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EDITED TRANSCRIPT

MXIM - Maxim Integrated Products Inc at Morgan Stanley Technology, Media & Telecom Conference

EVENT DATE/TIME: MARCH 01, 2016 / 9:15PM GMT

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PRESENTATION

Craig Hettenbach - *Morgan Stanley - Analyst*

Great. Good afternoon, everyone. My name is Craig Hettenbach, one of the Semiconductor analysts here at Morgan Stanley. I focus on the analog and MCU segments. I'm very pleased to have with us today, Maxim, and CFO, Bruce Kiddoo. And Kathy Todd, Investor Relations, is here with us as well. So, welcome, Bruce.

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

Thank you. Thank you all.

QUESTIONS AND ANSWERS

Craig Hettenbach - *Morgan Stanley - Analyst*

Now, before we dig into just some of the kind of fundamental growth drivers and business makeup of Maxim, we'd like to kind of hit, up front, just some of the macro; I mean, swirling around the conference in terms of what's going on in the world today versus what the broad-based semiconductor suppliers are seeing in that business. If you can give us some context.

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

Yes. I think that's the million dollar question because we all see things seasonal and the markets are maybe indicating something else.

From our point of view, if we think of the March quarter and the first half of the year, it's seasonally, it's always a good quarter for industrial, automotive. We guided both those businesses up strongly. And, from a bookings flow, we're seeing everything that's normal. We look at kind of inventory in the channel; it's doing well. So, we haven't found anything out there yet that is worrisome. It's not like the world is great, but it's not like it's kind of danger signals out there.

We also guided up our communication and data center business. I think that's more just a statement of calendar of 2015 was weak. So, I think it's just sort of a recovery as opposed to a seasonal statement. So, I mean we're obviously looking out wherever we can and usually it's in the distribution. Things look okay there.

I think people are also concerned about China. I think, from a -- it's hard to get what exactly our business is there, but if I look at us, we're probably under-indexed compared to kind of most semi companies, in that we don't have a big base-station business, we don't have a big handset business there, and we don't have a big broad-based industrial business there. So, in general, the business we have is the luxury automotive that ships in from there or a Samsung phone that ships into there. So, we're not seeing any big feedback on China either. So, overall, it feels normal, which, I know, is different than maybe what the market has been so far this year.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. And that comment -- I mean the industry went through a correction last summer and things kind of got reset. Is there any differences you can make today in terms of what's going on in the business versus last summer when there was a bit of slowdown?

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

If anything, if I look at 2015, 2015 had lots of stories involved with it. I remember in like the first part of the year, there was the currency issue and we had lower bookings in Europe in March and we had a below-seasonal in June. Obviously, the comm infrastructure market never quite caught on. So, there's lots of things to talk about. So far, this year just feels -- and it's a word we like to use -- is boring. It's just --

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Craig Hettenbach - *Morgan Stanley - Analyst*

I think people will take boring.

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

Yes. I mean it is just sort of -- we're executing on all of our profit improvement plans, the cash flow. We're not seeing any big dramatic swings from a forecast point of view. It's things are happening as they should.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got you. Alright, well, with that backdrop; coming off of a recent analyst day, I did want to talk about the growth drivers and understanding the target of 50% above is a longer term. It's not this year or next, but what you aspire to do longer term. Are there a to-two or -three things that you think will reinvigorate the growth for Maxim as we go forward here?

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

Sure. I mean I think if you, from a growth point of view, I think there's two sides to it. Just to deal with the negative first, is we need our Samsung exposure just to stabilize. It's already in half of where it used to be. And we think that we're getting very close to that. But I think that business stabilized.

And then, on the positive side, the automotive business has been growing over 30% the last several years. And it's a big business now. It's 17% of revenue. So, we used to say it's just growing off of a small base. It's now growing very strongly off of a medium-sized base. So, I think automotive is clearly going to be the biggest growth driver for us.

The industrial business, we've been investing and kind of getting back into that business for the last several years. And I think we're starting to see the benefits of that. And so, I expect that just to grow in-line with the industry. And I think most people think of industrial business as sort of global GDP-plus business. But if you look at it, every time you kind of look back, say, look back for the last three years, it's actually has always kind of grown 6%. 7%; not to say it will in the future, but it's a good business. It's a good solid business. Obviously, a profitable business.

The third growth driver will be in the data center side. Our big believer is that kind of the cloud providers, the hyper-scale folks, the Amazon, the Googles, the Facebook, the Microsoft, these guys are now designing their own hardware, their own servers, their own storage, their own connectivity. They care about performance. They care about kind of total cost of ownership. And the ability to lower their utility bill through our technologies is something that's going to provide a big growth driver for us. That's probably more 2017 than 2016. I think you'll start to see evidence of that in 2016, but I think that's going to be a big driver.

And then, the final one, again, I think more 2017 versus 2016, is kind of the whole wearable market. I think this is going to be one that will be a big market. It's going to be somewhat fragmented. You're going to have different categories, from sort of extensions of your phone in the Apple Watch or the Samsung Gear. You're going to have fitness devices; the Garmin or the Fitbit. And then, you're going to have medical wearables, which are FDA-approved or for hospital usage.

There is no doubt in my mind these are going to be large markets; it's just a question of, it's not one market. And so, you have to approach it from a technology point of view; what do I have that I can sell across multiple OEMs and, really, from a general-purpose or a application-specific product set that we have. And, for us, again, that's power management and sensors and analog that goes along with that.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. I want to touch on just the comments on industrial and growth. And one thing that you highlighted at the analysts' day is in terms of the focus on some of the general-purpose building blocks; where it's a really good base business, but there's things you can do to maybe drive some better growth. So, if you can expand on that.

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

Sure. It was interesting. We end -- our fiscal year ends in June and, last year, always in kind of the May timeframe we do what other companies do, we'll do our planning process and kind of the strategic planning review. And a lot of things came out of that. Part of that was sort of the transformation of manufacturing, which drove up gross margins 4 points, and kind of the portfolio management, which allowed us to lower our operating expenses.

And the other piece was, since we kind of looked at about a third of our business is products that have been out there for over 10 years. And these are all very high, 70%-plus gross margin business. And they were sort of the cash cows that were sitting in each one of our business units. So, what we did is we took them out of the business units and gave them their own business. And, in doing that, we now have one guy who's focused on growing that business. And, in the past, this was a business that was probably flat, maybe down 1% a year. And this is the beautiful thing about analog; is that you have these products that are very profitable. They're designed in, in an industrial system or a communications device, and it's going to be there for a very long time.

Well, if we can just tip that up instead of flat to down, have it grow 1%, 2% -- and that's just things like better strategies with our distribution partners, better support from an online tool to make it easier for these kind of small customers to be able to design it in, different strategies around pricing to be able to capture the value of these parts.

So, that opportunity, actually, it's not going to be one where I'm going to sit there on an earnings call and say; oh, because of our core business unit, we saw revenue outperform. But, over time, that's just going to be where you just kind of consistently see strength, both from an industrial start to do a little bit better versus our peers, and, second, the profitability of the Company. We've given this target of 65%. We'll get there just off of kind of the restructuring our manufacturing footprint. But this will just be another tailwind to help continue to support and drive gross margin going forward.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got you. And I know, within distribution, Avnet is an important partner for you guys. Can you talk about just your strategy in the channel and then ways that you can help drive growth that way, as well?

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

Sure. I think Avnet has been a great partner of ours. We, initially, kind of just worked with them to get mindshare. We're kind of now moving on to things like top-selling programs. I think, at the end of the day, analytics is a big part of all of our businesses these days and the ability to identify what parts people want. You would think it's all basic stuff, right? But, to the extent that there's like Amazon; Amazon says, "Oh buy this. What did you think about that?" Analog semiconductors can do the same thing, from that point of view.

So, I think those type of programs, those analytics to identify what are the top-selling parts, what are the parts that go with that, providing better support. Again, I think some of our peers historically probably did a little bit better job than us on online tools to help folks design in the parts. That's another area of focus for us. So, I think all of those commitment to Avnet and then where they can see we're making that investment, they will then kind of go along with us and make a similar investment.

Craig Hettenbach - *Morgan Stanley - Analyst*

Sure. Excellent. Maybe we can switch gears into the automotive space, which has been quite a success story in terms of growth driver for you guys in recent years. From what we hear from investors, everyone is focused on the market because it's a big and growing market. So, what really differentiates Maxim in this space? Kind of where are you in the growth curve and what should we expect as you go forward?

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

Yes. I think the biggest thing that differentiates us is

the growth has been on the infotainment side and we've really been focused on that since 2004. This isn't a business that you can just decide, hey; you sit in your annual planning session and say, "let's go invest in automotive." So, we've been investing in it since 2004. We started getting revenue in 2007.

And this has been one of those kind of beautiful; you kind of start of, you get your business, it won't give you a lot. You have to prove yourself from a quality point of view. You have to prove yourself from a supply-chain point of view. And then, it just starts to accelerate. You continue to get more design wins. And, at the same time, the old design wins don't go away because of the very long product lifecycles.

And so, this is one where we've, now, we're a strategic supplier. We've hit the sweet spot from, if you think of what infotainment is; it's a lot of processors. Think of NVIDIA application processors that are processing data and electrical content. We do the power management for that.

That's the same if you think of what the next trend is going to be in automotive; it's going to be driver assistance, safety, at some point, five, 10 years out, the ability to do autonomous driving. Again, lots of processors. We're going to do the power management for that.

So, I think this is the business that it rewards those people who have invested in it. You've established the relationships. It's not something that it's easy to enter. And I think that's going to be, probably, the biggest barrier to entry. Let alone the fact that, as a company, we're a market leader in power management. That's what our biggest market is within automotive. And so, we'll continue to leverage our technology, our leadership position to grow in these high-growth areas within automotive.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got you. And you mentioned it's gone from kind of a growth off of a small base to now it's much bigger. So, do those large numbers come into play in terms of the pacing of growth and, maybe more broadly, what your opportunity sets are in automotive?

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

Sure. This isn't a business that's going to grow 30% forever. We know that. We do think, though, that if you kind of look at the market that we're addressing, it's probably growing at 9%, 10%. We've been growing almost 3X that. I think, long term, over the next five years, the ability to grow

2X that. There's going to be some slope. There's going to be some slope as that growth rate slows. I think that's going to be a relatively gradual slope.

So, ultimately, you'll get to a 15%, five years out, long-term growth rate for that business. But, near term, I think we're going to continue, because of what's happening continued on the infotainment side, what's happening on the safety side, the market that, the technology we have for electric vehicles and hybrids. I think you can look out at automotive and, from a content story, set aside units and peak auto and all those issues, from a content point of view, I think this is still a 10-year growth market for the industry.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. And just on the near-term concerns; so, for you, it might not be as protective in terms of you're growing in this space and you're growing content and platforms. But, to the concern about peak auto production and just from a production perspective, any light you can shed on that in terms of customer interactions and what you're seeing?

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

Yes. As you say, I think we're -- I mean we have forecast reviews internally. Someone always stands up and talks about SAR units and growth. And, to date, no correlation to actually what's happening with our business. Has it been all about kind of content growth? I think, at some point, as we become a more mature automotive business, it becomes a much larger business, certainly we'll be impacted by kind of the macro trends within automotive. Today, it has not had an impact. Certainly, if there's suddenly a recession in automotive instead of SAR units, instead of going up 4%, go down 4%, we won't be immune to that. I don't mean to be too casual about it. But it has been, to date, a content story for us.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. If we can just switch gears to the data center; that's one of the growth areas within semis today. What is it about Maxim in terms of the products you're addressing and opportunities within the data center?

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

Sure. I think the huge change in data center is, in the past, it was the enterprise OEMs who were supplying the hardware; the IBMs, the HPs, the Dell's. Without question, the hyper-scale guys are going to -- they're designing their own hardware. They care about total cost of ownership. So, they care about the energy bill that they're paying, what they're paying the utility company. And so, to the extent that we have leading technology from a power management point of view, which is what we've had, this is something that they're interested in. They're willing to pay for it. They're willing to pay for performance. (inaudible) capture value. And so, we have a number of design wins already in this space. We think this is, over the next year, will ramp up to become a material business for us.

The other side of this is connectivity. Certainly, just the amount of traffic that's happening now in a data center and the connectivity within that data center is going from 40 gig to 100 gig optical connectivity. We had very little share in 10 gig. We've had kind of growing share in 40 gig. And we think we have a leadership position in 100 gig. We've already, like this quarter, we're starting -- I mean the product just sampled in the back half of last year, yet we're shipping low-volume production units this quarter. Just kind of -- it's not material to the quarter, of course, but just as an indicator of the pull that we're getting from these hyper-scale folks.

So, I think, clearly, this is going to be a transition to the cloud providers. I think, clearly, they'll pay for performance. And I think, in these two areas, in power and connectivity, I think we have leadership products.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. Maybe just one last one before we get into some of the margin initiatives; part of the story, just in the consumer segment, the puts and takes there in terms of maybe stabilizing the large OEM customer on the handset side versus some of the growth opportunities you see in wearables and tablets.

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

Sure. I think when we look at this business, we've decided just to focus on where we have market share, what we do well. And that would be power management, audio, and sensors. So, we're not looking to grow or expand or go after new markets. So, first, we're staying very focused.

The second thing we're doing is we're avoiding the sort of any high R&D custom products, which are usually, can be high return, but are very high-risk as well. So, we're just trying to do kind of either general-purpose or application-specific products in power, in audio, and in sensors.

And I think the audio is a perfect example. We have a very focused effort just around some smart amplifiers. We have design wins at the two large OEMs plus China. So, there's an area where we have a common product. We've kind of sold it across the board. And so, I think, from that point of view, we've been able to kind of build a very, what I would say, tactical business with Apple, where it's simply kind of parts across their whole product line. There's no one big part and it's not all in one product or the other. So, I think that's a nice tactical business that's doing well.

The Samsung side has come down. And then, we're kind of growing the -- very selectively growing the China business; again, where somebody like a Huawei is looking for kind of high performance as opposed to being on the lower-end phone.

I think on the wearables side, which is actually growing very nicely, business at Garmin, Fitbit. Obviously we're in the watches as well. And, as I mentioned in my opening comments, I think this is a nice long-term growth market, but I don't think there's -- it's going to be more fragmented. And, where we win is with the power management, with the sensors, and, in some cases, with a very low-power microcontroller.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got you. Okay, last one before I open it up to investors for questions. On the margin initiatives, if you can talk about that, the OpEx reductions that are taking place and also the transition of fab-light; kind of where you are and the implications as you move through the year.

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

Sure. I mean, last July, we announced a plan to basically save $180 million, take gross margin from 61% to mid-60%, take OpEx from kind of the old target of 30% to a new target of 35%.

To date, we've executed on everything we said we were going to do. We shut down a small development fab in San Jose and sold that. We took a large production fab in San Antonio and sold that to PowerJazz and signed up to a very, a long-term supply agreement, so we'll continue to be able to get the parts that we need from that fab. But we've taken it and we've turned a fixed cost into a variable cost. We're on track to shut down the Dallas fab that we had. Basically, a year from now, we'll be shutting that down.

So, all of that will, in essence, take about $100 million of cost out of our COGS line. About $40 million of that is depreciation and the other $60 million is cash savings. And so, I think that is on track, will happen. The vast majority of the work has already been done and so I feel very confident.

I think on the OpEx side, we said we were going to kind of go from $200 million a quarter down to $180 million a quarter. That was partially from kind of portfolio management. We sold our touch business. We sold our smart meter business. We're in the process of looking at alternatives for our MEMS business. And so, from that point of view, we're on track.

At the same time, we didn't take all of the savings to the P&L. We are reinvesting in our growth markets. We've added -- we've reallocated resources in automotive and data center and the industrial side. So, yes, we're saving money, but, at the same time, I think we're just being smarter and more focused on where we are investing.

And I do think some people worry that; oh, we're cutting too much. Let's be clear; we were probably spending too much, is the right way to think about that. We were at 22%, 23% of revenue. Our peers, people we respect, ADI, Linear; they were all at like 17%, 18%. And so, I think, for us, I think there was room to bring down spending while continuing to invest in the growth areas and be able to support a growing top line.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. With that, are there any questions from investors? I'll keep it going until there are.

Just on the topic of capital allocation, broadly, and specifically M&A. So, if I think about the cash returns have been really generous in terms of your growing dividend and buybacks. From an M&A perspective, you've down more tuck-in in type of nature. We're seeing bigger deals happen across the space. What's your approach to capital allocation and your thoughts on the consolidation and opportunities for Maxim?

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

Sure. I mean Maxim just generates a tremendous amount of cash in a very stable way. And so, historically, we were generating at about 25% free cash flow margin. With our reduction in CapEx -- we were spending around 6% to 7% in CapEx. As we've moved to this more fab-light model, we're probably going to spend, now, in the 2% to 3%. So, that has allowed us to kind of get up to 30% free cash flow margin. And then, with the improved profitability, we believe that will allow us to get into the kind of a 30% to 35% free cash flow margin. And, last quarter on a trailing-12-month, we were at 32%. We generated $700 million in free cash flow, as a company, on a trailing-12-month basis.

And so, we believe this is very stable. And so, from that point of view, we return it to shareholders. Our commitment is 80%. Last four years, we returned 94% to shareholders from a combination of both dividend and buyback. Dividend, of course, is sort of -- we follow free cash flow. We think of it as a free cash flow payout, usually on a trailing-12-month, just to make sure there's no -- we're not trying to bank on some future outcome and then can't deliver. So, we try to do that. And then, buyback, of course, is on a matrix basis, from that point of view.

I think from an M&A, certainly to the extent that we have the cash flow, we've improved the EBITDA, the profitability of the Company, we have the capacity to do major acquisitions, certainly well above what, historically, we would call a tuck-in. And so -- and we've talked about kind of companies that are in the $1 billion, $2 billion range that we believe are probably too small to survive, long term, in this industry and are really kind of a prime area for people to look at, us and others, from a consolidation. And I think, to the extent that we looked at that, I think we could do that within our cash flow.

Maybe, near term, you would pull back on the buyback. Certainly, you would never touch the dividend. But, again, I think if you're generating 30%, 35% free cash flow margin, clearly you have the ability to go off and handle increased debt. Today, we're at kind of right at just kind of 1-times EBITDA.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. There's a question.

Unidentified Audience Member

Thank you, Craig. So, talking about the automotive business, you were quite bullish about the content per car. So, there is actually something that we are monitoring, in research at Morgan Stanley, is actually the level of auto credit for cars. And it looks like now it's about 20%, 25% higher than in 2007. So, it feels like it's very easy for anyone to buy a car on credit.

So, is it something you're looking at, as well, because it feels like that, yes, there is more contents per car, but also it's much easier to buy the car. So, if there is a credit squeeze or a credit freeze, what would be the impact on the supply chain, in your view?

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

Yes. I mean, certainly, at a high level, aware of the fact that a group of people have started to use autos to replace sub-prime -- auto loans as opposed to sub-prime mortgages. Not smart enough to know anything more beyond that and to predict where that ends or how that -- or that outcome is. To the extent that it impacted units, certainly that would have an impact on our business. It just depends on the severity of it.

As I said, I think, initially, it is a content story, but if suddenly SAR units went from 4% up to down 4% because if there was some major correction, similar to what happened in the housing market, that would be an impact. But, I don't have the insights to be able to predict if that's going to happen and, if it does, if there's -- the level of impact of that. So, that's certainly a risk out there, to the extent that that -- the level that that's occurring today and the risk of that imploding.

Unidentified Audience Member

Thank you.

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

Yes.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay. I think, with that, we're on time, so thanks for your time today, Bruce, and for being here.

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

Great. Thank you.
