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MXIM - Maxim Integrated Products Inc at JPMorgan Tech Forum at CES Conference

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PRESENTATION

Harlan Sur *- JPMorgan - Analyst*

Okay, why do we go ahead and get started. I'm very pleased to have Bruce Kiddoo, who is the Chief Financial Officer at Maxim Integrated here with us today. What I have asked Bruce to do is to give us a brief overview of what the team at Maxim is showcasing here at CES, and then we will dive right into the Q&A.

Bruce, thank you for joining us today, and let me go ahead and turn it over to you.

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

Okay. Thank you. Thank you all. I think CES, when you think about that, for Maxim, probably the primary focus area this year is going to be in automotive. I think that's an area which -- it is interesting how CES has evolved over the years, and certainly how it has evolved over for Maxim where today computing is about 5% of our business, right, and is not a focus area for us.

But the investments that we've made in consumer products, consumer technology is what has allowed us to do very well in the automotive space because automotive is an interesting combination of consumer technology within automotive quality. And this is a business we have been in for 10 years, and so it's not just a business that you can just enter into.

It's also a very nice business in that once you win you get that seven-year product life cycle. And what's been happening for Maxim has been every year we win new designs. We have very nice growth in the first half of the year in the March and June quarter as those new design wins go into production within automotive. Then you sustain that in the back half of the year such that automotive has actually grown 40% year over year over the most recent quarters; it's now 11% of our business.

So when we think about some of the products that we will be demoing in -- and just to be fair, we don't actually have a booth on the floor, but, obviously, our business unit GMs and engineers are here and what they are demoing to customers. Certainly, if you look at the areas where we have strong technologies -- as you would expect, power management -- there are a lot of devices and functionality in cars today that require power management.

We have a very strong business in video distribution throughout the car. This initially started from an infotainment point of view, and this is really as you take it from a camera to a processor or to a display. We do that. The SerDes technology, this is an area where you can get $30 to $40 a car in content, which is very significant for a Company like Maxim where, in general, we have $0.75 to $1 ASPs.

Harlan Sur *- JPMorgan - Analyst*

Right.

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

So the SerDes technology is one that, as you go from infotainment to safety in the ADAS market, has been very positive for us. We obviously have other technologies around lighting, USB ports. We are also demonstrating our Keyless Go technology, which is the smart key fob. Very low frequency technology, very low power. Again, an opportunity for us to gain share.

But, in summary, when you think of our automotive business, it is actually very broad based in the products that we offer and to the customers that we sell into such that it's been a very stable, very fast-growing business for us with good visibility.

QUESTIONS AND ANSWERS

Harlan Sur - *JPMorgan - Analyst*

Great. That's a good way to start off. Automotive, it's 11% of your revenues in the most recent quarter. It's been an extremely -- it's been a great bright spot for Maxim. This segment grew 43% year over year in the September quarter. You just talked about some of the design win pipelines.

Talk about the customer base. Talk about the potential expansion of the customer base. And what is your growth expectations for this year and next, and how do you see content trending over the next few years?

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

We basically started with our strength was in Europe. We would sell into the Tier 1 suppliers, the Continental, the Bosch, Harmon. And Europe, selling into the high-end luxury, whether that's Mercedes or Audi. We then moved over into Asia and have done well in Japan on the -- primarily on RF and tuners, and then have actually started to gain momentum in Korea.

We are a qualified supplier into DENSO. And so from that point of view, it's done -- probably the best growth we're going to get is we will have steady growth out of Europe, good new growth opportunities out of Asia. And then our smallest market today is the US; it's an area where we are focused on. But I think as most people know, to the extent you focus on that today that's a revenue opportunity three years from now from the US point of view.

But I think as far as that steady roadmap of growth long term, the US should provide that to us longer term, with Europe happening today and Asia coming soon.

Harlan Sur - *JPMorgan - Analyst*

Your business has been trending, like I said, growing 40% year over year. Obviously, that's not sustainable, but you have a great pipeline. If I take a snapshot looking out over the next 12 to 24 months, where do you think that growth trajectory can move towards? What is the steady-state, year-over-year growth you think the business can trend towards?

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

It's actually interesting, because we have done so well and we have struggled to figure out what is the inherent growth rate of the business. We know units and automotive grow 4% or 5% a year. We know semiconductor content has probably been growing at about 4% or 5% a year, so you get to a 10% growth rate.

When you look at -- and you say, let's just look at the analog semi content within automotive -- because if you think about what's happening in automotive, it is about sensors. It is about the interface of the real world, which is analog, and then converting that to digital and processing it and using that to help the user experience in the car.

So when we look at analog growth, we see that current market estimates are maybe around 15%, 20% for the analog semi content growth in cars. We're at 40%, so I would expect over time, two, three years, that will probably come down to that 20% level. It's certainly not going to go overnight from that range. But, again, I don't think you can continue to grow a business that's now 11% of revenue, a $250 million business, at 40%. So I think it will come down, but I think it will come down gradually over the next couple of years and get to the -- come down close to the market rate.

Harlan Sur - *JPMorgan - Analyst*

Got it, okay. Then maybe switching gears for second. So here at the beginning of the new year, give us your view on -- you talked about automotive, but give us your view on what is going to be the drivers of your business in calendar year 2015? What of your end markets -- consumer, industrial, common data center, you talked about automotive -- do you expect the fastest growth rates? And maybe which of those segments do you expect potential challenges?

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

Sure. Well, clearly automotive is at something between 20% and 40% is going to be the fastest growing market for us. That's clear. If you go down, I do believe industrial has the ability to grow at probably this high single-digits to low double-digits growth rate.

There is the core industrial. And industrial for us is about 28% in the last quarter, 28% of revenue. 18% of that is what you would call core industrial building-block products sold through distribution. That will grow at probably mid-single digits, maybe a little bit better depending on what's happening in the economy.

That other 10% is our vertical markets. That's things like mobile payment terminals. That's things like smart meters. That's things like wearable medical products or medical products overall. And those, we expect, should be able to grow at a faster rate such that you can get overall industrial into that high single digits rate.

Of course a very profitable, stable business and, so, be able to have that 28% of business growing at that rate is very nice. I think in the comm and data center market, the data center is where a lot of growth is occurring for us. We have two businesses there. One is a fiber-optic business, a connectivity business, 10 gig connectivity going to 40 gig. That business is set up for nice growth in 2015.

In addition to that, we have the opportunity, although we will probably just start to see the growth in 2015, is the power management technology that we got from Volterra. That ability for the cloud-based data centers who are designing their own servers and they're running their own data centers, they're going to pay for better power management because that results in lower operating costs.

So I think the common data center and really specifically around the data center should provide good growth for us in 2015.

I think when you go to the consumer market, for us, and which is really mobility, I think you have to separate that between Samsung and the other customers. I think our view is Samsung has been declining the last couple of years. We have actually increased content per phone or device, but their units have been declining, and that's been what's been offsetting the growth in all of our other businesses.

Our hope is that we think we will continue to increase content and that the decline in units will decline, will slow down such that those two can offset each other. So that Samsung remains flat or becomes much less of a drag on our business.

Then the ability to grow the other large OEM -- mobility OEM and the ability to grow in China. We clearly have design wins and actual growth already occurring at Apple. We have talked about design wins in audio. To the extent that they have other wearable products coming out, we have talked about content opportunities there.

I think that business will grow. In essence, I think we will see all of our businesses that have been growing continue to grow. I think we see new opportunities for growth within mobility, and if we can just keep our Samsung business not declining.

And you think about it, it's gone from -- it's 27% of revenue down to 13% of revenue. So in one sense, the hope is that we took our pain, we took our medicine in calendar 2014.

Harlan Sur - *JPMorgan - Analyst*

On that note, on the mobility business, which does tend to be a focus area for the market, so we all know about the issues that your largest customer has had in the second half of the year for the past two years. Obviously, they are on the cusp of ramping their next platform. You talked about the high-profile wearable guy that potentially will be ramping.

China, 4G smart phones are looking like they're going to start to accelerate. I guess the question there is with Samsung down to now more manageable levels and with these other opportunities ramping, do you feel like the second half of last year is the trough point for Maxim's mobile and wireless business?

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

We believe that to the extent we have visibility, which is probably more in the first half of the year of calendar 2015. We clearly see growth opportunities. I think ultimately what happens on those markets, how well do we do in China, how well does the new wearable device do, how well does Samsung do in the market will help determine the back half of the year.

But I think the critical thing is that's becoming a smaller part of our business. I think our largest customer is becoming down into a much more manageable range in the low teens. And all of our other businesses, we believe, will continue to grow and be able to offset any weakness there.

Harlan Sur - *JPMorgan - Analyst*

One of the -- we are looking for -- for 2015, we are looking for semiconductor industry growth around 4% to 5% based off of some of our own recent research efforts. Inventories in the channel, whether they are the distis or the OEMs, or at the semiconductor companies themselves seem to be well below historical peak levels. Lead times still seem to be fairly disciplined.

We have heard from other companies today that it does feel like the industrial and automotive markets, while maybe a bit slightly weaker in the second half, are looking like they're going to be seasonally better in the first half. Would you agree with that sense of things being okay as we exit 2014?

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

Yes. I think if you look at the traditional majors that we look at, certainly channel inventory is at very reasonable levels. It's about 55 days for us, which is right in line with the average over the last three years. I think from that point of view, we are in decent shape as a Company.

You look at lead times, they have been very stable for several years now where we can offer our customers five- to six-week lead times, and our customers generally order in the eight- to 10-week lead time range. Some of those, obviously, to the extent they are on VMI, it's on a poll basis, and, so, from that point of view.

So I think those markets look good for us. I think industrial and automotive are always strong in the first half of the year. So I think we always feel good in January, and we get the guidance from companies like Maxim and our peers. I think in general it slows down in the summertime and we all get nervous again, but I think a lot of that's just normal seasonality.

So I think we are set up nicely. I do think there is nothing structurally out there right now that is going to -- would prevent normal seasonality.

Harlan Sur - *JPMorgan - Analyst*

Okay, great. Any questions from the audience? Right here.

Unidentified Audience Member

You mentioned the Apple and China on the wireless side. How confident are you at this point as it relates to just diversification and design wins? Because I think one of the biggest issues that some of us have had is obviously customer concentration at Samsung. To the extent that you have visibility at other wireless OEMs, obviously, that's a great thing from a Maxim perspective. Talk a little bit about the process of ramping up those design wins and the visibility that you have heading into 2015. That would be helpful.

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

Sure. I think when we think about diversification, we said within mobility it was really around customers, technologies and platforms are the three things. Certainly around from a customer point of view, we have through teardowns known design wins on the audio side and tablets. We clearly have publicly indicated that we have design wins in upcoming wearable devices.

So, very confident in the design wins. I think the big question, of course, is what is going to be the end-unit demand for some of those products. I feel very good about that account. I do believe in China. It's a much smaller opportunity for us. I think we are growing that business; we have design wins. But it's been multiple vendors, multiple SKUs, and no single design win is going to move the needle for you.

So I would say I am less bullish on that opportunity. I think it's more longer term for us.

I think the other piece that we really wanted to do was diversification around technologies. And certainly we used to be focused on power management. That's still a core strength for us, and we continue to do well in power management. Where we are growing our business in China is primarily in power management.

That said, we have done very well diversifying into sensors, optical sensors being the best case for us today where we have done very well in optical sensors. That's an area, it's interesting, where people are clearly want to try to diverse -- innovate and create a product that people want to buy, something new and different, and sensors is one of those areas.

We started off with some early design wins in biosensors. We have now moved into environmental sensors, and we are shipping those in production now. You could see in the future other centers around temperature, chemicals, both in your body or in the air. So I think there's a lot of opportunity for innovation there. I would say the final area has been in audio, both at the two large mobility OEMs, and additionally in China has added that diversification for us as well.

I think we feel good about it. I think it's going to take time to -- when you have one customer who is 13%, but even at that customer we have been able to grow content simply through this diversification strategy.

Harlan Sur - *JPMorgan - Analyst*

Any other questions? Let's focus on the industrial business, good business for you guys. 28% to 30% of total revs. As you mentioned, on a longer-term basis, high single digits type of growth. You've got two buckets within industrial: you have got the core catalog business, and then you have got the vertical business.

Let's talk about the core catalog business because that is a business that's diversified. It's got probably the highest gross margins in the Company. What is the team doing to drive -- and companies -- some of your competitors like Texas Instruments and Linear, that's all they focus on is catalog. What is the Maxim team doing to expand and grow its catalog portfolio?

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

Sure. As you said, industrial, 28% of revenue. That core is probably 18% to 20% within industrial. Certainly, from our point of view one of the changes we made -- a couple of years back, we made a change in our distribution strategy, and I think that's been very successful in growing that business. Distribution is now -- was about 25% of revenue, it's now in the low 30%s. Plus we have an internal, low-volume desk which probably adds another 10 points, which is similar to low-touch distribution business.

So we actually have a pretty large, which I would -- if you want to categorize it as catalog business -- probably over 40% of our business is sold through that channel.

The one area we have really been focusing on recently is getting better at making it easier for our customers to buy our products. I think some of our competitors have been very -- have been better than us, candidly speaking, at online design tools for engineers at all these small customers. Having reference designs available for the customers, the application notes.

It's something -- we actually created a business unit whose sole job was, we called it, the mass-market solutions business unit, whose sole job is to make it easier for all these small industrial customers to design in our products. I think National was a company that was very good at doing this in the past. And I think that's an area -- we are focused on our top sellers and using analytics to identify what products to target this towards and what customers to target it towards.

So I think that's an area that, with no incremental R&D, will allow us to grow our industrial business probably a little bit faster than we would otherwise.

Harlan Sur - *JPMorgan - Analyst*

Question right here.

Unidentified Audience Member

Just a follow-up on that. Did Texas Instruments consume National Semiconductor? How much price pressure is there in the catalog side or are the other sockets really (inaudible)?

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

There is actually very little price pressure in the catalog side. It is really about who has someone used in the past, getting that share of mind with the distributor. Having your distributor fully trained on your product so that when a small customer comes to you or comes to the disti, they recommend Maxim over someone else.

Then how easy is it for that small customer to design in your products? Because if you think about on average an analog part, it's $1. So it's not a huge part of the bomb when people look at it from a pricing point of view. It is more about who have they traditionally used. How easy -- how much support do they get from the distributor? How much support do they get from the company? So there is actually not much pricing pressure. As Harlan said, that's by far the most profitable part of our business.

Harlan Sur - *JPMorgan - Analyst*

Then the other 10% of your industrial business is the vertical focus, which is the fastest-growing part of your market. Talk about the different areas that you are focused on and -- different areas that you're focused on, and what are the opportunities in terms of content growth on a go-forward basis.

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

Sure. I think if you think of what we call our vertical markets, these are areas like mobile payment systems. These are areas like smart meters, medical products including wearable medical products. All of these markets are dependent on high integration, which is an area which is -- Maxim is a leader in from an integration point of view in delivering a complete solution to our customers.

These are all secular growth drivers that are probably going to grow faster than the core industrial business. It's an area where we have, I think, leadership positions certainly in smart meters. We are one of the leading market share. And, again, where we take a secure microcontroller -- and when you think about a lot of these systems, security is going to be key as we think about cyber security and people accessing. As the world becomes connected, the piece that is going to be critical in all this is the security around that, and we have the ability for our microcontrollers both from a software point of view and from a physical point of view to ensure that's a fully secure microcontroller.

We have that secure microcontroller, plus you then wrap analog around that. And so on a smart meter what you are wrapping around that is certainly the converter and the analog front end that's actually doing the energy measurement. You also have to the extent that there is power management that there is any type of support for the connectivity, not the RF, but the baseband stack for the baseband.

So you get, again, integration around that. If you think of financial terminals, again, what are you looking for? You are looking for a secure microcontroller and wrapping analog around that. That's an area where we think we have a unique advantage in some high-growth markets that today -- as we have said, those three together are about 10%, so you can assume they are collectively about 3% to 4% each.

I think medical, although it's -- the growth is the furthest out, I think that's going to be a huge market. I think today where we have been doing well is where a product that was -- you had to use in the doctor's office is now mobile.

Ultrasound is an area where we do very, very well in moving that ultrasound device and making it a mobile device through our high integration. Ultimately going to wearable medicals. I know there's a lot of debate on wearables, and what's the use case and will people use them. I think ultimately from a medical point of view, when you have a specific condition and your doctor says you need to wear this device so that we can track you real-time, I think that will be a very real market. I think it's FDA approval. It's not going to be something that's tomorrow. But I think that will be a very real market, and I think it's an area for us where we have the technology to do very well.

Harlan Sur - *JPMorgan - Analyst*

Question.

Unidentified Audience Member

In the financial and security side, can you work with NXP collaboratively or do you bang heads with them? Are they the (inaudible) guy out there?

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

If you think about from a secure payments point of view, think of NXP on the card. They do it on the card, and now from electronic right they have the identification, say, within the smart phone. And you think of Maxim at the terminal side.

We actually don't compete. They are on the, call it, the client side, and we are on the terminal side of that.

Harlan Sur - *JPMorgan - Analyst*

Let's move over to the financials. Last May at your analyst meeting, the team put out a financial target of 30% operating margins, free cash flow margins in that 25% to 30% range. Potentially achieved by fiscal Q4 of 2015, which would be the June quarter of this year, but obviously that was before the mobile and wireless business had a little bit of a hiccup in the second half of the year.

Take us through where we are in progress towards achieving these goals. And what is it going to take revenue-wise to get you to those levels? If it looks like revenue-wise it's not possible within the near to midterm, is the team prepared to take further action?

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

Sure. I think when we were at our investor day -- and we have always had a goal, stated goal was to get to 30% op margin. We hadn't achieved that the last couple of years. And we said, look at, either we are going to commit to it and make it happen, or we should just take it off the slide.

We committed to that. We did expect that we would be able to just keep spending flat and grow into that. We didn't see as the revenue growth that we expected, and therefore in our last earnings call we announced a restructuring where fundamentally we are taking out $20 million a quarter out of our run rate. $10 million of that in OpEx we will achieve by the June quarter. The other $10 million in COGS will take a little bit longer because it involves shutting down a small development fab. But clearly are very committed to hitting that 30%.

I think one of the things how we have helped people think about how to get there, if you go back to June of 2014 and that quarter, we were at $642 million in revenue and 25% operating margin. If you think about the $20 million a quarter, that's about 3 points.

In that quarter as well, we had an abnormal inventory charge, which impacted margins by about 1 point. There, you get to 29%. You either -- you need a little bit more revenue or a little bit more cost cutting, and you can get to that 30%.

If revenue doesn't come in line, and then to the extent that we need to look at our product lines and find opportunities for further cost savings, that's something we will seriously consider and do. We are committed that to improve profitability at any revenue level. We think as a Company and we think our business model strongly supports a 30% op margin target. We should be there, and we will find that ability.

We think there is opportunities to grow our business, but at the same time we are going to actively manage the spending side as well.

Harlan Sur - *JPMorgan - Analyst*

Well, it certainly sounds like, given the pipeline that you laid out to us today in all of your businesses, that a mid-$600 million-ish type of level is -- in the near to midterm is not out of the realm of possibility. It's good. We are looking forward to monitoring the progress of the Maxim team as calendar 2015 unfolds.

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

I guess just to quickly say, the other side half of your question was around the cash side and that 25% to 30%. Last quarter, trailing 12-month free cash flow was 27% of revenue, so we are achieving that. The moving the CapEx from 5% to 7% of revenue down to 3% to 5%, we have actually said we are probably going to be on the low end of that 3% to 5% this year. So very clearly, we have reduced the CapEx, which will drive that free cash flow margin.

To the extent we get the op margin expansion, that will be the other piece that gets you to that -- close to that 30%.

Harlan Sur - *JPMorgan - Analyst*

Absolutely.

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

This is a business that does have the ability to generate tremendous amount of cash. Even in a tough quarter like September, we still grew free cash flow 11% year over year on a trailing 12-month basis. Even in a difficult time period, we are able to grow cash substantially.

We believe that we should be able to continue and even do better. And, of course, our commitment is to return that to shareholders, 80% at least. Over the last several years, we've returned over 90% to shareholders.

Harlan Sur - *JPMorgan - Analyst*

Great. Thank you very much, Bruce.

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

Thank you. Appreciate it. Raphael 3
