

**POWER INTEGRATIONS**

**Moderator: Joe Shiffler**  
**April 29, 2014**  
**4:45 p.m. ET**

Operator: Good afternoon, my name is (Leta), and I will be your conference operator today. At this time I would like to welcome everyone to the Power Integrations first quarter results conference call. All lines have been placed on mute to prevent any background noise. After the presenters' remarks, there will be a question and answer session. If you would like to ask a question during this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, please press the pound key.

Thank you. Mr. Joe Shiffler, Director of Investor Relations, you may begin your conference now.

Joe Shiffler: Thank you, Leta. Good afternoon and thanks for joining us to discuss Power Integrations financial results for the first quarter of 2014. With me on the call are Balu Balakrishnan, President and CEO of Power Integrations and Sandeep Nayyar, our Chief Financial Officer.

During today's call we will refer to financial measures not calculated according to Generally Accepted Accounting Principles. Please refer to today's press release available on our Web site at [investors.powerint.com](http://investors.powerint.com) for an explanation of our reasons for using such non-GAAP measures, as well tables reconciling these measures to our GAAP results. Also our discussion today, including the Q&A session, will include forward-looking statements, reflecting management's current forecast of certain aspects of the Company's future business.

Forward-looking statements are denoted by such words as will, would, believe, should, expect, outlook, estimate, plan, goal, anticipate, project, potential, forecast, and similar expressions that look towards future events or performance. Forward-looking statements are based on current information that is, by its nature, dynamic and subject to rapid and even abrupt changes.

Our forward-looking statements are subject to risks and uncertainties, which may cause actual results to differ materially from those projected or implied in our statements. Such risks and uncertainties are discussed in today's press release and under the caption item 1A, risk factors, in part 2 of our most recent Form 10-K, filed with the SEC on February 13, 2014.

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

And now I'll turn the call over to Balu.

Balu Balakrishnan: Thanks, Joe and good afternoon. First quarter revenues were \$83.1 million, below our forecasted range, but nonetheless 8 percent higher than a year ago. Non-GAAP earnings per share grew nearly 20 percent year-over-year as our gross margin increased to its highest level in nearly eight years.

We generated solid cash flow and further strengthened our balance sheet prompting our Board of Directors to raise our dividend just two quarters after the most recent increase.

We also made good progress during the quarter on our key growth initiatives and we expect healthy sequential revenue growth in Q2. With accelerated growth likely in the second half of the year as we roll out an exciting new technology that has received an enthusiastic response from customers and has already won a number of high volume designs.

I'll talk more about that in a moment, but I first want to address the first quarter revenue shortfall, which came primarily from the computing and communications end markets. Sales into the computer markets declined nearly 20 percent sequentially due to a sharp reduction in sell through for our

desktop power supply applications. This appears to have been nothing more than a ripple in the supply chain, similar to what occurred in the first quarter of last year, when our computing revenues declined by an identical percentage.

Importantly, even after the sequential decline, our revenues from the PC market in the first quarter of 2014 were up more than 10 percent year-over-year, reflecting significant market share gains in both main and stand-by power supplies over the past year.

That bodes well for the rest of 2014 if we see a repeat of last year, when the soft first quarter was followed by three consecutive quarters of strong sequential growth in PC applications. It was also a challenging quarter in the communications end market with revenues down about 20 percent sequentially.

This market tends to be unpredictable given a high level of competitive churn and the preponderance of high volume applications, but multiple factors converged to make this an unusually volatile quarter.

One of our largest customers, a manufacturer of small scale networking equipment, pushed out a substantial amount of demand that had been in our backlog at the time we gave the revenue forecast. We also saw lower revenues from cell phone charges due to a slow-down in demand at our largest end customer, as well as churn at the low end of the market where market share tends to shift frequently.

While our first quarter revenues are disappointing we believe they are largely the result of short-term market fluctuations with virtually no implications for our long-term growth trajectory. We are as bullish as ever about the opportunities ahead of us in areas like area LED lighting, rapid charging for the mobility market, and our expansion into higher power applications, which has already added a billion dollars to our addressable market with more to come as we expand our mid- and high-power product portfolios.

We are also heavily focused on the rollout of revolutionary new technology that we plan to launch formally later this year but have already introduced to key customers for high volume applications.

Incorporating primary and secondary circuitry as well as safety-isolated feedback all in a single device, we believe this new technology offers the most radical simplification of low-power AC/DC power supplies since the introduction of our ground breaking TOPSwitch family two decades ago.

The first product incorporating this new technology has already been designed in by several smartphone vendors for rapid charging applications and we expect initial shipments to begin in Q2, with volumes ramping through the second half of the year. The new technology also dramatically improves active mode efficiency and arrives just in time for a new round of energy efficiency standards in the U.S. and Europe.

In February the U.S. Department of Energy announced substantial revisions to their mandatory standards for external power supplies making them easily the most stringent power supply efficiency standards anywhere in the world. Set to take effect early 2016, the new standards include tighter active mode efficiency requirements and much stricter limitations on standby consumption, going from current levels of 500 milliwatts to a challenging 100 milliwatts for most external power supplies.

Meanwhile, the European Union's voluntary Code of Conduct specifications for external power supplies were tightened effective January of this year with a further tightening set to take effect in 2016. We expect a wave of redesign activity in external power supplies as we approach the effective dates of these new standards and we believe our new technology will position us to capture a significant share of this market.

Another key element of our growth strategy is LED lighting, and we expect growth in that market to accelerate this year, as prices on LED lamps continue to fall and as our highly integrated LYTSwitch product family continues to get strong traction in the marketplace.

We won a large number of designs in Q1 ranging from street lights to replacement bulbs, including a high volume design for a major home furnishings retailer and another for a name brand bulb manufacturer.

We also had a strong quarter in our higher power market, winning new designs for main power supplies in both TV and PC applications, while our Concept IGBT drivers continue to gain share in attractive end markets like renewable energy, electric transportation, and energy exploration.

In March we announced the first shipments of drivers featuring our latest chip set known as Scale 2+, in products targeting solar inverters, uninterruptible power supplies, and industrial motors. This next generation technology enhances our already industry leading level of integration, enabling greater reliability, ease of design, and smaller board footprint.

We won several high value designs in the first quarter including wind inverters for China and India. And a large solar inverter project at a Canadian customer and we believe we are on track for another year of double-digit growth in high power.

Before I turn it over to Sandeep, I'd like to touch on the latest development in our long running patent litigation against Fairchild Semiconductor. Last month a jury in federal district court in California found that Fairchild and its System General subsidiary infringed two of our patents and awarded us damages of \$105 million.

The infringement was found to be willful, which means the court could enhance the damages up to three times the amount awarded by the jury. In addition to enhanced damages, we are seeking a permanent injunction against the more than 150 infringing Fairchild products implicated in the decision and any other products with the infringing circuitry.

These parts would be in addition to 100 parts already under permanent injunction based on earlier litigation and more than 80 other parts for which we are already seeking an injunction based on a case decided in 2012.

This marks the fourth time Fairchild and SG have been found to infringe our patents and we hope that this latest decision will cause Fairchild to finally re-examine its business practices and begin respecting our intellectual property rights.

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

Sandeep Nayyar: Thank you, and good afternoon. I'll review the Q1 numbers and the outlook and then we will open it up for Q&A. In my prepared remarks, I will focus primarily on the non-GAAP numbers, which are reconciled to the corresponding GAAP numbers in the tables accompanying our press release.

First quarter revenues were \$83.1 million, up 8 percent from a year ago. We had double-digit year-over-year growth in three of our four end-market categories, with only the communication end market showing a decline from the prior year.

Sequentially, revenues were down 8 percent with consumer roughly flat, industrial down mid-single digits, and both computer and communications down roughly 20 percent. The revenue mix for the first quarter was 37 percent consumer, 35 percent industrial, 18 percent communication, and 10 percent computer.

Our non-GAAP gross margin increased nearly 2 points from the prior quarter to 56.4 percent, its highest level since 2006. The increase was primarily due to end-market mix, as the softer than expected demand came in lower margin end markets. A small incremental benefit from last year's depreciation in the dollar versus the Japanese yen also contributed to the gross margin improvements.

Non-GAAP operating expenses for the first quarter were \$28.4 million. That's below our forecast due in part to litigation expenses, and also a number of expense-saving measures we implemented in the latter part of the quarter in response to the weaker revenue.

Our non-GAAP tax rate for the first quarter was 6.3 percent, up from the last year reflecting the expiration of the federal R&D tax credit, but in line with

our expectations. Non-GAAP earnings for the quarter were \$0.56 per diluted share, up 19 percent from a year ago when we earned \$0.47.

We generated \$16.2 million of cash flow from operations in the quarter, while capital expenditures totaled \$4.5 million. Cash and investments on the balance sheet total \$217.7 million at quarter end, up \$15.5 million during the quarter.

As Balu indicated, our board of directors has declared a 20 percent increase in our quarterly dividend, effective in the third quarter of this year, when the dividend will rise to \$0.12 (per) quarter. We also have approximately \$30 million remaining on our buy-back authorization.

Internal inventories increased by \$5.7 million during the quarter, partly as a result of lower than expected sales, but also in anticipation of the growth ahead of us. We had 118 days of inventory on hand at quarter end, which is within our targeted range of 110 days plus or minus 15.

As for the outlook, we expect second quarter revenues to be in the range of \$89 million, plus or minus \$3 million, which would be up 7 percent sequentially at the midpoint. Non-GAAP gross margin should be roughly 54.5 percent, reflecting a combination of less favorable end-market mix, lower production volumes, and the initial ramp of new products.

I expect non-GAAP operating expenses to be between \$29 million and \$29.5 million in the second quarter. That's an increase from Q1, due in part to the timing of the annual salary increases, which are effective April 1st. I then expect OpEx to remain at a similar quarterly run rate through the second half of the year. Lastly, I expect the non-GAAP tax rate for Q2 in the balance of the year to be approximately 7 percent.

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

Joe Shiffler: Thanks, Sandeep. We'll open it up for the Q&A session now. In the interest of time, I'd like to ask for callers to adhere to a limit of two questions at a time. We will be happy to come back around for a second round of questions, time permitting.

Operator, would you please now give the instructions for the Q&A session?

Operator: At this time I would like to remind everyone, in order to ask a question please press star then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. Your first question comes from Andrew Huang with Sterne Agee. Your line is now open.

Andrew Huang: Hello, thanks guys. So the first question is with respect to the communications. So I understand that it was down sequentially for the March quarter, but I was wondering if you could give us a little bit of color or maybe conviction that you know it is not share loss, and you know when I look at your margin guidance for the June quarter it would suggest that there's probably going to be a rebound there, but any more color would be helpful.

Balu Balakrishnan: Hi, Andrew, yes, I can do that. So in the communications market there were really two areas, one is cell phones and the other is networking area where we had a shortfall. In the networking area, one of our largest customers, who has been a very, very successful customer in this area, they make wireless routers. We had a very high share of this customer, and they have been growing very rapidly, and it looks like their demand slowed down after a very significant increase over the last couple of years. They are almost 5 percent [of sales] – not quite 5 percent but a bit less than 5 percent customer.

And what happened was, in February, they pushed out a significant portion of that order so it was actually on the books when we gave the revenue forecast but we found out later that they wanted the orders pushed out. It is not clear when it will come back, so we are conservatively assuming it is not going to come back in Q2 very significantly. So that's one portion of the shortfall. In the cell phone area there is several reasons. One is that one of our largest end customers, they – they have multiple suppliers and two of the suppliers reduced their demand unexpectedly.

We were expecting them to order in the normal pattern but we found out that the demand had declined so they reduced their orders. So that is one aspect of it. The other one is that we in the low end of that market which is primarily



feature phones, there was a shift in the – in the share of one of our customers. You know that are usually multiple customers supplying to an end OEM and it is not uncommon for the share to shift back and forth and unfortunately one of our customers, lost significant portion of their share to one of their competitors who does not use our solution.

And then there was another case where we chose to walk away from a low end phone opportunity because you know pricing was irrational, and we do that all the time as I've explained it in the past. So it was kind of a perfect storm, everything happened altogether, and that's what affected the communications market by 20 percent sequentially.

Andrew Huang: Got it. OK. And then maybe, you know, I think you mentioned briefly about this revolutionary new technology for the second half of the year. So I think everyone would appreciate a little more color on what that technology is and what applications it could be used for.

Balu Balakrishnan: The technology is very fundamental, meaning it can be used with any application in the low power and maybe even into mid-power. And what that allows us to do, for the first time, we are able to combine not only the primary side of the power supply, which is what we are we have been always integrating in the past, you take TOPSwitch, TinYSwitch, or LinkSwitch, it is all on the high-voltage side. But this technology allows us to combine the primary side, or the high-voltage side electronics, with the secondary side or the low voltage side on the same device.

And to do that, we have to provide safety isolation and also communication. Because the feedback signals have to flow from the secondary to primary through a safety isolation. And we have a very clever way of doing that in a single device, and we have gotten approvals from all of the safety agencies around the world.

And so we are ready to go into production with this device. Now the first product with this technology is targeted towards adaptors, specifically for mobile devices, whether it is the cell phones or tablets, or even – even laptops in the future.

So that product for the first time in the world, we are able to combine both sides, which also gives us a lot more flexibility in doing some clever things on the secondary side which we never played in the past, for example, we do what is known as synchronous rectification on the secondary side, which increases the active-mode efficiency significantly and allows us to easily meet the DOE requirements that will take effect in 2016.

And of course on the standby side we have always had extremely low stand by consumption and will take us even further and allow us to meet standby consumption to less than 10 milliwatts. So I hope that gives you sufficient color.

Andrew Huang: OK. If it is OK, can you give us some color on ASP or margin for that new product?

Balu Balakrishnan: Well, I can't talk about ASP but let me give you some rough idea. So if you take just the primary side, let's say the cost of – I mean the price is 1X, the fact that implementing secondary side and the isolation will give us at least 2X kind of an ASP. And of course if you implement more complicated secondary side functions that could increase incrementally from there.

Andrew Huang: That's helpful. Thank you very much.

Operator: Your next question comes from Tore Svanberg from Stifel. Your line is now open.

Evan Wang: Hi, thank you. This is Evan calling in for Tore. Could you talk a little bit about high power performed this quarter? Sounds like the bulk of your revenue you relied on this sector this time.

Balu Balakrishnan: The high power revenue was slightly down this quarter but that's just a quarter to quarter fluctuation. The high power revenue the extent we can tell does not have any seasonality. It is not like the general industrial market where it is the strongest in Q1, because it goes into a lot of infrastructure projects which are determined more by timings of major infrastructure improvements in various countries. But having said that we are very bullish

on the high power for the year. We expect it to grow double-digits this year. So you know there is really no concern at all about it being slightly lower in Q1.

Evan: OK. Great. Thank you. Also, just going back to your guidance, can you give us some sense about where you are in your backlog in supporting your guidance. And also whether there could be some upside to your guidance where that upside might come from if things turn out to be more favorable than you think right now?

Balu Balakrishnan: In terms of backlog, as you realize, we recognize most of our revenue, 90 percent of our revenue, on sell-through basis. And so our backlog is not very meaningful indicator of the actual revenue. Having said that, we obviously take that into account for our forecast. So it is consistent with our forecast.

We generally don't like to give the backlog to date because it can be misleading many times. And I think your other question was related to whether there are any upsides? Of course, there is always upside but we have to go by what we know today. In general Q2 is very broad-based increase for us. We see improvements in LED, PC standby, because we had such a sharp downturn in Q1 in PCs, we expect that to come back. So it depends on how much and how far it comes back. And we also see growth in mid-power and high power in Q2.

Sandeep Nayyar: And Evan, as Balu mentioned in his prepared remarks, we will see accelerated growth in the second half with the introduction of new products including revolutionary products.

Evan: Great. Thank you very much.

Balu Balakrishnan: You're welcome.

Operator: Your next question comes from Steve Smigie from Raymond James. Your line is now open.

Vince: This is Vince in for Steve Smigie. I was wondering if you could go specifically into the CT-Concept business, as far as any kind of share gain

opportunity, if you think in the next 12 months roughly a 2 percent increase seems realistic?

Balu Balakrishnan: I'm trying to find [the list of] designs. So we had significant design wins in the high-power area, both with the new technology that was recently introduced which is Scale -2+, and also with the existing projects. So we won a design for wind power I think I mentioned in my report – sorry, prepared script, in China and India.

And also we are seeing a lot of opportunities for designs for oil exploration, actually it's fracking, I should say. So the other thing that is happening around the world is solar is becoming more and more attractive. It has hit grid parity in many parts of the world. We are seeing solar coming back after a long time of softness. So we see lot of opportunities and we expect as I said double-digit growth this year.

Vince: OK. Great. Thank you. And moving on to white goods, I was hoping if you could kind of give a forecast on that if you think roughly two times GDP seems about right over the next 12 months, and any color on that would be great.

Balu Balakrishnan: That is another area we're doing extremely well. In fact, even in Q1 the appliance did very well and we have number of design wins in appliance and we expect appliance to continue to grow. It's a very sticky market so we are very excited about that part of the market.

Sandeep Nayyar: And we are also getting multi-chip opportunities in the appliance area. So that in itself – we're seeing much more growth coming through multiple chip sales in the unit.

(Vince Allen Thomas): OK. Great. Thank you.

Operator: Your next question comes from Ross Seymore from Deutsche Bank, your line is now open.

Matt Diamond: Hey, good afternoon, guys. This is actually Matt Diamond on Ross Seymore's behalf. And I wanted to ask you about the guidance with respect

to your end markets. So if you could just give us an idea of what would be expected to be up most and least just sort of a stratification of your four different segments there?

Balu Balakrishnan: Sure. Let us start with industrial. In industrial we expect LED to be up. We expect the high power to be up. And in the consumer we expect the appliances, which is slightly more than two-thirds of the market to be up. And in computers we expect both the standby and PC main markets to be up in Q2. The only area we think is not going to be significantly up is communications.

We are basically assuming that it's not going to come back strongly except for the new product to start shipping in Q2, and that will be in the order of maybe half a million to a million dollars worth of revenue in Q2 but it will be significantly higher in Q3 as this rapid charging programs go into production, and then it will continue to increase in revenue through the fourth quarter of this year.

Matt Diamond: OK. And the gross margin, it looks like it's down roughly two points sequentially and it was mentioned that is a function of less favorable mix, lower volumes, and these new product ramps. If you could sort of specify what exactly would drive the gross margin down the most, and what – how we should expect it to potentially ramp up in the second half of the year?

Sandeep Nayar: So I think in the second quarter the impact of the gross margin for the three items you mentioned is about a third each. But in the third and fourth quarter we expect the margins to go down further as we are ramping new products as well as ramping the revolutionary product, in the second half.

Overall, if you're looking for an overall, if you remember in the last quarter we had said that the gross margin for the year would be about 50 basis points, on a non-GAAP basis, would be about 50 basis points below 2013, which was about 53.8 percent.

But considering the favorable gross margin in the first quarter that we've seen, we expect the overall gross margin should be slightly higher. But the gross

margin in the second half even though it is going down, will stay well within our targeted range.

Matt Diamond: OK. Great. Thanks so much.

Balu Balakrishnan: You're welcome.

Operator: Again, if you would like to ask a question, please press star one on your telephone keypad. Your next question comes from Vernon Essi from Needham & Company. Your line is now open.

Vernon Essi: Thank you very much. I was wondering, Balu, if you could give any more details on the rapid charge front or quick charge front, and what you're seeing out there in the marketplace?

Balu Balakrishnan: Absolutely. In terms of rapid charging almost every OEM we have spoken to wants to go into rapid charging. So that's not an issue at all. Everybody will do rapid charging. In terms of the Quick Charge protocol, Qualcomm protocol, we have seen a significant number of customers who decided to use Quick Charge at least on some of their models. I think at the last count it was about nine of the OEMs who have decided to use Quick Charge.

The real question is how broadly they will use Quick Charge going forward. But we are very enthused by the acceptance of Quick Charge. There are still a few OEMs who have not made a decision yet, they're evaluating Quick Charge along with a couple of other protocols, and we are closely monitoring that situation.

We are – you know engaged with all of those other customers. As far as we are concerned, whether it is Quick Charge protocol, or some other protocol, or no protocol at all, is somewhat orthogonal to what we want to do, which is sell our power conversion chips.

For example, this new technology we talked about will go into any kind of rapid charging application and if it is Quick Charge, we'll also sell the

protocol chip which is the CHY100 chip we announced last year. If not, we'll sell the power conversion chip which is the new technology which happens to be the significant portion of the dollar content in the charger.

Vernon Essi: All right. So, and I just want to be clear, too, you're probably – I'm noticing you're not getting into any details or milestones versus the last couple of calls in terms of discussing any new design wins. I mean, is that something you're going to discontinue to do or has there any new design win activity to speak of? On the ...?

Balu Balakrishnan: I can certainly comment on that. We have roughly about six companies, six OEMs who are going to use our product. About half of them, about three of them, are using Quick Charge. The other three are using rapid charge without the Quick Charge protocol.

And as I mentioned earlier, nine of them have already committed but they have not gone into preproduction or haven't placed orders. So we don't consider them as design wins at this point. In addition to that, there are a number of other customers in their evaluations. So we expect to get more design wins in Q2.

Vernon Essi: OK. And then just two sort of I guess housekeeping first related to the charger side. What's your sort of rule of thumb in terms of how much of your revenue – and obviously some of the communications segment – but how much is typically charger on a full run basis and should we be thinking about to change given the fact that you've had this sort of setback on the networking side?

Sandeep Nayyar: So I think what you are looking for is how much the cell phone as a portion of the total communication. It is still running at about half. I think with the revolutionary new product coming out and that depending on the power levels and where it gets supplied I think over a period of time you should see that as a portion go up.

Vernon Essi: OK. And then finally on LED you had some prepared comments even in your press release discussing it, how did that business do in terms of overall

revenue? Any hints you can give us as to how that's growing and any potential targets you might have for the revenue of 2014, would be appreciated.

Balu Balakrishnan: Sure. Our revenue in LED is in the high single digits. So it is – there are two major applications within industrial and the number one is high-power, the number two is LED. High-power is slightly over 10 percent and LED is slightly below that. And we expect a number of new design wins we have going into production in Q2, so we expect to grow LED revenue through the rest of the year.

Vernon Essi: OK. That's fair enough. Thank you.

Balu Balakrishnan: Thank you.

Operator: There are no further questions at this time. I turn the call back over to Mr. Shiffler.

Joe Shiffler: OK. Thank you, and thanks for everyone to be listening. There will be a replay on our website, which is [investors.powerint.com](http://investors.powerint.com). Thanks again for listening, and good afternoon.

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

**END**