

1 UNITED STATES DISTRICT COURT
2 FOR THE EASTERN DISTRICT OF VIRGINIA
3 ALEXANDRIA DIVISION

4 UNITED STATES OF AMERICA,
5 Plaintiff,

7 v.

Civil No:

9 MICROSEMI CORPORATION,
10 Defendant.

13
14 TRANSCRIPT OF PRESIDENT'S FORUM PODCAST
15 FEATURING JAMES PETERSON, CEO OF MICROSEMI CORPORATION
16 DATED MAY 21, 2006

17
18 This is a great opportunity for Microsemi to rub shoulders as a,
19 you know, kind of a corporate citizen for Orange County.

20 Microsemi, we are a publicly traded company. About seven years
21 ago our market capital was around \$24 million. Seven years later
22 we're- our market capital right now we're touching just about \$2
23 billion in the last seven years. And the company is formulated by
24 predominately a lot of acquisitions. You know, we did a lot of
25 acquisitions, and we did a lot of blocking and tackling in
26 putting companies together. And, the presentation, this
27 presentation I'm going to show you today is pretty much the one
28 that I show Wall Street. And but when I'm with Wall Street, I am

1 pushing on gross margin, operating margins, efficiencies, you
2 know, trying to convince the institutional investor why they
3 should put money in Microsemi and believe in our, in our story.

4 Today is going to be a little different, because when I
5 looked at the instructions for this conference-and I understand
6 that, you know, it is predominately private companies and
7 entrepreneurs here-I am going to try to walk you through some of
8 the tough decisions that we made and some of the things that took
9 us from the \$20-something million to the \$2 billion, and I am
10 here to tell you, \$2 billion and growing. Being a public company,
11 I have to show you these disclaimers. [Audience laughter] You
12 know, there are many, many benefits to going public. There are
13 many, many more benefits to not. [Audience laughter] And that's a
14 whole different talk, but I could tell you about it. Essentially,
15 when you get to the short here, is what I'm telling you here that
16 everything I'm going to tell you is really a disclaimer. And if
17 you really want to know what is going on in my life, you need to
18 read the 8Ks, the 10Ks, the 10Qs, and whatever else documents you
19 want and people come up with. It intrigues me.

20 The first thing about Microsemi that made us very, very
21 successful-or, becoming successful-is we put together a business
22 plan where we were focusing on a lot of diversity. You know, I
23 firmly believe in the old rolling recession, where I don't think
24 the whole world has one large recession, but if you, you know you
25 look at the wave like at a football stadium where they stand and
26 they do the wave, there's always a recession somewhere. All
27 right, so what we are is an extremely diverse company in multiple
28 markets, and it's kind of scattered out enough right now where we

1 operate in what I call buckets, because once again auditing
2 committees don't let you use the words segments or anything. But
3 we- we- we operate a lot of unique buckets, and I'll walk you
4 through them.

5 We have two major product lines. One is high reliability
6 products. High reliability products, we focus on aerospace,
7 defense, satellite business, implantable medical (defibrillators,
8 pacemakers), and we do all the IC's that are-that predominately
9 inside that control them. A lot of business in the satellite
10 business. Satellite business is-is right now pretty much on fire.
11 We will probably launch maybe 17 to 24 satellites this year and
12 double that for the next three years going forward. And our
13 content in-in satellites, somewhere between \$500,000 and
14 \$1,000,000 per satellite, and all very, very high gross margins.

15 Here I did a lot of manufacturing efficiencies. Essentially,
16 I took 15 different factories, bought 25, took 15, that were last
17 man-standing and consolidated them to four factories-four
18 facilities. So by the end of this year I will have four operating
19 facilities. So I took these, pretty much, well, let's say the
20 oldest houses on the blocks, where utilization is about 20
21 percent, and I did a lot-a lot of blocking and tackling and
22 assembled the companies.

23 I have high barriers to entry. Essentially what I bought was
24 old technology nobody else really wanted in this particular
25 market space. This is technology that was built 15, 20, 25 years
26 ago and I call the name "high reliability products." The fact of
27 the matter for anyone that knows technology, these things are
28 discretely. Wall Street gives you no value if you use the wrong

1 word—if you use the word discrete, you are going to get a
2 multiple on your stock at maybe 1.2 times to 1.5 times. So what I
3 did, around four years ago, I stopped the word discrete. Now what
4 they are is “high reliability products,” which they truly are.
5 They go into human body, they go into space, and they get a price
6 of about \$2 to maybe \$10 per high reliability product.

7 The fact of the matter is nothing but discretely, nobody else
8 wanted it. We bought all the companies at one time revenue or
9 less, because they were using the word discrete, and no one gave
10 them any value for it, and they were under utilized, so we put
11 them into the Microsemi family.

12 The barriers to entry are very, very high. Nobody can build
13 Microsemi product because they can't just go to a sub-contractor
14 and say, “I want to build the equipment and manufacture this
15 guy's product,” because no one makes this manufacturing equipment
16 anymore. It is all pretty unique, we maintain it, and anybody
17 that had any manufacturing equipment to buy it, I either bought
18 the equipment, I put it in storage, or I flat-out destroyed it.
19 So the barriers to entry are easily three to five years and
20 gaining for us.

21 It is becoming very profitable, and I will tell you why. I
22 am 70 to 90 percent sole source at all these spaces over here, so
23 what I simply did after I did the blocking and tackling is that I
24 raised the prices. Technology, you can't raise prices. All right,
25 a lot of businesses are very difficult to raise prices. I raise
26 the price in excess of, what I tell Wall Street, between 40 and
27 70 percent over the last 18 months. And going forward, I told the
28 customers to expect, over the next three years, year after year,

1 a 10 percent increase in price, and I explained to them why. You
2 know, essentially, this is a market space where they want you to
3 build everything in the United States, and the United States is
4 very expensive. They don't want you to obsolete any product
5 because it's going to be on defense programs. And last but not
6 least, we spent \$2 to \$3 million taking lead out of all of our
7 ICs, and guess what, military guys want lead. So they are going
8 to pay for it, and the margins tell the tale.

9 Very predictable, lead times on these things. For someone
10 who has a business, our returns rate's less than 30 percent
11 quarter-over-quarter, which is probably the best in the industry,
12 and my lead time is somewhere between, for this high reliability
13 sector, I get orders 18- to 26-week lead time is not uncommon. So
14 I have plenty of time to get my product out for any given
15 quarter.

16 The other side, this is where the technology is, this is the
17 high performance analog mixed signal. Essentially, it's analog.
18 Does the industry give you a multiple for analog? No, but they
19 give you a great multiple for high performance analog mixed
20 signal. All right. So, once again, just kind of a branding
21 situation.

22 Here, we are truly a technology leader in- in- in the
23 gadgets to widgets to consumer products. Our focus is
24 predominately driving lamps and driving CCFL lamps and lights.
25 For instance, inside this notebook here, these are light- lamps
26 under here are CCFL lamps, in-dashboard navigation systems, CCFL
27 lamps, next-generation LCD TVs, all CCFL lamps, and we- we
28 entered that market extremely strong, and I will walk you through

1 some of the growth factors that we- that we performed in there.

2 I do a lot of wireless stuff. I do power amplifiers for
3 wireless LAN. There are 14 to 15 manufacturers that make the
4 chipsets; there are only two guys in the world that can make
5 power amplifiers 528 GZ and above, with
6 [indistinguishable]...Microsemi is one of them. That was a nice
7 strategic acquisition of technology that is kind of a black
8 magic, mixed generation RF technology, and we bought that because
9 we knew that it was going to be exclusive, and that it would-it
10 would take a team of people, or- or multiple companies to get
11 together and share technologies, and I bought most of the patents
12 in- in this- in this particular area.

13 This model is fabulous. We used to- we used to build
14 everything right up here in Garden Grove, in a four-inch
15 facility. I've taken this entire product line and moved it over
16 to China. Oh my, what a- what a surprise. All right, and the
17 reason for that is my manufacturing costs are down substantially
18 than it was seven years ago.

19 High margins. Wall Street studies margins. Everything I
20 introduce in here is 50 percent gross margins or better, and
21 operating margins are 27 [percent] or better. If- if they don't
22 hit those margin targets, I don't introduce the product. Usually
23 if I introduce a product in this area-and these are high-end
24 ICs-the day I introduce the product, my engineering team has to
25 have the shrink right in place, and that is how fast the price
26 gets detracted in the consumer product space.

27 High growth area and very, very system-engineered. High
28 reliability products, just to give you a breakout, 40 percent of

1 my business is in defense, aerospace, and the satellite business;
2 19 percent of the business implantable medical, and I'll walk you
3 through those market segments a little closer: defibrillators,
4 MRI machines, and pacemakers. High performance analog mixed
5 signal: 19 percent of my business is now in notebooks, LCD TVs.
6 One year ago, that was about 4 percent of our business, so you
7 can see there are a lot of growth areas in the notebooks and LCD
8 TVs.

9 Automotive is kind of a misnomer. What I do there is redrive
10 the lamps inside in-dashboard navigation systems, I have about 70
11 to 80 percent market share. So every time you buy- if you buy a
12 new automobile, and it comes with a display in there, it's
13 Microsemi product driving those lamps.

14 Mobile connectivities, 10 percent, that's predominately the
15 power amplifier that I told you about, wireless LAN, 80211, a,b,
16 and g, and for those that are technocrats, 80211n, pre-n, we have
17 about 90 percent market share there as well.

18 Industrial and other, that is the catch-all box. When you
19 buy a lot of companies and put it together, you have to have a
20 box to put the stuff that really doesn't meet, you know, the
21 financial standards that you want. What I am doing with that box
22 right now, is I am pretty much separating it, walking away from
23 the business as I- as I grow the other businesses, and/or moving
24 to the Phillipines to manufacture- once again, oh my, what a
25 surprise. Can't build in the United States, can't afford it.

26 Just another ex- this pretty much shows diversity, you know,
27 everybody's got a customer list of the who's who- it's very nice,
28 they're very similar- in the market space. But what differentiates

1 Microsemi is we don't have any customer larger than 10 percent—
2 the trick is if you read the Q's and the K's, you'll find out
3 that I don't have any customer larger than 6 percent, okay, and
4 that just is the breadth and the diversity of the company, and it
5 is not uncommon in any given quarter that I will have one of the
6 top seven customers in each of the six boxes. So it is very, very
7 diverse, so if one market kind of slides off, it is ok, the other
8 markets will balance Microsemi.

9 This is [indistinguishable] it started back in 2001, we put
10 a plan together and we said okay, we had 15 sites, utilization
11 was probably about 20 percent, what doesn't show on this chart is
12 there were 2,600 Microsemi employees worldwide, it was probably
13 the most inefficient operation, that's about when I joined the
14 company, about 6 months before here. Income per employee was
15 about \$3,000, gross margin was 28, and the operating margin was
16 6.3, and Wall Street gave you no marketing cap, no nothing. So we
17 put together an aggressive plan, we gave it a nice name, "Factory
18 Utilization Enhancement Program," and we all liked that, Wall
19 Street likes things that are being enhanced.

20 Essentially, last quarter that I report I took it from 15
21 sites down to six, my sales per employee were up to about
22 \$221,000, income from employee about \$37,000, gross margins up to
23 50 percent, which was my original target if you go to the right,
24 and my operating margins 27.3 percent. So we hit our financial
25 targets, right, so Wall Street says, "What's next?"

26 So we had to come up with things. I bought, yet, another
27 company. I bought a company called Advanced Power Technology.
28 They were up in Bend, Oregon. I gave them 1.6 times revenue going

1 forward, which was about \$140 million I gave them. They were a
2 public company, I am going to strip out all of their public
3 costs, right, very difficult for a company under \$100 million to
4 go public these days. You know, the cost of the auditors is
5 phenomenally high. I am trying to lower my rate as-as I speak
6 here. But it's a fact small- you know, under a \$100 million going
7 public today, well, with all the embedded costs is very
8 difficult, so I am taking them to where they- they- they can't
9 go. And I get a probably a six times multiple from my market, so
10 if I buy them, I get 1.6 for them, six times multiple I will pay
11 \$140, and Wall Street will give me a valuation of it of \$700 or
12 \$800 million, and that will hit in the next four or five weeks.

13 High reliability products, discretetes, you have to have a
14 business plan. [Indistinguishable] My business plan is this, by
15 the way. This is the same business plan I show my board of
16 directors, it's the same one I go through my employees, it's the
17 same one I show Wall Street. There is no big secret on what
18 Microsemi is doing, and it shouldn't be. I think the person at
19 the front desk should know as much about the company as the Board
20 of Directors. Okay, so this is a pretty good template that we use
21 here at Microsemi.

22 The value of proposition is real plain and simple, you put
23 four or five, you know what they are. One is sole-source
24 positioning. Almost all of my markets, I either have 70 percent
25 or greater market share, or I am entering with the intention of
26 having 70 percent market share going forward. You know, and if-
27 if you don't get the 70, that's all right, you get the 10, the
28 20, the 30, step-by-step, but just keep bringing the business in.

1 A lot of lean manufacturing initiatives. Manufacturing is
2 the key—you burn a lot of money if you don't manufacture right.
3 You know, not to mention [indistinguishable]. A lot of growth in
4 military spending. You know, you might have noticed there's a
5 conflict going on. And- and more to come. Military spending is
6 robust, and it is going to get stronger over the next five years.
7 Anybody that thinks the budget is going to go down in defense is
8 absolutely incorrect, okay, and my backlog proves that. A lot of
9 growing electronic content. That is the beauty of life, everybody
10 likes more electronics. And then in Medicare, we started putting
11 product in the implantable defibrillators, and just when you
12 think life can't get any better, what happens? Medicare decides
13 they are going to cover implantable operations for
14 defibrillators. And once Medicare gets in, I'm telling you, it
15 gets abused, and the volumes go up in any given product. You
16 know, someone goes in, fifty years old right, right, feeling a
17 little tired, right, their foot hurts; they are walking out with
18 a defibrillator. Guaranteed. [Audience laughter]

19 Bragging about defibrillators for us. You know, what we do
20 is we do the charging, the switching, the protection of these
21 devices, and as these devices expand in functionality, so does
22 Microsemi content. So you get a pretty good market here, you- you
23 know, this is a great one if you are in the medical market space:
24 there's three customers, right, there is a guy named St. Jude in
25 Metronics, they own 95 percent of the business, not hard to
26 figure out what the business is going to do, you got to talk to
27 your three guys in this particular market. Now remember, it's
28 about 19 percent of my business. The organic growth rate of this

1 particular market-you've got to know the growth rates of your
2 markets, right? If you don't know the growth rates of your
3 markets, go find out. The organic growth rate of this market is
4 15 to 20 percent over the next twelve months, and probably will
5 consistently grow somewhere between 18 and 22 over the next three
6 to five years. In addition to that, my dollar content keeps
7 increasing. We started with \$22, so I get the organic growth rate
8 of 15 to 20 percent, and then I got a dollar content by the end
9 of 2006 of greater than \$100. So you do the math. This particular
10 section, which is a very high margin, high profitable section,
11 will grow over 40-45 percent per year, over the next three years.
12 And just, raking the money. And it is predominately sole-source.

13 Military programs? Like I mentioned, we did a lot of
14 acquisitions. We bought every last man standing guy in the
15 discrete business, except for two small little private companies,
16 all right, and how I manage them is yet another story. You know,
17 essentially it is their product I give away for free; my sole-
18 source product, I charge for. Kind of drives them out of- out of
19 the market, and that is all legal, by the way. It's fair
20 competition, or so they say. Defense program- there is probably
21 not a defense program that Microsemi is not on. And we are all
22 over the place, we have our communications, cockpit landing gear,
23 there's just, it's all predominately 90 percent or so sole-source
24 Microsemi content, and that is why I raised the prices. All
25 right, I raised the prices because, simply, we could.

26 High performance analog mixed signal? This is the juice,
27 this is the one that gets all the money. All the R&D money, I
28 spend about \$20 to 30 million a year on R&D, 95 percent of it

1 goes into this particular section here because this is the real
2 growth of the company [indistinguishable]. For the other one, we
3 will rake in a tremendous amount of cash, it is not a cash cow
4 but it rakes in a lot of cash. But, guys in technology like
5 myself, we've got to spend, and we got to put money in
6 technology. So what we did is we put together a company, we
7 started with a little four-inch facility, acquired a little
8 company called Infinity Up the Road, convinced the
9 [indistinguishable] that owned that to sell it to Microsemi, and
10 myself and my management team, when the owners of Microsemi,
11 because Microsemi has been around, what, since 1960 for you guys
12 here in Orange County. You saw that old dirty building years ago,
13 that I have since closed down. The guys that ran Microsemi, they
14 were busy measuring my property at Garden Grove and my mixed
15 signal company, and as they were measuring the property, I had my
16 eye on the stock ticker. So lo and behold, one year later it was
17 kind of like "who bought who," and we sold it to them for \$20
18 million dollars, [indistinguishable] and got their stock ticker,
19 and then, you know, started modifying things.

20 This particular hyper dialog signal, really system-
21 engineered driven, you really got to sit down and understand the-
22 the building blocks, the architecture and the fundamentals of
23 your customer's product, and you got to know that product better
24 than they know it. Lot of new products, and I have a lot of
25 intellectual property, I have a lot of patents, and most of the
26 patents, I bought.

27 Let me just tell you about integration of products that are
28 very, very important. When we started Microsemi, we had a family

1 of products-in the top left-hand-and we started building CCFL
2 controllers, lighting controllers, for in-dashboard navigation
3 systems, and our claim to fame was that our patents would allow
4 the lights to strike in all-weather testing, and you don't sell
5 to an automotive market space unless you can meet the all-weather
6 testing and the roll-over, ignite crash testing and the like,
7 and we had a nice little business. All right, the problem was
8 that it's, you know, there's only so many in-dashboard navigation
9 systems, and its about 6 percent of the total business of the
10 company now, years ago it was around 30, and it declines in ASP.
11 So what we did is we said okay, we are [indistinguishable] to use
12 the same lamps, and then were very happy to find out that, guess
13 what, in every notebook computer there are the same exact lamps,
14 all right, they are a little bit longer, you have to strike them
15 a little bit different, and then oh guess what, there is a
16 product coming down the road called LCD TVs-to the top right, and
17 there is a heaven, right, when LCD TVs hit the market because,
18 guess what, they are all CCFL lamps. And the beauty of it is that
19 there are not two lamps, like in an automotive navigation system,
20 and there's not two to four like in a notebook, there's 20 to 40
21 to 80 lamps and gaining. All right, so what we did is we entered
22 that notebook market space and LCD TV market space 18 months ago.
23 Eighteen months ago we went to Wall Street, and went to our
24 customers and said, "We are entering the notebook market space
25 and we are taking on the entrenched leader," (the guy's name was
26 O2-and I say was because he's losing a lot of market share), and
27 LCD TVs were just starting so there was no real entrenched
28 customer- competitor, but we- we entered the market. We closed

1 the first year of shipping product, we now, I think we ship
2 to-you know, CCFL controls is about 10 percent of notebooks-so
3 one out of every ten notebooks now has Microsemi's CCFL
4 controller in it and gaining, and the intent here is to get 30 to
5 40 percent of the market share in the next five years, and if you
6 have 30 to 40 percent of notebooks, the volumes are very high and
7 there is a lot of money to be made.

8 In addition to it, we are introducing a family of product to
9 go along with it, ambient light sensors. We invented a light
10 sensor technology, or we found a little company that had it and
11 bought them, I forget how it went, but here or there, we come up
12 with a technology that extends the battery life in a notebook
13 over one hour, and we- we- we convinced HP, and everyone of the
14 HP platform is now are using our ambient light sensor, we call
15 it-or visible light sensor is the technical term for it-and lo
16 and behold, others are following as we speak. The next generation
17 of product will extend the battery life up to two hours. A
18 Blackberry like you got, Steele, we could extend the battery life
19 up to 22 hours with a next generation ambient light sensor. And-
20 and most cell phones. I just got to find the right packaging so I
21 can package it and sell-you know, you know a little smaller form
22 [indistinguishable], but we will, someone out there has that
23 technology, or we will develop it.

24 LCD TVs, this is- this is if you like to play in markets,
25 this is one of the best markets. Two years ago, we shipped eight
26 million LCD TVs in the market space, and they were pretty
27 horrible, okay, they were very, very discrete-oriented. I used
28 the D-word there. Old technology just trying to fill an

1 application. Last year, we shipped as an industry 20 million LCD
2 TVs. So what is happening now is, you know, that we hit the price
3 target where the consumer will buy it. All right, next year, or
4 this year we're in right now, they are expecting to ship
5 somewhere between 45 and 48 million LCD TVs. So I got a great
6 market that is doubling, and doubling again, and I am here to
7 tell you that it will probably be 100 million the following year
8 out.

9 What we are doing at Microsemi is, okay guys,
10 [indistinguishable] CCLF controller, and that controller sells
11 for on or about \$1.32, okay, and 27 inches and above, I have got
12 30 percent market share and gaining. Which is all the new, next
13 generation monolithic solutions. So the play here for Microsemi
14 to, you know, to continue our strength and growing, is simply
15 dollars per widgets. You are inside this one unit, all right, and
16 what else can you sell to them? And we've got in our- in our
17 little handbag [indistinguishable] probably about \$8 worth of
18 content for every LCD TV, so today the math is pretty simple, I
19 am shipping a \$1.32 to 30 percent of the LCD TVs. All right, now
20 what I'm trying to do, or going to do, is get the dollar content
21 up. Next year at this time, if I were here to speak next time, I
22 will probably have \$3.00 worth of content in every LCD TV, and
23 you do the math, and gain market share. And in three years out we
24 will easily have \$8 to \$10 worth of technology.

25 And this- the ICs that we have, we already have in our bag.
26 We have a great family of, I don't know if anybody is
27 [indistinguishable] here, Class D audio, all it is is an advanced
28 PWM, but it needs no heat-sync, and every LCD TV is going to put

1 audio in it obviously, and we've got that technology, so we can
2 design wins as we speak. And then there is a multitude of other
3 streaming video, media that you do on your website, well LCD TV
4 is going to have that built into it, there is going to be a
5 standard wireless LAN called 80211n, and we have got about \$4 or
6 \$5 worth of content in every 80211n out there; as a matter of
7 fact, we are pretty much the sole-source guy at 5/8 and above.
8 This is the wi-fi segment area- power amplifiers, we have 77
9 [percent] market share and gaining. Once again, we just bought a
10 company that had some technology, and we built the product
11 roadmap for them.

12 Let me just walk you through some of the numbers now. Let me
13 do the pictures, it's easier to speak off it. This is pretty much
14 the last eight or ten quarters. We have, you know, we have
15 continued over the last 13 quarters, we've grown the company
16 somewhere between 3 to 5 percent in revenue per quarter. The
17 gross margins went up the last 8-9 quarters, from 31 percent to
18 50 [percent] and gaining. The real play here is operating
19 margins, this is- this is the whole story is right here, is how
20 much money you make? All right, no one really cares about your
21 products, they don't really care about your story, at the end of
22 the day they are going to measure you up real plain and simple:
23 how much money are you making, how much free cash flow is coming
24 into your corporation. And what we've done is the operating
25 margin at a target of 27, we just blew through that, I'll modify
26 that after my next acquisition, and we will announce to the
27 world, or Wall Street, what the number or the target will be. But
28 we have been growing the gross margins nicely, but the operating

1 margins we've been going from 1.6 to 1.8x, which means you start
2 throwing down a lot of cash. And what we do with the cash is,
3 back in 2002, we were about \$23 million in cash, and we had \$5
4 million in debt. You go back one year before that, I had \$24
5 million in cash, and \$19 million in debt, pretty much on the edge
6 of being out of business. It was gone. Okay, so what we've done
7 over the last, you know, 4 or 5 years is cash positions up to
8 about \$113 million, which is not a lot of cash in our
9 environment, but it's a secure position with cash, and we have
10 zero debt. That's called pretty much just paying your bills.

11 And that's pretty much the story of Microsemi. It's just
12 that, well, you know, go into a market, know your competitors
13 better than they know themselves, acquire the ones that you want,
14 and make sure you're running very, very efficiently. That's
15 pretty much the key to success. And you can take it from \$20
16 million, to \$2 billion, and I'm sure, play it right, you can
17 double it again, and double it again, and double it again. There
18 is a lot of opportunity out there, and that's what we do. Okay.
19 Any- any [indistinguishable] questions?

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