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MXIM - Maxim Integrated Products at Stifel, Nicolaus Technology, Internet & Media Conference

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PRESENTATION

Tore Svanberg - *Stifel, Nicolaus - Analyst*

It's my pleasure to introduce Maxim this afternoon here at the Stifel Technology, Internet and Media Conference 2014.

My name is Tore Svanberg, and I'm a senior semis analyst covering analog and mixed-signal semiconductors.

It's my pleasure to introduce Maxim. With us from the Company, we have Bruce Kiddoo, who's here up on stage, and he's the Company's Chief Financial Officer. And also, right there in the front is Kathy Ta, who is the Company's Director of Investor Relations.

The particular format for this session is Q&A. So with that, we're just going to get started. Thank you.

So, Bruce, thank you again for participating in our conference this year.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Sure.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

Great to see you.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Great to be here.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

I guess, the way we start, we start nice and easy. Maybe you could just give us a general overview about Maxim, especially for those that don't know the Company as well, and maybe focusing a little bit on what makes Maxim so different from some of the other analog companies out there.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Sure. So Maxim, obviously, analog semiconductor is a great business model, $2.5 billion in revenue, good gross margins, 61% to 64%. Good spending controls. Our op margin in the 25% to 30%, 30% is the target.

You have a low tax rate, low CapEx, so generate a lot of cash. Cash flow from operations -- or free -- cash flow from operations over 30%, CapEx 5% to 7%, and trending down. So free cash flow around 25 percent-plus, and very actively return that to shareholders through a dividend program and also through buyback.

Really, our strategy, and as analog has always been, is a diversified model. We participate broadly in all the end markets, weather that's the consumer or mobility market, industrial, communications, and computing.

I think really what separates Maxim and really kind of the move we made, probably 5, 6 years ago, really when Tunc took over as CEO, and it had started a little bit before that, was this move from component supplier to a system supplier. And we do that through integration and something the digital guys had done for a long time, and, certainly, it makes sense for all the obvious reasons, as far as space, power, and cost.

We're one of the few folks who have done that. It was obvious in the mobility space, we did very well in mobility. We've used that to do very well in other areas. We're doing great in automotive right now, again, a big reason for that is our system integration skills, things like smart meters and medical as well. So industrial is doing will.

You can see that same system requirements in communication, and so that's helped us as well.

So in an industry where some people -- where growth is slowing down, we've clearly, I think, found something that differentiates Maxim and gives us the opportunity to continue growing a little bit faster than the rest of our peers.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

That's a very good introduction. And maybe we can sort of use this forum to talk a little bit more about your non-mobility business. And the reason why I phrase it that way, because I know that just gets a lot of attention.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Sure.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

But, in all reality, I mean, more than two-thirds of your business is actually non-mobility.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Yes.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

So maybe you could talk a little bit about some of the sub-segments just so investors know more what's going on at Maxim beyond Samsung and so on and so forth.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Sure. No, I think if you look at all of our businesses, and we always have viewed our self as a broadly diversified company, and industrial has always been the core for analog companies. It's about 28%, 29%, of our revenue. It's doing very well right now. It was, in essence, flat in a seasonally weak quarter in December, and it's up strongly in the March quarter.

And if you look at our industrial business in that kind of 28%, 29%, it's split roughly half and half. Half of that [kind of] general-purpose industrial, and this is your classic high-performance analog building-block parts that are primarily sold through distribution.

So that's a business that we have kind of a global relationship with Avnet. They've done a very good job at finding new customers, new design opportunities for us, and so that's a business that's doing well. It's usually seasonally strong in the first half of the year, and it's certainly showing good strength right now.

What really sets us apart, I think, on the industrial side is the other half of our industrial business, which is what we call vertical markets. But these are application-specific opportunities, system solutions.

Automotive is the best example of that. When I joined probably 6.5 years ago, automotive was probably 2% of sales, and today it's high single digits and has been growing over the last 4 years in around kind of 10% to 12%. And we expect that over the next couple years to at least continue with that growth rate.

And this is infotainment. So think about -- it's one thing, people say, well, gee, I don't like the mobility business. A lot of that technology that's been developed for mobility is actually translating into automotive. So if you think of there's a lot of processors in a car today, those all need power management. There's video distribution throughout the car, there's -- which we provide the (inaudible) for. There's a lot USB ports, which we're a leader in from kind of a port protection point of few. High brightness LED lighting, Keyless Go.

So there's a lot of opportunities from an automotive point of view that are really leveraging our integration skills and leveraging a lot of the technology from mobility. So that's worked out very well.

The other kind of area there that's doing well is in the smart meter market. Again, we've taken integration, where we've integrated the analog front end, added to that the microcontroller, and really brought in the third component, which is security, which, increasingly, in a connected world, security is going to be a key element, kind of a horizontal technology that you're going to need in any connected opportunity is the level of security.

And finally in industrial is medical. It's a market that's still small for us. And historically, we've been in whether it's ultrasound, and then some of the consumables, a blood glucose meter, a pulse oximeter.

Now, seeing that capability we've had and having that kind of transition over into these more kind of wearable devices, and so it's interesting, again, where you're starting to see these kind of convergence of these end markets. And our strength in integration, our strength in the mobility side as far as low power, small form factor, high performance, and our strength in medical as these start coming together in various devices that we're starting to hear about, and I think is going to be kind of very prevalent over probably the next 5 years.

So that's industrial. It's kind of a long answer to your first question. But I'll let you ask another one. But certainly, calm computing, I think there's equally interesting things going on.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

Yes, and we'll go into those markets in a minute. Before we go there, I wanted to ask you a question, and it's very related to what you just talked about, because some investors may not appreciate, or maybe that's not the right word. But they certainly don't seem to value your mobility business as much.

But clearly, there's a lot of intangible benefits of the mobility part, because, and I think you've said this in the past, designing products for the smart phone is probably one of the most challenging designs you can work on, and it's technically very, very advanced. And once you've done that, you can now go after some other areas within industrial or communications and so on.

So maybe you could talk a little bit about that intangible benefit and has that experience in mobility really helped you penetrate some new segment leads and participate in, in (inaudible)?

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Yes. Well, I think first thing, just to be very clear, mobility's been a great market for us, right?

Tore Svanberg - *Stifel, Nicolaus - Analyst*

Sure.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

It's run well-above average. It's a profitable -- more profitable than most people think, business for us. And going forward, it's going to continue to be a great business for us.

Absolutely, we're looking to diversify across other customers, other technologies, other platforms. We can talk about that. But I think we've done -- started to make good progress there.

And even at our larges customer, kind of business is doing well year over year.

So from that point of view, we like the mobility business. We think it was the right decision and continues to be the right positioned.

That said, to your question, which I agree with, a lot of those skills -- so just, first, as we already talked, we used integration. We used integration. We learned how to do that in the mobility side. Clearly, its being driven across all of our other end markets.

So we talked about automotive. We talked about medical. We talked about smart meter.

If you look in the communication space, they're starting to get, if you look in small cells, there are more integrated solutions there instead of point solutions. Within small cells today, we have 70% share in integrated RF transceivers. This is an area where integration makes sense.

You're going to see the same thing in some computing applications. If you look at the Volterra acquisition, one of the reasons they were so successful was that they had an integrative solution versus all of their peers who had discrete solutions, which gave them significant density and performance advantages.

Another area [where] the idea of mobility was just speed. You had to go fast, and so you had to reduce your cycle times. This is an amazing business. You can take up to 2 years to design a product, and then it still takes a year to get it designed and qualified. So from the time you kind of have the idea, it can be 3 years later before that's in the market, 3, 4 years later.

So the belief to move fast, even in a slower moving market, is a huge advantage, to be able to take advantage of opportunities to get in there and get design wins.

So I think kind of the push for cycle time that was started with mobility, has absolutely benefited in other markets.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

Moving on to the communications part of your business, maybe you could talk a little bit about the sub-segments there. It's a market that I think, at least from my perspective, has been kind of frustrating the last few years, maybe primarily because of the CapEx environment, the microeconomic climate, and so on.

But what are some of the main sub-segments that you participate in there? And what are you seeing as far as growth in those segments for 2014?

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Sure. I think if you look at our communication business, it's about 16%, 17% of revenue. The largest about half of that business is our networking and data comm, and really saying fiber optics, for the most part, for that business.

This is in a number of areas. It's fiber to the home. We have some very good business in China where they're doing large deployments there. It's backhaul out of base stations. So to the extent that you hear about the kind of China LTE deployment finally, we'll participate that in a couple ways, but one way is in the backhaul. Fiber optics in the data center, again, I think another kind of secular opportunity for growth.

And so I think, in the optical business, while from a supply chain point of view, it's a little bit of a lumpy business. I mean, they're either in expedite or push-out mode, to be very candid, about how that business operates.

But long term, I think it's a good business. And there isn't actually as much competition. You don't hear the normal names in that business as much. So we like that business. So that's our largest.

We do have a base station business. It's kind of mid-single digits, so it's not nearly as large as maybe some others. So we're not the guys to give you the insights on the China kind of CapEx deployment.

We do have a business there to the extent it is doing well, which it is starting to ramp now, we participate, and it gives us growth.

We also have, [since] I mentioned before, small cell business. Again, we [are in the kind] of femtocell, small market, but we have very good share, and that's a business that's growing.

And finally, we have a cable infrastructure business, sort of the cable head ends, if you think about it from that point of view. And again, very high margin business.

So my view overall of communications is, I think this is a business which is steady growth. I don't think it's a high-growth business. It may go through some cycles. It's good gross margin. So I think any time you can get a nice steady, profitable, growing business, it's a great addition to your portfolio and something that will -- you always have to make sure you kind of manage the investment for the growth opportunity. I think we do that well.

And so it's an area that we will continue to invest in, and I like it. I mean, if we rank the opportunities from a growth point of view, you have mobility, industrial, and then comm.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

So just to round it up with the computing business then, there, obviously, you have some bigger sub-segments like servers, financial terminal. I know you've been getting out of the notebook market for a long, long time now.

But I also know the company you just acquired, they did have a small notebook piece.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Right.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

So maybe you could just talk a little about the moving parts within the computing segment. And maybe talking a little bit more about how you expect the Volterra server business to evolve, especially now that it's part of the Maxim umbrella.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Sure. I mean, if you think of computing, and, yes, we had been getting out of the notebook business starting in 2007. It had gotten down to about 2% of revenue.

If you think of Volterra, out of there kind of $35 million, $36 million a quarter. Are they about 20% in the last quarter with notebook? I think at its peak, it was probably 35% of revenue or so. So that's already been coming down. So that's just $6 million, $7 million, that will continue to trail of.

But it always takes longer than you think. So I don't think it's going to be that much of a headwind.

We always had a server business. We like the server business. We actually were never able to compete. It's about a $400 million, $500 million market.

Volterra was the one who was the winner in that market. They had done very well. They have about 25% share in that market. And certainly, through this acquisition, I think we have that opportunity to kind of enter that market in a meaningful way.

We think Volterra has great technology. This was a company we had, to be candid, looked at several times, at $36 before any premium, it was probably a little high. $15, $16, that was something I think that was actionable. We love the team. I mean, you know these guys. We love the team. We love the technology.

We absolutely think they're going to continue to do well in servers. They did have some issues, and we've worked through those issues, both technically, financial. So I think this is a business that will stabilize and then ultimately grow their server business.

Their technology is very applicable to the communication. Again, another $400 million comm power. Another $400 million SAM, which they had, it was like 10% of their revenue, small percent of our business.

So again, taking their technology, using our customer relationships, selling it to the likes of the Cisco, and the Ericssons and the [Walkways], we'll be able to grow that business significantly. So we feel good about that.

They had really no presence in cloud. They really sold to IBM, HP, some to Dell. But really, they didn't have a large presence in cloud. We'll certainly be able to do that. We have the relationships both with the guys who are defining the servers, the Googles, Facebooks, Amazons of the world, and with the ODMs who are building them.

I mean, I think we have to remember, Volterra had 10 salesmen. So this is a company that did a tremendous job of focus and execution. I mean you give them a tremendous amount of credit. They built $150-a-year business, being very focused on the technology they developed and the applications.

And, but really, I think they recognize to scaling and to go to that next level, they needed the support of a bigger company. And we certainly are excited about the opportunity to take them there.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

That makes sense. Moving on to financials and maybe -- I don't know how to define it, if it's a philosophical question, what have you. But, I mean, the company's shown very good growth the last few years. You've also returned tons of cash to shareholders, as much, if not more, than some of your analog peers.

Yet, for some reason, the valuation doesn't seem to reflect one or the other. So, do you think that's because of the shareholder base? Is it because there's sort of confusion between value and growth? I mean what's your take on this topic? Because to me, it's a little bit puzzling. You continue to do a lot of things that's right, yet, obviously, the stock trades at a discount to your peers?

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Yes. I mean, we outperform both financially, and actually from a stock price and a total return, from both, from stock price and return on capital, over a 5-year period very substantially. Obviously, last year there was an issue with our largest customer, had an inventory correction. So I think that identified risk, as some people felt.

I certainly, from our point of view, we already we had diversification efforts underway within mobility, and I think we'll continue to show that progress.

But I mean, more importantly, though, is I do think people maybe lost a little bit of sight of the rest of the business in the conversation, and you think of that industrial business, 28%, very good margin business. You think of the calm business, and generates a lot of cash. And our ability to return that to shareholders, I think the number was for CY13, 127% of free cash flow.

Now, certainly, that's not sustainable long term. But that was a year when we fell from a stock price point of view, because we did underperform and traded at a discount. We thought that was the right time to use that capital to buyback, and we reduced our share count by over 10 million shares. And so I think we were good about that.

So I think our view of this is, as management, we're just going to -- we think we have the right strategy. We're going to execute. If we do that, we think eventually the market will recognize the value that we deliver.

And so certainly that's what we can control.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

Sure.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

And that's what -- we're going to kind of wake up every day and go work on it.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

That sounds reasonable. With that, I'm going to open up to questions. Right here.

Unidentified Audience Member

(Inaudible microphone inaccessible)

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Yes. I mean, certainly, this is a -- it's a small industry. We all know each other. And it's very easy to look at the different strategies of the different companies.

I think we have a tremendous amount of respect for linear. I mean, you talked, we had dinner last night with Paul. I mean, those guys have executed very well. They have a very good model.

I think we, as a company, have said we believe you need a certain level of growth really to make the P&L were. If you really want to return capital to shareholders, you really want to increase dividends over time. You need to grow the top line.

I mean, there's so much you can do from a leverage point of view, and we'll always work on that from a gross margin and an operating leverage, from an operating margin. But ultimately, you need some exposure from a growth point a view.

And so we've chosen to kind of selectively get into some higher growth markets like mobility, where we actually get much better margin than most people think. It's very close to corporate average from a profitability point of view business.

And I think over the long term, I think that has been a good strategy. And if you look at kind of a total return over a 5-year period, I think you would see that we outperform. That said, when your largest customer catches a cold in on year, that is going to cause a problem.

I think as a management team, I agree with your assessment. I think given the issues that our largest customer had last year that highlighted that risk and that's impacted our valuation, I think if we -- I think the strategy long term still makes sense. And if we continue to execute, if we diversify, and, again, I think those investments we made in mobility for the issues that kind of Tore highlighted before, whether that market continues to grow, whether it applies to other markets, whether you start getting a convergence between medical and mobility or automotive and mobility, you can see, I think, that's going to pay off in very, very solid returns and in a more diversified model for us.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

Other questions? [Jimmy].

Unidentified Audience Member

In your experience [at] Broadcom (inaudible - microphone inaccessible)

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Yes. So to the extent that it continues and becomes a greater and greater percentage of the business, I think it's going to continue the same way.

I think part of the integration on the digital side, [what helped], obviously, is they went down to lower and lower process [nodes], and that allowed them to sort of -- that supported that integration strategy. I don't think you get that benefit on the analog side.

I do think integration on the analog side is much harder. It just is, just from a technology, again, if you just think about it from a -- as you're integrating in these different functions, I mean, just thinking about analog, one of the values of analog has always been, we have all these different process technologies, ways we manufacture. So now having to do integration, you have to get it all on the same process. I mean, we manufacture 150 different ways, different variance of our manufacturing. So that now you have to find a way to get that on a common manufacturing platform, whereas, the digital guys, they have that (inaudible).

So I think it's much harder on the analog side. I think that's why you have fewer people doing it. To the extent that we figured it out, I think it's a huge advantage for us, because I think the benefits to the customer are absolutely the same, absolutely, you get the lower cost, lower space, lower power, lower part count.

If you think of automotive, what do you want to do? You want to reduce your [BOM], you want to make it easier. I think it's harder, but I think the advantages are there. And I think the work we put in as a company to create this capability, I think is going to be a very, very valuable asset for us.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

Question in the back first, please.

Unidentified Audience Member

You mentioned trying to stimulate top-line growth. Obviously, you bought Volterra last year.

Can you just talk about M&A as sort of the strategy forward over the next (inaudible)?

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Sure. I think we've always looked at tuck-in acquisitions to really support our integration strategy, to find some technology on a make-or-buy kind of creation or opportunity.

We've also used M&A to kind of balance kind of the growth rates within the company. You've seen our deals are more on the industrial or comm side, sort of offset the organic growth on the mobility side.

I do think you're seeing within an industry, a starting of activity. That's kind of the small and mid-cap analog guys. I think with industry growth slowing down, it's much harder from a scale point of view to survive as a small company.

So I think you start to see some level of consolidation, and, certainly, we've seen that in some of the deals that have been announced over the last year.

I think from a Maxim point of view, we're still not a believer in kind of large peer-to-peer acquisitions, but I think, selectively, to look at the very high-quality assets that potentially you can get at a reasonable price as this consolidation happens at the low level, that's something we would look at.

Volterra's the perfect example of that, very high-quality asset. [With] that selling at a reasonable price, and we feel good about that. And I think, again, our focus right now, 100% is on making Volterra successful, and proving that that is going to be a great deal.

We're ahead of the game from the cost savings and the synergies, and [we feel] very good about technology. And I think once we kind of get that one behind us, I think we'll always be looking for other opportunities.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

We've actually run out time. I know we had another question. Maybe we can just take that question --

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Sure.

Tore Svanberg - *Stifel, Nicolaus - Analyst*

-- as you walk out. But we've run out of time. So I wanted to thank Bruce and Kathy for being here, and also thank all of you for coming to the Maxim session. Thank you.

Bruce Kiddoo - *Maxim Integrated Products - CFO*

Thanks.