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EDITED TRANSCRIPT

POWI - Q3 2017 Power Integrations Inc Earnings Call

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OVERVIEW:

Co. reported 3Q17 revenues of \$111.3m and non-GAAP diluted EPS of \$0.78. Expects 4Q17 revenues to be \$110m, plus or minus \$3m.



OCTOBER 26, 2017 / 8:30PM, POWI - Q3 2017 Power Integrations Inc Earnings Call

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Jeriel Ong *Deutsche Bank*

PRESENTATION

Operator

Good afternoon. My name is Emily, and I will be your conference operator today. At this time, I would like to welcome everyone to Power Integrations' Third Quarter 2017 Earnings Call. (Operator Instructions)

Thank you. It is now my pleasure to turn the call over to your host, Joe Shiffler, Director of Investor Relations. Please go ahead.

Joe Shiffler

Thank you. Good afternoon. Thanks for joining us. With me on the call today are Balu Balakrishnan, President and CEO of Power Integrations; and Sandeep Nayyar, our Chief Financial Officer.

Our third quarter results are calculated using the sell-in method of revenue recognition on sales to distributors, reflecting our adoption of ASC 606 effective January 1 of this year. On today's call and in our press release, comparisons to prior year results make use of recast financial information calculated as if the new accounting standard had been in effect for the prior periods.

Recast data for 2015 and 2016 can be found in the historical financial tables posted on our investor website, investors.power.com. Also during the call today, we'll refer to financial measures not calculated according to generally accepted accounting principles. Please refer to today's press release, which is posted on our investor website for an explanation of our reasons for using such non-GAAP measures as well as tables reconciling these measures to our GAAP results.

Our discussion today, including the Q&A session, will include forward-looking statements denoted by words like will, would, believe, should, expect, outlook, forecast and similar expressions that look toward future events or performance. Forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those projected or implied in our statements. Such risks and uncertainties are discussed in our press release and in our most recent Form 10-K filed with the SEC on February 8, 2017.

Finally, this call is the property of Power Integrations, and any recording or rebroadcast is expressly prohibited without the written consent of Power Integrations.

Now I'll turn the call over to Balu.



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Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Thanks, Joe, and good afternoon. Third quarter revenues were a record \$111.3 million, up 9% year-over-year. Non-GAAP earnings per share grew faster than revenues, increasing 16% from a year ago, and we generated just under \$25 million in cash flow from operations in the quarter.

Our growth in Q3 was once again driven by the industrial and consumer categories which grew at a combined rate of 20% year-over-year. The industrial category saw broad-based growth across a wide range of applications, led by our high-power products, which are on track to grow more than 20% this year, driven by design wins in renewable energy and DC transmission applications.

As we have discussed on prior calls, China is embarking on a multiyear effort to install a massive DC transmission grid, which will be capable of transporting power far more efficiently over long distances than traditional AC transmission infrastructure. Unlike AC transmission, which uses magnetic transformers, DC transmission facilities require highly-sophisticated power conversion electronics, including high-voltage IGBT modules, each paired with a gate driver, whose sole role is to ensure safe and reliable operation.

With voltages running as high as 1 million volts and with many millions of utility customers dependent on this infrastructure, reliability and safety are the utmost importance in this application.

The fact that our SCALE-2 drivers have been chosen for this application is a testament to the strength of our gate driver technology, and we expect this project to continue generating significant revenues in the years ahead.

The low-power component of the industrial category also contributed strong growth in the third quarter, driven by variety of verticals, including smart meters, battery-powered lawn equipment, E-bikes, LED lighting and home automation applications such as USB wall sockets and power strips. In all, industrial revenues have increased nearly 20% through the first 3 quarters of this year as compared to mid-single-digit growth in 2016.

Going forward, we expect continued growth from applications I have mentioned, and also from new verticals such as automotive, where our SCALE-iDriver ICs are being qualified for the use in electric vehicles; as well as smart lighting, where low standby power consumption is essential to realizing the energy savings benefits of intelligent lighting control.

For example, last week, we introduced a new reference design demonstrating a power supply for smart wall switches incorporating features such as occupancy sensors, voice control and wireless connectivity. Homeowners installing such systems naturally prefer to use them with LED lights to maximize the efficiency benefits of the technology, but often find that LEDs tend to flicker when turned off because of standby current leaking through the smart switch. The new design, which features our LinkSwitch-TN2 products, solves this compatibility issue by reducing standby current to such low levels that the LEDs don't flicker.

We believe this is just one of many examples of always-connected IoT-type applications that will take advantage of our ultra-low standby technology in the years ahead.

The consumer category -- in the consumer category, revenue growth continues to be driven mainly by appliance applications, where our share continues to expand, thanks to reliability and efficiency benefits of our products. Share gains are being magnified by rising dollar content as connectivity and other electronic intelligence are incorporated into broader range of appliances, and as designers look to silicon technology to help achieve tighter energy-efficiency specs. These factors combined with growing demand for convenience and comfort appliances in markets like China and India, has driven year-to-date growth of nearly 20% in our consumer category.

In the communications category, revenues declined from a year ago, though we saw a strong sequential recovery from the softness we witnessed in the China handset market last quarter. We won several new rapid charge designs in Q3 with InnoSwitch, and we expect growth to accelerate next year as faster charging becomes an increasingly important feature in the mobile device market.

In particular, we expect the USB PD standard to stimulate faster adoption of rapid charging in the second half of next year, as the standard finally appears to be ready for mass adoption.



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Looking ahead, our outlook for the fourth quarter is for revenues in the range of \$110 million plus or minus \$3 million. The midpoint of which would bring our full year growth rate to 11%. This would be our second straight year of double-digit growth. And we are making the investments in capacity, products and infrastructure, necessary to sustain our momentum into 2018 and beyond.

As we noted on last quarter's call, we are making capital investments of more than \$30 million this year, adding capacity at new and existing manufacturing partners, and adding the infrastructure we need to support our long-term plans. For example, earlier this month, we cut the ribbon on Power Integrations Malaysia, a new facility located in Penang, commonly known as the Silicon Valley of the East. This new location will serve as an operations hub, as well as an R&D center and production support location for the benefit of our Asian customers. This 12,000 square-foot facility already houses more than 20 employees, and we expect that number to more than double over the next few years. We believe this investment will help us better serve our customers and streamline our operations as we drive towards the \$500 million mark in annual revenues and beyond in the coming years.

We also continue to invest aggressively in R&D in order to make -- maintain our competitive advantage, while expanding our addressable market. Last month, we introduced our next-generation InnoSwitch devices, called InnoSwitch3, which represents a significant advance in the state-of-the-art for power supply technology. These next-generation devices achieve up to 94% efficiency, as compared to an already industry-leading 92% for the prior generation. To power supply designers, this gain of 2 percentage points is a massive improvement amounting to a 25% reduction in losses. The corresponding reduction in heat means that power supplies up to 65 watts no longer require heatsinks which in-turn brings dramatic savings for our customers in terms of cost, size and weight.

In addition to being the most efficient power supply IC on the market, InnoSwitch3 also offers the highest level of integration, resulting in a dramatically lower component count than that of any competing product. We believe InnoSwitch3 will appeal to an extremely broad range of customers across all of our end markets, and we are encouraged by the response we have seen since the last month launch.

We won designs for appliance and rapid charging applications in Q3, and already have more than 200 design opportunities in our pipeline, including chargers for smartphones, tablets, notebooks, as well as appliances, IoT applications, standby power supplies for the server market and a broad range of industrial and consumer electronics applications.

InnoSwitch3 enables us to bring the benefits of InnoSwitch technology to a wider range of power levels and applications, and represents the next step in our ongoing efforts to expand our addressable market. Since 2010, our SAM has grown from \$1.5 billion to more than \$3 billion, and we have additional products in our pipeline that will take it to more than \$4 billion by the end of next year.

With that, I'll turn it over to Sandeep, for a review of the financials.

Sandeep Nayyar - *Power Integrations, Inc. - CFO and VP of Finance*

Thanks, Balu, and good afternoon. Our Q3 results are fairly straightforward, so I will just quickly touch on a few financial highlights, and then we will open it up for the Q&A session.

Third quarter revenues were \$111.3 million, up 3% compared to the prior quarter. The sequential growth was led by a double-digit increase in the industrial category, driven by the high-power business, as well as strength in E-bikes, tools, and metering applications.

Communication revenues were up high single digits sequentially, recovering from the softness we saw in Q2, while the Computer segment grew mid-single digits sequentially. Consumer revenues declined mid-single digits from the prior quarter, reflecting the expected seasonal slowdown in the air conditioning market.

Revenue mix for the quarter was 37% consumer; 35% industrial; 23% communication and 5% computer. Non-GAAP gross margin rose by 40 basis points sequentially to 51.3%. The increase was driven mainly by the postelection rise in the dollar versus the yen, which had a beneficial impact on the cost of wafers from our Japanese foundries.



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Non-GAAP operating expenses were \$33 million for the quarter, up \$300,000 from the prior quarter, and exactly in line with our forecast. Non-GAAP operating margin reached its highest level in 3 years, coming in at 21.6%, up 110 basis points from the prior quarter.

Other income for the quarter was about \$900,000, up more than \$400,000 from the prior quarter. The increase partially reflects higher interest rates and a higher cash balance, but also an impact of roughly \$250,000 from foreign currency fluctuations.

Non-GAAP net income was \$0.78 per diluted share for the quarter, up from \$0.69 in the prior quarter. Cash flow from operations was \$24.6 million for the quarter, while capital expenditures totaled \$6.7 million.

We also utilized \$6.7 million for share repurchases, buying back approximately 96,000 shares at an average price of around \$70. Cash and investments on the balance sheet over \$264 million at quarter-end, an increase of about \$10 million during the quarter.

Internal inventories increased to 91 days on hand, up 3 days from the prior quarter, while the channel inventory rose slightly to 7 weeks. Looking ahead, we expect fourth quarter revenues to be in the range of \$110 million, plus or minus \$3 million, or about a 1% sequential decrease at the midpoint. This reflects typical year-end seasonality under sell-in revenue recognition, as distributors tend to reduce inventories at year-end.

I expect non-GAAP gross margin to be around 51% for the fourth quarter, which would be a slight sequential decrease reflecting a less favorable exchange rate between the dollar and the yen earlier in the year.

Non-GAAP operating expenses should be flat to slightly higher on a sequential basis in the fourth quarter in a range of \$33 million to \$33.5 million. I expect other income to be slightly lower sequentially, in the absence of the FX benefit we saw in the third quarter. And our non-GAAP effective tax rate for the fourth quarter should remain around 5%.

And with that, I'll turn it back over to Joe.

Joe Shiffler

Thanks, Sandeep. We'll open up now for a Q&A session. Emily, would you please repeat the instructions for the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Ross Seymore with Deutsche Bank.

Jeriel Ong - Deutsche Bank

This is Jeriel Ong on behalf of Ross Seymore. So you talked about this a little bit in your prepared remarks. I was just hoping for a little bit more detail. We understand you guys released InnoSwitch3 about a month ago, coincidentally, while you were at our conference. And you talked a little bit about some of these design wins, I guess, and we understand the product is supposed to have a little bit of a broader appeal in terms of end market mix under smartphones. And so can you talk a little bit about a few of the notable design wins you've had or perhaps design traction that you've had since then?

Balu Balakrishnan - Power Integrations, Inc. - CEO, President and Director

Sure. One of the design wins is in monitors to improve the overall efficiency of the monitor. That is a new requirement called total energy consumption, which basically limits the amount of power you can consume over a period of one year. And so people are looking for very high efficiency power

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supplies to be able to do that. And we got design into that actually well before our launch, and we've been shipping in volumes to this customer. It's a Korean customer who is very large in the monitors. The other one was a set-top box also for a consumer application. And that has been in production for some time now. In terms of new designs, we have won a design with -- in a smartphone charger, a rapid charger, this is for a Chinese customer. But this originally used to be an American company. And then there was also an appliance design for a European customer that -- and I'm trying to remember what I think -- I believe it's a vacuum machine, if I remember correctly. And so those are some of the examples.

Jeriel Ong - *Deutsche Bank*

All right. That's really helpful. It sounds like it's all good. Definitely getting more diverse.

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Yes.

Jeriel Ong - *Deutsche Bank*

Yes. And so as a follow-up, just understand you guys don't typically provide specific segment guidance, but I was just hoping you could speak to any notable differences within the quarter from a segment perspective versus your expectations going into the quarter 3 months ago.

Sandeep Nayyar - *Power Integrations, Inc. - CFO and VP of Finance*

Yes. So basically, and that is part of the reason if you look at it, guidance for the margin versus where we came out was favorable because we were expecting more of communications and industrial. The industrial did happen, but the communications which would have tended to keep the lower grew, but not to the extent we expected it. And that's why we got more favorable margin. And typically in the third quarter, as you know, air conditioning does come down and that impacts the Consumer segment.

Jeriel Ong - *Deutsche Bank*

That all makes sense. And so just on the gross -- topic of gross margins and a little bit of longer term question here. What will it take to get your gross margin to the midpoint of your 50% to 55% long-term range? How does InnoSwitch3 factor into this gross profit (inaudible), is it above or below?

Sandeep Nayyar - *Power Integrations, Inc. - CFO and VP of Finance*

So as we have indicated earlier that in the near term, especially if you're looking a year ahead even though it's a little early, we expect our margin to be in the lower end, this year we're going to probably average somewhere around 50.5%, 50.6%. And next year it's going to hover around that. As we come up with more higher generation, higher ASP products, that's going to help us improve over a period of time. Historically, if you've looked at it, we've averaged somewhere in the 51% to 52% range. As I've indicated earlier, for us, it is more important to get the operating margin because of the leverage in our model, than getting the gross margins. Because we're trying to leverage and increase our revenue and try to get our operating margin moving more towards the mid-20s. And as you can see, we are back into the 20s this year, and that's something that we want to inch our way up towards the mid-20s.

Operator

Your next question comes from the line of Tore Svanberg with Stifel.



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Tore Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

My first question is for Balu. Balu, you mentioned that you expect USB PD to materialize more in the second half of '18. I'm just wondering, what are some of the recent developments that gives you that conviction?

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Well, I think I've talked about this before. USB PD gives you a lot of flexibility in adjusting the amount of power that you deliver to a mobile phone. The mobile phone or any mobile device for that matter, whether it's tablet or even a notebook, can talk to a USB PD enabled charger, and ask for any voltage or current. So this standard actually was almost final last year. But there was some resistance for the standard to be accepted by all the cell phone companies. Each cell phone company had a slightly different requirement. Especially, the Chinese guys had thought that they had a better way to charge batteries. And so they wanted some additional features. And that actually delayed the USB PD. That's kind of the bad news. The good news is, the changes they made to USB PD, it makes it a lot more inclusive of all the cell phone companies. We truly believe now -- almost all of the cell phone companies will switch to USB PD. It now has enough volts to do everything everybody wants. So basically, at a fundamental level, the USB PD allows you to adjust the voltage in very small steps like in 10, 20 millivolt steps and current in the 50 milli-amp steps, all the way from, say, about 5 volts to 20 volts, which makes it a very flexible power supply to be used with any mobile device. So because of that, we feel pretty strongly that now that it is complete, it actually completed, believe it or not, just a few weeks ago. It got voted in. So we feel now pretty confident that by second half of next year, we will start generating revenue, and that will continue to grow well into 2019 and beyond. And we know that most of the cell phone companies have made the decision to adopt USB PD, and so that's what gives us confidence that we will get a fair share or unfair share of this market. And InnoSwitch3 is perfectly suited for this application because of the power levels. It is a much higher power levels, and so it requires higher efficiency, and a smaller component count also makes a huge difference to make these products much smaller. And the efficiency also makes the power supply much lighter, not only smaller, but much lighter.

Tore Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Very good. And you talked a little bit more about appliances and connectivity at this time than I've heard you talk about before. And I think you mentioned that you're actually seeing ASP appreciation because of appliances being more and more connected. I was hoping you could elaborate a little bit on that. I mean, obviously, being connected means that it needs more power, but is there any reason why you are emphasizing this a little bit more now?

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

The reason is we are seeing a lot of appliance designs that incorporate what some people call IoT features, some people call it automation features, and so on. And an example of that would be a refrigerator having a screen in front where you can order food based on your requirements, and it will be delivered to your house. Another example is a washing machine, where if the motor is about to fail, that is detected by the vibration, and a signal is sent to the manufacturer. So before the motor fails, they can send somebody out to replace the motor. There are also applications where your washing machine will wash your clothes when the electricity is the cheapest, and you don't have to worry about it. You just load it and then forget about it, and it will automatically turn on and wash your machine. So there's a lot of these kinds of features that are being introduced into these products. And we see more and more designs that require higher power because of that. The other aspect that's also increasing our ASP is energy efficiency. Most of the appliances are now going to what is known as electronically-controlled brushless DC motors, which are significantly more efficient, but it requires a separate control and a separate power supply in most cases. So now you're talking about more than 1 power supply in many of these appliances. Added to this, LED lighting is becoming, of course, very common. And in many of these applications, the places that are lit are user touchable, and therefore it needs an isolated LED driver. And probably the best example is the refrigerator. The LED lighting is not only very efficient, it also produces less heat. So most refrigerators have now gone to LED lighting, and many of them have a separate power supply for that. So all of this increases our content. One last thing I would add is that in spite of all these additional features, they still have to meet a very low standby consumption spec of 500 milliwatts, and the only way you can do that is by adding some additional functionality, like our CAPZero



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chip. So CAPZero is becoming very popular for appliance applications. And the overriding factor, of course, is reliability. So we have such a strong record in appliances that we are sitting in a very good position to take advantage of all these developments that will increase our ASP.

Tore Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

That's very helpful. Just one last question. And I'm just trying to understand the potential return on this recent CapEx increase. Is the CapEx increase kind of just catching up from maybe not spending a lot the last few years? Or are you actually starting to see some new markets, new programs that you really want to go after? And I'm especially thinking about it in relation to what you said about the SAM growing to more than \$4 billion by the end of next year.

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

It really comes from 2 factors: One is that, we see a demand growth coming that we want to be prepared for. Number two, the capacity worldwide for 6- and 8-inch wafers is relatively tight. So to increase the capacity, we have to do some investments because sometimes the fabs may not have all the equipment we need to implement our technology, so we will have to spend some of the -- spend for some of the equipment to expand the capacity. If there was a lot of excess capacity, of course, there's a lot more incentive for our vendors to offer that capacity at no cost to us. But when there is a tightness, we at least have to put in our fair share to get the capacity. So that's really the 2 reasons. It's the growth that we see coming. And also the fact that the capacity is tight. The good news is, we do -- we have acquired more than sufficient capacity to fuel our growth for the foreseeable future.

Operator

Your next question comes from the line of David Williams from Drexel Hamilton.

David Neil Williams - *Drexel Hamilton, LLC, Research Division - Equity Research Associate*

Balu, I guess this first one is for you. If I'm thinking about the health of the channel inventory and after the correction that you saw last quarter in the Communications segment. You talked a little bit about how you're seeing the health of the channel inventory and if you're seeing anything specific today that gives you any concern heading into the back half of the year?

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Well, if you talk about our distribution inventory, it's pretty much where we expect it to be. So 7 weeks plus or minus is where we -- it should be, at least for Q3 and -- I mean, Q2 and Q3. Q4 tends to be lower. At the end of Q4, most distributors try to reduce their inventory at the year-end. And then at the end of Q1, it tends to be higher because they're preparing for growth in Q2. As far as our customer inventories go, our visibility is not that great because not all customers buy directly from us, a lot of them buy from distributors. However, having said that, we believe this China slowdown and the resulting inventory build is for -- to the extent we can tell, is pretty much gone. So we should see the demand as it happens going forward.

David Neil Williams - *Drexel Hamilton, LLC, Research Division - Equity Research Associate*

Great. And then in the Communications segment, if you kind of think about the switch to USB PD, that you had mentioned. Do you expect that maybe ahead of that, you'll see a slowdown in the Communications segment as you get into the first part of the next year before that picks up?



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Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Yes. Just to be clear, we actually grew in cell phone chargers. The reason our Communications segment was down year-over-year was more to do with networking business which is down. This is primarily Wi-Fi business. So the Consumer is growing this year, it will grow this year, but it will grow much more significantly, the second half of next year. And since everybody is switching over to USB PD, you can imagine that they're not going to do redesigns of existing devices or switch smartphones from existing chargers to fast chargers. So you could argue that the growth will be limited until USB PD comes on board, but it's still growing.

David Neil Williams - *Drexel Hamilton, LLC, Research Division - Equity Research Associate*

Great. And then how -- if you can talk a little bit maybe about your -- the SCALE IGBT drivers and how that's faring. You recently -- I believe you said you were expecting to begin shipping that this quarter. Can you talk a little bit about that ramp and how is it faring to what your expectations were?

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

The answer to the last question is yes. The iDriver goes into very high reliability type applications, like electric buses and commercial air conditioning, commercial solar installations, and also UPS power supplies. So the design cycle is very long. We will have some revenue this year, but very small. But next year we expect to have -- start seeing revenues of significance, and then that will continue to grow for many years to come.

Operator

(Operator Instructions) Your next question comes from the line of Edgar Roesch with Sidoti & Company.

Edgar Burling Roesch - *Sidoti & Company, LLC - Research Analyst*

Balu, looking at the major retailers right now, it seems like there's a number of laptops powered through a USB Type-C connector. Could you just comment on the development of that market? Whether we're seeing a bridge to when USB PD is adopted? Or what stage we're really witnessing so far?

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Thanks, Ed, for the question. Most of the laptops actually use very -- what do you call, unique connectors for each one of the manufacturers. The first laptop that was introduced with USB PD was by -- it is the Apple, Mac Air -- Airbook -- what do you call that? You know what I'm talking about. Anyway, so that one...

Edgar Burling Roesch - *Sidoti & Company, LLC - Research Analyst*

MacBook Pro, I think.

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Yes. But the first cell phone using USB was introduced by Google, which is a Pixel phone, and we are in it, as I think we've mentioned that before. So it's just in very early stages. We expect all of the mobile devices, whether it is cell phones or laptops or tablets, will eventually move to USB PD for really multiple reasons. One is the connector, which is what's called a C connector, is very small and capable. It can handle up to 100 watts. Yet it is very small and it is reversible, just like the lightning connector on Apple phones. So it's a very convenient connector. But it can only be used with USB PD. And PD, part of the USB standard, which is the USB 3 standard, or third-generation USB standard, the PD stands for power delivery.



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And that's the protocol that has been modified to make it much more flexible to provide different voltages and currents. And that got only approved recently. So the USB PD will -- we believe will take off, but because of the design cycles, it will be the second half of next year, when we'll start seeing significant revenue.

Edgar Burling Roesch - *Sidoti & Company, LLC - Research Analyst*

Okay. And then on these industrial wins like the Chinese electric transmission program and the -- you mentioned getting qualified for electric vehicle content. Are those type of wins arriving through existing customer relationships? Maybe some large European industrial companies? Could you speak a little bit about whether you've had to cultivate a whole new set of relationships to win this?

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Excellent question. It comes from relationships we've already had. We have had very good relationships with the large industrial customers in Europe, and also in China. In China specifically, the Chinese railways and also the Chinese electrical grid guys. And they have been experimenting with DC transmission for quite some time now, using not only our products, but also competitors' product. And what they found was that the competitors' product quality was not very good. They blew up a whole bunch of them, which is a huge problem for DC transmission. And so far, we have had a perfect record of no failures on our products. So they have chosen us for the real implementation, which is the actual implementation of the high voltage DC transmission. Now, high-voltage DC transmission is not new. We already have some installations in the U.S. and several in Europe. I think the first one was installed between the U.K. and France. But what is new is a grid. Usually, DC transmission was used for point-to-point links. Like for example, we have one from Portland to California, Southern California, which is a DC transmission. But what China is doing now is using that in a grid fashion. And to do that, you need quite sophisticated electronics on each end of that transmission, which you have, obviously, many different ends if you have multiple grids, multiple transmission lines connected in a grid. And they've been working on it for quite some time now, many years, but now they are ready to deploy it. And we believe this will be -- this will propagate to other countries like Europe and U.S. But this is not a short-term thing. This will happen first in China because they are in the process of installing a huge grid. But it will eventually propagate to other countries because DC is more efficient -- significantly more efficient than AC transmission.

Edgar Burling Roesch - *Sidoti & Company, LLC - Research Analyst*

This is a contractor that could conceivably be going to other regions and doing similar projects, huh?

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Not necessarily. Just -- yes. Absolutely, the guys who actually build the power conversion units. And typically they are large industrial companies like ABB, General Electric, Siemens, Schneider and those guys. And once they have that product available, it's relatively straightforward for other people to implement.

Edgar Burling Roesch - *Sidoti & Company, LLC - Research Analyst*

Great. And then one last question for you guys. If I remember correctly, last year, I think the company declined to take a normal year-end shutdown of any period, is that going to be the same thing this year-end?

Balu Balakrishnan - *Power Integrations, Inc. - CEO, President and Director*

Well, last year, we didn't take it because we were very tight on getting all the products out. But I think we're in better shape now. So we will take a few days off between Christmas and New Year.



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I'm showing no further audio questions at this time. I will now turn the call back to Joe Shiffler.

Joe Shiffler

Okay. Thanks, everyone, for listening. There will be a replay of this call available on our website, investors.power.com. Thanks, again, and good afternoon.

Operator

This concludes today's conference. You may now disconnect.

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