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

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CORPORATE PARTICIPANTS

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

CONFERENCE CALL PARTICIPANTS

Tore Svanberg *Stifel - Analyst*

PRESENTATION

Tore Svanberg - *Stifel - Analyst*

I think we're just going to get started. I know a lot of you are eager to go and get a cocktail pretty soon. So I wanted to get going as quickly as we can.

So I guess was it 10 nanometer to 180 nanometer. So this is going to be --

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

Excuse me. 90.

Tore Svanberg - *Stifel - Analyst*

All right 90. From 10 nanometer to 90 nanometer. So welcome to the last session of the day here at the Stifel 2016 Technology Internet and Media Conference, Maxim Integrated.

It's my pleasure to introduce the company this afternoon. My name is Tore Svanberg. I'm the senior (inaudible) analyst, and I cover analog and IoT semiconductors.

And with us from Maxim today, we have Bruce Kiddoo, the Company's Executive Vice President and Chief Financial Officer. And he's on stage here to my left. And then also we have Kathy Ta, who's the Company's Managing Director in charge of Investor Relations, and she's right here in the front.

The particular format for this session is fireside chat. So with that, we're just going to get started.

Tore Svanberg - *Stifel - Analyst*

So thanks again for coming, Bruce. We appreciate it.

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

Sure.

Tore Svanberg - *Stifel - Analyst*

I wanted to maybe get started on some of the key things that you and Tunc talked about during your Analyst Day, because I thought your Analyst Day was a key message to the investment community as far as how you're changing the business.

And I remember one of the core topics was really to try and strengthen your position in power and maybe even try and diversify your exposure in the power management sector. So if you can maybe start there, and then we'll take it from there.

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

Sure. I do want to thank everybody who's wanting to go watch the Sharks game in a little bit, right. So hopefully this will be just as exciting. And besides, those games all end up in overtime anyways, that's how they get won. So first 20 minutes is not that interesting.

But you're right, at our Investor Day, we really focused on three things - power management, kind of differentiated technologies and other markets, and then operational excellence.

And when we think about power management, a year ago right about this time, we went through our annual planning process. And we have a fiscal year that ends in June. So this is the time we kind of do our annual planning.

And we had gone through a restructuring in the Company, and Matt Murphy took over running all of our sales and business units. And we got to take kind of a fresh look and looked across the Company. And while we always knew power management was a key technology for us, looking at that and coming to the realization that it was actually over right around 50% of our business.

And we had never -- we always kind of looked at our business by end market and thought of our business that way, and we hadn't, in a little while, taken a cut of it by technology.

And when we looked at that, it made sense to us. This is something we've always been very good at. At the same time, we kind of came to the conclusion which in a slower growth market we really needed to focus on what we did well, where we had share, where we had a good brand.

And again, that led itself to power management. And so it's an area that we decided to focus on. It's something where if you look at kind of the growth opportunities for us as a company, and I'm sure we'll talk about automotive, where a business that's been growing at 25% to 30% year over year and it's so large this quarter will probably be a $400 million annualized business, our strength there is in power management.

If we look in the industrial market, probably kind of the most profitable, most stable business within analog, again, an area where we believe our power management, while in the past has actually not been a big part, we think is a big opportunity for us to grow within industrial.

A nice area, I think second to automotive from a growth opportunity is the data center. Again, I think our technology from a power management point of view and as the industry moves to 48 volt architectures within data centers, again something where we believe we have a leadership position.

And finally, even if you kind of go out, whether in the wearable market, whether that's selling into some of these fitness devices or sort of medical grade wearable devices more in the future, again we're leading with power management.

So it's something we have a core technology in. It's something where our R&D can be amortized across all these various markets, such that we can very efficiently address these markets. It's something where we're able to build up a platform technology. And so that gives us advantages.

And finally, it's an area where kind of our move to a more outsource relationship, working with foundries, making the move into 90 nanometer provides benefits that many of our peers who are up at still kind of older generation technologies won't be able to compete as effectively long term in power management.

So again, we think it's who we are. It's our D&A. We feel like it's a major advantage for us. And we think the focus of shifting resources from say some other technologies in the power will be good for us and kind of reigniting our growth and kind of getting back to our roots, which has always been kind of one of the fundamental strengths of Maxim.

Tore Svanberg - *Stifel - Analyst*

And you announced this sort of officially to investors in February. But my understanding is this is something that you started working on already, like you said maybe over a year ago.

So have you started seeing any examples of success of this new strategy, whether that's in industrial or communications, where like, hey, we're a little bit refocused on power again, especially some of the core technologies and core products. Do you have any examples you can share with us or -- ?

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

So certainly automotive is a huge example. That's been going on for several years. But I think some of the newer examples, one would be in industrial power. That was probably three years ago, we started refocusing on power management within industrial, primarily for factory automation.

And if you think about what's happening in factories today is basically the PLMs, or the control units, the processing is moving out to the edge, and so closer to the sensors, closer to the robotics. And so that's where power management is critical as you're getting in these smaller devices and you need lower energy, lower heat.

So we're starting to see some business and some revenue traction there. So I would say that's one area where we've seen that today.

The other area, of course, is in the data center and focusing on power management for data centers. And the big transition that's happening there is servers are now being kind of defined and built by the actual cloud computing or cloud OEMs - the Googles, the Amazons, the Facebooks, the Microsofts of the world, as opposed to the IBMs and HPs and Dells.

And in so doing, what they care about is lowering their energy bill on a total cost of ownership, and also the density, the ability to get more servers within an existing space. Power management is critical for that. It's an area where we're starting to grow the 12 volt, kind of the traditional power management within a server, but there's been now, even since our Investor Day, some of these cloud OEMs have started, cloud providers have started to go out and talk about 48 volt. And that's an area where we've kind of announced we have very -- IP that lends itself to a leadership position within 48 volt.

So that will be another area. That's probably about a year out to get that opportunity. But that will be another big opportunity for us to leverage our power capabilities.

Tore Svanberg - *Stifel - Analyst*

Okay. The second big topic, and you already touched upon it a little bit, which is diversification of markets. And you certainly talked about [more and more] industrial. The other side of that coin, of course, is maybe less consumer.

So could you talk a little bit more about how you're treating the consumer bucket now? Is it more of an opportunistic market for you? Are you very selective on the R&D resources you allocate to that market?

I mean, I know you mentioned wearables. But, obviously, consumer is a pretty big bucket, so.

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

Sure. I mean, consumer still is a large business within analog. It's a large market. It's not something that can be ignored.

That said, I think we need to be very, to use your word, very opportunistic as we approach that market, and really look at more standard products, more application-specific products that can be sold across the OEM base.

We're looking to move away from custom products that are high R&D, high risk within the consumer space. We're looking to have more diversification, whether that's across phones or tablets or wearable devices, other products within that space.

And so I think by having that diversification we'll be able to address the market, but minimize the volatility that has historically come with the consumer market.

Tore Svanberg - *Stifel - Analyst*

Okay. The third topic was, I think it was operational excellence.

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

Yes.

Tore Svanberg - *Stifel - Analyst*

And there's obviously many parts of that. But I know one of the parts that you discussed was you divested a few business units. And I think you mentioned there were maybe a few others that you were considering.

So can you maybe update us on which are the ones that may still not be considered for long-term strategic value in Maxim's eyes?

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

Sure. And for those who didn't attend our Investor Day, operational excellence really meant being able to substantially improve our margin profile both from a P&L point of view and from a cash flow point of view.

And, in essence, we're taking both our operating margin and our free cash flow margin from about 25% when we kicked off this process, up to the mid-30s.

And so we're doing that both by transforming our manufacturing footprint, in essence, moving to a more outsourced model, and also by looking and being very focused in managing our portfolio of businesses, figuring our where our growth opportunities are, and doubling down our investment in power management across the various markets.

And to the extent that there's certain markets where we don't have high share, we don't have a highly differentiated technology, to either reduce our investment in those markets or, in some cases, divest of those markets.

And so that really started a year ago when we sold our Touch business. We followed up in the March quarter by selling our Smart Meter business. And then the final one which we've said that we've signed an agreement to sell but we have not yet closed that deal, is the sale of our MEMS business.

So again you can see these are markets, Touch and MEMS, there's a lot of competition out there. They're in the consumer space, so generally, that may mean there's some more price pressure. And we did not have a unique kind of market share position or IP offering.

And so I think from that point of view, we continue to look at our portfolio. I think one year into the transformation and $180 million of savings, I think we believe we've made probably, you know, got it mostly right.

I think there'll continue to be kind of resource allocations as we move maybe power management folks from mobility, say into automotive or data center or maybe we move some RF folks from, say comm infrastructure into automotive.

But I think from a divestiture point of view, with this final deal that we expect to close in the June quarter, I think we're done for now.

Tore Svanberg - *Stifel - Analyst*

Okay. And I believe, I think you mentioned there were -- weren't there five or six specific manufacturing steps that you wanted to take too? Can you update us on where we are on those?

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

Sure. We've, in essence, gone from about 50% of our fab, kind of the front end of our manufacturing process, 50% was done internal and 50% was done external.

So we had a small development fab in San Jose. We sold that. That kind of closed in December. And we're going to see the full benefit of that in the June quarter.

We're going to see probably two points of gross margin improvement. We kind of guided at the midpoint to 63%.

We had a fab in Texas and San Antonio which we sold to TowerJazz. That deal has closed. I think it closed in January, kind of the third week in January. We will start to see benefit for that over time, because that's one where sort of on day one we're going to pay for kind of what the current cost was.

But as TowerJazz is able to qualify their processes and fill that fab selling to their customers, we'll be able to, A, our commitment on volumes will go down and our pricing will go down. So that will happen over a multiyear period.

We had a small kind of wafer level packaging or bump facility in Dallas. That will -- we expect to wrap that up and transfer all those products by March of 2017.

And then finally, we had a small facility in the Philippines which we consolidated with our larger facility in the Philippines.

So in the end, where we started at about 61% gross margin, this quarter our midpoint is 63% based on me San Jose fab. After we shut down the Dallas bump fab in kind of early CY17, we should get to 64%. And then as we start kind of realizing the benefits of the sale of the San Antonio fab, by the end of CY17, we should get to the 65%.

And I think it's worthwhile noting this is all -- we can do all this at kind of current revenue levels. This isn't one of these kind of margin expansion on the gross margin side, at least, that's dependent on revenue. This is taking costs out of the model and fundamentally transforming our manufacturing footprint and cost structure from a fixed cost to a variable cost.

Tore Svanberg - *Stifel - Analyst*

Thanks. So maybe moving on to maybe a more fun topic. I don't know if that's the right word. But since you are the CFO, I'd like to ask you this question because -- and you know I've covered analog for a long time. And when I look at a lot of the analog companies out there today, obviously, all of them do a great job generating cash and then returning that cash back to shareholders.

So then the question becomes, all right, well, if there's a handful of you out there, if you are an investor, which one would you pick? Because, I mean, I don't think [are all in a] basket, right. I mean, they will pick some. I mean, maybe so far [maybe value] investors pick TI.

So as a CFO, how do you think about that topic? And what would you say to investors, here's a reason why you should own Maxim over, let's say ADI and TI, even though they generate tons of cash, too, and return it back to shareholders.

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

Sure. Well, I think in general the analog space is a great industry. And I think those companies that you mentioned are extremely well managed, very high quality competitors. It is a fun place to be.

I think if you look at Maxim, we're in a period of kind of transformation. So while other companies maybe have already achieved kind of their margin and their cash flow targets, this is something we're still kind of growing into.

And in general, I think correctly so, investors will kind of discount that transformation until you actually achieve it.

And so for us, moving from 25% free cash flow margin to 35%, that's a journey and it takes some time.

This last quarter, March, I think we were at about $680 million of free cash flow, about 31% of -- you know, trailing 12 months, about 31% free cash flow margin.

And so we still have that opportunity as we continue to improve margins. And as we have a little bit more in CapEx, Cap Ex is running at about 3%, and that's probably going to come down to about 2%.

And so we have that opportunity to further increase and achieve those free cash flow margins.

And I think from an investor point of view, we've been able to show from a margin point of view we've taken all the steps we had to take. They're actually all done. It's just a matter of now seeing those benefits come through the P&L and come through the cash flow.

And so to the extent that you can get ahead of that, you could comment better than I. But when we take a look at sort of the multiples we're being paid for that free cash flow, just from our humble position, it looks a little bit like there's still a discount there. And I understand that because we haven't fully achieved it.

So I think when companies are kind of still in the middle of those transformations, those are usually the opportunities.

Tore Svanberg - *Stifel - Analyst*

The other thing that maybe a little bit different for Maxim than some of those companies is when it comes to the growth target.

So I think again, as part of the new model, I think you've indicated you expect to grow 50% above the market, five zero.

Based on where you sit today, you know what you've done in automotive or what you're doing in automotive. You know the -- your shift to the resources [with] industrial.

I mean, is that something that you feel really comfortable with? And again, it doesn't matter if the analog industry grows at 2% or 4%, you can still grow 50% above it.

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

Yes. Well, I guess the good news, if the analog industry is growing at 4%, then that's only two points higher, right, and I have gray hair. In the old days, that was sort of rounding.

But, I think to be very fair, we haven't grown last several years. So I think the first, we just have to be able to return to growth. I think that's, without question, the near-term focus of the Company.

We do believe when we look at there's been businesses, automotive, and some of the -- on the industrial side where [we have some] good growth, but, our consumer business and our communications business have been holding us back.

We do believe on the communication business, as sort of our enterprise server business has bottomed out and we believe the cloud-based data center will be a significant growth driver for us, so I think we feel comfortable that one's kind of going in the right direction.

And then, so then it comes down to can we stabilize the consumer business? Certainly our largest customer is now half the size that they used to be, much more diversified across other markets.

And I still think June is a perfect example where our largest customers, we're guiding them to be flat sequentially, yet, we're guiding consumer up strongly because of diversification across multiple markets.

So I think to the extent that we can stabilize consumer, grow in comm and data center, continue the 20%-plus growth in automotive, and kind of grow just at industry in industrial, I think that will get us certainly back to growth. And then once we kind of check that box, then I will have a conversation with you about growing just a little bit faster than our peers.

But I think to be fair, I think today we just have to get that return to growth.

Tore Svanberg - *Stifel - Analyst*

Sure.

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

With our model and the possibility, kind of the margin levels we're at and both from a P&L and a cash flow, any growth will generate a tremendous amount of cash.

Tore Svanberg - *Stifel - Analyst*

Yes. Yes, that's right. So one last question for me, then I'll open it up to the audience.

So consolidation obviously has been a huge theme in semis the last couple years now. And there's some investors even suggest that five years from now maybe there'll be like 10 big companies out there.

Now, Obviously, analog is a bit different. But what's your view on that? And is the aspiration for scale or the need for scale as important as it may be perceived today?

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

Yes. So I do believe consolidation is inevitable. I think when a market starts, kind of the growth rates dip below 5%, I think it's harder to drive double-digit profit and cash flow growth. And certainly, I think it's much harder for smaller companies that don't have that scale.

And so I do think consolidation will occur, and I do think it's going to happen initially at the smaller cap companies. Although, last year we jumped ahead of that and had a couple combinations of large cap companies very clearly.

I think for us, we're in a very good position. We're large. We're profitable. We're stable. We have the scale to be successful in this business. We're driving up to 35% op margin. So I don't think it's something we have to do.

That said, if the right opportunity presents itself where it's something that fits our strategy, it's in analog, going to post synergies, it's kind of consistent with our margin profiles, and the hardest one of the filters is we can get it at a reasonable price, then that's something that we'll certainly look at.

We have the capacity. We have the balance sheet. We have the cash flow. We have the ability to cut costs, we've proven that, internally.

So I do think there's opportunities to create value in a consolidating industry, and I think we can participate in that.

All that said, we will be very disciplined about it because we think we can be patient. We're a cash buyer. We know the market always goes through cycles, if only economic. And we'll just wait for the right opportunity.

Tore Svanberg - *Stifel - Analyst*

With that, I'm going to open it up for questions. Sure, right here.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Two related questions. One, (inaudible - microphone inaccessible) market, can you give a little more color on the [particular] advantage you have with competitors? (Inaudible) standardizing (inaudible). Is it more (inaudible)? [What area of competitive excellence] do you have (inaudible)?

The second question is, how much of an advantage (inaudible) given that these markets (inaudible) or a niche versus (inaudible).

Tore Svanberg - *Stifel - Analyst*

If you can repeat the first question, then I'll try and remember the second one just for the webcast, yes.

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

Sure so the first question had to do with we're moving to a more outsource model and less proprietary, how will we be able to differentiate specifically in power management?

First off just for clarification, and I may not have been as clear. While we're moving to a more outsource model, we're still retaining our proprietary manufacturing processes. So to the extent that, say we've sold our San Antonio fab to TowerJazz, they will continue to run our proprietary processes.

So the benefit that analog has always had of running proprietary process, we'll retain that.

But even very specifically in your question about power management, we will work with our foundry partners but to develop proprietary processes that support power management, that give us the advantages, whether that's in density from, which means, in essence, smaller size, whether that's an efficiency, which means that when we step down voltage from, say 48 volt to one volt, there's very little loss in that equation.

And so I think our ability to work with foundries with proprietary, still our proprietary manufacturing process will actually give us an advantage even more so because by working with foundries, that allows us to go to, for analog, more advanced technologies like 90 nanometer versus our peers that maybe are at 130 or 180.

And so we'll get further advantages by, in essence, leveraging these advanced technology notes, which give us further advantages in power management than maybe our peers.

Unidentified Audience Member

Is that still exclusive?

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

It is still exclusive, absolutely. The agreements are that, whether if we're working with a relationship where we're just transferring our technology we're their only analog supplier or if you're working with a merchant fab house, that proprietary process technology is ours. So that makes sense.

Tore Svanberg - *Stifel - Analyst*

And I believe the second question was on customization, custom products.

Unidentified Audience Member

Yes, basically how long (inaudible - microphone inaccessible) revamping (inaudible) market (inaudible), and just wondering how much of that (inaudible) will create product that (inaudible)? For instance, there's one product mobile (inaudible). Is that where (inaudible) or is it more (inaudible)?

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

Yes. So I think in the world of, if you kind of take the scale of custom products, complication-specific, and then general purpose, I think we used to do, especially in mobility, I would say we would do custom products.

I would say we're moving away from that and where we're going to is more application-specific. So it's a part that's designed, say for automotive and meets the specific needs of the automotive market, but it can be sold broadly across the OEM base.

And so I think that ability to have these application-specific that, A, can be [sold] broadly, but leverages our technology is really what allows us to win.

So I do think it's -- and the bottom line, I think it's more of a technology sale. And then what Maxim has always been very good at is product definition, understanding what it is our customers want and defining that product.

So I think it's a combination of that product definition and the fact that it's an application-specific product that can be sold kind of across that OEM base that I think gives us our advantage.

I need to also say, and kind of like when I opened up, I do think a big part of the analog market today and especially as growth slows down is where you have share today. The power of incumbency is very strong.

And so to the extent that like we've been in automotive since 2004, and we've focused on infotainment and now on driver assistance and autonomous driving and battery management for electric vehicles, that power of incumbency is very, very strong.

And we think that's, as well, that's going to help us continue to succeed. We're just focused on power, right. And then some other niches where we've always had a long-term advantage.

Tore Svanberg - *Stifel - Analyst*

Yes. And if anything, if I can recall from your Analyst Day, I think management said that maybe you had deemphasized, I wouldn't say deemphasized, but you wanted to pay a little bit more attention to your catalog business again. As you were doing more custom parts, the catalog business didn't get as much love and now seems to be getting a little bit more love again, so.

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

Yes.

Tore Svanberg - *Stifel - Analyst*

And that is the traditional analog model, right, is to have a pretty nice catalog of annuity revenue products.

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

Yes. I mean, in essence, what we did was we went and looked at our business. And about a third of our business is parts that have been out there for over 10 years and were catalog-type products which had very high gross margins, in essence, were the cash cows in all of the divisions. Every business unit had their sense of these old products that were just generating tremendous cash, no R&D investment, high margin.

We took all those out and actually gave them to one business unit because -- and just to focus on them. And it's very low R&D. But just how do we have better programs with our distributors to sell these products? How do we have better online tools to help those thousands of customers that we can't touch? How do we have those better tools to allow them to design in these products?

And this is a business that historically has been flat to slightly down, these very old parts. If we can just tilt that up, just up to grow 1% to 2% at very high gross margins and, obviously, extremely high operating margins, we will never have a quarter where we say, oh, revenue grew due to our core business unit, but that's just going to be kind of built into and be a tailwind for profitability for the Company once we get past these kind of major visible transformations.

Unidentified Audience Member

You see that happening in the next year?

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

So we kicked this off a year ago and created that business unit. I think, again, catalog products, long product life cycles. But I think we'll start seeing some benefits in this kind of current fiscal year, FY17 that's starting in July. But it's going to be a slow, gradual up tick.

But again, if we can just tip that [a third] of our business from flat to down one to up one to two at very high operating margins, I think that will start to come through the P&L and the cash flow.

Tore Svanberg - *Stifel - Analyst*

Maybe one more question before cocktail, and it's another fun question. You may not like it, but I got to ask it because I ask this question to a lot of analog executives.

So Rich Templeton has been heard saying the cash we generate belongs to the shareholders, and it has no business sitting abroad. It should be here locally.

What's your view on that? I mean, obviously, he can say that because they generate a lot of cash in the US. But what's your view of that? And is that becoming a fundamental important part of an analog company strategy now to try and generate as much cash as you can on shore, so you can return it to shareholders?

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

Certainly, first goal is to generate as much cash as possible, right, as efficiently as possible. Second goal, certainly is to return that to shareholders.

I think there's multiple ways of being able to make that cash available to shareholders. I think in some cases there may be more efficient ways than giving up a third of it.

Tore Svanberg - *Stifel - Analyst*

Sure.

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

Now, that said, of course, you're going to follow all the rules. You're going to do everything that's right and appropriate.

But I do think it's our job to maximize cash that's available to shareholders. And I think kind of focusing on where that cash is generated and making that available are key elements of strategy for analog companies.

But I think there's multiple ways to do that. I don't think there's just one way. And I think it's my job as the CFO to be as efficient as possible at doing that.

Tore Svanberg - *Stifel - Analyst*

That's funny that because we're arguing about cash and how to return it, right, is kind of [what I get]?

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

Yes.

Tore Svanberg - *Stifel - Analyst*

It's a luxury problem to have, I guess.

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

Yes, exactly right.

Tore Svanberg - *Stifel - Analyst*

So with that, we have cocktails and drinks at the front of the hotel. I want to thank you all for attending today, the Stifel Technology Conference Day. And thank you also to Bruce and for Kathy for coming to our conference, and we'll see you tomorrow. Have a good night. Thank you.

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

Thanks everybody.
