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MXIM - Maxim Integrated Products Inc at Stifel, Nicolaus Technology, Internet & Media Conference

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PRESENTATION

Tore Svanberg - *Stifel Nicolaus - Analyst*

Welcome to the Maxim session here at the Stifel Technology, Internet and Media Conference 2015. My name is Tore Svanberg. I am a senior semiconductor analyst and I cover the analog semiconductor space.

It is my pleasure to introduce Maxim. With us with from the Company is Bruce Kiddoo, who is the Company's Chief Financial Officer. And with us from Maxim is also Kathy Ta, right here in the front. She is head of investor relations. The format for this particular session is just pure Q&A. So with that, we are just going to get started.

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

So the question you have to ask is, how many people know who Steve Young is.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Yes. Well, why don't we start with that question? So Bruce, I was hoping we could talk a little bit first about sort of the near-term. You know, you reported numbers too long ago. Just remind us, especially focusing on what the outlook is, because this is going to be an abnormal seasonal quarter for you. So maybe we can start there.

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

Sure. I think the question on Maxim is, all of our businesses have been doing very well. We have done -- announced a lot of cost reductions in order announced to improve profitability. And the key question is, then, what is happening on the consumer business? Has that stabilized?

I think we saw in the December quarter, we came in a little bit stronger than our midpoint of our guidance. That was primarily due to our consumer business and both -- our largest customer did a little bit better than we thought. And some of the new opportunities, our diversification within consumer, actually came in a little bit better than we thought.

So then, leading into the March quarter, we actually guided up 3% at the midpoint. Normally we are down 1% to 2%. And again, I think, if you look at two things -- one, we do think our largest customer probably has stabilized, as they get prepared for their new product launch the end of March. Our diversification opportunities -- certainly we are in some new devices that will start continue the production ramp in the March quarter.

And then, this is a seasonally very strong quarter, obviously, for our automotive business. That is a business that has been growing 30%, 40% a year. It did better than seasonal in December. We have guided it up strongly for the March quarter. March and June are also good quarters for industrial. So from that point of view, we expect to see that business grow in the March quarter.

And then, even in the communications and data center market, which was actually kind of the weakest performer in the December quarter, which I think a number of companies has kind of indicated that there was sort of a broad-based weakness within comm in December, we kind of expect that to kind of bounce back up off of a low quarter. So, with our largest customer stabilizing, new opportunities through diversification in wearable devices, and then just normal strength that we have been seeing now have been for an extended time period in automotive, industrial, and comm, we think sets us up for certainly an above seasonal and a nice quarter.

Combine that with the cost reductions that we have already announced and are kind of taking place over the next few quarters, reduction in CapEx, we get to -- you are in my favorite topic, which is free cash flow margin getting up to 30% and returning that to shareholders in a consistently aggressive way.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Very good; thank you for that. If I could start asking some questions on the business segments, and let's start with consumer or mobility. So you had this announcement last quarter that you are exiting the touch part of that. Just strategically talking here, how can investors feel comfortable that what you invest in now or in the future will not go the same way?

I know it is hard, because I think these are very short product life cycles. We are talking about consumer markets and things move fast really. So whatever you invest in now, who knows? It could be around three years from now. But how does Maxim think about that? Because, obviously, you want to make sure that you actually get the returns from what you are investing in today.

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

Sure. I think, when we think about our consumer business, there is probably two things -- how we are really managing it. A, we think it needs to be the right size. It can't be too big. We have to manage customer concentration. And some people might say, well, that is easier said than done. What if you get a design win and that product is really well?

I think the other piece is we are managing from a margin point of view. And so if you think of the decision to exit the consumer MEMS business or to exit the touch business, that was really about, can we achieve that -- the profitability targets? Can we get our return targets in those businesses? And we concluded that, while we had what we thought were some great technologies, some great innovation, the market isn't willing to pay for that at this point in time. And, therefore, that is how we are going to exit.

So I think when investors kind of look at Maxim now, the idea is, from a concentration point of view, we have taken Samsung from 28% down to 14%, 15%. We expect it to actually tick down a little bit in the March quarter. We have taken our overall consumer business from 47% down to 30%, 33%, of revenue. We have clearly diversified that business across different customers, different platforms.

We used to mainly be in phones, now we have a good business in tablets. We have a growing business in wearables, different technologies, whether it is optical sensors, audio, and our continued strength in power management. And, as we always have, but the continued focus on profitability; I think most people realize this is a very profitable business for us.

I think we have shown our commitment to that by making sure that we do not chase revenue in lower profit businesses like the ones we exited. And kind of that commitment to keep it at kind of the right size to manage the one negative, which has been the volatility, which certainly has been painful for us over the last year.

Tore Svanberg - *Stifel Nicolaus - Analyst*

All right. Good. And maybe on that same topic, one of your peers -- a very large peer -- they keep talking about how their 300-millimeter strategy is really helping their cash flows and then also how they can return those cash flows to shareholders. Now, in your case, I mean, you also have a 300-millimeter strategy. You have had a lot of volatility in your top line, but your cash flow has aptly been quite exceptional. So can you talk a little bit about how 300-millimeter really helps Maxim's strategy when it comes to cash flow?

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

Sure. Well, our 300 millimeter is actually 0% cash because it is all outsourced from that point of view. So it wasn't like we bought, yes, old equipment. We bought zero equipment. So I think that one has helped us out from that point of view.

And I think you have to look at the type of business that 300 millimeter makes sense. It is certainly where you have larger die, you have higher integration products. And so, generally, that has been in our mobility space and having that outsourced provides us that flexibility when you do get the volatility that we happen to see.

So I think it has been good for us, in that it has helped us from a gross margin point of view. 300 millimeter is obviously lower cost, all else being the same. Clearly, we also have to take a look at internal fab utilization. And if the trade-off is 300 millimeter external versus filling existing capacity internally, generally the economics says it is better to fill it internally and get kind of that overhead absorption.

And so, certainly, that is what we are working on today as we try to drive up utilizations from 60% in the December quarter, probably mid-60s in March, and continuing to see that utilization increase, which, historically, has been the key driver towards gross margin expansion. The restructuring that we announced two quarters ago, shutting down a small development fab in San Jose, is another area that will probably add 1.5% of gross margin leverage when that is complete. So both you get the utilization uptick, the cost reductions. Both of those should help us drive the gross margin back up to the upper half of our range of 61% to 64%.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Very good. So moving on to automotive, which has been your fastest growing segment, I think you mentioned it has grown 40%, 50% here the last few years. And I actually think you have surprised a lot of people. I think you sort of come from behind and grown that business quite significantly. Where are we in that ramp? Are we still sort of an the early innings? And, obviously, you can't grow that business 40%, 50% every year. Where will that growth rate end up being, do you think, over the next few years?

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

Sure. Automotive is an interesting business. It's not something you can decide I want to be in automotive, and next year you have a business. We started investing in this business in 2004 and focused initially on power management, which is what our core strength was. We have grown that business.

We extended it into other areas, SerDes technology for video distribution throughout the car; USB ports, high brightness LED lighting, keyless go technologies, RF tuner technology for satellites such that we now have a very broad based business, multiple technologies across many OEMs, which is -- the growth has actually accelerated the last couple of years. Obviously, as you say, you're not going to be able to maintain that 40%-plus growth rate.

We think the industry probably -- we know units are growing something at 4%; semiconductor content, maybe another 5%. You get 9%, 10% unit market growth for this business. We are obviously doing much, much better than that. We look at our design wins. This is a business where you get very nice visibility. You get good stability as well.

So we think we will be able to grow at least double digits for the next several years. It will come down over time, as you said, just kind of the law of large numbers. And it is now 12% of our business. It is our fastest growing market, has all the nice characteristics that we like.

And I guess the other piece about this is, it is actually the margins are improving in this business. It is below the corporate average currently. And when we say below the corporate average, that just means 50% to 60%. For us, that is -- we never really go below that in any long-term fashion.

And so we have been able to improve our cost structure, fundamentally by improving quality at the design stage versus testing in that quality. And by doing that, you reduce test time, prove yields, and so we have actually seen the margins improve while the business has been growing at these very high rates. So it's our fastest growing with improving margins.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Very good. Moving on to industrial, from my perspective, your performance there has been not as exciting. I mean, obviously, it has grown much less than automotive. But, even in relation to some of your peers, I would say the industrial business has lagged a little bit.

Can you talk about some of the moving parts there? Has there been any pieces that have suffered from headwinds? And where do we stand there now? And what are some of the growth drivers for that business going forward?

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

Sure. If you think of industrial, it is 27% of revenue. Probably about two-thirds of that is core industrial, selling catalog parts through distribution; obviously, a very high margin, a very stable business; probably the business that is most correlated to global GDP. I think we have done well in that business.

I think we can do better. We have been working on that over the last 12, 18 months as far as making it easier for customers to buy our products. And this is online design tools, collateral. I would say some of our peers initially did that better. That is an area of focus for us and I think we are starting to see that pay off. So I think that is an opportunity to increase the momentum in this business and we are starting to see that.

The other third of our industrial business is what we call vertical markets. But think of these as something like smart meters or medical or mobile payment terminals, all which I think have long-term secular growth drivers above kind of the core industrial business. I think medical takes time as that market grows. We do very well in ultrasound. We're starting to grow the business in medical wearables, areas like that.

The smart meter business has had periods of strong growth and then some periods where, like, say in Europe, deployment of smart meters kind of slowed down with the economic environment. So I think overall, I think we are still very well positioned with industrial. I would say, over the last year, two years, we have been in line with our peers. I would say, before that, we were a little bit below, to your comment.

I think, going forward, we are very well positioned. Our core industrial, our relationship with Apna is very strong. The tools and support we are providing to our customers to design in our products has improved significantly. And I do believe in the secular growth drivers, whether it is smart meters or medical or mobile payment terminals. All those should allow us to grow that business high single digits. This is not going to have the double-digit growth that we are going to see in automotive.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Okay. So I had a question on your Volterra acquisition that you made about 18 months ago -- now 15 to 18 months ago now. I know that business, initially it was going to lose some share because of the OEMs here in the US, but that eventually there will be a sort of crossover and you start to gain some share with some of the -- I guess you call them white box players or the Internet companies, if you will.

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

Sure.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Where do we stand right now in that process or at least getting close to that crossover point?

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

I think that is going very well. And, if you think about our thesis for buying the company, one of them was to sell into the cloud computing environment and the other one was for the communication power, both markets which Volterra had not really entered. They were very strong in the enterprise OEM market.

So within cloud computing -- and this is really -- it is the Google, Amazon, Facebooks of the world who actually design their own servers, they determine the bill of materials. They are the ones are actually running the data centers and, therefore, power management. And the cost of operating those data centers is important to them.

So to the extent that we have a more efficient power management chip, that is something they will select and then, yes, they hand that bomb off to an ODM in China or Taiwan who will manufacture that. But I think it is important to note, it is actually -- it is the data center operators who are designing the servers, determining the bond. It has gone very well for us. We actually have some early design wins there.

We actually expect that business to start ramping in the second half of this year. I think it is going to be small, but it is really -- I think calendar year 2016 is where you're going to see a nice ramp of that business. So I think we feel good about that.

I think the communication power is probably kind of going on track. Where the cloud has gone faster than we thought, I think comm is going on track. And that, again, is kind of a multi-year process.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Just a quick question, back to mobile. Does it matter for Maxim at all whether ARM has relatively high share versus x86? Does it really matter for you as a Company? You know, there is obviously more and more chatter that x86 is going to get some traction and so on and so forth. And Maxim has had history in both. I mean in PCs, you had history and then you also had the same in ARM. So does it matter?

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

No, not really. I think certainly most people know, from a baseband or an application processor, the digital chips were not doing power management for those chips. So from a processor point of view, whether it is ARM or x86, we are not doing the power management for either. So from that point of view, it doesn't impact us.

Certainly, what we have done very well is sort of system power for all the other functionality within a phone. And then, obviously, integrating whether it is the battery charger, the fuel gauge, the USB port, the display drivers, putting all that into a single chip. The chip that we first won in 2008, and have held that socket all the way through every phone thereafter, at our largest customer it is what we have done well with -- gotten business with in China, that same kind of technology that we do well in the wearables. And so that power management -- highly integrated power management kind of independent of the digital chips is what has done well for us.

Tore Svanberg - *Stifel Nicolaus - Analyst*

So, to sum it all up or sum up at least this segment, I know your strategy is really grow through integration. And you obviously did a very good job in the mobile markets. And I think you have talked about leveraging that capability to all the other markets, really. Where do we stand in that process? I mean, is this still the first inning seeing really integrated parts and industrial, communications, computing type markets?

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

I mean, if you think about it, that third of our business in industrial, which was the vertical market, clearly that is all high integration products. If it is a smart meter, it is a microcontroller with security and analog wrapped around it. Same thing for a mobile payment terminal where you have a secure microcontroller with analog integrated into that.

Medical, you think of, for an ultrasound, we are the ones -- the only ones that can deliver a transceiver that has both the high-voltage transmit with a very low-power receive capability. And so I think that clearly is an area where there has been significant integration.

We are very early innings in automotive. Many of the products that we took over from our mobility and sold into infotainment, I would say the integration level there is very early. There has been a lot of like single function power management. As the infotainment -- as the dash gets more complicated, and space is starting to get more constrained within the front -- the head end unit of a car, I think integration has a big opportunity there.

And, finally, the same thing with in communications. Again, I think we have a small business, say, within base stations in the signal chain. The disruptive technology we are trying to bring to bear will be around integration, where today, if you look at a macro base station it is a lot of discrete chips providing single function capabilities.

Tore Svanberg - *Stifel Nicolaus - Analyst*

With that, I'm going to open it up to questions from the audience. So I will keep going. If you do have a question, please raise your hand.

So Bruce, just looking at some of the newer opportunities and newer markets, you talked about wearables being an opportunity for you. Obviously, the wearable market is clearly in its infancy. So, nobody really knows how that is going to play out. As you commit R&D dollars to that market, how do you think about what you want to go after and what you want to shy away from?

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

Sure. When we think about these markets, what you are really taking is standard IP that we have already developed. And you are just adopting it to that. So whether it is power management, which is something highly integrated -- power management for a mobile device -- whether that is a phone; whether that is for a watch; whether that is for some other type of wearable that is a medical wearable, this is technology we already have within the Company.

So, to a large extent, it is reuse of that technology. Same thing when it comes to sensors; we have a good business in biosensors and environmental sensors. These are the same technology that are going to be used -- going to move from a watch to -- or from a phone to some type of wearable.

So from that point of view, I think there is a significant incremental investment. It is more leveraging what we are -- kind of these core technologies that have we already been investing in.

Tore Svanberg - *Stifel Nicolaus - Analyst*

So from that perspective, it is more about just managing the risk of the ROI as opposed to, well, you know, here is a customer you think is going to be successful, but who knows for how long.

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

Yes. For us, it is, as we kind of started off today, it is about diversification, taking those technologies, selling it across multiple platforms, multiple customers, so that there is not one bet, one socket, one customer. From a managing the business point of view, that is just too difficult.

Tore Svanberg - *Stifel Nicolaus - Analyst*

And just looking at IP blocks or looking at core competency, and I know many, many years ago, Maxim had an effort in sort of high-speed analog, even a fiber optics type business. Is that an area that Maxim is looking at again? Because, from my perspective, I think there are some great growth opportunities there.

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

Yes. I mean, if you look at our comm business, 23% of revenue, about a third of that is fiber optics. And if you look at where we are the biggest growth opportunity right now, it is a relatively small business, but is in data center connectivity. I think we are kind of growing our 10 gig business, but what we are doing very, very well is, as 40 gig starts to ramp in volume, we are doing very well from a market share in that business, both to the traditional OEMs and also to the, say, cloud data center folks. So I do believe that is a good opportunity.

We also do the kind of traditional fiber optics, the backhaul from the bay station. I would say fiber to the home is becoming more of a commodity at this point. And so that is a business which, again, as we sort of manage our portfolio, kind of focusing more on the new R&D dollars in the data center where we think the strong growth will be, and maybe less in the fiber to the home.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Very good. I had a question on investor perception, or at least the way I think you're being valued. And it seems to me that you have very good cash generation and you return the cash back to shareholders. From that perspective you do as well, if not better than, most analog companies.

But, investors obviously focus a lot more on your consumer business, your mobility business, there is headlines, and so on and so forth. So what can the Company do to try and maybe change that perception or even -- I mean, I know it the end of the day, investors will pay for the stock, right, but is it the diversification strategy or what are some of the things that you are trying to change that perception?

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

Yes. I mean, I think we have to do a couple of things. One, and the biggest, is exactly what you said. I think consumer by itself is not bad, but you have to have a well-diversified consumer business. You look at some of our other competitors, some people who think of purely as now catalog return to capital company and they have, what, 33%, 34% of their business is consumer.

So I don't think consumer, but when you have one customer who is 28%, that is a problem. And it was very painful kind of coming -- you know, correcting that. And, now, with that at 14%, 15% and continuing to -- the focus is how do we continue to diversify. How do we kind of spread the IP across there versus making some big bets. So I think investors are starting to see that.

And, in the end, it is not perception. It is our results, how are we doing on our diversification. And I know everybody kind of understand and I think we get pretty good credit for doing well in all of our other businesses. People just want to see has the consumer business stabilized. We believe there is an opportunity for that to happen this year.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Is there a number you're now willing to really -- is there like a magic number, like if you don't want a customer to be more than 20% or anything like that or no?

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

Certainly, we think there is a number. It is less than 20%.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Okay. All right.

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

I think the challenge is, let's just say it is in the 10% to 15% range. And we are managing that by kind of raising the margin targets for those customers to make sure -- if we are selling something. But if we got something -- a piece of business at 60 points of margin, that did really well, that is all being outsourced manufacturing, and this is kicking off tremendous cash flow and we believe it is sustainable, then that is probably a good problem to have.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Very good. We have a question back here.

QUESTIONS AND ANSWERS

Unidentified Audience Member

(inaudible - microphone inaccessible)

Tore Svanberg - *Stifel Nicolaus - Analyst*

Sure.

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

Sure. Yes. I mean, we had the best stress test in the recession in 2008 and 2009. Revenue went down 20%. It went from $2 billion to $1.6 billion, yet free cash flow was still $300 million versus a $240 million dividend at the time. So absolutely, dividend is -- we have never cut it. In the recession year, we kept it flat. Every other year we have increased it.

So I think that analog is a great business; I think Maxim as well. So I think managing our cash -- and even in the time period where we have had a challenge with our largest customer, as that concentration come down and revenue has followed it down, free cash flow has grown in double digits during this time period, primarily because of CapEx coming down as well. So it is the cycle. We will manage costs. CapEx comes down naturally.

If it is a severe cycle, buybacks -- we would reduce those. But the dividend, we generate far in excess -- I mean, we generally target a 40% to 50% payout ratio. And every year before we increase the dividend, we do that exact sensitivity analysis. We look at a 10% down year or a 20% down year and make sure that that payout never goes above 100%.

Even if we had -- obviously, we got $1.3 billion, $1.4 billion cash on the balance sheet. You could eat into that, but I think from an investor point of view, we don't ever want to put any doubt in anyone's mind that that is not sustainable.

Tore Svanberg - *Stifel Nicolaus - Analyst*

So I saw a lot of people leaving here. Maybe Steve Young is more popular than me and you. Is that what's going on here? Well, actually, we have run out of time so I want to thank all of you for coming. You are also invited to join the large luncheon starting here at 12, and Steve Young is going to be there. So thank you again.

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

Thank you.
