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MXIM - Maxim Integrated Products Inc at Credit Suisse Technology Conference

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CORPORATE PARTICIPANTS

John Pitzer *Credit Suisse - Analyst*

Tunc Doluca *Maxim Integrated Products Inc. - CEO*

Bruce Kiddoo *Maxim Integrated Products Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Operator

Unidentified Speaker

PRESENTATION

John Pitzer - *Credit Suisse - Analyst*

I'd like to welcome everyone to this afternoon's session. My name is John Pitzer, I cover the semiconductor industry here at Credit Suisse. It's my pleasure this afternoon to introduce the management team of Maxim Integrated Products. To my immediate left is Tunc Doluca, who is the Chief Executive Officer of Maxim. Sitting to his left is Bruce Kiddoo, who many of you know the Chief Financial Officer. We've got a fireside chat format for the next 20 minutes or so.

We want to make this as interactive as possible, so if you have any burning questions please raise your hands, we'll get a mic to you. But with that, Tunc, maybe I'll start off with sort of the obligatory question at a fireside chat, and especially for people new to the story in the room. Can you spend a couple of minutes just kind of positioning the company, your core IP, the markets you address and kind of what your core strategy for growth and returns are?

Tunc Doluca - *Maxim Integrated Products Inc. - CEO*

Sure, I'd love to. So Maxim for any of you who have probably followed us for many years, we're in the semiconductor business, but more specifically on the analog and mixed signal side of it. This is about a \$45 billion business. As you know, our revenues are about slightly under \$2.5 billion. So we're a relatively small player in a relatively large market, so that gives us good growth potential for the Company. We pretty much have followed a very diversified market portfolio strategy throughout the year. So we got our hands in pretty much all of the basic analog segments that you can think of. So we have a piece of our business in the consumer, mostly on the mobility side and good presence in industrial, good presence in communications and data center, as well as a growing presence in the automotive market.

So roughly about 30% consumers, last quarter numbers, 28% industrial, I think in 25%, 26% comms and data center, and automotive is about 11%. So from a strategy standpoint, what we've pursued is a balanced business model where we're investing in segments of this market that have long product life cycles highly profitable, as well investing in segments that have greater growth potential because the product life cycles are shorter and that's the mobility on the consumer side. And a very important piece of the strategy is to really deliver solutions to customers of balance of building block products that are very high performance, but also have differentiated from many of our competitors deliver high integration products that really provide a solution to the customer in the smaller space and the lowest energy consumption possible, and that unique or differentiated strategy is really served us well.

That piece of the business, the piece that we call the high integration piece of the business has grown almost two-and-half-fold in the last five or six years and has really contributed to the growth of the company. So, I think in terms of an investment portfolio, we are pretty different from many of the other analog companies in our space.



John Pitzer - Credit Suisse - Analyst

Tunc, in 2011 and 2012, Maxim was the primary beneficiary of the smartphone phenomenon specifically levered to the big guy over in Korea, where you did a fantastic job gaining socket share in models that were gaining unit share in the marketplace. Starting kind of the second half of last year and for most of this year, it's been a real headwind to the business, not really because of any content losses on your part, it's just that the unit demand for that one customer just didn't materialize as well as people had hoped.

The primary question I get from investors on you guys is where are we in sort of that headwind cycle, is the worst behind us, has that part of the business finally bottomed, what kind of comfort level can you give us, or what's your view of that business that customer and where we are sort of their kind of growing pains, as we try to figure out their own handset strategy?

Tunc Doluca - Maxim Integrated Products Inc. - CEO

So you're absolutely right in stating history. It's we've --.

John Pitzer - Credit Suisse - Analyst

Really good at that.

Tunc Doluca - Maxim Integrated Products Inc. - CEO

Yes.

John Pitzer - Credit Suisse - Analyst

Predicting.

Tunc Doluca - Maxim Integrated Products Inc. - CEO

We did really well and we had a fantastic run in the smartphone, especially high-end smartphone boom. And in the last year and a half, it's turned into more of a headwind for the company. What we found is that we could continue to grow our content for flagship phone that they have and we've done that successfully over the past two generations. Where as you stated, they're selling fewer units, so that's clearly not helping us.

And it has been a headwind, so the way we're modeling and looking into the future is we really don't know what they have up their sleeve for next year's models in terms of experienced for the end consumer, but we do know where we're going to get content and our current thoughts are that we will continue to increase the content, but we also are not counting on a big bounce back in high-end smartphone sales from that largest customers. And we think those two kind of balance each other out. So that's why in the latest talks we had been investors, we basically said that headwind in most likelihood is this is it. And the mobility space, we actually do see opportunity for us to grow again, which is another question that I get all the time, because we've got new content and the other large supplier in tablets and also in the newest launch, which is expected to occur in the beginning of 2015.

And we also have longer term more revenue as we can get from some products we've actually been making for the China high end phone model. So just to summarize it, we think we believe that the Samsung headwinds are stabilizing and now there's opportunity for us to grow, but the other piece of information that's really important is that the rest of the business has done really well. And I think we keep talking about it in the company and we just got all four cylinders going at once. It's going to be fantastic, but we have not been -- we've been out of phase so far. But I think that it's kind of a summary of the way we see now. On top of this, if that large customer comes up with a product that's fantastic, that will be great.

John Pitzer - *Credit Suisse - Analyst*

So Tunc, how do you think that the long-term growth rate of mobility for maximum. Is it still in your mind a 10% grower and if it is it more now because of China or is it more because of the wearable market and then maybe you could talk a little bit more about the opportunity in wearables going forward?

Tunc Doluca - *Maxim Integrated Products Inc. - CEO*

The way we're investing in it we do expect to -- we do our planning on growing with the product investments that we're making. What the exact number is going to be we don't know, but we surely definitely wanted to grow at a faster rate than the -- business grows for sure and it's going to really come from the fact that we've been working for about a year and a half now trying to diversify the business so that we're not so concentrated on one customer. I would say that the headwinds that maximum face was really some people equate that to us being in the mobility market. It's really more because of us having a concentration issue in the mobility market.

I think that if we were able to make sure that revenue was coming from many products, many platforms, then many customers, I think we'd be having a lot of this discussion right now about the subject, but I think there is significant opportunity in wearables. How big that's going to be in my view is really going to be set by the new Apple products that are coming out. We really don't know the full extent of the product itself, but we will see how that goes in that respect. But we also see, in a related field, I see most of the products that are out there in the market are more fitness products, they're really not medical products. And I think that there is huge opportunity for suppliers like us that can make the whole system for medical applications -- true medical applications where people needed really to be healthy, to be fit.

So I think that's going to be a good growth area and we're fortunate enough to have invested in through mobility. Now, we have that technology to sell into a real medical type opportunity. And I think you asked also about the China growth. I think that's -- our investment there again is in the high end. We're really not -- we don't see the profitability goals met with going after the low end of the market. And we do see attraction to our power technologies and attraction to our newer boosted audio amplifiers and so on in that market as well. And our current business is not that much, so that's why it's a growth thing, because penetration is low.

John Pitzer - *Credit Suisse - Analyst*

I think we talked about this a little bit at dinner last night, but when -- I think the average investor thinks about wearables and sensing technologies going into wearables, they kind of think about accelerometers, something you can monetize very easily. Maybe you can talk a little bit about what you think your dollar content could look like in a wearable relative to what it has been in the high-end smartphone. I guess more importantly, when you look at your IP portfolio of sensing technology, what applications are coming down the pipeline that will continue to kind of push the envelope and prevent that part of the market from being commoditized?

Tunc Doluca - *Maxim Integrated Products Inc. - CEO*

Okay. So, hopefully I'll remember all the questions you asked in there. So, first piece was about wearable content, and that really depends a lot on what the wearable class of product it is. I mean, if it's a real simple step counter, there really is not a lot (inaudible) in there. I'd say it's less than a dollar. But if you're looking at more complex product. It can measure your -- measure environmental things or measure your heart rate your blood oxygen level. In the future maybe we'll figure out how to measure blood glucose. I mean there's many things that have not been concrete yet.

It really increases and I can see in those really high-end applications, the analog content could be you know as high as it is in the smartphone. But it's -- some of those have not been -- the problems have not been solved, which is something that we're good at doing. But we can see in some of those products as low as a dollar, but some of them it is as high as we get in a high-end smartphone as a company. So, the piece there -- the form is we kind of know what that dollar content is. We don't know what they multiplied with right now.

And our investments are, I would say kind of cautious taking what we do for smartphones, where you can justify the volume and the investment and repurchasing those products into wearable space. That's kind of the strategy that we have been following.

John Pitzer - *Credit Suisse - Analyst*

From a competitive perspective, is there anybody out there from your perspective that has the breadth of IP to tackle this market? Who do you see most frequently in the marketplace?

Tunc Doluca - *Maxim Integrated Products Inc. - CEO*

Well, on the power management side, I mean if you just making power management products the count is not all analog companies can do them. But there are companies that are well-known names that know how to do it. And some of them even have the capability to integrate a lot of these functions, but not that many. I mean it's not even -- not even you count it in one hands fingers. But it is much less. When you go and think about sensors that can be made even fewer. So, that's one of our criteria that we see. Other people can make this product and try to get into ones where there are not that many suppliers that can.

So when you talk about high integration products, high level of requirements for sensors process technologies that are unique. When you put all these barriers up, we find that it's a very short list and obviously, I don't want to name the name. It's not a long list like people might guess and we're one of the companies that unique to as you stated this broad portfolio that can make these products. And some of these problems are real tough engineering problems to solve. And we talked about some of those at dinner.

John Pitzer - *Credit Suisse - Analyst*

Tunc, you mentioned it earlier that kind of a headwind in the consumer part of the business of kind of math some pretty good and the rest of the business portfolio. Maybe you can walk through and talk a little bit about the industrial, the automotive side of the business? What are the core drivers and again if you could kind of help us think about what you think the long-term growth rate is going to be in those businesses would be helpful?

Tunc Doluca - *Maxim Integrated Products Inc. - CEO*

Yes, so I think the best is to break it down, because I think just talking about it in the non-consumer finance is probably not fair. If you look at that market, and I'll start with the one that we've had the best success recently, in automotive we decided to get into this business 10 years ago. So it's not a business you build overnight, it takes a long time, and we've been investing in it for all those years. The good news is that once you gotten into sockets you're in there for seven or eight years. That's great. What we're seeing is, Bruce mentioned it before, we got 40 plus percent growth year-over-year last year.

Next year we'll -- and 2015 will probably be not that high, but definitely in the double-digits growth for us. And what is driving that growth, I think that was part of your question. It really is, if you look at the number of cars sold, it's only grown at 4% or so. It's not much more than GDP. But the content in cars is growing at a much faster rate. And if you look at the high-performance piece of that content it's growing even faster. So we're playing in the space that's, I'd call driver assistance electronics, infotainment and connectivity electronics, those pieces are the ones that we're seeing the most level of interest and what Maxim can deliver.

And that's mainly because of this content increase and the fact that the space you got to put all this electronics is limited, the customer is looking for high integration products. And they do need the technology that we can provide so that they can make a PC board that's got fewer components on it and that gives them better reliability. So that piece of the business I think is going to continue to grow. In other words, once you're on the slope, that slope just doesn't die in a year. If you look at -- and we really expanded the number of customers. In 2007, we showed that we only had a few customers, and now we've got pretty much the who's who in tier ones and automotive, and we've expanded the technologies we sell to.



We basically set a lot of power management products, supervisory products back then. Today we sell Keyless Go, we sell video distribution in a car, power, lots of receivers for RF and so on. So that will be the good growth area for years to come for the Company. In Industrial we really have two segments that we invest in, one of them we call catalog products or core products, which go to many customers and mostly through distribution. In that business, we believe we can grow at a faster rate than the overall analog growth and the reason for that is that we really have a product line that's under sold.

We've lost distribution market share for years in the 2000 decade and in 2008 and 2009, we changed our strategies to really work much more closely with our distribution partners to help them win designs, and as a result of that we're seeing that our declining share and distribution reverse trend and began to grow in the right direction to the upper right and that's helped us tremendously. So encouraged by that we actually we started the business unit, whose sole function is to sell the Maxim product line, help the distributors to sell our products more effectively. And we did something I thought was really smart which is we didn't give them any R&D resources. All they can do is sell what they have and when you're that constraint you get a lot better at it than if you do with the BU that has R&D resources.

So I think the core industrial will grow well above industry because of the tailwind. And then we have our vertical industrials that we invest in as well, things like utility meters and financial terminals, medical products in that field. So those are a little bit more rapid product cycles. But I tell you, those are markets that really value high integration because they really want a total solution from you and that's why we're successful in those. Comps and data centers, we have essentially decided to invest in three areas, power management for either wire or wireless communications and we've also invested in optical mainly for data center applications because the amount of communication is needed within the data center is just exploding.

And the only efficient way to get that across the distances and the datacenter is optical. So we're investing in those and then in RF, small base stations, we've invested in. Fortunately, that has not really completely taken off yet, but it's going to because that's the market forces are going in that direction. And in macro or traditional base stations, we're investing heavily in new ways of doing the RF. Just leave it at that and I think what we're finding was the Volterra -- when we did the Volterra acquisition, we kind of knew there would be some headwinds because of a notebook and the enterprise customers. We thought that we could sell the product line a lot more effectively to the cloud customers, and that's turning out to be the case.

Because they pay for electricity throughout the life, they really watch carefully what your efficiencies are, how small you can make the product and so on. So all the great advantages of that technologies has really caught the attention of the cloud customers, which is an upside that we're kind of guessing at, that's kind of getting validated now which is good to see.

John Pitzer - Credit Suisse - Analyst

Maybe switching gears here to the business model, hard to poke holes on your absolute profitability. I mean you're still running a 60% gross margin business, north of 20% op margins, but if you look at kind of the longer-term targets you have for the business, you're now sitting kind of at the lower end of that and understandable given some of the revenue headwinds in the consumer space, but you are now taking some initiatives that you're not just waiting for revenue growth to come back to actually improve the profitability of the business.

Can you walk through some of the initiatives that you've announced and talked about to try to move the margins closer to the higher end of your targeted range?

Tunc Doluca - Maxim Integrated Products Inc. - CEO

Sure. Our gross margin target is kind of the low 60s. We've said 61% to 64%. And we've always had a 30% off margin target. We got there in 2011, we hadn't been there subsequently. I think we've been doing well, maintaining kind of Opex flat, and kind of holding gross margin, and we thought we'd sort of grow into the 30% off margin. Because of the headwinds from Samsung, we haven't been able to grow into that. So therefore, the commitment to the profitability, we announced some restructurings in our last earnings conference call. It's about \$20 million per quarter. About

half of that was from gross margin by shutting down kind of a small fab in San Jose, and the other half of was in operating expenses and reducing those expenses by the June quarter.

So I think the way we think about it is first off, we wanted to improve profitability at any revenue level. So we wanted to make sure that we're kind of increasing profitability no matter what happens from a revenue point of view. And to the extent that we get some sort of revenue, and I think where we kind of point people towards, if you look at last June, we were at \$642 million in revenue and about 25% off margin. If you look at the \$20 million in restructuring, we've discussed that gets you about three points in that quarter.

We had inventory reserve charge that was above normal that was about a point impact. So, there you can get to about 29%. You probably need a little bit more revenue growth to get there. The flip side is we know all the fab closure won't happen all buybacks that timeframe. So I think the method is we're committed to that profitability target, we're taking kind of proactive actions to get there. It'll be a combination of revenue growth and spending management and depending on how those levers move it depends on what actions we take, but I think it comes in obviously we're strongly focused on.

I think the other thing that's important too is we talk about profitability from a P&L, certainly if you think about it from like a cash flow or free cash flow margins, if you look at our trailing 12 months were 27% free cash flow as a percent of revenue, we have the benefit that CapEx is coming down, which helps us in two ways obviously from a free cash flow, but depreciation is now running at about \$40 million a quarter, CapEx at \$20 million a quarter, certainly that provides leverage on sort of the EBITDA margin and it also eventually provide a tailwind from a gross margin point of view. So continuing to manage kind of the P and L profitability and we're seeing very strong profitability on the balance sheet and cash flow.

QUESTIONS AND ANSWERS

John Pitzer - *Credit Suisse - Analyst*

Any questions in the audience?

Unidentified Speaker

Yes. Tunc, you mentioned earlier that you view the business almost like a Portfolio Manager and I'm just curious the experience that the over concentration in consumer particularly with Samsung going forward from here, I'm just wondering what you learn from that experience and how that leads into your thinking about not only concentration or lack thereof and then marks from here and also how you prioritize investments across the businesses, if you could site some metrics that would be helpful? How do you manage that portfolio going forward in that mix?

Tunc Doluca - *Maxim Integrated Products Inc. - CEO*

So, I mean essentially what do we learn from the experience. Well, I think, when it was greater was great. It was a good tailwind for the company and we've made a lot of profits and we distribute a lot of that to investors. So I think it worked out well for us. But what we try to do now is just to see if we can really take the R&D spending we're going to put in mobility and how do we really distribute it, so that we have products and multiple customers and multiple markets. The question you had about how do we do the portfolio management, we kind of look at the size of the markets in each space and each of the major markets we talked about and at a high level kind of allocate where the R&D dollars should go.

And then within those markets we look at what's the return on R&D investment we're going to get for each product line. We've got -- the company has about 35 or so product lines that we invested within the five markets that we talked about. And then we look at within those what's the return on R&D investment going to be like, how crowded in the space looking at from a supplier standpoint and how narrow with the space from a customer standpoint.



So, it's not really an easy formula where we look at that annually, say what do we do and then mid-year we look at a course correction if we need one. We've made some mistakes in our decisions and of course mid-year. And there is a certain level of return on investment that we expect otherwise then we start shifting from one market to another, which we've done also in the past. Hopefully, I was able to explain. We have a breakout session so we can talk a little bit more about.

John Pitzer - *Credit Suisse - Analyst*

With that we've ended the session here, but as Tunc pointed out there is a breakout session. I want to thank both Tunc and Bruce for spending time with us today and everyone for joining us. Thank you.

Tunc Doluca - *Maxim Integrated Products Inc. - CEO*

Thanks John.

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