THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MXIM - Maxim Integrated Products Inc at Credit Suisse Technology, Media & Telecom Conference

EVENT DATE/TIME: DECEMBER 01, 2015 / 11:00PM GMT

CORPORATE PARTICIPANTS

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

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

PRESENTATION

Unidentified Participant

Why don't we go ahead and get started. I'd like to welcome everyone to this afternoon's presentation with Maxim.

To my immediate left, it's my pleasure to introduce Tunc Doluca, who's the Chief Executive Officer of Maxim. To his left is Bruce Kiddoo, who is the Chief Financial Officer.

We've got a fireside chat format for the next 25 minutes or so. If you have any questions, raise your hand, we'll get you a mic. But I will kick things off.

And Tunc, as I always do, in case there's any new investors in the audience, can you spend the first couple minutes kind of just positioning Maxim? What's your core IP, what markets are you going after, and kind of what's the core strategy for the Company?

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

So from a strategy viewpoint, for those of you that don't know us, we're in a segment of the semiconductor business known as the analog mixed-signal piece. And Maxim has been in the business since 1984, so it's pretty well established. About $2.3 billion, $2.4 billion in sales.

I'd say that most customers recognize us from our strong presence in terms of technology in the power management business. And if you took that segment or that technology, we very effectively sell that to multiple end markets within analog. So you've got strong presence on the mobile and the consumer side in power, we've got strong presence and power in communications and the datacenters market, very strong presence in automotive, where we've got good revenue growth, and also beginning to get good growth in the industrial and medical piece.

So power kind of cuts across. There are all different types of products, because the needs are different in each market. But it kind of cuts all of those vertical markets in terms of investment. It's almost about half of our revenue base today.

The other piece of the strategy is in analog -- to find areas where we have significant presence in analog mixed-signal in each one of these verticals I mentioned. So invest in those -- for instance, in communications and datacenter, we have strong investments and presence in optical piece. In medical and industrial, we've got strong presence in industrial robust communications within a factory. And we have products to do power management in that area as well. In automotive, in addition to power, we've got presence in video -- transportation of video data in a car for safety and driver-assistant type programs.

So we've got a very broad range of products that we sell, with particular great brand in power management across these. We've made -- from a more recent strategy improvements in the Company, we've made some transformational changes, which should improve the financials and the cash flow of the Company. Much of that comes from changes we've made in our manufacturing strategy. And we're -- and that's about $100 million in cost savings, which we're working on and have made great progress. So we're pretty much on plan to achieve that.

And also, we did some improvements in our operating spending, really focusing more of our energy where we're strong -- which is, as I mentioned before, in the power management -- and also shifting some investments we had in markets that we didn't have much presence into that area.

So in the near term, that's going to be a good tailwind for us in terms of growth of margins and free cash flow. And in the longer term, this focus they've put into the markets that I mentioned should provide growth to the Company on the top line as well.

Unidentified Participant

Tunc, you specifically have some customer timing issues in the December and March quarter. If you take that out of the equation, I think a lot of investors are here this week trying to get a better understanding of what the macro environment or the macro demand picture looks like. So if you exclude that one customer with the timing issues around products, how would you characterize the rest of the demand portfolio today, especially in things like industrial and auto?

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

Yes. So as in any problem you're trying to describe, it's better to kind of section it into areas. So if you exclude consumer and mobile, as you said, and look at their other markets, we continue to see growth in the market as well as, in particular, in Maxim sales and automotive. So that continues to be strong. And we expect it to be strong growth again in the March quarter. This quarter, obviously, it's down a little bit, if I remember correctly.

In the other industrial markets, we expect seasonality to come back. It's been kind of going somewhat sideways, nothing [exciting] going up or down in it. It's been very surprising to everybody, because each of the companies selling into that market were really off from each other in terms of timing. And I'm not going to repeat that, but I think everybody in the audience is familiar with how it played out during the year. But we're not seeing or expecting surprises in industrial.

Comms infrastructure has been weak for a while. We really -- and in that area as well, when we look at data from various companies, again there's big discrepancies between every quarter what each of us is reporting. We're really not expecting that to bounce back strongly near term. We will more project it as a bounce-back when we actually see some orders, rather than try to forecast it.

So that's the view of the comms, communications infrastructure. And I think mobile, we're not -- you excluded that, so I'm not going to talk about that.

Unidentified Participant

Mobile's going to be the next question.

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

Okay.

Unidentified Participant

As we kind of go into the mobile market, clearly, there's some product timing issues with your largest customer, which is setting up for a difficult December, but what's expected to be a pretty significant rebound in the March quarter. How do we get comfortable that you have the visibility on that March rebound?

And I guess importantly, as you think about consumer as a percent of revenue, from a strategic standpoint, what's the right number? Because you clearly have great products that your customer values in that market. But you've been sort of prisoner to their relative success or lack thereof. And so how do you think about investing in the consumer market, and the consumer market as a percent of revenue, longer term?

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

Okay. So that was a lot of questions --

Unidentified Participant

Two questions.

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

-- in one.

(Laughter)

But I think from what gave us the -- first of all, it's not our practice to guide beyond the quarter. So the question that came up is -- well, why did we do it this time? Because something really special happened this time. And it was mostly because that particular customer really pulled in the ramp of their previous product, their note-generation product, which gave a gap in this quarter, which -- we felt like we had to explain it to be -- explain that well to all our investors, and not leave them hanging.

In terms of the ramp next quarter -- it's pretty much, pretty close to what they've done before, with maybe a little bit of pull in. We've got reasonably good confidence in the content we have. And I think there -- we believe that, from our look and the builds they have to qualify, it looks like they're going to be on plan.

The rest of the growth really comes from other seasonal changes. Automotive always kind of ramps up at the beginning of the year. Industrial has the same type of bounce-back. And as I said before, on comms infrastructure, we just were cautious. And even though some of our business units and managers were saying there would be a bounce-back, Bruce and I are going to be cautious and not count that until it happens.

So that's why we felt like it was the right thing to do, to give that visibility this time. But don't expect it going forward.

Unidentified Participant

Before you get to the longer-term part of that question -- and kind of hate to ask this as a follow up, but I think there's been a lot of confusion. On the conference call, there were some qualitative comments even beyond March on the June quarter. I thought what I heard was that June is usually a seasonally strong quarter. And so we have that as kind of a tailwind as we move from the strong consumer March to a strong sort of industrial auto June. Without you guys really talking about what June was going to be, but there seems to be a lot of confusion with the investors I talked to -- is there any clarification around the qualitative comment on the June quarter -- from either you or Bruce would be appreciated, I think.

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

Who made the comments on the phone (multiple speakers)?

Unidentified Participant

I think they were Bruce's comments on the call.

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

Then he should clear it up.

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

I can clarify, or attempt to re-confuse folks more.

No, I think the question came up is -- given that potentially you're going to see an earlier ramp of the Samsung flagship phone in the March quarter, would that have an impact on your June quarter. And certainly, the answer was yes, that normally we see a strong ramp in our consumer business in June. And with that ramp potentially kind of pulled forward into March, that would absolutely impact the June quarter, and consumer probably would be down versus up, which is the normal seasonality.

Beyond that, we didn't -- yes, it's typically a strong quarter for industrial and automotive. But we have no unique insights, certainly, at this time whether that's going to be true again in June or not.

Unidentified Participant

That's helpful.

And then, Tunc, just the longer-term question -- what's the right level for consumer as a percent of revenue? And then, I guess, help us understand. Because we've got in our minds that we should value consumer business as lower-quality business from a multiple perspective. But when you think about shared R&D, and what the consumer R&D might be able to bring to other parts of the market, are we sort of mislabeling consumer in your mind?

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

To some extent. I mean, I think that in terms of its volatility, I understand the way investors look at it. And I think it's a valid point. I think that the way we see it is that we're in the business for several reasons. One of them is that it is -- the consumer market we're playing in is trying to make products that are valued -- whose performance is valued by customers. And we can get the margin structure that's more in line with what the Company's is.

So those are the ones we invest in. And if we don't do that, it's not something we're (inaudible). We'll just divert those investments somewhere else.

In terms of what is the use to the rest of the Company -- there are some benefits that are qualitative that are not really apparent from the outside. Number one is that the technology that's developed there is done at a very fast pace and usually leads how soon we develop those technologies for other markets. And therefore, it gets leveraged by other business units in other markets very effectively. So that's number one.

And a good example of that -- I think Bruce and I talked about this in our last investor conference -- we made all these products to be able to power up these applications processors that are used. And guess what? Those same applications processors are now being used in infotainment systems.

And we pretty much have the products ready to power them up. We just have to make the more automotive type designs more robust and so on. But that's incremental, small work.

So the IP developed there definitely gets leveraged into the other parts of the business. That's number one.

Number two -- it really sets up a good example of how quickly and agile engineering can be in the Company. So it's kind of like here's a group that can develop products in six to nine months, while the rest of the company is on a two-year product development. So it shows it is possible to do. And it helps from that respect in getting the agility of the old company up as a result of that.

But regardless of whether these are side benefits -- if it doesn't make financial sense, we're not going to do products. It's pretty simple.

Unidentified Participant

Well, (inaudible), when you look back at some of the issues you've had with your consumer exposure, has it been because consumer was a large percent of revenue, or because you had lacked diversity within the consumer bucket? And can you talk a little bit about sort of broadening out the diversity within that consumer bucket, whether it's other large handset suppliers or, more importantly, things like wearables?

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

Yes. So I think in general, the short answer is that we really did lack diversity. I mean, most of our revenue was coming from flagship smartphones at one customer. And I give credit to the engineers that were in that business. They've won a lot of business, generated a lot of cash for the Company. But it was very concentrated. So when that happens, the reverse of the growth can occur as well.

So our goals have been really to diversify that as much as we can. But you have to admit that that's not very easy. Because there's two customers that dominate it. And if you win the other customers, yes, you can diversify the business some. But it still doesn't move the needle that much.

Regardless, that's what we've been doing. We've been making products in wearables, whether it's fitness or watch type applications; and actually been doing well, taking our power products and winning at pretty much all of the other customers that make wearable products on the power management side.

And we actually was able to win a lot of products at the other large customer in that business. But they're not big hitters in terms of very high-volume products; they're more standard products that find their way into all kinds of products at the other customers. That's good diversity, even within that customer.

But regardless of that, our largest customer is still half our consumer business, even though we've worked hard to diversify it. And we continue to do that. I think going into the future, we are going to see that shift go more and more towards possibly just having consumer stay about the same, but be more diversified than it is right now. That's our goal.

Unidentified Participant

Bruce, Tunc had mentioned earlier some cost-cutting initiatives, I think, in his opening comments about positioning the Company. Give us an update on kind of where you are. From here, what's kind of the heavy lifting and the big levers on the cost-cutting and margin story?

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

Sure. I mean, we announced in July $180 million in cost reductions, $100 million in manufacturing and $80 million in operating expenses. When we kind of go through the manufacturing side, there was a couple key milestones there. One was shutting down our -- we had a small development fab in San Jose. That was actually going to save us about $45 million a year. That fab has been shut down. We will announce the sale of that fab as well this quarter. So that's basically on track. We'll see the full benefit from an accounting point of view in the March quarter. So that's doing very well.

The second initiative was to sell our San Antonio fab to a strategic foundry partner. We've announced that as well, the sale of that fab, to TowerJazz for $40 million. Again, very positive kind of win-win scenario, in that we get to maintain our proprietary manufacturing processes that are done only in that fab. Right?

So we get -- obviously, those are very high-margin products for us. So we get to maintain through a long-term supply agreement the ability to ship those products. But now we don't -- it's a variable cost model. Right? And our foundry partner will be able to qualify their processes in this fab and support their customers through this fab. So we'll be able to generate, over time, lower wafer costs, lower capacity commitments; and really kind of change then to a variable cost structure.

So that piece is -- the deal is announced. It'll be effective January 4th. That will take some time to see kind of the full cost savings. Because we've sort of built in time for our partner to qualify their process and bring their customers into that fab and really realize the benefits of the higher utilization.

The third piece of that was really shutting down a small fab in Dallas. That will happen probably in kind of the March quarter of 2017, so a little over a year out. High confidence that we'll do that. The only reason it takes time is there's just a number -- there's lots of products that have to be -- the mass [set] has to be transferred out to kind of the Asian suppliers for this capability. But we're highly confident we'll be able to execute on that.

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

And some of it to our Beaverton fab as well. So both places.

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

Right.

And then we just have some other additional kind of cost reductions, which are also on track. So manufacturing is in great shape.

Sort of the operating expense -- we basically said we were going to go from $200 million a quarter down to $180 million, with the only offset being any increases in profit sharing, as kind of the revenue and profitability of the Company increases year over year.

We're at $193 million in our September quarter. We guided to around $190 million in the December quarter. We're on track. We've done the reductions that we can do at this point. The remaining reductions will come through the divestiture of certain businesses. Those are on track. We expect probably more in the March quarter. Maybe we might see an announcement in the December quarter. But those are on track as well.

And if we're not successful divesting those businesses, then we would just harvest them. Right? Clearly, it's the better scenario for our employees, for our customers, and for us as a company be able to monetize that. But again, the confidence level in achieving those reductions.

So overall, we had -- we're very confident in the ability to do this. We actually started this a year ago, when we said we were going to go from $220 million down to $200 million a quarter in operating expense. Actually, we said $220 million to $210 million, and we overachieved by $10 million last year.

So again, I think we have a track record. And certainly, we've hit all of our milestones to date.

Unidentified Participant

Since I challenged myself not to ask an M&A question for the first 20 minutes -- and we're 22 minutes into the fireside chat, so now I can ask the M&A question.

Clearly, a lot of speculation about M&A. I'm kind of curious, though -- when I look at Maxim, you've got 60% gross margins, you've got 30% op margins. You don't lack of scale. You've got a great product portfolio. I mean, you're one of the premiere pieces of real estate within the semi market. Under what scenario is this a more valuable asset inside of a large company than it is as a standalone asset?

Because it seems to me, if you just execute to your strategy over time, there's a lot of shareholder value still to unlock in the Maxim integrated product story as a standalone company. And if anything, given your relative scale, you should be looking to buy things, and not the other way around.

So help me understand kind of your mindset around M&A in general for the Company.

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

So, what we're operating to is pretty simple. We're executing at the plan that we believe is the best thing to increase the value of the Company. It's the plans that Bruce talked about and the investment decisions that we made in terms of strategy. Those are the best things to do for us.

Part of -- and that increases our value in any scenario, whether somebody is interested in us and buys us, whether we remain independent, and the investors realize the benefits from it.

And we also are open-minded to looking at potential companies that we can acquire. But we do want these companies to be something we understand how to run. So they got to be in our general field of analog and mixed-signal.

We do want them to have -- after any synergies that are possible to get to operating margin structures that are like ours -- good, high gross margins and so on. And obviously, it's got to make financial sense in terms of return on investment.

But when you put all those together, there's not -- it's not a whole lot of companies to list. And I think that we've got a pretty active business development team. And they're looking at these assets for -- whether it makes sense for us to acquire or not.

So we're basically heads-down doing the work we need to do to increase value for the Company. And we're open to going after other companies that fit well within our strategy. When something comes from the outside, then clearly it's our duty to listen and see if that makes sense. And that's the model we're operating under.

But I think we agree with you. We've got the scale to run pretty well as a very profitable company that generates a lot of free cash that we share with investors every quarter. And that's the plan that we're working under.

Unidentified Participant

Any questions from the audience?

Tunc, Bruce, maybe I can follow up with that. We do an investor survey every year before the conference. And one of the questions we've asked over the last six, seven years is what should management teams do with their excess cash. And over the last five years, almost predictably, it was buybacks, dividends, buybacks, dividends. And what ranked really low was M&A and investing in your own business.

This year, that changed. Almost 43% of the investors say -- we want companies to actually invest in their own business.

As you guys embark sort of on this cost-cutting program, how do we get confident, from the outside looking in, that you're still investing in the right areas? Because it does look like you're taking a lot of cost out at a time when actually investors are telling you, or at least telling us in the survey, that maybe they want you to start spending some more to invest in organic growth. So how do we get comfort level that you're making the right investment decisions on the OpEx line?

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

So in terms of -- I mean, the bulk of that investment, obviously, is in R&D.

Unidentified Participant

Yes.

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

And that's the piece I assume investors are most interested in. But if you look at the level of R&D investment in the Company, we still -- even after the cuts that Bruce mentioned, we're still in the 20% range. So it's a very healthy amount of investment.

And when we went about coming up with what we should do in terms of internal investments, we really did it in a new way for us. In most companies, it's a budgeting process that's -- this is what we're going to spend, and then find a way to get to that. Whereas what we said is we gave -- after we reorganized the Company and put -- reduced the number of BUs and put them under one organization, we basically asked the general managers -- what is the right amount of money for you to spend, to grow the business with the risk profile that we're interested in?

And so this was like a bottoms-up model that came up. And basically, that's what gives me confidence that it's not something that we dictated. It's more something that came from the general managers who are responsible to grow the business.

And trust me, these guys always want to spend more. But in this case, they came up with a model that said we don't have to spend all this money. Because there's some very high-risk investments that we don't want to go into themselves. And we agreed with them.

So that's why I'm comfortable with the level of spending that we've got. And it's putting into the right areas, the areas I mentioned at the opening. That gives us good growth opportunities, increased growth opportunities in the future. In the meantime, the cost savings also drops to the bottom line.

So I'm confident. We're on the right path.

Unidentified Participant

Great.

With that, we've ended time in this session. Apologies. But I'd like to thank both Tunc and Bruce for spending some time with us this afternoon. Really appreciate it. Thank you.

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

All right. Thanks.

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

Thank you.