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EDITED TRANSCRIPT

MXIM - Maxim Integrated Products Inc at Bank of America Merrill Lynch Global Technology Conference

EVENT DATE/TIME: JUNE 02, 2015 / 9:50PM GMT

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PRESENTATION

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

--to this session with Maxim Integrated. I'm Vivek Arya, semiconductor analyst at BofA Merrill Lynch. Absolutely delighted to have Bruce Kiddoo, CFO of Maxim; and Kathy Ta from Maxim's investor relations team meet with us this afternoon.

We will start with some just opening remarks on the overall demand environment. And then just jump into a Q&A. Please feel free to raise your hands if you would like to ask questions in between. So with that, Bruce, welcome.

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

Right. Thank you. Thank you for being here. So I think just from raw demand, if you kind of look at our business, really Maxim over the last year, our goal has -- we've been growing very well, obviously, in automotive. Industrial has been a good growth market for us. And those are really the two growth drivers.

And our goal has been to diversify the consumer business. And so we believe we've kind of stabilized the revenue within that. We've taken Samsung down from a very high percent to around 15%. We've grown at the other large kind of mobility OEM. Our business in China has started to grow.

So we believe we've kind of stabilized consumer and I think we continue to see that. Automotive continues to be very strong. It grew 13% sequential in the March quarter, over 30% year over year and now that's kind of trending towards a $300 million a year business.

So it's a very large business for us. We believe industrial will continue to be a very good long term business for us. We did see some weakness in bookings in the March quarter, which we reflected in our guidance in the June quarter.

We do think that kind of that industrial kind of general purpose business is consistent with our peers. And to the extent that the overall market is seasonal, we believe that will probably kind of correct itself either in the June or the September quarter from that point of view. And then com, I think, consistent with others. I think that's probably been the weaker of our end market exposures.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. And maybe, Bruce, before we go into the different end markets, I just wanted to touch on this issue of margin. You mentioned you had stabilized the business model. So in the context of this stabilized business model, how do you think of your overall business model in terms of operating margins? What revenue run rates do you think you can achieve -- you can get -- you need to get to to achieve those operating margins?

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

Yes. I think last year, actually last May, our investor conference we kind of drew the line in the sand and said we were going to get to 30% op margin.

I think since that time period, I think there have been, last summer additional challenges from a revenue point of view. We took specific actions in October to announce savings both in our manufacturing and in our below the line spending.

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And so you've seen that we actually have -- we had said $10 million a quarter in below -- OpEx savings. We've actually over-achieved. We've received about $20 million a quarter in savings there.

We identified about $10 million a quarter in savings from shutting down a fab. We said that would take about 18 months. We've kind of pulled that in and we'll see sort of in the December quarter we'll get the full benefits from that fab closure.

That said, so that's probably taken, I mean, we used to kind of talk about kind of mid $600 million in revenue as to where we would achieve that 30% op margin. Given that we over-achieved on the OpEx, I think that probably pulled down that 30% op margin probably by about $20 million to $30 million from that point of view.

I think the interesting thing to note is once you sort of of get started down the path of kind of looking at cost, you build up momentum. We recently announced that -- a reorganization where Matt Murphy kind of took responsibility for all the business units and sales.

One of the rationale for that was our ability to make decisions faster, invest in our growth businesses, but also be more efficient from our R&D point of view. And so we have a June quarter end, our year end. That's when we do our normal planning.

So we just finished that process and I think we're comfortable at this point in time that we'll be able to achieve additional cost reductions in addition to what we've announced previously.

We'll provide kind of further details at our earnings call but we do think it's probably of the same magnitude of what we announced last October, both in operating expenses and in cost of goods sold.

So very clearly, that commitment to driving margin while at the same time investing in our key growth areas, whether that's automotive, whether that's industrial, whether that's in the cloud market.

And the ability to kind of manage costs while not sacrificing long-term growth is really kind of the focus for the Company. And I think we've over-achieved to date and I think we're going to continue kind of down that path to continue to drive margin expansion.

And if you think about that, we're at 25% operating margin today. Clearly, we're going to commit to this 30% op margin. I think we'll actually eventually beat that, translate that into free cash flow margin, which today is at 27%.

You have five points at least in operating margin leverage, plus CapEx that used to be in a 3% to 5% range and is now kind of in the 2% to 3% range. And you're going to get free cash flow margin well above 30%.

So I think even in a demand environment which is uncertain or certainly in our industry a slower growth environment, the ability to drive margin substantially above where it is today, both from an operating margin and a free cash flow margin is really what's kind of the focus of Maxim.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. So to maybe simplify this discussion so I have the numbers right, so if in the past you could get to your 30% operating margin target at, say, the mid $600 million in revenue, where can you get to that margin now? What revenue run rate would you need to get to that margin?

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

Sure. I think as we said, just off of what we had already achieved, we said we would get kind of $20 million, $30 million below that. So you can kind of do the math on that.

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On the additional reductions that we're talking about today, I think at this point it's probably a little premature to give kind of that new break-even point. Obviously, it will be lower again. But I think when -- at our earnings call, we'll be able to talk about that in more detail.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Right. So conceptually, closer to, say, a $600 million than it was to -- I understand. But the free cash flow part is, also, I think, very interesting. And it's perhaps, I think, less understood about Maxim.

People have always looked at D.I. as sort of leading the charge on free cash flow and their focus on free cash flow margins. So can you talk about, have you set specific targets on free cash flow? And how do they -- and I think you just mentioned that you could over-achieve those as you lower the cost structure.

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

Sure. I think our goal had been free cash flow margin of 25% to 30% of revenue. And then we've always had the goal of returning 80% of free cash to shareholders.

Generally, if you look back over the last five years, we've been closer to 90% return on capital. Even with the challenges from the revenue point of view, kind of what we've done from a margin point of view and even specifically what we've done from a CapEx point of view, we used to probably have CapEx at around 6% of revenue.

This quarter, it's going -- I mean, this year, it's probably going to be at 2%. So that's been a dramatic reduction in the CapEx. And obviously that's what's driven us from about the mid-20s to probably high 20s as free cash flow margin.

And then as you now take the operating margin from 25% to 30% or longer term better, that's clearly going to get you kind of above that 30% free cash flow margin with the continued commitment as we've demonstrated over the years of returning that to shareholders both through a combination of dividend and share repurchase.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. And as we look into -- consolidation has been an important trend for semiconductors in the last two years. It's really heated up in the last two weeks. How do you think about M&A in the context of your growth strategy?

So yes, you have stabilized the business model. But the growth rate, if I look historically, that has lagged some of the peers. So from a Maxim perspective, do you think you need to acquire? Or do you think now that the consumer business has stabilized, that there is enough growth organically in your industrial, especially automotive areas, that you don't have to look outside?

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

Yes. I think we don't need to do consolidation simply to drive growth. I think as you said to the extent consumer has stabilized, automotive growing 30% plus a year, industrial com will kind of grow in line with kind of market rates, which is probably kind of mid-single, high-single digits for industrial, mid-single digits for com kind of numbers.

So I think our business has stabilized and we can grow the top line. And clearly, we can improve profitability at an even faster rate. That said, if you look at the environment, obviously there is a tremendous amount of activity occurring.

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We believe, certainly, we have the balance sheet, the ability to do acquisitions. And you look at the opportunities in this kind of $1 billion to $3 billion market cap range. There are obviously some quality assets that are out there that we would look at.

I think people are going to be more selective these days, because these are -- I was -- you know, we've done 14 deals so far, 14, 15 deals at Maxim. They're all kind of smaller $100 million, $200 million deals. We did the Volterra acquisition, which was $450 million enterprise value. But now we're talking larger.

So I think people are going to be -- and certainly Maxim, does it fit our strategy? Is there a value creation opportunity? And to the extent it helps further diversify our business, those are all the types of things we would look at as an acquirer.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Right. And in terms of end markets, one strategy is you already know the foreign market quite well. But there are perhaps ways of expanding your share of the available materials. And the other one is to just expand in the broader, more diversified analog business. What is the right way to think about your strategy?

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

Yes, clearly, we want to, I think, diversify within the broader business. We know automotive is going to be a growing part of our business. Today at 13% of revenue. Again, we just kind of got done with our planning phase. So if you looked out five years, it's not unreasonable to think of that kind of getting to 20% or more of our business.

We'll continue to grow in industrial. One way that's interesting to look at our business is people think about end markets. But actually, if you looked across all of our end markets, 50% or more of our business comes from power management.

And so that ability to say, this is something we do very well. And whether back in the mid-2005, that was invested in notebook power management. We moved that over to smartphones as that business was strong.

Now, today if you look at where a lot of energy is, it's in automotive power management. So the ability to kind of re-allocate those engineers to where you're going to get the highest return. Industrial power, when we look at the cloud, kind of opportunities and the data centers, again, those are folks kind of the large cloud data center operators.

They're designing their own hardware, their own servers. They're running their own data centers. They care about kind of lowering their energy costs. So again, another area where I think power management will provide a significant opportunity.

So I really think of us kind of thinking more horizontally about where we have kind of sustainable advantages. And power management's clearly the biggest area for that.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. And just the last question, then, on the topic of consolidation is does Maxim feel comfortable levering up the balance sheet? Like, are there certain leverage ratios? What I've seen in the industry, for example, is at most 3.5X is where people feel comfortable.

How do you think about just the overall financial metrics as you look at targets? Even though the $1 billion to $3 billion doesn't require you to step outside of that comfort zone, I imagine.

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

Sure. I mean, we have $1 billion of debt on the balance sheet today. It's kind of close to 1X EBITDA. Certainly I think we would be comfortable for a strategic acquisition to go higher than that.

Certainly just even from a rating agency point of view, kind of long term, they look for, like, 1.5. Clearly you can go, as you indicated, you can go above that in order to do an acquisition with a pack back from the cash flow that you generate from that acquisition from the synergies.

So I think as a company, we would want to maintain our investment grade rating. But I think we would be comfortable with some level of debt in order to create value and participate in consolidation.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Okay. And then maybe let's talk about the automotive market. I think that has sort of been a very sort of sleeper growth area. Just came -- and now it's almost 13% of your business. You mentioned over next few years, it could be a much bigger proportion.

What specific applications are driving that? And how should we think about your content in those applications? Is it building more units? Or is it expanding content?

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

Yes, so as you said, it's 13% of revenue. We really started investing in 2004. And if anything, it's just been accelerating. In our last fiscal year, it grew over 40% year over year.

On a -- from a technology point of view, we've been strongest in power management, as you would expect. That's been -- initially was strong in infotainment and to the extent that there's processors throughout a car to drive the different infotainment devices, we would do the power management for that.

To the extent that cars are now moving towards safety and driver assistance, again, you're going to have processors that require power management. So I would say power management is probably the largest technology within cars.

The other area is video distribution throughout a car. And this is sort of our serializer, de-serializer technology across co-ax cables. This, again, started in infotainment when you had sort of just a rear seat TV screen for movie watching.

That's also moving now into safety. Obviously, rear camera, blind spot, 360. And again, those require -- it has to have the -- kind of the high speed, no latency kind of 30s technology which we provide. So that's another good business that, again, started in infotainment, moving towards kind of driver assistance and safety.

And then finally, we just have a whole host, it's very broad-based. We do R.F. We're in satellite tuners. We do DAB tuners for Europe. We have actually a nice exterior, like, high brightness LED lighting business. We actually have some battery management system for electric vehicles and hybrids.

And so it's a very broadly diversified both across -- we sell to most of the tier one OEMS. The DENSO, the Conti, the Bosch, the Harman, the Delphi. We sell it across -- Germany is our -- I mean, Germany or -- Europe. There happens to be some luxury car makers in Germany, too.

But Europe is our strongest market, followed by Japan and Korea. And then with the biggest opportunity probably in the U.S. to kind of catch up with the rest of the geographies.

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Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. You know, 30%, 40% growth rate is quite amazing in automotive when units are growing only single di-- is it just that you got a lot of design wins all coming to fruition at the same time? What is a sustainable growth rate in your automotive business?

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

So I think certainly it's not going to stay at 30% to 40% when the market's growing maybe 10%. Right? Kind of units at, I don't know, three, four and then semiconductor content on top of that.

I think we've been working at this for, again, almost ten years, 11 years now. We've been working closely with the tier one OEMS. We've built up this base of business. And one of the things I think we found here is once you get kind of qualified at a vendor and once you get a part qualified that goes through all the quality standards, there's so much effort in that process that they just kind of keep using you.

And the other piece that's happened is this kind of seven year life cycles. And so if you think about if we started in 2004, takes a couple years to get the business and to get into production. So 2007.

So every year you win new business. And March and June are always kind of the -- when you ship the new design wins. But the old business doesn't go away. So we've just been layering on this business every year while keeping the old business.

And so I think that's what allowed us to have this kind of 3X, 4X industry growth rate. At some point we're going to see that baseline start to fall off. And I think we're not seeing any slowdown in the new design wins.

But you will see sort of the base at some point start to fall off. And that will kind of slow our growth rate. And I think you'll see that slope down. The interesting thing is, we keep forecasting that, okay, well, when people say seven year life cy-- I mean, this is new to us, right?

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Right.

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

We keep waiting for that to fall off. And I think to date we haven't seen that significant fall off in the older design wins. I think because once you get kind of qualified, it's just much easier for them to take our part and put it in a new platform than it is to bring in a substitute.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. It's sticky business, for sure. What about gross margins? Because in some ways, the automotive market is not the same. But it's similar to sort of the handset OEM business. Lot of buying power even though design cycles are much longer than you have. So is there gross margin headwinds in automotive?

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

We've said previously that actually our gross margins were below the corporate average. I don't think this was as much due to the buying power which very sophisticated for (inaudible) organizations, obviously, within automotive.

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I think it was more to do to meet the quality standards. I think our initial products were really kind of repurposed products from other industries that we sold into automotive. And so we had to kind of go to extraordinary lengths to kind of test in quality.

Which means you had lower yields. You had to have more CapEx invested in that. So that's really what pulled down our margins. We've been on kind of -- starting really aggressively last year, we've taken our margins from probably kind of lower 50s to mid-50s.

And we expect over the next one to two years to be able to get those margins up to the corporate average. Kind of get it starting with a six. So this is our fastest growing business with expanding margins.

And I don't think it's going to get above that. But I do think, given the amount of innovation that's occurring in automobiles right now and to the extent that you can provide what they want at the quality standards with all this kind of the supply chain performance that they demand. I think this is a business where you can earn an acceptable return.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. Now, you have stabilized the consumer business but Samsung is still a big part of sales. When the year started, they had the new product out, Galaxy S6. It -- the sales have not been as exciting as I thought it was believed originally.

How do you look at them as a customer? So not them specifically, but just overall your smartphone business? Especially what I'm thinking about is the second half, when you have the big U.S. player coming out with another new product cycle. So what impact do you think that will have in your overall consumer sales as you look toward the rest of the year?

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

Sure. I think clearly our concentration is more on Samsung than on Apple. Certainly when we look at the March quarter and the June quarter, those are usually stronger than September and December.

I think the Note products usually come out in the second half of the year. And so that will be one opportunity to kind of offset that. I do think we've seen Samsung be much better this year in managing kind of their older phones.

I think we had given guidance that said we were kind of thinking the S6 in the month of June, which up a little bit less than the S5. And I think there was some debate about that early on. I think maybe not as much debate anymore.

But very clearly, kind of the older products, they are managing inventory very closely on the S5. Or on the Note 4 from that point of view. And I think that's going to be helpful as well, because you won't see this inventory build that then falls off.

So I think you're going to see a more natural tail versus an inventory correction in the back half. So the last two years it's really been about an inventory correction. Now I think you're going to hopefully see a more kind of natural demand flow which shouldn't be as bad.

Now, obviously, we continue to -- we have our business with the new wearable devices. No idea how the end demand will be for those but that's certainly that product is still just sort of ramping. So that's a potential opportunity for us. We continue to sell a small business but -- into China. And then just kind of other consumer products across the different OEMS.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. So how do you then exceed on the gross margin side? When you have this volatility on the phone side? And you have automotive, which is an area of growth, but where you are clearly expanding margins. But both these areas, I would assume, is lower than corporate average.

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

Yes. Well, I think the one area that we've kind of clarified over the years was when you look at our mobility business, it's generally a -- it's close to corporate average.

And to the extent that there's businesses that aren't, we announced that we were exiting consumer mems. The reason being that this was not an area where we had differentiation and therefore we were getting kind of commodity-like margins. And we're not in the business to get commodity-like margins.

So I think we are and generally have been kind of selective in the business that we take to ensure that our mobility business is not a large drag on overall margin. So I do think that piece is manageable.

And certainly as our consumer business a couple years ago was at, I think, 47%, 48% of revenue. Today it's right around 30%. I think the trend of that will continue to come down slightly. So I think that mix has actually worked in our favor. And industrial at 27%, 28% of revenue, obviously that business has been growing. So I think the mix is actually working in our favor right now.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. And if we look broadly, Maxim's strategy over the years has been to go after more ASSB-like products, rather than a broad catalog of products. Which is a different strategy than what we see with D.I., for example. They are going after more of a catalog approach.

Can you help us understand the difference between the two approaches? Why is a more ASSB-like approach better for Maxim?

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

Yes. And I don't know if one approach is better or worse. I think actually if you look at Maxim, we do both. We do believe in certain end markets where customers are looking for kind of like you say, kind of an application-specific product for their area.

That's where our integration capabilities kind of distinguish Maxim. That ability to do these highly integrated parts that support automotive, support communication, support industrial or even support mobility.

So I think there, clearly from a customer point of view in providing solutions to a customer, customers clearly want these application-specific solutions. That said, there's a big part of analog which is the catalog business where you have small customers that are just buying general purpose, single function parts.

One of the other benefits of the recent re-organization that we just went through is we kind of pulled out all the catalog parts which were traditionally sort of in our vertical business units.

We've kind of pulled those out and put those in what we would call core products or a catalog products business unit. And these are products which had really when they were part of the vertical business units were getting no attention.

Because the business units really cared about the new products and launching those and making those successful. Now we've taken all these catalog products out, it's interesting. It's about 30% of our revenue. Of just ten-plus-year-old catalog products.

And the ability to pull those out, just give them a little attention from a channel management point of view, how do we maximize sales through the channel and working with our channel partners, providing design collateral so it's easier for our customers, these small customers, to design them in.

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Sort of managing pricing to optimize margins on those products. Maybe putting a small amount of R&D, just a very small amount of R&D just to sort of change the package, just extend the life of these products.

So we actually think that's a big opportunity because I think you're correct in that we had focused more on the application-specific products. And we've had this tremendous profit engine of these kind of legacy products.

And we're going to focus on those, give them some attention, and really -- and I think be able to further extend the life of these products and the profit that they generate. So I think it's a big opportunity for us.

So we like both. And I think that's the great thing about a company like Maxim. We have kind of the scale to be able to successfully sell both these catalog products and where customers want it. And usually your larger customers, to be honest. These application-specific products.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. One question, Bruce, I forgot to ask you in the automotive side is we are seeing a lot of -- people think of the auto as a large smartphone now. A lot of smartphone technologies are going into the car.

And the same way you see a lot of smartphone processor companies also getting into the car. We had NVIDIA present before. One of your past employers was also talking about opportunity. Qualcomm has spoken about it. A lot of them have their internal power management design teams as well. So you know, not everyone but some of them. For example, Qualcomm does.

Do you see that as incremental competition if the smartphone processor companies are successful in automotive? Does that pose more competition for your power management?

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

Yes, well, it's interesting with NVIDIA, certainly we've kind of publicly announced a partnership with them where we are actually doing the power management for their processors.

And if you look at the folks, the kind of the other processor, whether that's FREESCO or Renesas or some of the other folks who are in large and automotive, we generally have in the past been able to work with them. And they generally don't have their own sort of analog power management capabilities.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

So it's more complementary, then.

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

So I think at this point that has been complementary. To the extent that some of the pure smartphone apps processor guys make their way into automotive, that will be some level of competition. Today, that -- those aren't the people who are selling processors in cars.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. How important is scale in analog? We had Texas Instruments present earlier. And they said that our sustainable differentiator and the reason we have managed to take share consistently is our scale, our feet on the street, our distribution channels and breadth of product and access to 300

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millimeter. I mean, you have some of that access as well. So but how do you think conceptually about scale in analog? And how is that important to success?

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

Yes. I mean, I think scale is important at a certain level in a slower growth environment to be able to fund the R&D that's required. So I think one of the challenges you see with smaller companies, sort of sub-$1 billion in revenue companies, is, yes, on a slower growth environment, it's harder to fund that R&D.

And so you're seeing kind of lower op margins. Certainly Maxim doesn't have that issue. And if anything, we're able to drive further leverage within R&D and further drive the op margin up.

So I think scale matters at a certain level. I think from a sales force point of view, to the extent that today you can -- 30%, actually closer to 35% of our business goes through distribution. The ability to leverage kind of, in our case, Avnet as a global franchise partner helps to kind of compensate for that.

On a manufacturing point of view, analog is a bunch of very small little chips. So while we have 300 millimeter and, I don't know, 20%, 30% of our business goes through, our 300 millimeter fab, I think that helps from a cost structure point of view. I don't think that helps you sell product. I think you sell product because you have the best product. And you have the performance that people care about.

Once you sell that product, it's good having the low cost structure. But I don't think that's a scale issue. Again, this is a foundry partner. We have an exclusive relationship with them. So they only provide analog foundry services for us.

But we haven't had to spend any capital to do that. So I don't think -- there, that's just how you work with your partners both in the sales channel, from distribution, and in manufacturing where we have our 300 millimeter foundry partner.

So there's obviously some advantages to scale. I think when you get to a certain level, I don't know where the magic line is. Certainly where Maxim is, I think we're fine.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. And then on the industrial business, I know it tends to be a mix of a lot of different end markets. I think when you had reported earlier in the year, you mentioned some softness on the industrial side that seemed to be different than what we heard from some other players.

But we had Analog Devices present in an earlier session. And to them, industrial is more healthcare. It's defense. So how do you think about your industrial business? What are the key end markets driving that business?

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

Sure. If you think of our industrial business, it's 27%, 28% of revenue. About two-thirds of that I would -- what we all core industrial. Think of it as catalog products that sell through distribution.

So that's 18%, 20% and these are just kind of thousands of parts that sell through our distribution partners. Kind of a very high margin business, very sticky. You know, that's sort of that core business unit that I talked about earlier. They're going to be kind of selling these products.

So that's a business that has -- if you looked within it, maybe there's factory automation in there. There's defense businesses in there. But it's a very diversified, very broad-based business.

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And that's really do you have the products? Do you have the channel management partners? Do you have the kind of the online tools to help people design in your products? And that's how we think about that.

The other kind of third of our business is what we call our vertical markets within industrial. It's medical. It's smart meter. It's financial terminals and financial terminals being kind of point of sale devices.

And we believe there's secular growth drivers in each one of those. I think kind of near term, it's probably financial terminals over the next year. It's having a little kind of trough now but we think that grows.

Longer term, we think medical and kind of moving to medical wearable. Kind of FDA approved wearable devices over a five, ten year period will actually be a very strong growth business.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. One question on the supply chain in the few minutes we have left. Every year the distribution channel gets skinnier. And every year we hear, well, things cannot get any leaner than where they are.

What is the normal level of what you would consider normal inventory in the distribution channel? Where are you right now? And do you think they can get even leaner than where they are right now?

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

Yes, I think the channel over the last four years at least has managed very tightly within a 50% to 55% range. And if it drops down below that, which it did, say, a year ago March. I think it dropped down to 48% and then a year ago June it kind of went back up to 54%.

This year, we ended March at 57% as we had sort of the -- some demand issues in China. Sort of from a macro point of view we saw growth in our inventory in Asia. My expectation is that gets back to the 55% or lower.

I think the discipline amongst the distribution partners at this point in time, it stays there. Now, helping that, of course, we haven't seen huge gyrations, right? We haven't seen-- (multiple speakers) a big cycle.

So anytime you say, well, things are different this time, maybe if you start to see some significant event that happens either macro or some shortage in some part out there, maybe that will change. But for now, I mean, literally four years it's been in this 50 to 55 days range.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Got it. And just the last question, then Bruce, on uses of cash. Maxim has always had a very strong dividend policy. Do you think having a high dividend has helped you attract the kind of shareholders you wanted to attract with that? Or do you think it is better to focus on boosting buybacks? How do you conceptually think about each one of these two levels as the way to attract the right sort of investors to Maxim?

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

Yes. So the classic debate where I don't know if there's a right answer. So we've chosen to kind of do both and kind of equally. I think if you look at how we do that -- if you look at over a five year period, it's probably pretty close to 50/50.

I would say in our industry, back in the days when it was people were most focused on growth and certainly the buyback was kind of the preferred. As growth has slowed and people were thinking about total return, I think you've seen a shift towards dividends.

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And certainly kind of Analog and then you look at kind of the Maxim, we're in a great position in order to kind of reliably provide that dividend. We're growing our free cash. Even when we've had challenges the last couple years with our largest customer in revenue, free cash flow has grown strongly.

It looks like it's probably going to accelerate that growth over the next couple years. And so that ability to kind of let investors kind of rely upon that and certainly when we kind of look at the large shareholders in our stock and many of those conversations is around that reliable return.

And they're, like, okay, there's going to be some cycle to your business. But if we know and you get that 3%, 4% return, I think that's a very powerful return for investors.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Absolutely. Terrific. Thank you so much, Bruce. Really practice your time and insights.

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

Thank you.

Vivek Arya - *Bank of America Merrill Lynch - Analyst*

Thanks, everyone.

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

Yes. (applause)

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