growing steadily and profitably since years.

Sales in the quarter were $183 million, 10 percent above prior quarter and 15 percent above prior year, which excludes exchange rate effects. More normal, but still strong book-to-bill ratio of 1.08 after 1.30 in the first quarter. Backlog started to normalize from 7.4 months – coming from 8 months to 7.4 months. We have seen this development coming down from a very high level. Still there are long lead times and still there are shortages of supply for the diodes.

Gross margin in the quarter climbed to a record of 29 percent of sales, driven by increasing volume and better selling prices. Inventory turns remained at a very satisfactory level of 4.9. We – also for diodes, we see increasing selling prices, prices were up by 1.7 percent versus prior quarter and by 1.7 percent also versus prior year. We keep expanding manufacturing capacities for all critical lines as fast as we can.

Coming to the MOSFETs. Vishay continues to be one of the market leaders in MOSFET transistors. MOSFETs, over the last years, developed a strong and growing position in automotive and we expect this trend to continue. Sales in the quarter were $137 million, 8 percent above prior quarter and 18 percent above prior year, without exchange rate impacts.

The book-to-bill ratio was 0.96 after 1.23 in the first quarter, and like for the diodes, the backlog started to normalize somewhat, 7.0 months coming from 7.7 months. But again, also for the MOSFETs, there are still very long lead times and shortages of supply. Mainly due to higher sales and supported by better prices, gross margin in the quarter grew to a record level of 28 percent of sales after 25 percent in prior quarter. Very satisfactory inventory turns of 4.6 and the selling prices increased, plus 0.8 percent versus prior quarter and plus 0.2 percent versus prior year. Also for the MOSFETs, we expand manufacturing capacities.

Let me summarize. Vishay enjoys another very successful year, approaching historical profitability records in stellar years like the year 2000 and 2010. The driving force behind this development is an enormously strong demand for most of our product lines in virtually all market segments.

Let me reemphasize. The present favorable market conditions neither represent a spike of demand created by a few applications like in the year 2000, nor a recovery from a general crisis like in the year 2010. We presently may see the start of some of normalization of inflated backlog for semis, but an even accelerating demand for most of our passives. In this context, the July book-to-bill ratio in total remained noticeably over 1 versus 1.11 July.

Overall, we trust in an accelerated growth trend of our markets in particular of automotive and industrial for years to come. We prepare ourselves and continue to raise critical manufacturing capacities ambitiously, while remaining careful in adding operational fixed costs. For the third quarter, we guide for the sales range between $755 million and $795 million, at gross margins of 29 percent to 30 percent of sales.

Thank you very much. Peter?

Peter G. Henrici:

Thank you, Dr. Paul. We'll now open the call to questions. (Shelby), please take the first question.

Operator:
Your first question comes from Ruplu Bhattacharya from Bank of America.

Ruplu Bhattacharya:
Dr. Paul, I wanted to ask you, you're guiding the 3Q revenues to be sequentially up 2 percent. Given that and given that this is a supply-constrained environment, how should we think about the seasonality of fiscal 4Q?

Gerald Paul:
Seasonality exists, of course. We – on the other hand, we are adding capacities through the year and the outcome of both elements is this 2 percent more, which we guide for. The seasonality principal continues to exist, of course, especially in Europe, but we add more equipment.

Ruplu Bhattacharya:
OK. OK, that's helpful. And then just an overall question on industry supply and demand. Given that you are adding capacity and probably some of your competitors are adding capacity, when are you seeing overall supply demand comes into balance? Is it this year, or do you think it's well into 2019 before supply comes into balance with demand?

Gerald Paul:
Well, I think I said it – presently, and believe me if you look carefully, we see no tangible signs for any cooling-off. That means, we are in a cyclical business. Sooner or later, we are going to see a cycle, but at this point in time, we absolutely see nothing. Also, when nothing, which looks like a downturn.

Also, if you look at the supply chain, I think the terms in distribution are very normal, very normal, even good. So basically, at this point in time, it's hard to say. At least, we cannot see anything. This is my comment.

Ruplu Bhattacharya:
OK. Well, that makes sense. And in my last question is, I think you mentioned that you're going to repatriate a net of $450 million of U.S. dollars in the third quarter. How should we think about the use of that cash? And I will you restart the buyback at all?

Gerald Paul:
Well, as you noticed, we are bringing back substantial monies to the U.S., which creates different position, we have concerning the liquidity in the United States. And we currently are in process to evaluate options to use it, this new liquidity beneficially for the shareholders. It's a new situation, we will address the situation. And this will take some time, but we are in process to do so.

Operator:
Your next question comes from Shawn Harrison of Longbow.

Shawn Matthew Harrison:
First question, just the substantial rise in the book-to-bill for the capacitor's business. Is that a function of demand? Or are you seeing some substitution related demand, maybe from ceramics versus more of your tantalum-focused business that's occurring as well, because that was a sharp increase in the book-to-bill ratio, sequentially?

Gerald Paul:
No, these are more or less longer-term orders which we see. I guess, you refer to the present shortage of MLCCs equity merger, right? Which we can see on the margin. If so, that is not as. Our MLCCs are not exactly the same product, a mass product, which is short of supply these days.

We – since a long time have withdrawn to a specialty business on MLCCs, which in fact is a different technology, so it's a niche business. But we see strong interesting capacitors also, but this is not really MLCCs in our case. It's our broad spectrum of specialties, which we have.

Shawn Matthew Harrison:
OK. And there's a follow-up, where there any singularities in the June quarter that boosted the gross margin? Because at the midpoint, the guide is for gross margin to decline a little bit sequentially on higher sequential revenues?

Gerald Paul:
You mean incremental performance, I guess, right?

Shawn Matthew Harrison:
Correct. And into the September quarter.

Gerald Paul:
So at as a matter of fact, in quarter 2, we have, basically seen the necessity to raise the fixed quarter. We are running this company really at the edge of its capacity possibilities and this raises some fixed costs. The fixed cost in such a situation is not really constant, as a matter of fact. And this is really burdening a little bit the incremental performance.

Also, the second quarter, we are to raise the incentive accruals for the incentive payments. But I guess, you talked about the third quarter also, you asked about the third quarter? And what is your observation for the third quarter, sorry?

Shawn Matthew Harrison:
Yes, on higher incremental sales, the guidance for gross margin is down a little bit. And so I guess, it appears, you are continuing to add fixed cost, because, as you mentioned, you're running at the edge of capacity?

Gerald Paul:
Yes, that's right. Basically, yes.

Shawn Matthew Harrison:
And then lastly, I know you've addressed this in the past, but you mentioned that backlog is beginning to normalize in semis, and a lot of that backlog is from longer-term orders. Do you expect backlog to be canceled? Or does this just kind of level out the sales growth you would see in the semi's business for a quarter or 2?

Gerald Paul:
I added the information of July and in July, we are substantially above 1, again it's 1.11 for the whole company. As it matter – as it related to semiconductors, partially it's our own doing. We are managing our backlog together with our customers. So it's not really a strong sign for a normalization, in particular as July's strong again.

So again, I can only repeat, we do not see any signs, really for a downturn. Not even the normalization is partially based on a cooperation with our customers. And looking now, July was strong again.

Operator:
Your next question comes from a Matt Sheerin of Stifel.

Matthew John Sheerin:
Dr. Paul, the pricing environment, obviously, is better now. You talked about some selective price increases, which is impacting the numbers.

Are really – are you still – I mean, we are hearing from other suppliers that they're just having discussions, particularly auto and the larger industrial customers going into next year. So do you see the pricing environment continuing to get better, which could drive a better contribution margin for you over the next few quarters?

Gerald Paul:
Right, indeed we started a big negations now. And it's true that our position in this negotiations are better than in previous year. There is no question about it. But of course, it's a matter of negotiation and especially, when it comes down to the larger automotive accounts, we want to, also to defend I will share there. We want to grow our share, we want to be heavily in design in – involved. So there are – it's a give-and-take situation, but it's very true what you say, our position is better than it was.

Matthew John Sheerin:
OK, and you talked about – we saw the book-to-bill come down in a few of your segments, particularly the MOSFETs, which is negative and I – but the backlog is still very strong, and you talked about shortages. Is that a function of some supply coming online?

So some of that lead times have gone from whatever 30 weeks to 20, so some of that a backlog goes away, so we shouldn't read that much into it? And as you add more capacity in other segments, will we see a negative book-to-bill at some point? And should that be a red flag to investors? Or just assign the more normalization?

Gerald Paul:
Two comments. Number 1, what I wrote this still true, of course. I haven't known July yet and July is strong again, so we take it to the (kilogram) will solve the whole thing. It's a very true. This is not a warning signal whatsoever. This 0.98 book-to-bill in the MOSFETs was a part our own doing, as I tried to say before. Managing backlog between us and optimizing the backlog between us and customers.

So at this point in time, Matt, we don't see anything. It's very strong, it continues strong. But, of course, at the end – at a point in time in future, backlog will normalize and mathematically, you can – and you know it like me, you can only normalize the backlog with a certain point, a certain period of book-to-bill's below 1. This is mathematically the case. So sooner or later, yes, but not now.

Operator:
Your next question comes from Harlan Sur of JPMorgan.

Harlan Sur:
Obviously, demand continues to be quite strong. You guys came in right at the midpoint of guidance on revenue. I would've thought, Dr. Paul, that the team would have something a bit more revenue capacity to try and bring the backlog down a bit and I also notice that your CapEx was lower, at least, than what I was expecting.

Did the team have issues procuring more equipment to expand capacity in Q2? I'm just trying to figure out, what if thought maybe revenues would have been better, and CapEx would've been a bit higher?

Gerald Paul:
Well, it's not a matter of spending the money. You are absolutely right. There are lead times on the equipment. But this not related to the second quarter, we don't see our special second quarter effect. In general, the lead times of equipment, not only for Vishay, but for all servers has gone out.

Back to the latest to sales output of a quarter, I would not go so far. It's just the maximum we could produce with the pieces of equipment we had installed. The company's booked out at this point and of course, we are going to add capacity further. About it was not so that unexpected delays and bringing on capacities in the second quarter wasn't so.

Harlan Sur:
Great. I appreciate the commentary there. Were you able to stabilize your lead times in line with your stable backlog trends in Q2? Or are they still going up? And maybe if you can just help us articulating some of the lead times by product category? Was his and inductors, capacitors, MOSFETs, diodes et cetera?

Gerald Paul:
Most of the commodity products have very long lead times, very unheard of long lead times. But this is the situation, but you shouldn't forget that the larger customers have an ongoing

allocation, have an ongoing a – it's not so that everybody – but if a person – if a company comes to Vishay, he has to wait a long time for most of the products at this point.

And we can only our capacities, as you said before, as the people are ready to supply us the equipment and we can find and train people to operate them. So we do our absolute maximum, but it's true that customers overwhelm us with orders, and not only us.

Harlan Sur:
And then my last question on the Asia/China growth initiatives. I think the metric that you guide go out there, as you've grown the Asia, primarily China and an 18 percent CAGR over the past 5 years.

I assume you're extending above this category rate, now maybe can help us quantify what China is a growing at on a run-rate basis? And where are you guys seen the biggest area of growth? Is it China auto, China industrial, what applications?

Gerald Paul:
First of all I don't have a new number, but it's a very strong growth there, very strong. And it is limited not by us finding customers, it's limited by our capacity again, as a matter of fact. And the areas of the strongest growth are really – our strong area anyway, which is automotive and industrial, as you said. There is no question.

If I had more capacity, I could sell more to Asia, the question. But is also true for Europe and this is also true for the U.S. at this point. But I don't want to mislead you. As you continue to be especially in these 2 market segments, our basic trust we have in the future for our growth, no question. But at the moment, everything (inaudible) is equalized by a normal demand from all market or geographies.

Operator:
As a reminder, if you would like to ask a question please press star one. That is star one to ask a question.

Your next question comes from Jim Suva of Citi.

Jim Suva:
Dr. Paul, is it fair to assume that many of your customers are on kind of longer-term contracts and since our tightness in supply has happened, for say, 6 months now or pretty much year-to-date, that there are still multiple, multiple quarters left of quite favorable pricing because those contracts renew at different times?

Gerald Paul:
OK. The price question has not disappeared completely for sure, because especially with this largest customer we are dealing with income of the Porter trust in us and for long-term and we do the same something. There will be also price decline going forward, but I think we are in a much better position to negotiate today than we have been before.

When you really see a change of the price pressure, it's obviously in distribution, which is 50 percent of our total sales, approximately. In this case, it's a very true, we can be more opportunistic and we are. But principally speaking, coming back to the point, of course, we also foresee, for a longer period, especially in automotive and I guess come also and industrial. The major demand, which automatically will put us in a better position for also in future for price negotiations, this is also my opinion.

Jim Suva:
Great. And just to confirm, the automotive and industrial, many of those contracts are still being discussed or to negotiate and have not already been recognized in the most recent quarter (or two) of favorable pricing?

Gerald Paul:
No. It's absolutely true. These are running contracts, yes.

Operator:
There are no other questions in queue.

Peter G. Henrici:
Thank you. This concludes our Second Quarter Conference Call. Thank you for your interest in Vishay Intertechnology.

Operator:
This concludes today's conference call. You may now disconnect.

END