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MXIM - Maxim Integrated Products Inc at Pacific Crest Global
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Mike McConnell *Pacific Crest - Analyst*

PRESENTATION

Mike McConnell - *Pacific Crest - Analyst*

Alright, good afternoon. My name is Mike McConnell. I'm the lead semiconductor analyst at Pacific Crest, for you -- for those of you that don't know me. Very pleased to have Maxim Integrated presenting this afternoon. Representing Maxim is Bruce Kiddoo, their Chief Financial Officer. So as usual, I'll start off with some Q&A. We always encourage audience participation. So feel free to ask questions and hopefully we can hit the key topics that you want to hear about.

So maybe we can start off, Bruce, high level, kind of, strategic comments on the Company. You've built kind of a strategy around integration and I think a lot of questions I usually get are what's the differentiation you can provide in competitive advantages through the strategy, and if there's any limitations also maybe touch on that but -- and can you extend the integration strategy, we've seen it's been so successful in mobile, to other areas of the business?

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

So I think people know, we really went towards integration and integration is about a couple of things. One, it is just providing system solutions and makes life easier for our customer, it increases time to market, it lowers their total cost or total BOMs or total space and power. All those things are kind of well known, and certainly in the digital side, companies have done it for a long time and the successful companies are those that have really focused on system solutions.

So I don't think that's a surprise. I think the idea of doing that in analog, which was always a component business, was something different when we kind of embarked on this about six, seven years ago. And so I think that was something new and that really differentiated us from others. I think it's a reason we have done as well as we have in mobility.

I think what is new and different right now is how much -- what we learned in mobility around integration and system solutions is playing out in other markets. We've done very well in automotive. It's now 10% of revenue. Last year, year-over-year, it grew 43%. A big part of that is kind of the technology that we've developed in mobility and many of the highly integrated products, applying those into the Infotainment side of mobility.

When we look at smart meters and industrial that's a combination of an integrated analog front end, plus a microcontroller. When we look at financial terminals and mobile payment systems, again, high integration of analog and a secure encrypted microcontroller. And so everywhere, we're able to go into a market and grab market share, in most cases that's because of sort of this integration system solution. So it's one which allowed us to do well in mobility. It's clearly allowing us to do well in non-mobility market.

So it is one of the reasons we continue to invest in mobility. A, we think it's a good market. It's high growth, it's very profitable for us. And B, what we learn there, we're able to apply in the non-mobility markets.

Mike McConnell - *Pacific Crest - Analyst*

So, then the markets we should think about in addition to mobility, you think where it's most applicable, automotive and smart meters?



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

Smart meters, financial terminals, medical, certainly if you think of -- especially as once you go to moving it out of the doctor's office a portable sonogram, EKG ultimately when you move it all the way to a wearable, you're going to see that as well. So I think medical is another big area. We've seen it actually in the car market. And as we're starting to do highly integrated kind of signal chain devices for base stations that started off in small cell. That's now -- we're getting design wins in the kind of the macro base stations as well.

So I think it's probably the only place it doesn't is maybe in somewhere like the core industrial. But even there control and automation and people working on small manufacturing cells, those are becoming more distributed and looking for more integrated solutions.

Mike McConnell - *Pacific Crest - Analyst*

And how much would that be roughly, total revenues, you think those adjacent markets you just discussed?

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

So, if we think today, our total integration is about just under 50% of our total revenue. It's still above 50%, 60% of that is in mobility, but the other kind of 40% or so is in the non-mobility side.

Mike McConnell - *Pacific Crest - Analyst*

So touching on mobile, it's been an area of controversy, not just for Maxim, but a lot of semiconductor companies. When you think about high-end smartphone saturation in developed markets where you generally participate in that area of the segment, what impact at all is this had on the franchise, and I guess how are you -- what's the strategy to maybe offset maybe unit growth beginning to flat-line a little bit here on that segment of the market?

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

Now, it's a good question. I think first just to make it very clear to everyone, our mobility business is actually a very good business, it's a profitable business. I think most people know, because they've seen it when it was a high percent of our business and we still had gross margins in the low 60s that our gross margins are below corporate average, but close. We get leverage on the R&D and OpEx side, so that op margins are very good, and this is the part of our business that we outsource. So from a cash flow generation, return on invested capital, this is a very good business. So this is something that we like. We just need to make sure it's part of a balanced portfolio, so that we can manage the cyclicity of this business.

To your question on high-end smartphones, clearly high-end smartphone growth is slowing down from where it was. That said, we're a Company that did very well really one customer, Samsung, selling one technology, power management. So even though units may be slowing down, there is a huge opportunity for us to gain share, whether that's selling to other customers. Obviously, today, in addition to Samsung, people want to -- you have to target Apple and you have to target China right? So those are the two other markets where I think we're making good progress from that point of view.

We've been focused on other technologies in addition to power. We've done very well in sensors, primarily optical sensors, and doing biosensors and roadmap for environmental sensors and you can think about really measuring all the elements in which we exist in. After sensors, audio will be the next opportunity, we've gained share, again, at one large account. We've been selling that into Samsung. It's an opportunity into China. And then after audio, we still have kind of MEMS opportunities. And last on the list would be touch.

So whether it's selling into new customers, whether it's selling new technologies or whether it's selling into new platforms, whether that's gaining share in tablets, like we have at a large customer in selling audio or whether that's selling into wearables, right. We have good content today in



pretty much all the wearables, whether it's the Samsung or the Garmin or the Jawbone or something like that, we have good business and expect to have business going forward in the wearable market.

Mike McConnell - *Pacific Crest - Analyst*

Any questions in the audience? So if we look at last quarter, there was an earning shortfall, guidance was more cautious than I think a lot of people anticipated. And, again, the culprit was Samsung. Second year that this has happened. I guess it is what it is, but when we think about the internal controls that that you're thinking about putting in place here, strategies to maybe prevent this from happening again, what can you kind of share to maybe try to reduce this from occurring again next year, I guess?

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

I think a couple of things. So the gross margin here from an inventory, we put -- I think we've always had good controls in place. I think we always erred on the side of making sure we met all of our customers' delivery requirements. I think in an environment where demand can shift so dramatically, we've cut back on those buffers and we've cut back on sort of the kind of building ahead from that point of view, and so I think that'll be very helpful from a gross margin and an inventory charge point of view.

Ultimately, there is a just better managing expectations. I mean Samsung used to be an account that grew strongly in June, grew strongly in September, and then had its inventory correction in December. I think we've all been conditioned with that product cycle. I think starting with S4 and continuing with -- and even more so with S5, they went to sort of the big bang announcement, where they distributed product globally and filled the channel on a global basis, such that you had a very strong June. And then even if the product is selling well, you may have a flat-to-down September. And so, I think part of that is just managing expectations and understanding that. But most important of all is what we've been working on, and that's broadening that revenue base. Again, our mobility business, Samsung, this is good business for us, but Samsung as a percent of revenue needs to come down, right? It was 27% two years ago. It was 20% in FY14 that just ended in June, and it's going to be 15% in the -- around 15% in the September quarter.

We have to sell into the other mobility customers, whether that's China, whether it's the other large consumer guy, and we have to continue to grow our other businesses, such that automotive up 43%, right, our industrial business up double-digits, the [comm] business with Volterra up 30% year-over-year. So we have to continue to manage the rest of our business, so that while our Samsung business is a good business, it's got to fit within a larger portfolio, so that we can manage any of the volatility around that and not sort of have these big cycles as far as revenue and earnings.

Mike McConnell - *Pacific Crest - Analyst*

With the buffer inventory comments and maybe being more prudent, when you're talking to Samsung, though, obviously it's in their interest to make sure you have the inventory, so they can pull it if they ever have upside, I'm sure, to their demand forecast. So how do you manage that in negotiations with them? Is that something that's easy or are you just going to do it, I guess?

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

Well, I think part of it is just we've had very high delivery performance to Samsung, and I think they're very pleased with that. Being better at managing that doesn't mean we have to sacrifice that delivery performance. I think we just erred too far on the side of having extra, because the idea was, it's okay if you build up extra on the launch, because over an 18-month cycle, you are going to sell it eventually. I think what's happened with their big-bang launch now and to the extent that demand doesn't end up as strong as they thought, you can actually build lifetime in the initial launch plus buffer. So I think that's just what you have to be more careful about.

Mike McConnell - Pacific Crest - Analyst

So you can cut back on your side, but still keep them happy?

Bruce Kiddoo - Maxim Integrated Products, Inc. - SVP & CFO

Yes.

Mike McConnell - Pacific Crest - Analyst

Any questions?

QUESTIONS AND ANSWERS

Unidentified Audience Member

(inaudible - microphone inaccessible)

Bruce Kiddoo - Maxim Integrated Products, Inc. - SVP & CFO

I mean I think there have been other companies that are certainly doing well and we all know content growth is increasing in automotive in a very significant way, certainly for analog. Where we've done well is in Infotainment, and if you think about that, that's power management. There's lots of processors that are sitting in a car today. It's just like you have in any consumer electronic device that require power management. So we've done well there.

If you think of video distribution through the car, we have a very good business in SerDes, which is -- initially it was just for like the rear-seat displays. Now there'll be at tablets, those aren't as required. That's just been replaced though with the cameras around, for there's the rear camera. It's the side blind-spot cameras. So within a car we can have \$35, \$40 worth of content just on SerDes. You put power management in there, USB ports. It's, again, classic great analog market. There's something -- some number, 60 million, 65 million USB ports going to be shipped this year in automobiles. That could grow to 100 million. You can get \$1 a port.

US interface has always been a strength for Maxim, all right. We have satellite tuners. We have DAB tuners for Europe, we have battery management systems for hybrids and electric vehicles. So we're very diverse within the auto market. It's the nice seven-year product life cycles. You add your design wins every year, it grows very strong in March and June, and then up a little bit in September and December. And a market that in the June quarter, it was [53%] up year-over-year. That's going to slow down, but not -- it's still going to be well above the market growth that you could estimate at -- I don't know -- 12% or 8% -- if you say 4% for automotive and 4% for content growth, say the market's growing 8% to 10%, we are gaining substantial share.

Unidentified Audience Member

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Bruce Kiddoo - Maxim Integrated Products, Inc. - SVP & CFO

I think we've always known we had from the beginning, if you remember innovate, integrate, balance, our very simple strategy for the last five years, right. So balance has always been an important part of that. I think we always knew there was a challenge, in that there was different organic



growth rates for the different parts of our businesses. If mobility did well, by definition it would grow as a percent of our total business and that is exactly what happened. So from that point of view, if you look at kind of the small acquisitions we did historically, they've all been on the industrial side, on the comm side.

And so I think we've -- I think I would say a few years back we probably didn't -- I think comm, we did -- we were kind of in line with the market. I think industrial we underperformed the market, so we probably didn't execute as well there. I think over the last couple of years, I think we've done very well in automotive. I think we've done well in industrial, we've kind of revitalized that business. We did the Volterra acquisition. The key question is, is how fast can we grow those other businesses and to be able to offset the mobility effect. And I do think as long as we can get kind of a broad revenue base within mobility and that has with accounts that are on different cycles, I think that will help tremendously as well.

So it's a big focus. We look at it organically. We will continue to look at acquisitions as well. The primary purpose for an acquisition of course would be to create value to drive synergies, fit with our strategy, but to the extent it helped on diversification as well and helped accelerate that that would be a plus also.

Unidentified Audience Member

(inaudible - microphone inaccessible)

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

So I think Volterra, we're very happy with. I think we knew those guys very early. I think it's the -- the story is their CTO, Tony Stratakos interviewed with Tunc Doluca, our CEO, back in -- I don't know -- 1990 or something like that when he was coming out of -- or 1999 somewhere, when he was just coming out of grad school and he is either going to work at Maxim or go to a startup. He decided to go do a startup called Volterra. So all those top guys have stayed. At Maxim, they have key roles and so I think -- from that point of view, I think we've done a good job with the Volterra team. I think, overall, we've done okay, keeping that talent -- I mean, like you say, I think that when you're buying smaller companies, it's easier to fit them into our culture. I think as you start shifting to larger acquisitions and maybe peer-to-peer, I think that cultural question will be a key part of that decision on whether to do that acquisition or not, because as you say, the value of what you're buying is those engineers, right?

The other factor is, as you have consolidation, there's less opportunities for those folks to go somewhere else. And so, from that point of view, it's sort of like who is the best company and having a 30-year analog engineer as your CEO certainly helps motivate engineers.

Mike McConnell - *Pacific Crest - Analyst*

Maybe we can touch a little bit about Apple, company talked a lot of -- [well you] touched on Apple as the incremental opportunity at the Analyst Day -- recent Analyst Day. That's been a place where you've had lower relative presence versus Samsung. So when you think about balancing out, as you talked about the peaks and troughs of the mobility cycle throughout the course of the year, where Samsung is kind of heavier or stronger in the first half of the year, [to pull] that transition to Apple in the back half of the year. What can you tell us about the incremental opportunity there and how that's progressing?

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

I think -- [so there's] been kind of well documented around some wins in tablets, right. I think we've indicated, we feel good about our technology there and how we continue to do well there on that side. I think our business in it's -- this has been an account that we've been in for a very long time. So our business is actually healthy, probably healthier than most people would think, certainly not a 10% customer. So we've never had to disclose that amount. We do think we continue to kind of make good progress there. We have talked about opportunities in new products, where we think we have the ability to grow our business further. And certainly -- so I think, overall, I think we feel good about the ability to kind of grow

our share there. It's an important customer, has been for a long time and I think this is just a matter of just kind of continuing along that execution path.

Mike McConnell - *Pacific Crest - Analyst*

So if I look at September quarter, I estimate, my calculations, not yours, but that Samsung is down about 30% sequentially in revenue. And then if we talk about some opportunities at Apple here potentially materializing over the next quarter or two, is it fair to say that you feel pretty confident that this quarter will be the bottom for the mobile business? Is that something that we can start to think about and kind of bank on as we think about the next six to nine months?

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

So I think with what we know today, I think that's a comfortable assumption. That said, we're not always good at forecasting mobility, as evidenced. So -- and sometimes -- so I think you have to take what we know today, even assuming Samsung has its normal inventory correction in the December quarter, which I think is a reasonable assumption, right, some people will say, oh, they're taking [or they're paying] now, but even last year when they had kind of a weak September, they still were down in December.

Mike McConnell - *Pacific Crest - Analyst*

And you grew, though, as a Company?

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

Right. And so, I think the ability to have other opportunities to offset that I think we feel -- what we know today that, yes, we should be able to kind of grow our mobility business going forward.

Mike McConnell - *Pacific Crest - Analyst*

I just look at the stock, so dividend yields hovering close to 4%. You've been great. You raised the dividend last quarter even after the difficulty at Samsung. Anything else we can think about in terms of increasing shareholder returns, just particularly given where the dividend yield is right now?

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

I think when we -- it's interesting, people say, oh, well you had maybe a bad quarter. First off, we had record revenue in the June quarter. I understand it was only 6% growth not 7%. I understand managing expectations and it's coming down in the September quarter. Obviously, we're still a very profitable company. We generate tremendous amount of cash. CapEx is coming down from the 5 to 7 to the 3 to 5, so that cash flow from ops will be over 30%. Free cash flow in the high 20s. So that decision on the dividend was, well, of course, it gets proper review and consideration, was reasonably straightforward. I mean that's the great thing about analog, all right, sort of the stability and the strength of the profits, even as you go through rough periods. So I think that's -- a rough period in analog is better than what most companies achieve. So that's nice.

As far as additional sort of capital allocation, we've indicated before, our buyback is on a matrix, it's a 10b5-1 matrix and certainly to the extent the stock prices come down, we buy more. And when the stock price goes up, we buy less. I mean it's a very straightforward process. We'll always look at it to see should we adjust the matrix to be more or less aggressive in our buyback and that's something we're always looking at, but is ultimately a Board decision.



Mike McConnell - *Pacific Crest - Analyst*

I think that's all we have time for. Thank you very much, Bruce.

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

Thanks Mike. Appreciate it. Thanks everybody.

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