Cirrus Logic

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Blayne Curtis: Alright, we'll go ahead and get started. I'm Blayne Curtis, semiconductor analyst here at Barclays. Happy to have next up Cirrus Logic, from the company Jason Rhode, President and CEO. He'll walk you through a presentation and then we'll take some Q&A if there's time. Thanks. Jason.

Jason Rhode: Morning. Thank you for thinking of us. Alright, I'll just pause real briefly on our Safe Harbor. It's been brought to our attention over the last I don't know now many decades that there are people in the semiconductor industry that think everything goes up and to the right forever. So we put a fair amount of time into our risk factors and relook at those all the time and try to at least give you some clues about how things don't always go exactly the why everybody expects. We're not baking cookies here. We do our best. But I encourage you to have a look at that.

Cirrus has been around for a long time, founded in 1984 by Mike Hackworth and Suhas Patil. Hackworth was a giant in the industry and spent his whole career really helping us get Cirrus to where it is today, one of the most amazing people I've met in this industry. The company is really composed of two product lines, audio and energy. In audio, of course, our largest business is portable audio, but we've been in everything for many years from professional audio, home audio, automotive, you name it if there's audio in it there's usually a good opportunity for us.

Our energy business has gone through something of a rebirth over the last few years. It used to really be more of an industrial measurement focused business and today what we're investing in are energy control applications such as LED lighting. So we'll get into some more details about that shortly.

Really the vision for the company is to be the first choice in signal processing components. And that competency we have is especially strong around the analog to digital boundary. So anything you can think of that is signal conditioning or signal processing around that analog to digital boundary is an area that we think is pretty interesting. Historically in audio and then you'd be surprised to find how much commonality there can be with some of the energy applications we're targeting. One of our strengths is engineering execution. It's a pretty well understood and just generally assumed thing in our industry that chips are going to be late. We don't think that should be the case. We thing our customers when we tell them a date when a new device is going to be available we think we should be able to hit that date and help make their product successful so they can rely on it. That's been a strength of ours over the past few years and that's certainly been part of what's helped us build our portable audio business.

Of course we've been fabless from our inception. Cirrus wasn't the -- I don't think was the first fabless company, but it was the first major fabless company to make that model successful. So we've got a great supply chain management team and that's a significant advantage in our industry.

Of course an extensive IP portfolio as you would imagine for a company our size. There's an interesting metric that we had at our patent recognition dinner the other night, ranked in terms of patents per engineer or patents per employee, we're absolutely at the top of the industry in terms of the number of patents we've got per employee. So I think that's a good metric that we're very efficiently turning our R&D spending into valuable assets for the company.

Yes, I think the days of building an inch deep, mile wide business, while they may not be over it's certainly a lot more challenging than it used to be. So our strategy is much more along the lines of picking the best customers in a space, picking very compelling markets that have specific secular fast growth going associated with them. Really engaging with tier one leaders rather than trying cast the bread on the waters and work through distribution and all that. Develop meaningful engineering relationships for our best people or talking to the best people at the customers, solving problems and trying to gain an understanding of where they're going and what problems they can solve in the future. And then once we're in, really focus on boutique level of service with the customer and expand our business to more content and more boxes. That's how we've become a leader in the analog and mixed signal business. We try to leverage that IP across as many platforms as we can and just turn the whole thing into a virtuous cycle.

I mentioned customers, it's interesting small customers, and customers you never heard of often take more support and more bandwidth than the big guys, so we're very, very proud of our blue chip customer base. It we do business with just about everybody who's a name brand in audio. Some of our customers I won't mention like to do press releases and joint press, et cetera with us. Others don't so much so we just try to be respectful of that, not our job to do our customers' marketing. It's our job to just take care of business and let them do what they do well. But that said, we do have a broad array of business, 2,500 customers worldwide. We get a lot of commentary about revenue diversification, customer diversification. We are quite diverse from a customer point of view. It just happens that one of them happens to be really, really successful, which is a fine problem to have.

Most of our products, it's an interesting dynamic, I think relative to the industry most of our products do not go through distribution in any form. So that reduces one element of concern, I think, that people have in the semiconductor space is a bunch of inventory piles up at distribution, creates revenues bubbles and other strange things. We really actually typically don't have that concern as much as others might.

It takes a really long time to build a new business in this space. I look at portable audio as an example. From the time we started investing in portable audio to the time we hit simple payback on the investment was five years, and I don't think we missed a trick. I think we had a lot of things go our way and we were fortunate to engage with some customers that were just on fire. And so that requires us to have a very long term mindset, a very long term investment horizon. I don't know how to build a business like that if you've got your valuable people joining and leaving on a mean time that's shorter than how long it takes you to build the business in the first place. So we put a lot of focus on our culture. We want to make sure that we're able to attract and retain the best people in our space. There's definitely a shortage of qualified engineers out in the world, so we want to get our unfair share of those and then we want to make sure that they love their

jobs and they want to stay there. Our voluntary turnover is extremely, extremely low and most of the people now that I talk to after we've hired them, I have lunch with all the new hires every couple of weeks, most of those folks quote that one of the reasons they joined us is they heard it was a great place to work or they saw it in the news that we're one of the best places to work. We're the only semiconductor company on that list in our category, our side category I should say. And I think one of the things that makes that especially compelling is we're in a fairly creative, we're in a creative industry and if you want people to do their very best work in a creative space they need to like their jobs. They need to be passionate about it. So I just find that interesting. People ask me a lot of time why does it matter to you that you're recognized as a best place to work and partially it's because I work there and partially it's because I think people do better work in that environment.

So turning to audio, portable audio as I mentioned is by far our biggest business. It's been the fastest growing. This is Smartphones and other really other battery powered media applications, which is overall still just a tremendous opportunity for us. There's new form factors coming on all the time. Smartphones themselves are just a tremendously high volume opportunity. It is a very competitive market. That puts a lot of pricing pressure in our camp. It's something we need to be responsive to, make sure we're positioning our customers to be successful. And in that context of course as that market matures the growth slows a little bit, but the counter to that is if we're able to add additional features to drive an expansion in our town. So of late we've moved from being what we've traditionally been, which is somebody that really helps our customers differentiate on audio quality such as distortion, performance, dynamic range, things like that, we've really put a lot of additional focus now on voice enhancement. There's not so many people that make a cell phone that care about differentiating on audio, as you may have noticed. But everybody that makes a cell phone would like it to be a better phone. Everybody would like the speakerphone to work a little better or be able to pick your voice out of a loud crowd more easily, be able to hear when you put it in speakerphone and say you're in California and you don't have the headset with you, you want to be able to lay the phone on the seat next to you and actually hear the speakerphone. Those are features that are attractive to everybody. So these give us a lot of opportunities to expand the sound within mobile phones, and then of course, portable audio is a pretty dynamic space. There's new form factors coming on all the time. So over all, it's just a great opportunity for us. It really fits in well with what we do. It's a great audio signal processing market, but they also care in general about very low power, very small form factor. So it just gives us a lot of axes to innovate along that help us add value.

So these are kind of some of the products that we're talking about, boosting speaker amps or a technology that allows you to get more sound of a small speaker, help them to be able to be able to drive the speaker a little bit harder without damaging it. Noise cancellation, there's a whole variety of algorithms that are around doing smart things with the voice, the speaker's voice and the background noise in one direction or another. Of course high fidelity, once audio becomes a checkbox there's usually not a good opportunity for us. It's usually a good opportunity for us when people are really trying to create a great audio experience.

And then finally, kind of in a little bit of the grab bag category, we've got an ultra-low power audio DSP. A lot of the general market DSPs targeted out there haven't done a great job of targeting audio specific features. This enables our customers at the last minute to add new ideas on the fly and really has served as a great, I guess, fishing lure if you will as we go out and engage with new customers about what they might be interested in.

Looking at the other audio businesses, automotive is something that we've invested in for a long time. I think there's some great dynamics in that space, in particular for audio as premium sound systems in cars migrate down from the premium models of cars down to more of the entry level. Home entertainment is an area where quite frankly there's not been as much innovation as I think there should have been at the end product level. So we serve that today with a broad portfolio of products and it's an area we're interested in. It's an area that I think is ripe for more innovation. There's lots of things in your home that I think more audio can add a lot of value to. There's a lot of customers that are thinking about that but as consumers we haven't seen a whole ton of that over the last few years, but nonetheless, it's a good opportunity for our general market products, which is similar for professional. In a lot of cases the consumer audio product performance is driven up so far that it's the very same kind of devices from us that can go into professional applications which is a good margin play for us. And it's something that's fairly near and dear to our hearts because that's where we got our start in audio.

So we've got a strong IP portfolio, blue chip customer base, we're targeting some pretty quickly growing markets and we've got a great track record of engineering execution. So audio remains a great opportunity for us and we're certainly looking to expand our business in that area.

But outside of audio we've got some really compelling opportunities within energy as well. As I mentioned, a number of years ago we rebranded or we re-envisioned what this division needs to do, really more from kind of a sleepy industrial measurement business, very high margin, but almost no growth in the space that we were targeting at the time. And we really decided that some of the more interesting areas that we go after were related to energy control. Some of our folks were very passionate about green applications for where we could help people save energy and save power. We've had a power meter business for a long time and we continue to invest in that space. But going forward, some of the bigger investments are really in the areas of LED lighting in particular is a significant investment for us.

So where we are today, we're shipping with a couple of OEMs. The product we build is a chip that actually goes in the light bulb, enables the light bulb to be compatible with the dimmers that are installed around the world. The adoption of these products, as I mentioned, building any kind of new business is a slow proposition however light bulbs in particular is quite a fragmented market. It's a small handful of OEMs that make up the volume but every one of those has 100 different SKUs if you think about all the different form factors of lighting that are out there. But nonetheless, the adoption is accelerating. We're shipping in more units every quarter. We're getting designed in at a pretty good clip. We feel very good about where that business is today.

So retrofit market is what we're targeting initially but we're also looking at luminaires and other sort of industrial applications. But this market is -- if there is a faster growing element of the semiconductor space I don't know what it would be. It's fairly unit volumes today gone to the billions of units over the next few years depending on who's market research you look at.

There's other form factors certainly. Incandescents are being phased out. There's CFLs out there. Obviously, nobody's a big fan of compact flourescents. They've got a number of issues that go with them. But if you've bought any of the LED bulbs that are on the market today you're probably not overly thrilled with most of what you've bought. The colors are awful. Sometimes and certainly if you happen to have a dimmer in your house, even the ones that say dimmer compatible on them, they flicker, they don't dim all the way, they flash when they turn on. There's a number of different issues. So since our solution is all digital, all of the algorithm is embedded in the digital portion of the device,

that gives us a lot of opportunity to be compatible with a broader array of dimmers. We found over 200 different categories of dimmers around the world. There's an installed base of 500 million plus dimmers out there. Our device works virtually indistinguishable from an incandescent light bulb in the vast majority of cases, massively better than the nearest competition. We've got better dimmer compatibility, less flicker, better dimming range. We've got some features and color blending that enable a warm light that is similar in style to what in incandescent does. So an incandescent as you turn it down it gets kind of that warm glow. We've got some features that enable our customers to build that in if they want. Our platform is programmable so we can change things on the fly without having to make a change to the board, enables us to do things like calibration of the brightness or the color at the end of the manufacturers' production line. We're hoping that that will help our customers monetize other things in the light bulb as the volume grows such as the LEDs themselves. And we've got quite an extensive IP portfolio in this space. So in short, it will take a long time to build this business, but it is something we're very excited about. It's ticking off our milestones on our way to the successful business.

So in terms of financials, we've got a great balance sheet. We've got a lot of cash. We've got no debt. Our operations generate a lot of cash. We've been repurchasing shares a fair amount over the past few quarters. We've got $114 million remaining on an existing authorization, about $81 million in deferred tax asset and you can see the inventory there.

Our financial outlook for the June quarter, $150 million to $170 million. I will point out we feel good about that range. This is a dynamic industry. There's always a lot of business in the last couple of weeks of the quarter. It's always kind of exciting but that's the range we feel good at. Gross margin for Q1 in the 50 to 52 range.

So looking forward, when we really reformed the company or redirected the company in 2007 we kind of took a look at what does it take to make a great company, what does it take to be considered a great company in the semiconductor space and we took a look at all of our peers and we ranked our peers on terms of revenue growth, ranked our peers in terms of operating profit and looked at that over a handful of years. And in the revenue growth case, if you looked at about 15% revenue growth, that put you in about the upper third of the revenue growth chart. And year after year the companies on that list would change, but every year it felt like it was about 15% revenue growth put you in the upper third. And on operating profit it was about 20% for the same thing, little less volatile than the revenue growth. But interestingly, in most years we looked at it there was only ever one or two companies that were in the upper third of all. So that was the model we set for ourselves. So it's not intended to be a forecast. It's the metrics that we hold ourselves accountable to. That's actually where our comp is derived is in relationship to that model.

As I mentioned, a lot of our business is in Smartphone. We are getting a lot of pricing pressure in that space as you can imagine given the size of the market, so we do expect our margins to be more in the mid 40s range as we move into the second half of this calendar year. So that's obviously not what we want to hear or what anyone that's familiar with us really wants to hear but at the same time we feel good about our ability to stick with the model and make our model work in terms of revenue growth and operating profit.

If you look long term, I would be nice if the semiconductor industry came in nice linear chunks and it did the same thing every year and we could have this nice, steady growth. Some years we get amazing growth, for example FY '11 or FY '13 where we grew just hugely in excess of the industry. Other years are years where we don't have the

opportunity to do that, but over the long term we feel good about that 15% being able to sustain or exceed that 15% over the long term.

In terms of operating profit, you can see that 20% kind of line that we have internally as a metric some years, this past year we were able with the revenue growth to be able to shoot substantially above that but it wasn't turned out to be totally sustainable to be up that high. Certainly we're investing in other areas. The non-portable aspects of our business do run significantly higher in terms of margin, so as we're able to grow those businesses that should give us some benefit on the margin line as well.

So and that is all I have for you except for the ever exciting GAAP to non-GAAP reconciliation. If we have any questions? I wasn't going to read it. Yes? Sure. Should we open it up to Q&A?

Blayne Curtis: I'll ask the first question. Obviously, the big change is to the gross margin and you also said the ASPs coming down and given your concentration of customers it probably makes sense that that's where it's coming down. On your last earnings call you did talk about a flat fiscal year. Is this incremental to that or was that all encapsulated when you talked about a flat fiscal year?

Jason Rhode: Well, this is pretty new news. We got this pricing pressure out as quickly as we could. If we had known about it at the earnings call we would have got it out then. So I would take whatever model you had before and run it with the lower margin and that will give you your sense on the top line. For us, I mean, I would love to give a great guidance. I would love to give solid guidance for the year. We give guidance for the current quarter because our visibility about how many of what is going to ship in Q3 is not any better than anyone else's guess so we just keep that close to the vest.

Blayne Curtis: It's always tough for you to talk about because of sensitivities but I'll try to ask the question, see if you can answer it. But kind of what's the motivation here and I guess, it sounds like you're getting back in line with some of the other suppliers at this mid 40s level and the mobile market is very competitive, so I guess that makes some sense. A lot of your story has been adding new content and getting rewarded for that. How does this new dynamic change that in the longer term story?

Jason Rhode: That aspect of the story I think is in great shape. In fact, I think it gives us, it positions us to where we're clearly in the thick of things in terms of the value that we get out of our products, the premium that we charge. But the opportunity to continue to add content and grow into new form factors as they come out I think is still very high. We're in good shape in that regard. But you're right, I mean, we were significantly higher than some of our peers supplying the mobile space. So the two biggest concerns I've ever heard of is we're going to lose a big socket or that our margins are going to go down, well now we've got one of those behind us.

Blayne Curtis: Right. And I guess this still means that you're still going to be shipping the products to your largest customer, so I guess that is still positive. I guess when we talk about, it does sound like it's a new chip that you'll be shipping. I don't know if you can address what exactly is happening. Is there less features that you're offering or is it essentially, the same feature set and just you're getting compensated less for that? It does seem like it would be a material step down in the ASPs to get to kind of revenue and margins you're talking about.

Jason Rhode: Yes, we really haven't broken anything out in terms of new or existing or that sort of thing.

Blayne Curtis: And do you see similar dynamics, you sell two chips, a Kodak which has a lot of additional IT in it as well as audio amps, which is new to you and there's tear downs to the shell, so I guess it's public at this point. Is this dynamic across all of your products and this is just overall right sizing or are there specific changes that are happening with certain products?

Jason Rhode: I'd say it's kind of a right sizing in portable. In some -- and even within portable there's some diversity of the margins. Amps are more competitive than anything else. I would say there's a lot of folks out there that try to target that space more so than some of the more advanced single processing kind of products.

Unidentified Participant: Since your June guide gross margins are 50 to 52 what time frame do we get to your long term goals?

Jason Rhode: By long term goals, you mean mid 40s? Yes, I guess I wouldn't describe that as a goal. Long term goal of 20% operating and 15% growth.

Unidentified Participant: (inaudible)

Jason Rhode: So we expect, as I said, we expect this lower margin to be in the second half of this calendar year.

Unidentified Participant: So I have a question on the long term goal, 15% growth and 20% operating margins. Given your concentration with the one customer, how are you going to get to 15% growth? Can you map out some reservations of the company?

Jason Rhode: I mean, we've done quite a good job. I think the fact that we've picked our customers wisely is what's enabled us to eclipse that goal in the past. I think doing that if you're targeting a broad swath of the semiconductor market would be really, really difficult. You've got pick customers wisely. They're going to be coming out with new products and new stuff and that's how we've been able to do that in the past. I don't think anything's changed about that.

Unidentified Participant: I think the question is, are you going to have meaningful customer diversification over the next two years? For example to get there or are you still basically relying on the same customers at this point in time?

Jason Rhode: Well, our goal is certainly to diversify our customer base and our revenue base. We're making good progress on that with the LED lighting. I can say that will take a long time before it has a huge financial impact, but the signs are there that that's going to be successful in the long term over the coming years. Within portable audio, we mentioned on our call we mentioned we should be shipping in another mobile phone this summer with one of our catalog products. So it's a good sign that some of these bean forming applications, some of these newer catalog products that we've got out are being well received and that's frankly how our business in portable audio got started in the first place. Once we got the general market product gets designed in and we're able to work closely with the customer's engineers, understand what their future needs are then we can kind of turn that in to more of a customer relationship and grow our content from there, but it takes time. So while we've got a lot of efforts and energy going into diversifying our revenue base, our first goal of course is make sure we take care of the customers that got us where we are and invest for the long term to diversity that business.

Unidentified Participant: Jason, can you go through the milestones you're looking at achieving right now at this stage of the LED dimming opportunity relative to what you've achieved to your competition and the things that you study that say okay this is an opportunity that Cirrus

is going to be successful similar to the degree we were in audio and then touch upon the strength of our IP how that relates to those various milestones?

Jason Rhode: I'm sorry, I didn't quite catch the first part of that.

Unidentified Participant: The milestones you have articulated you have achieved on LED dimming, can you articulate what those are relative to where the competition is today and then tie that into the strength of the IP that you really have in that space?

Jason Rhode: Sure. Yes, I mean, yes in terms of IP we've filed 60 some odd patents in that space. The areas that we're trying to differentiate on are in terms of really true incandescent style dimming, meaning that you don't have to worry about what kind of dimmer you've got because people don't know. We want to see buying a light bulb get back to being a much simpler proposition. I mean, as it is today you go to the hardware store and there's this bewildering array of stuff to pick from. We would like it to be just you buy the light bulb the size that you want and screw it in and it works. And for that to be the case you really have to work with pretty much every dimmer that's out there. The closest competition from our metric point of view and there is no good standard to be able to quote, but from the perspective of the way we test dimmers, where our 98% score came from, the closest competition is more in the 60s, meaning it does 60% of the dimmers out there will work okay with that product but the other 40% are going to cause something strange to happen. It will flash or it won't turn off. And then, obviously, in such a price sensitive market as a light bulb that's expected to grow as fast as it is the overall cost of bill of materials is really important, so that's why the most recent device we launched is what we refer to as a single stage controller. It reduces a lot of the power electronics, in particular the magnetics that go with the solution, which has a double effect. One is it just decreases straight away the bill of materials, the electronic bill of materials. But two, if you think about it, the form factors of the light bulb as we have today were not ever intended to have electronics down in the base of them. So fitting all of that stuff in there, it's a very complicated design. Fitting all of that in the base of the bulb is quite complicated so anything you can remove or reduce in that really helps the physical design of being able to get all the electronics in there and get the heat out. So those are kinds of the areas that we're trying to differentiate on. We think we've got a great advantage in that space. We're shipping with some of the best respected names in lighting, so we think that's a good sign and then obviously we'll work to broaden that out. But it is interesting how many different light bulbs every one of these brands have and it is quite a complicated power electronic device, so it takes a while to rack up enough form factors that we're shipping in to have it really start to add up. But the base is growing at a pretty good clip.

Unidentified Participant: I mean, do you think your products in the LED market can meet your stated long term goals here, specifically 20% operating margins?

Jason Rhode: We think they contribute to that. They're actually -- we haven't commented in the margins specifically within LED but we do think it's supportive of the overall company average. But it is a compelling and fast growing market so there will be pressures there. We just need to try to do a good job of decreasing the external bill of materials so that they're able to reduce the cost of their light bulbs and make the volumes go up without necessarily taking it all out of our ASP. So we think we've got a number of good tricks up our sleeve to be able to do that, but it's a complicated market. We've never participated in anything that went from (inaudible) in order of magnitude plus over the amount of time that LED was expected to do so it will be interesting. Anything else?

Blayne Curtis: We'll leave it there, Jason. Thanks for your time and the breakout is set for four.

Jason Rhode: Great. Thank you very much. Thanks for the questions.