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EDITED TRANSCRIPT

MXIM - Maxim Integrated Products Inc at Barclays Global Tech Conference

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PRESENTATION

Blayne Curtis - *Barclays - Analyst*

All right, we'll go ahead and get started. Thanks for joining. Next up is Maxim Integrated Products, we have Bruce Kiddoo, the CFO. Thanks for joining Bruce.

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

Thanks Blayne.

Blayne Curtis - *Barclays - Analyst*

Wanted start out, I think, on the mobile business. It's been a blessing and curse, you've had a couple of patches to navigate through. I guess the blessing now is that it's a smaller portion. When you look at that business over the last couple of years what went right, what went wrong and then as you look forward, what are you most hopeful?

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

Obviously, a lot of stuff went very right. We had growing content and a customer that was growing share in a very fast growing market. So we were successful, we made a lot of money. We gave that back to shareholders very aggressively, returned 92% of free cash to shareholders. Of course, as we all know, when somebody gets over 20% that customer concentration, that always becomes a risk. As you said, painfully that's now down to 13% and so we think we've kind of worked through a lot of that pain.

I think the post-mortem would be, when you're doing that well right is to take that profit and force yourself to continue to invest in the other customers, other platforms, other technologies. I think we did that to an extent. We made some -- certainly from a technology, our investment in sensors, I think, has clearly paid off for us. We're starting to get into other platforms. We probably weren't as aggressive as we should have been with say the other large competitors or OEMs in that space. That's said, we're now growing at the other large OEM, we're growing our China business, we're in other technologies besides power, specifically audio is doing well, optical sensors are doing well. And we're in other platforms, tablets, wearables. So, I think that business is now becoming much broader and the risk profile is coming down.

Blayne Curtis - *Barclays - Analyst*

The one OEM that had a struggle this year, I think part of it was because some of the Chinese OEMs took share, which obviously is an opportunity. Talking about that diversification, if we look back few years from now, where do you see the diversification of your business versus where you had the one Korean customer be the vast majority for a while?

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

So certainly, China is an opportunity. It's a small business for us today. It's growing, probably growing a little bit slower than we initially expected, simply because there's multiple OEMs there, they all have more SKUs then say Samsung or Apple. So we're winning those businesses, but it does take time to build it up. So it's growing, but it's still small. So, I think it will add incremental growth in calendar 2015. Certainly our opportunity to grow at the other large OEM probably provides more leverage for us near-term, but as we know, we want to continue to be have that broad-based. It wasn't that in the past, we weren't, we did invest in other companies whether back in 2008, it was Nokia and then it was RIM and then HTC, figuring out which one is going to be the winner is always the challenge. We'll see in five years we're China is at.

Blayne Curtis - *Barclays - Analyst*

When you look at the product portfolio, your initial wins were PMICs for basebands and APs, system PMIC which has been a good cornerstone of that business. How defensible is the system PMIC? And then the recent addition was heart rate sensor where do you see the -- in terms of adoption of heart rate sensors I think wearables maybe a better fit. Do you see that thing in cell phones and where do you see your biggest opportunities to increase your content in terms both products?

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

So, first on power management, that's been one of our core strengths. We first got that design win in a 3G phone in January 2008, we started shipping that. That's kind of that system PMIC, system power capability has been in every phone in since then. So, it has been very sticky from that point of view. When we look at where we're doing well in China, it is again in the power management. I think we had to make sure, when we say system PMIC, in our world, we're doing power management for everything, but the digital chipsets, but there's also other -- our classic integration story where you got the battery charger in there, you got the fuel gauge in there, you have the USB port controller in there, you have some display drivers in there. So, it's really a way of just wrapping up all these discrete analog components, putting them into a single chip, the classic reasons why lower space, lower cost, lower power.

In a market that is cost competitive in China, that's what we're winning with, that's what we're leading with. So I think what we call the system PMIC today is really it's just integrated analog. I think that's something that we do well. People really haven't caught up with that and so I think that will continue to be a very stable and differentiated source of business for us.

The other area, obviously from a sensor point of view is the optical sensors, as you mentioned. We started off and we have a heart rate monitor technology that's clearly in a phone today. It can also do things like blood oxygen level in Note 4, it also does UV detection and measurement. I think you're going to see a very steady roadmap of new capabilities in the optical sensor or environmental sensors and you can just -- you know what we're doing today, but you can just imagine some big problems, cuffless blood pressure, core body temperature, chemical monitoring in the air, blood alcohol, there's a whole list. None of these are all solved and whether people want all these things, but if you look at from how do people differentiate and innovate, some of those might be on phones, some of them will most definitely be on wearables.

So I think that's the big -- it's still sort of being defined that marketplace. What do people want, what does the ecosystem look like around it? But it's clearly going to be ultimately, let's go up fast forward five years, a very large market. It's going to evolve from the fitness to something much more medical and that we'll all have and our doctors will require us to wear to the extent that we have some conditions.

Blayne Curtis - *Barclays - Analyst*

Just finishing on mobile, the Korean customer had a tough year. They also have (inaudible), I think maybe the worst is behind you. Do you think this business can grow from here? And as you look out to next year, across your product portfolio of the power PMIC, the heart rate sensor, optical sensors, (inaudible) sensors, audio, what categories are you most hopeful about growing next year?

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

If you look at our largest customer and you just look at sort of their annual seasonality. Obviously December quarter's the low point. So, just off of their normal seasonality, they come back to normal order patterns in March. June they launched their new phone. So, you're going to get the normal seasonal growth out of that business. I think we feel good about our content opportunities in the next-generation phone that we should be able to maintain or grow that content. I think the critical question though is really year-over-year unit demand for those high-end phones, what does that look like?

We're not expecting any strong snap back and we don't have a unique insight into that. But even if you say just off of a trend line it continues to decline somewhat. Our unit content growing should help to neutralize that and stabilize that business or find a trough as we've talk about. Clearly the fact that the unit content is increasing talks to we maintain our power business, we continue to do well in the optical sensors and we continue to the extent that we have audio now, our boosted amplifier in the Note 4. That would be an opportunity going forward.

So, I think in all the areas that we're investing and have been winning at other accounts, we should be able to have the opportunity to do well at Samsung. And then the good news of course is that piece of the business we think we can grow in China, we can grow at the other large OEM, and that 30% -- 70% of our business is automotive, that will get to all of that, that grew 40% last year. Industrial grew 8% to 10% last year. Comm and data center organically grew like 8% last year. So, all of those businesses, so if Samsung just becomes steady, the rest the consumer grows, the rest of our businesses grow, commitment to profitability. I think this is -- we can get back in delivering significant value to our shareholders.

Blayne Curtis - *Barclays - Analyst*

I just want to ask about the other segments. Maybe as a whole, you saw some correction where maybe a little earlier in your industrial business and maybe others in terms -- there was a turn here through going in earnings that there was a bigger correction going on. I think display looks not to be the case, but just curious your views of the health of the overall market and as you look I think the industrial and auto, is it seasonal or you seeing any more accentuated corrections? What would seasonality looks like as we go into Q1?

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

I think to the extent that there's markets that are correlated to have real seasonality, I think we're seeing normal seasonality. I would say the industrial is normally down in the December quarter, it's going to be down in the December quarter. Automotive is actually -- we're thinking that going to be slightly up in the quarter, that's a little bit better than seasonality. Comm and data center is much more about investment cycles and seasonality, and right now we've guided our comm business down in the quarter, and that's just some weakness in China. I think is what consistent pause in infrastructure spending there this quarter. So, there are some softness there.

When you look at the calendar 2015 -- and I do think our seasonality is going to change. I think people used to always think -- our seasonality really was our strong two quarters were June and September. You always had the start of the ramp for Samsung and then the follow-through in the September quarter. I think what you've seen now with our business, Samsung now does more of a -- and has pulled in their ramp and has gone global. So, it's much bigger in March and very large in June and then actually I think September, you'll start to see that to be seasonally down after the channel fill. And then within automotive now 11% of revenue, very strong in March, very strong in June. Industrial is always up in March and June. So, I think you're going to see our seasonality shift from June-September to more of a March-June strength.

Blayne Curtis - *Barclays - Analyst*

Everyone asked you about autos and you did break that out at your Analyst Day and had quite strong growth over the last few years. You've been strong in infotainment, curious what you see as opportunities continuing in infotainment and then where are other areas of Maxim that's been on?

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

So, when I join the company, it was like 2% of sales. It's been growing at an accelerated rate, now about 11% of sales, grew over 40% last year. It's been primarily in infotainment, power management, there is a lot of processors in a car today. They still require power management, USB ports, lighting, high-brightness LED lighting. We have a satellite tuner business, a European tuner business. So it's been primarily infotainment. I think from a growth point of view, when you start moving into ADAS, driver assisted security, the kind of video distribution, we have a very nice business and the actual distribution of the feed from the cameras to the processor and central display, that's a business that can be $30 a car.

So, that can be a material business and one which is we have a good share in and has been growing for us. We also have a battery management system, hybrids, EVs, that's one that's been out there. We have the design wins, whenever you get under the hood, it just takes time, you get a design wins and then you go wait a couple of years and then eventually that will ramp and then the end market itself, hasn't been as strong. So, I would say it's still infotainment with power being the leader, ADAS with video distribution and then some opportunities with battery management.

Blayne Curtis - *Barclays - Analyst*

(inaudible) but I think if I got it right, you've articulated that you've done acquisitions. You typically do a bigger one every few years and do a lot of tuck-ins. Broadcom had their Analyst Day yesterday and you came from Broadcom, they are one of the most prolific acquirers and now they say maybe we want to do as much. How would you grade yourself on your acquisitions since you've been at Maxim? Is it still part of your strategy?

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

I think we've done okay. I think over the -- the most recent one was Volterra, which I actually think is going to turn out much better than most people think. I mean there was the near-term -- they had a business in enterprise servers with US firms that have struggled. So, that business near-term has been a little weaker than we thought, but their ability to sell their power management solutions into the cloud providers, the people who build the Facebook, Amazon, Googles who build their own hardware for their data centers, they care about the cost of running that data center and the power cost and energy cost. So, I think that one has done well.

Our entrance into smart meters came through the Teridian acquisition. Our entrance into the mobile payments system came from the Innova Card and asset sale from Dialog. So, a lot of these growth markets that we're in, some of the fiber optic business came from Phyworks. So, I think in general, we've done well, there's clearly been some that we bought that haven't done as well. There was one that we sold off, we divested from that point of view, but I think overall it's -- I think the tuck-ins are harder. We all know the dynamics in our business, the number of VC funded firms, privately funded firms are fewer. So, that ability to go off what's that Broadcom model of buy all of the pre-IPO companies that's getting harder to find.

And as growth slows down, these small public companies are finding it harder to fund growth. That's what we've seen in our business. We've seen a consolidation of these smaller companies. When we think of Maxim, we have the scale to be successful, we're profitable, we're stable, we don't need to do acquisitions. If a great asset comes on the market that fits within our strategy and we can make money, deliver value, that's something we'll look at.

Blayne Curtis - *Barclays - Analyst*

When you look at your overall business, there is a focus on mobile. I'm guilty that I asked you about it first, it's only a portion of your business. What are investors missing when they look at -- when you look at your overall portfolio in terms of either product lines or capabilities or opportunities, what areas are you excited about that maybe people aren't spending their time with?

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

Everybody focuses on the volatility and the headwind of our largest customer and that's appropriate. That has driven some volatility in our results. I think most people understand -- we've done so well in the rest of our -- it's always good to say ex bad stuff, but tech ex-Samsung, this is a business that has grown 10% or 11% in the September quarter year-over-year. It's a business where even with that headwind, trailing 12-month free cash flow has grown 11% year-over-year. We have a free cash flow margin of 27%. So, this is a Company even when the topline has not grown as we would've liked, we're still very profitable, we generate significant cash and we've returned that to shareholders.

I would say the other piece that I don't think -- well, if you look at you and your peers, I think we've made the commitment to improving profitability at any revenue level. We have a stated target of 30% op margin. We will find a way to get to that number. I think we believe that's an appropriate level of profitability for the type of business we're in. So, we've said what the levers are, we needed a little bit of revenue help, we thought we could keep the spending flat. The revenue hasn't helped, therefore we've cut spending. So, that commitment to getting to that -- so I think that's another under-appreciated part. But that's fine, it's tough for us to go execute and that's what we're focused everyday on doing.

Blayne Curtis - *Barclays - Analyst*

I was going to ask you about that in terms of your view of the 30% op margin target and I think going into this year, you would've expected to be a little bit better. You rationalized the development fab and when you look out -- if 2015 just declines again for some unforeseen reason, would you -- when you see your trend of that 30% op margin, if the revenue doesn't deliver, would you look at other ways to get to that target?

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

I think we'll continuously look at the levers that we have, but if revenue has stayed -- let's just say, we guided a mid-point of $560 million this quarter, revenue stayed at $560 million, then we'd have to look at what's the appropriate expense level is that supports the business. We don't think revenue is going to stay at that level, but again I think we've shown -- we're very pragmatic that to the extent things don't happen at the pace that we would like, we'll manage the other levers. So again, that commitment to profitability, because we all know, this is about return on capital. You can grow the topline, you can increase P&L profitability, you can increase the efficiency of the balance sheet, we need to do all three of those things to show increasing return of capital.

Obviously, industry growth rates are slowing, driving that leverage within the P&L. And then taking CapEx, the huge move for us this year is taking CapEx from 5% to 7% of revenue down to 3% to 5% and we've even said we'll be in the lower half of that 3% to 5% this year. That's a significant benefit and it's permanent, it's structural, it's not going to -- isn't just like a light year from CapEx. This is structurally, we're moving more to an outsourced model, shutting down the development fab, all of that just reduced CapEx going forward.

Blayne Curtis - *Barclays - Analyst*

One area that you've been very good about is the returning of capital -- giving a hard time of 30% op margin, you still have a pretty good op margin. You have returned that cash, how do you look at versus -- you have a very strong dividend, you've done M&A, how do you prioritize dividend growth, buybacks, M&A in terms of your use of cash?

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

I think dividend's going to follow free cash. We look at our dividend as a pay-out of free cash to the extent that we are able to continue growing free cash flow, which certainly even in a difficult year, free cash flow increased 11% year-over-year on trailing-12. So, I think obviously it's something that the Board approves, but to the extent that our free cash flow continues to grow, we would return some of that through increasing dividends.

I think the tradeoff between buyback and acquisitions, over the long-term if you've looked at us, even where we've done acquisitions, our buyback has equaled our dividend, but the buyback as you would expect is more opportunistic in that -- we're a big profitable company, we have confidence in our business. When cyclical issues impact the stock price, we know our business is solid, we'll go off and buy our stock. So, from that point view, we'll continue to do that. To the extent an acquisition comes up -- and Volterra is a great example and we thought that was a high-quality asset, we bought it, we were actually doing a higher level of buyback. We brought just back to our historical levels and used that to refresh our balance sheet after the Volterra deal. So, I think that's sort of the dynamic you'll see.

Blayne Curtis - *Barclays - Analyst*

I wanted to ask you just finally the profitability of your business that when you look at gross margin, obviously a part of it's utilization and if you have better sales that will help. Other than that, what are the moving pieces going into next year in terms of product mix or do you have any other levers in terms of cost?

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

The biggest one is shutting down the fab. We've said that's $10 million, so that's a 0.5% of gross margin right there. Now, that's probably going to be more in the back half of calendar 2015. It takes some time to transfer all of those processes to either our other fabs or foundry partners. So, you may get a very small benefit in the June quarter, but really you'll start seeing that in September and December of next year. So, that's a big issue, that's a 0.5%. We've been running at a higher inventory reserve level certainly in June quarter that cost us about a point. We've made very significant changes, we'll get that back. And then of course, as you said, to the extent the revenue grows, utilization improves, that's the biggest lever.

Mix is not a big issue for Maxim. Structurally, if you look at our mix of business of our businesses or sort of a cross-eye, there's -- we're about 40% industrial auto, those are good margin businesses. 26% comm and data centers, close to corporate average and then 30% consumer which is just a little bit below corporate average. So, they're all kind of in a reasonable range and that generally isn't what drives long-term gross margin changes.

Blayne Curtis - *Barclays - Analyst*

And as final question, I do want to ask the thing that accounts disruptive trends effect, just from your perspective (inaudible) what disruptive trends do you see and how is Maxim (inaudible)?

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

I do think and if you look some of the things that are going on right now, certainly automotive and the (inaudible) thing. I think that's going to completely -- we started with infotainment and then you're going to go from a safety and driver assist, I think that will be huge. I do think -- let's just look at a five year horizon, I think wearables will be very large. I'm not -- yes, there's the step counters and those that's not -- when I think about sort of wearable medical type devices, that will be across the board. I think that will be big and then it's more of a theme big than an actionable market, but this whole idea of Internet of things is if you put in there, if you put medical wearable in there, right, you put mobile payment terminals, which we have a leadership position in.

So, I think all of that movement towards mobile devices, connected devices we have the analog, we have the power management, we have the embedded MCU, we have three of the four pieces that are required, the sensors to be successful in that. So, that will be a great opportunity for us.

Blayne Curtis - *Barclays - Analyst*

With that, the clock's winding down, I appreciate the time Bruce, thank you.

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

Thank you I appreciate it.
