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PRESENTATION

Craig Hettenbach - *Morgan Stanley - Analyst*

Good afternoon everyone. Thanks for being here at the conference. My name is Craig Hettenbach. I cover the analog and micro control space at Morgan Stanley. Very pleased to have with us Bruce Kiddoo, CFO of Maxim. So welcome.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Thank you. Appreciate being here.

Craig Hettenbach - *Morgan Stanley - Analyst*

Great. Before we jump into Maxim specific questions, we'd love to get your sense on particularly the industrial market, just the health you're seeing there and maybe any trends in the distribution channel that you'd care to talk about.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. I mean I think industrial right now for us is doing very, very well. I think we know this is kind of the -- March is always the strong quarter for the general purpose and if you think of Maxim, about 28% of our business is industrial. About half of it is general purpose and that business is doing very well, right. I mean we're seeing good strength. We saw it last year, right, where we saw March and June strong. So I think this is typical seasonality. I think the other part that's even more interesting is the other half of our industrial business is what we would call the vertical markets, things like automotive, medical, smart meters. And these are products that really rely on integration.

They're kind of application specific products and so those markets are doing even better than the general-purpose market. So automotive, I think most people know from a content point of view is doing well. I think high performance analog within that is doing even better and us growing off of a small base, this is a market that's grown the last four quarters sequentially. It's going to be up strongly in the March quarter and it's actually one of those nice businesses where you get the -- kind of the design wins. They stay for about five, seven years.

So every year, you just sort of layer on some new design wins. So if you have momentum in automotive, it grows and it's sticky. So I think from an industrial point of view, general purpose doing well, I think that's normal seasonality. I think it's nice that the macro environment is kind of benign right now. The vertical market is obviously doing very well for us. Automotive, we talked about. Smart meters and medical both good long-term growth markets for us.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. I want to --- we'll walk through each of the end markets, but just maybe before doing so, how is Maxim thinking about the growth in the analog industry. And then for Maxim, in particular, your served available markets.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. I mean I think the -- historically, people thought of analog as an 8% sort of business. I think that's come down now to probably 5% to 6%. And so I think the growth weight has come down. When you look at the markets that Maxim is addressing, and I think we're differentiated from most of our peers in that we've gone after a balanced approach, both the kind of historical, industrial, and comm markets. But we've also had the investment in the mobility side. And so if you look at those growth rates, certainly mobility, while that growth rates are slowing down from the very kind of 20%, 30% growth rates that we saw the last few years. It's still probably the fastest growing market in the analog space. And so certainly, double-digit growth market there.

Our second largest market from a growth point of view is automotive. Again, this is one over the last four years has probably grown the low double-digits. It's actually accelerating right now. I do think long-term, say the next four years it could probably still be in kind of that low double-digits. And so from our point of view, if the overall business is growing at kind of this 5%, 6% range, certainly because of our exposure to mobility, our exposure to automotive, some of these other verticals like smart meters, medical, will be opportunities for us to certainly grow above the industry and whether that's kind of 2, 3, 4 points above industry.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. I wanted to spend some time on automotive. As you mentioned, very strong growth there. Only five or six years ago, it was 1% or 2% of your business and now it's approaching 10%. So with many of the companies talking about automotive as a growth driver, what do you think Maxim, how do you differentiate what areas you're playing in and where do you see the growth?

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

This is one of those areas where having that kind of diversified product portfolio really helps. So to the extent that we've been very successful in mobility and invested in that, those technologies are what's allowing us to do well in automotive. So if you think of we're always been kind of known as a power management company, we've done very well in the mobility space in power management. If you think about automotive, there's a tremendous amount of processors now that are in a car, whether it's related to infotainment or other functionality within a car. So we're doing very well from a power management point of view.

If you think about sort of video distribution throughout a car, and these are, when we think of video distribution, within a car that can be $30 to $50 a car of content, just off of distributing video throughout the car. And that's an area where we have a leading market share. Keyless Go, kind of the fob in your pocket that knows as you go up to the car, right, it unlocks the door, all of those that are in high-end cars. Again, very high market share in that.

Other areas that we have been investing in and are now, again, kind of this growing business like high brightness LED lighting. So for us, it's -- we had started investing in automotive back in 2004-2005. We're starting to see the benefits of that, plus the benefits of our mobility business, those technologies being applicable to the automotive as well. And I think finally, the other piece about automotive that's in the markets, kind of the growth markets within automotive, these are high integration parts. These are parts where people from an automotive side, from a quality point of view, right, from reducing the bill of materials, they're looking for high integration. That's something within analog that Maxim is kind of one of the unique companies that does integration and does it very well. And so that's another place we've been able to differentiate versus the competition.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. When you talk about visibility in this market, continue to grow double-digits, it's quite different from the mobility where there's quicker design cycles. So can you just talk about whether it's the geography or certain cars that you think you're well positioned in from a dollar content perspective as you go forward?

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. I mean it makes sense that it's the -- kind of the higher end or luxury cars that have more content in it from an infotainment point of view, from a kind of systems and driver assistance type programs. And so certainly, we've done very well in Europe, high-end [op] cars. Second is probably Asia and then third is probably the US, from a growth point of view.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. Thanks for that. And if we switch over to the industrial market, as you mentioned, you have some building block products and then you also target be it smart metering in some verticals. So if you can just differentiate between the two in terms of maybe the growth opportunity and then particularly for the general purpose, interest in thing that you're doing with the distribution channel to grow that.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. I mean I when you look at the general-purpose, which we said is about half of our industrial business or around kind of 14% of revenue, that does sell through distribution. The investment we made in Avnet several years ago to really have them as our global franchise partner, that's certainly paid off. We have very good business, very good mind share with them. We've actually set up a new business unit within Maxim, which is like the mass-market business unit and it's fundamentally focused on selling what we have. All right, taking the products, and if you think of within distribution, there's an amazing statistic that over 50% of our revenue through distribution is products that are over 12 years old. All right.

So I mean that's the great thing about analog is its ability, these products, once you design them, they're just an annuity. And so we've, in addition to our focus on Avnet, we've also set up this -- kind of this mass-market business unit, which is really about selling what we have more effectively. And so it's a great model because no incremental R&D, it's selling the products that we already have. And it's just some incremental marketing, a little bit of sales support to help drive that business.

So I think overall that general-purpose industrialism, well it is going to be tied to macro. I think that's the one that's the most correlated of all of our business to what's happening on a global GDP basis. And so today, that market is -- GDP is doing well. This is the strong quarter for that. So we've seen just very good sales. You look at the kind of the resales numbers through Europe, through US, strong. So we expect a good quarter for that.

I think on the other side, as you talked about, right, the -- on the vertical markets, think of smart meters and the smart grid. The ability for the utility companies to kind of reduce CapEx by controlling when we use our electricity. This is an idea that's been out. It's an area where we have a leading market share. Again, it's an integration level product, a high integration product. It's one that's been a little bit lumpy. It was strong in the US. It did okay in Europe. Currently now, all the growth is out of China and then China as an exporter into the rest of Asia. And so that market is doing well. But long-term, the economic benefits of kind of moving to a smart grid is going to be a great long-term market for us. It's one where integration pays off and where we have a large market share.

And I guess the final one, which is actually I think very interesting is we've always been in the medical business. And we've sold pulse oximeter. We've sold blood glucose meters, right, we've sold insulin pumps, all of these kind of medical devices that require analog technology. What we're seeing now is this convergence between the mobility market and the medical market, right. We kind of refer to it today as wearables.

There's a lot of hype around wearables. I think we all can understand that. I do think long-term it's going to be a very real market, right. I think it's -- they're trying to -- everybody's trying to figure out who's going to win. Do the consumer guys win who are going to make devices that are tethered to your smartphone, but also do some medical functions, right. We've seen Samsung just announced a product that has a heart rate monitor on it, right. So those type of things versus the medical guys who are going to try to take their technology that's going to be used by a doctor, right, to monitor a medical condition and they're going to make it mobile.

The great thing about Maxim is we're on both sides, right. We sell to the Abbotts, and the Covidiens, and the Masimos. Right, we understand the medical market. We also understand the mobility market and have the relationships with all the large OEMs. So we can kind of bring together and understand what's required for both sides. And so that's, I think, going to be a very interesting market. Medical is a small market for us today. I think this convergence is kind of -- the market share are coming to Maxim.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got you. Thanks for that. If we switch gears and talk about the comm market, there's some optical business versus other companies, not as much base station, maybe some small cells in there, but talk about your comm business today and opportunities for growth as you look out over the next couple of years.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure, I mean comm, it's about 16% of revenue. And as you said, about half of that is sort of networking, data comm. It's really fiber optics. We think that's a good long-term market for us. Thinking about fiber to the home in China, right, has been a growth market for us, right. You think of kind of the backhaul half of all these LTE base stations, right. That's an optical market. Right, you think of fiber optics and the datacenter.

So we like that business. It's not a high growth business. It's definitely a lumpy business in that you look at all the optical guys, they're either in expedite mode or they're in push out mode. That's a very inefficient supply chain. That said, I think long-term that's a good growth market. It's not a huge growth but it's a nice, steady, profitable business.

When we, as you said, base station is probably kind of mid-single digits as a percent of revenue for us. So to the extent that China LTE deployment is occurring, we benefit from that. So as a result, we guided comm to be up this quarter. So while it's not a huge part of our business, it's certainly a growing part of our business. And as you said, there's other parts in there, whether it's for small cells or cable infrastructure.

All of those pieces right now, comm grew in the December quarter. It's growing in the March quarter and so, again, it's a nice kind of probably mid-single digit growth business, profitable, nice cash flow. It's a great, if you're thinking about a diversified portfolio, it's a nice segment of that portfolio.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got you. We appreciate the comments on lumpy. I don't think we've had one presentation where lumpiness hasn't been thrown out there, but at least directionally, it feels like that market is doing a little better. I want to focus on the computing market and really Volterra in particular, the acquisition, the appeal of that deal and when you think about capital allocation, doing that deal versus buying back your stock, if you can walk us through the thought process and why that deals makes sense to Maxim.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. Volterra, if you think about what Maxim's strategy was from an acquisition point of view, we were really doing tuck-ins, right. If you think about integration, you're always looking for different technologies that you may need. And so, on a make versus buy point of view, we've always sort of looked at these kind of small acquisitions.

We've always looked at Volterra. We think they have great technology. It's actually kind of the interesting side story is one of their founders interviewed with our CEO back in the 1990s. He was a grad student coming out of Berkeley and his choice was either join Maxim, who was the leader in notebook power management, or go start a startup. He went off and did a startup called Volterra, which ultimately 20 years later or 17 years later we ended up buying and he's now CTO of our compute bus. And so from our point of view, this is a business we always liked.

We always liked the technology. We tried to compete. To be honest, it's one of those ones where their technology, their IP prevented us. They were always kind of very fairly valued and therefore not reasonable for us.

They ran into some tough revenue in that their notebook business that had grown was coming down. So stock price went from probably 36 at a high down to 15. Right, that provided an opportunity for us to step in and buy them at a reasonable valuation, just under 3X trailing 12 months. So again, for a company that has 60% gross margins, basically a highly defensible IP position, we thought that was a very good opportunity to buy a company that we had always admired and respected for many years.

From a synergy point of view, OpEx, we're ahead of schedule. We had committed to kind of $15 million annually. We'll hit that number in March. We'll probably do better when we're done. From a revenue point of view, we had indicated that while their core business, their server business will continue to grow, their notebook business will come down. We had indicated that we think their revenue is going to be probably flat for a couple years. But from a synergy point of view on the revenue line, this is a company that has technology that they can sell into the comm market, basically a $400 million or $500 million market where they have great technology. They didn't have the customer relationships. We're already working with all of the large comm OEMs. They're all very interested in the technology. I think that's going very well.

The other opportunity was with the cloud. You think of a Google, or an Amazon, or a Facebook, they all are designing their own datacenters, their own servers. Again, we have the relationships with these folks that Volterra didn't. Those conversations have already started doing very well. So I think from a synergy point of view, we're getting the OpEx today. It's accretive, driving both profit and cash flow. Long-term, we'll be able to get those revenue synergies in both the comm and the cloud side.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. Thanks for that. Want to switch gears to wireless and we had the Samsung kind of reset last year and business has kind of improved from that, not just for Maxim but for many of the suppliers there. Can you talk through just the opportunity that still remains there and if there's any kind of color you could shed on dollar content, one generation to next, or things you're looking at --- how you keep growing that business.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. I mean I think when we think about our mobility business, we feel much better where we are this year versus a year ago. I think certainly, Samsung we're doing well and I think we're also in a much better position diversifying that business away from or in addition to Samsung in the power business.

So specifically on Samsung, we've announced that content in the S5, which was just announced at Mobile World Congress, that content is going up. We had talked about how we had wanted to get into different technologies, and so from this point of view, we found some new opportunities for some of our sensor technology. And so that's kind of worked very well for us. Audio was a small business for us. We've announced that we now have audio design wins both in a midrange phone at one of our large customers. In addition, there's been teardowns that show we have audio design wins at the other large OEM.

So from that point of view, I think we're doing well diversifying in audio. We also want to diversify the customer base. So in addition to the other large OEM in China, where we know that's where the growth is occurring from a smartphone point of view, that business doubled sequentially in the December quarter over September, small base. But we're still seeing that activity. We're selling into five different Chinese OEMs.

So I think overall, we look at our business and the Samsung business content is increasing, new technology. We look at our overall customer base. We're selling into significantly more business with new OEMs and we're selling different technologies, whether it's audio, whether it's sensors across midrange E-readers. So again, I think we're much better diversified than we were a year ago.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got you. And how do you think about that as you go forward in terms of that diversification? You mentioned E-readers, tablets, there's growth. So is the opportunity in those type applications or even within wireless to penetrate new customers?

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

I think it's going to be all three. I think it is going to be new technologies. I think it is going to be new customers, right, and I think it is going to be in those new platforms. As we like to say, right, we've got lots of irons in the fire. It's always difficult to know exactly which one is going to hit, right, which one is going to be successful in the marketplace. But our point of view is, to the extent that we can have as many opportunities out there. Ultimately, that overall market, if you believe that overall mobility market is going to continue to grow at a reasonable rate, we should do very well.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. Before we open it up to the audience, I just want to touch on your target model has been within that kind of 61% to 64% gross margin range, if you think that's still the appropriate range as you go forward. And then on the operating margin side, how you feel about longer term.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. I mean I think gross margin 61% to 64%, absolutely. We're still committed to that. I think we're currently at 61% and we're at the low end of that range. That's really from utilization and our internal fabs. Right, last quarter was at 62%. As that grows, back up to over 80%, I'm highly confident we'll get back up into the high end of that 61% to 64%.

So I think of all the things I worry about, that's one area I'm very confident in is the gross margin. I think from an OpEx point of view, we're at 23% R&D as a percent of revenue. Again, I think that's an opportunity we're above our peers in that area. I think some of that's justified, but I think there's an opportunity to bring that number down.

So fundamentally, if you think about we're a 30% op margin target. Last quarter, we were at 25%. I think it's a very achievable target over a reasonable time period to take that back up to the 30%. And I think that's something as a company we're strongly committed to. We're very disciplined at this point in time in driving that and have very specific plans around achieving it.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. Thanks for that. If there are any questions from the audience. If not, I can keep going here. So from a gross margin perspective, even wireless was strong, you were within that target, right, and the perception of wireless is that's it's a difficult market and there's a lot of pricing pressure. So can you talk about that dynamic and perhaps the innovation that you have there, the integration that you command those margins. And then more broadly beyond that, just kind of the end market mix in terms of different grow faster or lower, what that might do to the model.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. I mean everybody was worried from a mobility point of view that that would be a drag on gross margin. We've been in that business since 2008. We've always been within our gross margin target. The only issue that has ever impacted us was utilization. It was never mix. I think that's for two reasons. One, integration. Certainly, that drives down cost, right, for our customer, from reducing that bill of materials. We get to share some of that cost savings and that's helped us from a margin point of view.

Certainly, from an innovation, we keep delivering value above and beyond what the competition can deliver, and absolutely we get paid for that. I guess the third item was sort of the quiet one was to the extent that we have an outsourced foundry model, right, we have 300 millimeter, which within analog is unusual and certainly that gives us a low cost structure as well to do well in mobility. So I think to the extent that we continue to drive integration, continue to drive innovative products, I'm comfortable that we'll be able to maintain the good profitability that we have within our mobility business.

Now, in addition to that, right, we said our next biggest growth driver is industrial. I think most people know within analog, industrial is a good, very good gross margin business. We know distribution is kind of well -- kind of over 80% gross margin business. And we think even automotive, which is obviously lower, is still above corporate average from a gross margin point of view. And so I think we feel comfortable with that.

Comm, good margin, and then computing is generally also a little bit below the corporate average, but if you look at kind of the businesses that we're in now, server, storage, financial terminals, these are much better margin business than, say, notebook. So I think we feel good with kind of the mix of portfolio we have there.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. I wanted to come back to just capital allocation. We touched on Volterra in terms of doing that deal. Now that you've integrated that deal, how you think about prioritizing cash, return of cash, or buybacks, dividends, M&A in the future.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

I mean the good news is we generate a lot of cash, right. If you think about our business, right, so cash flow from operations is over 30% of revenue. CapEx is 5% to 7% of revenue. We think that number is coming down. Right. So free cash flow is 25% of revenue and increasing. So we've always and it's always a very stable business. So we've always been able to generate significant cash, very strong commitment to returning that to shareholders. Our dividend has increased every year except for the recession where kept it flat. We've always been able to have a kind of -- currently, we've been in that kind of 3%, 3.5% yield on that.

Buyback is opportunistic, right. We think about that from a matrix point of view and valuation. But if you look at over the last four years, we've actually returned 93% of free cash flow to shareholders. And so lots of people talk about targets. It's nice when you can talk about actuals from that point of view. And so I think we feel good about that. It's a great business. Analog is a great business, right. It's a profitable business. It generates a lot of cash. At Maxim, we're committed to returning that cash to shareholders and then we think this kind of combination of topline growth, high profit margin, commitment to return cash, that's what you need to really kind of show that return of capital and increasing return of capital over the long-term.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. Thank you. Maybe just coming back to wireless in China specifically, in addition to the enthusiasm around LTE build-out there's also I think some recent enthusiasm about LTE handsets, which would probably be good in terms of when we think mix. So can you talk about China, the opportunities there, and what's best fit for Maxim in terms of types of phones you might play in there?

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Sure. I think we're selling into five different Chinese OEMs right now. Ultimately, these are OEMs that want to have a global brand, right. They sell into the domestic market. They do well, but you look at them, MWC. These are folks who have global ambitions. They want to have all of the same functionality as the other OEMs. And so we can absolutely help them achieve those goals. The nice thing, the actual part that's doing best right now in China for us is our integrated power management chip, right. So if you think about that's what it does. It's a low-cost, saves on power, saves on space, not connected to the apps processor or the baseband.

So we're not in any way competing against the QUALCOMMs of the world. And so from that point of view, that's the market where we've done best and then the ability then to sell our audio technology, our sensor technology. So that's a business that is growing. Again, a small base but I think we feel good that those relationships are there and we're starting to benefit from those relationships.

As you said, on the infrastructure side that will be -- we'll participate in that. It's not a big market for us, to be honest. I think the other piece of China, again, is the whole optical side and the whole fiber to the home, again the mandates that all residences, residential units will have that. We have large contracts with the providers in China. So that business is doing well.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. Last one just in wrapping up. As you meet with investors, is there anything that you see as misunderstood about Maxim or what you guys are working on in terms of the message of the Company going forward.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

No, I think it's interesting. I think people are still waiting. They see that Samsung is fine for this year. So that's good. They're starting to get confidence in the diversification of our mobility business, but I think they're looking for more proof points on that. And I think we're starting to show, and I think that's good. I don't think we get as much credit for as well as we're doing for industrial. It's 28%, 29% of our revenue. It's growing very strongly. So I think that's another big part of our business that if consumer is -- if mobility is 35%, there's another 65% of our business that's very profitable, growing, kicking off a lot of cash that we're returning to shareholders.

And I guess the final one is I think we've been committed and have over the long-term returned capital to shareholders in probably, in industry-leading fashion. And I don't think we've gotten -- I don't think people recognize the leadership we've had in that. I think they count that we've done well, but I think they see others as that's their primary strategy.

Craig Hettenbach - *Morgan Stanley - Analyst*

A lot more vocal too.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

A lot more vocal. So I think that's -- and again I think our -- Maxim is a relatively understated Company, but we'll just continue to deliver and I think people will recognize for us eventually.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. With that, we'll wrap up. We really appreciate your time, Bruce.

Bruce Kiddoo - *Maxim Integrated Products, Inc. - CFO*

Great. Thanks, everybody.
