

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Micrel, Inc. (MCRL)



RAYMOND D. ZINN is a Co-Founder of Micrel, Inc., and has been the company's President, Chief Executive Officer and Chairman of the board since its inception in 1978. As CEO, Mr. Zinn gives the board of directors insight into and in-depth knowledge of the semiconductor industry, and Micrel's specific operations and strategies. He also provides leadership and extensive knowledge of semiconductor technology and of Micrel's business environment. Prior to co-founding the company, Mr. Zinn worked in various executive management and manufacturing capacities within the semiconductor industry, including positions at Electromask TRE, Electronic Arrays, Inc., Teledyne Technologies, Inc., Fairchild Semiconductor and Nortek, Inc. He holds a B.S. in industrial management from Brigham Young University and an M.S. in business administration from San Jose State University.

SECTOR — SEMICONDUCTORS

TWST: Give us a general overview of and a short introduction to Micrel.

Mr. Zinn: Micrel was founded in 1978 by me and another individual. We started the company with \$300,000 of our own money, without any venture capital investment. So it was funded with a minimal amount of money. Typically a semiconductor company like Micrel would be funded with \$20 million to \$30 million, even in that time frame. In the 32 years the company has been in business, we've only lost money one year out of the 32 years. That year was in 2002, when we consolidated two wafer fabrication facilities down to one. Even then we only lost around \$41,000 that year. So the company is very bottom-line oriented, highly profitable.

We are in the semiconductor business more like a pure-play analog company. We supply semiconductor solutions for all the major markets — industrial, computing, wireline, wireless and now in the automotive market. So the company is quite well diversified. Roughly about a third of our revenue comes from industrial, and then roughly the same for wireline, with the balance from computing, handsets and automotive. We have roughly 3,000 products. We serve approximately 11,000 significant customers worldwide. We have offices around the world. The company is located in San Jose, Calif. We have our own wafer fabrication facility. A substantial portion of our own wafers are manufactured locally in San Jose, Calif., while the rest of our wafers are fabricated through outside wafer fabrication facilities.

We subcontract our assembly and test through low-cost assembly and test areas in Asia. We are well known for our quality and reliability. In fact, the name Micrel comes from the term "microcircuits that are reliable." So our focus has always been on providing a very high-quality product with state-of-the-art applications. That kind of gives you in a nutshell about what Micrel is.

TWST: Perhaps you could explain what's driving the transition from analog to digital control.

Mr. Zinn: As more customers are looking for the ability to control their power, they want to be able to interface with the power management IC through a digital control or through some other computer interface. So going to digital allows the customer to interface his microprocessor or his network solution to control the power management of his system, so that gives him an interface to do that.

TWST: Would you comment on the end markets you support and how you reach out to them?

Mr. Zinn: The markets we serve — industrial, wireline communications and wireless — are worldwide. However, a lot of the design work is being done in the U.S., and then our customers, such as Cisco Systems, use Asian facilities to do their manufacturing. We have to work with the local design groups to get the product designed into their application, and then we also have to work with their manufacturing facilities, their original design manufacturer or contract manufacturer, throughout the world to get the product actually into the board and service that customer through its CM or ODM. So there are two things: You have local

design efforts, and you have to work with manufacturing facilities, which may be thousands of miles away. So that's more or less the interface issue we have. We also sell through distribution, classic distributors like Arrow, and Future and Nu Horizons. Those distributors then work directly with their customers. They buy the product from us and then redistribute to their customers. Roughly half of our business is done through that vehicle.

TWST: Do you customize much?

Mr. Zinn: We do some customization. But we generally build a generic product that can be used in multiple applications, and then we might tweak it for a particular customer application.

TWST: What is the competitive landscape like? Who do you view as your peers and what gives you the competitive or market advantage at this point?

Mr. Zinn: Our competitors are the analog companies, such as Linear Technology, Maxim, National Semiconductor, TI and Analog Devices. Those are the typical competitors that we have. They are much larger than we are. In fact, most of the companies I just named are four to five times larger than Micrel.

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So we have to scramble. We have to provide a lot more service, and we are willing to do more to get these large companies, such as Cisco Systems, to want to use our product versus some of the larger companies. So service is a real key for us to be able to compete with those larger analog companies, but our company is getting traction. As I mentioned, we do have 3,000 part numbers and 11,000 significant customers. We are getting traction and are becoming recognized as a major player in our field. In addition, we are also well known for our technology innovation. One of the other ways we have to compete is to be able to offer, for example, a smaller footprint for the customer in a particular application by providing functionality in a smaller size or integrating functionality so as to require fewer components. So we give our customers a size advantage or maybe a performance advantage over our competitors.

TWST: Looking ahead, what main items on your strategic agenda are you looking to achieve to capitalize on where the market is headed?

Mr. Zinn: Like the HDTV area, the new smartphones, for example, Samsung's Galaxy phone, the new displays that are coming out, like the OMLED-type displays, and then moving into the automotive area, we have a great relationship now with BMW in providing Ethernet solutions for automotive, which is a new market for us. Another hot market that we see is the server market. We're getting more and more into the large cloud servers. We are also in what we call "solid-state drives," which are a new type

of hard drive that is becoming available. We think we'll get a lot of traction in 2011 as large companies provide these solid state drives to consumers. So those are the primary, I think, hot markets for us right now.

TWST: What role will M&A activity play as you look at growth opportunities ahead?

Mr. Zinn: There are two ways that a company can grow: You can grow organically or you can grow through acquisitions. Since the company has been founded, we have acquired six companies. So we do acquire companies. They tend to be smaller companies, not huge companies. Our acquisitions in the past have been mainly to get technology. The other reason you would acquire a larger company is that you need the revenue to grow — that's not heretofore been a focus of our acquisitions. We've been mainly focused on getting technology, moving into a market that we currently don't serve. Our acquisition strategy has been primarily, I would say, more to grow our technology and to get into newer markets, as opposed to just grow the size of the company.

TWST: Would you comment on your current management team, both on the technology side and business side?

Mr. Zinn: The company now has a relatively young team. Some of my older team have retired. One of the founders recently passed way. So I've replaced the management that has been around for the last 30 years with a much younger group. I've got some hotshots coming from National and from Maxim, some of the others from TI. We have gone out and acquired a very strong team of upper management. The team average age, I think, is probably around 50 for the senior management, the vice presidents. We're also hiring a very good design team for our Ethernet group as well as for the analog group. We are reaching into some of my competitors and pulling away some of these key designers because they like a smaller company, and they like the ability to kind of make a name for themselves. The strong senior team has allowed me to really attract some very key talent for the company. My design teams in all three product lines are probably the strongest that we've ever had as a company.

TWST: Looking at cash and capital, what are the challenges there, if any? Do you feel you have sufficient resources for the opportunities that lie ahead?

Mr. Zinn: Micrel has always believed that cash is king, so we've always been bottom-line oriented. We're focused on our earnings; we offer a dividend; we are very shareholder friendly in that respect. I think we are the smallest semiconductor company to offer a dividend, so that just shows

the investors that not only are we shareholder friendly, but we have great faith in our earnings. We want to be able to continue providing that dividend, which means we believe that our company is going to continue to be profitable. Being bottom-line oriented and focusing on great cash flow is very important to us. The company does have great cash flow. I think we generated over \$20 million in cash during the most recent quarter. We have over \$100 million in cash now. So you can see that that's about a third of our annual revenue, at least on a run-rate basis. So we are quite cash-rich, relatively speaking. We still have a stock buyback program where the company goes into the market and buys its own stock back, thus again helping our shareholders by reducing the number of shares outstanding. We own all of our own corporate headquarters buildings, which again shows the solidness of the company. Our assets are owned outright. We have virtually no debt, so the company, without having to borrow much, if any, money, has been able to sustain its ongoing operations.

TWST: Would you care to comment on your current share price?

Mr. Zinn: We are undervalued if you look at us relative to our peers. Even though from a performance point of view our share price should be higher, we just haven't got that traction yet. We had a lot of overhang on the share price because of one large investor that we got into a proxy battle with a couple of years ago. They unloaded the shares when they lost the proxy battle. Then when the founder died a couple of years ago, his family sold off all his shares. So there was a huge amount of stock out there that depressed the stock price for almost a year. It's been slow in coming back. We just have to attract new investors to the story, and then I think you'll see the share price move back up. Almost all of our sell-side analysts have a 12-month target north of \$16. Currently we are around \$10. So there is a lot of room and lot of opportunity for the investor and our stock because the share price is somewhat depressed.

TWST: In dealing with investors, potential investors and analyst communities, are there any disconnects or places where their views, strategies and goals for the organization differ from your own?

Mr. Zinn: Yes, I think that — well, not all of them, but certainly some of the investors are concerned about Micrel's ability to grow its revenue. I think the biggest hurdle that we have to overcome with the investor is convincing them that we can grow our revenue. For the past five quarters, we've grown revenue consistently. In fact, in the current quarter just ending in June, the company grew its revenue 10%. So I think just getting back to, at or above the industry average on revenue growth would be the thing that investors will be looking forward to see if the company really will be able to grow its top line. I don't think they are concerned at all about our bottom line and our

ability to generate cash because that has not been one of the questions that has been raised. I think mainly it has been our ability to grow our top line.

TWST: What three or four summary points would you present today to convince or compel an investor to buy in?

Mr. Zinn: As I mentioned in my previous answer, the company has had five consecutive quarters of revenue growth. And the fact that we are at or above our target objectives for gross margin and operating margin says the company is on track to generate, we think, sterling numbers relative to our peers. We do believe that we are also on a trajectory to grow revenue at or above the industry average. Just the fact in the last year and half almost, we have had this consistent pattern of revenue growth at or above the industry average, and the fact that we are printing some pretty good numbers to the bottom line — paying a dividend, buying back our stock — indicates to investors that Micrel is very shareholder friendly and very concerned about giving the shareholders the performance they deserve.

TWST: Do you have any thoughts or issues to add?

Mr. Zinn: No, I think you've been very thorough in the way you've positioned Micrel and the questions you've asked. You have hit the key questions. I think the top-line growth issue has been at the forefront in the minds of investors. We touched on the fact that the company has been growing consistently for the past year and a half. That is, I think, an important issue for the investors, showing the company is getting back on track. Our goal is to become a billion-dollar semiconductor company on a revenue basis. In fact, we've broken through the \$300 million wall, as you would. I think it is also a key point to investors because it is always a concern whether a small company can break through that \$300 million, because the next jump is \$0.5 billion and then to a billion. So we have broken the \$300 million wall, and now I think the next hurdle for us is to hit that \$0.5 billion mark. We believe we have the team, we have the products and the momentum to do that. I think the take-home story for the investor is that Micrel is back on track.

TWST: Thank you. (KL)

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