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Connecting Market Leaders with Investors

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THE WALL STREET TRANSCRIPT**

## **COMPANY INTERVIEW**

# **GORDON HUNTER**

**Littelfuse, Inc. (LFUS)**

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# Littelfuse, Inc. (LFUS)



**GORDON HUNTER** was elected as the Chairman of the board of directors of Littelfuse, Inc., and President and Chief Executive Officer effective January 1, 2005. Mr. Hunter served as Chief Operating Officer of the company from November 2003 to January 2005. He was previously Vice President, Communications Group and General Manager, Optical Products Group, Intel, and Vice President, Raychem Corporation. Mr. Hunter holds an MBA from the London Business School and a B.S. in electrical engineering from the University of Liverpool, England.

## SECTOR — CONSUMER DURABLES

(AXI603) **TWST: Please give us a short background on Littelfuse.**

**Mr. Hunter:** Littelfuse was started by a couple of Chicago pioneers when the electrical and electronics industry was just really getting started in the 1920s. Chicago had quite a burgeoning industry in electronics at that time, with radio and the early TV industry, and the company was developed out of a need for a good circuit protection device, namely a fuse. So we were one of the very first manufacturers of fuses, and in fact that became part of the name.

The company focused on fuses for the first 50 years of its existence. It wasn't until the late 1990s that we made our first acquisition of a different technology, a ceramic technology, which gave us a product that provides overvoltage circuit protection. This is slightly different from a fuse and started to make the company realize it has a lot of application knowledge around electrical safety and electrical protection.

From the year 2000 to today, we have been expanding that capability into other technologies. As a result, we now have the broadest offering of circuit-protection products in the world. Circuit protection is protecting anything that uses electrical energy, from a cell phone to a laptop, a TV, a car, a piece of industrial equipment, an air conditioning unit. Almost anything you can think of that gets plugged in or is battery operated needs to have devices that protect against potential faults such as electrostatic discharge, short circuits, power surges and lightning. So it's a very, very broad range of markets and end customers and applications that use our products.

**TWST: You have said you are expanding into power control and sensing. Can you talk about that a bit?**

**Mr. Hunter:** Absolutely. This is part of our five-year strategy that we rolled out last December in New York. These other categories are beyond pure circuit protection but are clearly adjacencies. They still involve a broad range of components with functions that are close to circuit protection.

Sensing, as an example, is finding if there is a fault somewhere or if there is a signal that needs to be transmitted. Our sensors check a washing machine to see if the detergent or the water is at the correct level; if they're too low, it would send a signal indicating that. If the door is not closed correctly or completely, it

would send a signal about that. A sensing device finds something that's maybe not quite correct and sends a signal, whereas a circuit protection device is immediately activated when there is potential damage to the equipment. It is a subtle difference between what they do inside an appliance, but they both involve very high production volumes with literally billions of components.

We make about 7 billion components per year. It's manufacturing high volumes at extremely high quality levels, because these are critical safety devices that must work when the need arises. So we have to make sure that every device is at the highest level and then of course meet delivery schedules that fluctuate with all those different end markets.

**TWST: Is the automotive market a major market for you?**

**Mr. Hunter:** Absolutely, the automotive market is very important to us. It is changing very dramatically. There is a real focus on making cars much smarter. The three real drivers in the automotive world today are making cars safer, making them greener, and making them connected, and all of those drive a need for more circuit protection and more sensors.

There are more and more electronics in a vehicle, for example for lane control, even ultimately self-driving cars, but making a car safer in every way requires more sensors and an improved electrical system. The drive to make cars more fuel-efficient, whether it's a regular gas engine car or a hybrid or an all-electric vehicle, is a trend we see all over the world. In turn, this drives the need for different kinds of circuit protection and has been a huge boost to our automotive business over the last few years.

Lately, we are seeing cars with embedded connections so that the OEM can actually detect a potential fault in a car, it can send messages to the driver, and if the car is in an accident it can be located. They actually have embedded Internet into a car, not just when you take your smartphone into the car, but the car itself having embedded Internet is another trend that's happening pretty dramatically. So the automotive market is a very healthy market for us, and one where we expect to see above-average growth over the next few years.

**TWST: What are some of the other end markets where you see major growth opportunities right now?**

**Mr. Hunter:** As I mentioned, a lot of electrical equipment is used in many places, and one of the big megatrends is anything that's energy saving. For example, in lighting we see this big change in the move from incandescent lighting that has been around for 100 years to much more energy efficient LED lighting. We see it happening with street lighting, commercial lighting, and now it's starting to happen with residential lighting. That's a big boost for us. There is a big shift in the kind of lighting that is used, for example, in appliances, making them more efficient.

Then of course there's renewable energy, solar, which has had its ups and downs over the last few years, but we see it as a long-term healthy market that will continue. Whenever there's a need to change the electrical system or do it a little differently, as in the solar industry, the changes also require a different kind of circuit protection. This provides opportunities for us to develop new products, to innovate, to work with the leading customers. The trends of the future, whether it's improved performance in consumer electronics, TVs with better picture quality or appliances with better energy efficiency, usually mean the circuit protection demands change.

**TWST: As you noted, in New York last December you announced a five-year growth plan. Can you just lay out for us what that looks like and give us an update? How is it going?**

**Mr. Hunter:** It's going very well. We are now into one of those five years. Over the last 10 years, we have grown the company at a compounded annual growth rate of 9% on revenue, much more on operating income. But the topline growth has come from about five percentage points of growth from acquisitions and about four percentage points of organic growth, so that is a pretty good 10-year record, especially when you recognize that almost our entire industry declined in 2008 and 2009 along with the world's financial downturn. So despite that downturn, we have had a pretty healthy last 10 years, and in fact, our earnings per share have grown at a 22% compounded annual growth rate.

We think that with the expansion into the sensing market and many other new developments in the industry, such as the automotive trends I mentioned, there's an opportunity for us to grow even faster. When we announced our strategy, we said we would like to grow at 5% organically per year and 10% from acquisitions. That means either doing more acquisitions or slightly larger acquisitions than we have in the past. We have done an average of about one per year over the last 10 years, and we think we can do a little more; we've got more focus on it, we're a larger company, we've got more people working on it. It tended to be something that primarily our CFO and myself would work on; now we've got our business units much more focused on their own strategies to include acquisitions. We think this is a stretch, but if we can get 15% annual growth, in five years we double the business.

We've got an excellent management team and a very strong balance sheet, so we know we can afford these acquisitions. The company is a very strong cash flow generating machine, and we've clearly stated acquisitions are our first priority for use of funds, as we believe there are good companies out there to be acquired. We have a clear five-year strategy that is a stretch for us; it's a step up from what we have done in the past, but we think it's achievable even if it is a stretch. We have a very experienced global

management team, and I would say I think everybody's pretty excited about having a stretched target out there. If we can achieve this, it will be a great return for our shareholders.

***“Investors should look at our sales and order intake, which are a little above the end markets, and also at how our business is operating, particularly after we made acquisitions. And our product gross margins are competitive.”***

**TWST: Looking at your most recent quarterly results, what do you think are the most important numbers investors should be focused on?**

**Mr. Hunter:** I think investors should look at our sales and order intake, which are a little above the end markets, and also at how our business is operating, particularly after we made acquisitions. And our product gross margins are competitive. The electronics industry and automotive industry are characterized by expectations that prices need to be reduced every year. As we see with consumer electronics equipment, we get more and more features and better TVs every year for less money. We are part of that food chain, so it's a very competitive business. I like to say it's really a contact sport, particularly as a lot of the electronics business has moved to Asia. So product gross margins are a focus area for us.

We have a fanatical approach to lean in everything we do, not just in our factories, but across the whole company. So we are constantly thinking about driving waste out of all of our processes and how we manufacture, how we purchase, our logistics, all of these internal processes. Continuous cost reduction and continuous improvement are really part of the way of life of the company.

We've said our operating margins should be in the 16% to 19% range. Looking at our cash flow generation, which is typically an operating cash flow range of 16% to 19%, capital expenditures probably about 4%, and that would generate free cash flow of between 12% and 15%. By any comparison, that's a very strong cash flow generating model, and we have been able to demonstrate that for several years now. The use of that cash, as I said earlier, is primarily for acquisitions. We do pay a quarterly cash dividend, and we intend to increase that dividend annually. But we would use the majority of our cash flow for acquisitions, which we think can be very synergistic to our business and fit our strategy.

**TWST: Tell us about your background and then tell us a little bit about the rest of your management team.**

**Mr. Hunter:** I originate from Europe; I grew up in England, lived in Finland and then France before coming to California and working in Silicon Valley for over 20 years. So I've been in the electronics industry for over 30 years. I'm an engineer; I have an MBA from London Business School, and have traveled globally for all of my career.

We have a very high-caliber management team that is one of the cornerstones of this company's success. It's a very diverse

team; we've got a German living in Germany running our global automotive business, an Englishman in the U.K. running our global semiconductor business, and an Indian living in Los Angeles running our electronics business. We have a very strong team here in Chicago; very strong finance, excellent global operations and very strong HR, as developing talent is a critical part of the culture. So we have a very strong management team, very experienced, very global in outlook, and I think it's one of the things that is a real strength of our company. Having a strategy that everybody believes in and is a stretch fits the high-achieving management team that we have.

**TWST: You have won several awards, and one of the most recent is that you were recognized as one of the nation's most innovative users of business technologies, and not only did you win that, you won that for the sixth consecutive year. How important is innovation to your company, but also what does that mean?**

**Mr. Hunter:** A couple of things. First of all, innovation is best measured if it's really valued by customers. Delighting a customer by developing something that's new that they really wanted or didn't know they wanted, but now see as very beneficial, is why we are constantly enhancing our products. But innovation can also be internal in the way we operate our business.

During the years 2008 to maybe 2011, we consolidated our global operations from 16 plants around the world down to six, and created a much smoother supply chain for the delivery of our products. We are continuously looking at our internal structure and innovating there. We have everyone, including every new acquisition, coming on to our global ERP system — we use SAP. Getting everyone everywhere on SAP is one thing that we are very proud of that gives us incredible visibility to everything we do around the world. I think for a smaller company to be strong in the IT area and able to have access to all of our global financials and data and to measure metrics, I think shows that we do a pretty good job internally in innovating. But the number-one area of our innovation is customer-focused.

**TWST: When you talk to investors and potential investors, what are the main points they seem to want to discuss with you?**

**Mr. Hunter:** Our conversations typically focus on a couple of things. One is our business. Investors want to understand the electronics business. They realize it's a global business and a very competitive business. A lot of the business is in Asia, and it's been changing. We see China emerging as a dramatic force in the automotive industry, for example. So they want to know about the global nature and the sustainability of it. Can we sustain the margins

we've had over the last 10 years, and is that defensible? How strong is our brand?

They also want to know, what are the real threats to our business? What are the things that make us stay awake at night and worry about? I think investors really want to know about the management team and the culture. Is this a place where the people know what they're doing, have they got a good track record, and is this a company that they want to invest in? So there's quite a lot of questioning about how we operate the company as well as what our results are.

**TWST: In your opinion, what do you think really are your most competitive advantages, the things that set you apart?**

**Mr. Hunter:** I'd say first of all, brand recognition in the fields that we're in. I think a lot of design engineers out there, whether it's in the automotive industry or electronics industry, know the Littelfuse brand. They know that we have a lot of very technical people with a lot of application expertise in understanding how to make their products, whether it's a car, a laptop or a washing machine. We know how to make the electrical system safer and more reliable. That application expertise is really valued. It's been developed over many, many years, and it's very hard to replicate that.

Added to that, I mentioned that we make over 7 billion components per year. Having excellent levels of quality and delivery are critically important because our customers' demand fluctuates. A certain car model might succeed better than the car manufacturer thought it would, and their demand could be up for that particular model. They want to be able to respond to demand very, very quickly, and we need to ramp up, too, in order to supply them.

Finally, I can't say enough about our people. They have the depth of knowledge about electrical systems, industry regulations and many, many different products. Many things set us apart, but I would summarize it by saying it's an excellent reputation with our customers, our product and application knowledge in helping our customers solve problems time and time again, and letting them know that we're continuously improving what we do.

**TWST: Thank you. (LMR)**

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