

# Freescale looks to expand in Valley

## Valley serves 'critical need' for newly private tech firm

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The December sale of Freescale Semiconductor Inc. allied the company with the deep pockets of a consortium of private equity funds that plunked down \$17.6 billion for the nation's third-biggest maker of computer chips.

That could enable the company, which has 3,500 employees in the Valley who work at semiconductor fabrication plants in Chandler and Tempe, to increase its investment in research and development and expand by becoming an umbrella for other semiconductor makers the funds may acquire.

But the deal also saddled the remnant of Motorola Inc.'s once-giant Phoenix-based semiconductor business with \$9.5 billion in debt. Analysts note that the debt could become unwieldy in a downturn, resulting in cost cuts and layoffs that the buyers pledged to avoid.

The buyers - Blackstone Group, Carlyle Group, Permira Advisers LLC and Texas Pacific Group - paid \$40 per share for Freescale on Dec. 1 and took the former publicly held company private in the largest tech buyout ever. They say their goal is to grow Freescale over time instead of cutting costs and packaging it for a quick flip. The company, now based in Austin, Texas, has about 25,000 employees worldwide and operates three divisions.

They are a wireless and mobile-solutions business that makes chips for cellphones and mobile devices; a transportation and standard products business that makes chips, sensors and analog products for cars and other consumer and industrial products; and a networking and computing systems unit that makes chips for cellular base stations networking and telecommunications equipment.

### Valley expansion plans

Michel Mayer, a 47-year-old former IBM Corp. executive who has led the company since it was spun off from Motorola in 2004, said the Valley operations are integral parts of Freescale's operation and that the company plans to expand its operations here.

"We're growing here," Mayer said. He noted that the Phoenix area is home to the company's growing analog chip and sensor business, as well as the unit that makes chips that run cellphone base stations.

"Phoenix serves a critical need," he said, "not just for manufacturing but for the origin of products and for research and development."

Indeed, the company's new MRAM chip that uses magnetism instead of electricity to store information was developed here.

Jim Feldhan, president of Semico Research, a Phoenix firm that tracks the semiconductor industry, believes that Valley operations are secure.

"If they wanted to close Phoenix, they would have done so by now," he said.

Mayer said that he and the private equity firms share the goal of building the company into a global leader in the production of imbedded systems, which are chips that give artificial intelligence to myriad products.

"Going private is a means to end," Mayer said. He said that the \$4.5 billion in equity put into the company by the buyers gives Freescale financial stability while the company's new private status enables it to make quick decisions without having to "convince stockholders of your every move."

Making the company more aggressive and nimble has been a hallmark of Mayer's tenure at Freescale.

"The business under Motorola was an aircraft carrier," Feldhan said. "Mayer has turned it into a speedboat."

## **Debt load**

The \$4.5 billion boosted Freescale's equity to about \$9.5 billion, roughly equal to the debt.

Freescale's current \$9.5 billion debt load compares with \$1.4 billion at the end of the third quarter of 2006, the last period subject to Securities and Exchange Commission reporting rules before the company went private.

Robert Lee, a credit analyst with KDP Asset Management in Montpelier, Vt., believes the debt is manageable if the global economy continues to grow at 2 to 3 percent. He estimated the company could cover its capital expenses and make interest payments on the debt this year with about \$200 million in cash left to help it grow.

A sharp decline in chip sales could be trouble, because it could leave the company scrambling to make the payments.

But, because of its diverse products, Lee believes Free- scale could fare better in a downturn than other semiconductor companies.

"They are in so many products that all sectors would have to decline at once," he said.

## **Areas of concern**

Freescale is the world's largest supplier of the computer chips found in automobiles. The number of chips in the average car is growing as new features and options are added. But most of Freescale's business is tied up with struggling U.S. carmakers, which have lost market share to European and Asian manufacturers.

Mayer would prefer the U.S. carmakers do well, but he's not waiting for that. He is focusing on growing market share outside the United States, particularly in Japan and Asia.

Mayer noted that the company's Japanese automotive business increased 50 percent last year while its business in Asia grew 30 percent. That compares with declining sales to U.S. carmakers and flat sales to European manufacturers.

Another concern is the company's reliance on its former parent, Motorola, which accounts for between 20 and 25 percent of its revenue.

Freescale is the preferred provider of mobile-phone chips to Motorola, the world's second-largest maker of cellular telephones. But the heavy reliance on one customer could be risky; a loss of market share at Motorola could seriously affect Freescale.

Mayer is working to add cellphone customers to make the company less dependent on Motorola. But he also is aware of Motorola's importance to Freescale. Last month, Motorola extended its preferred supplier agreement with Freescale until 2009.

Until 2005, Freescale also made the chips for Apple notebook computers. The company lost the contract to Intel in what has proved to be a mixed blessing.

"It always hurts to lose a big customer," Mayer said. But he noted the loss has enabled the company to focus on higher-growth markets, such as mobile devices.

Mayer also noted that the center of innovation is moving away from PCs.

"It's in cars, games, cellphones and all those things that have an imbedded chip that performs some function," he said.

Indeed, Freescale's wireless and mobile solutions business is the fastest-growing of its three products sectors and accounted for more than one-third of its \$6.4 billion in 2006 sales. The segment grew 20 percent in 2006 while its transportation and standard products grew 5.5 percent.

Freescale's networking and computing systems segment grew 14 percent not counting the effects of the discontinued Apple business. With the discontinued operations, the business was flat.