FINAL TRANSCRIPT

Thomson StreetEvents℠

ADI - Q1 2010 Analog Devices Inc. Earnings Conference Call

Event Date/Time: Feb. 17. 2010 / 10:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

David Zinsner
Analog Devices Inc. - VP Finance & CFO

Jerry Fishman
Analog Devices Inc. - President & CEO

CONFERENCE CALL PARTICIPANTS

Romit Shah
Barclays Capital - Analyst

Jim Covello
Goldman Sachs - Analyst

Stacy Rasgon
Bernstein Research - Analyst

Terence Whalen
Citigroup - Analyst

Uche Orji
UBS Warburg - Analyst

Christopher Danely
JPMorgan - Analyst

Tristan Gerra
Robert W Baird - Analyst

Craig Ellis
Caris & Co - Analyst

David Wong
Wells Fargo - Analyst

Doug Freedman
Broadpoint AmTech - Analyst

PRESENTATION

Operator

Good afternoon. I will be your conference facilitator. At this time, I would like to welcome everyone to the Analog Devices fiscal first quarter 2010 earnings conference call. All lines have been placed on mute to prevent any background noise. After the opening remarks, there will be a question-and-answer period with our analyst participants. (Operator Instructions).

Mr. Zinsner, you may begin your conference.

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

Thanks, Christian. Good afternoon, everyone. This is Dave Zinsner, Vice President of Finance and CFO. Mindy is out sick, so I'm going to handle the intro this time. We appreciate you joining us for today's call. If you haven't yet seen our first quarter fiscal 2010 release, you can access it by visiting our website at analog.com, and clicking on the headline on the home page.

This conference call is also being webcast live from analog.com, select Investor Relations, and follow the instructions shown next to the microphone icon. A recording of this conference call will be available today within about two hours of this call's completion, and will remain available via telephone playback for one week. This webcast will also be archived on our IR website.

Joining me on today's call is Jerry Fishman, President and CEO. During the first part of the call, Jerry and I will present our first quarter results, as well as our short-term outlook, and then we'll open it up for questions during the latter part of the call.

During today's call, we'll refer to several non-GAAP financial measures that have been adjusted for one-time items in order to provide investors with useful information regarding our results of operations and business trends. We have included reconciliations of these non-GAAP measures to their most directly comparable GAAP measures in today's earnings release, which is posted on the IR website. We've also updated the schedules on our IR website, which include the historical quarterly and annual summary P&Ls for continuing operations, as well as historical quarterly and annual information for revenue from continuing operations by end market and product type.

Those interested in learning more about ADI are invited to listen to a live webcast of our analyst day taking place on Thursday, March 11, 2010, at 7:30 AM Eastern. A link to this webcast will be available on our IR website.

I would ask you to please note that the information we are about to discuss includes forward-looking statements, which include risks and uncertainties. The Company's actual results could differ materially from those we will be discussing. Factors that could contribute to such differences include but are not limited to those described in the Company's SEC filings, including our most recent quarterly report on form 10-Q.

The forward-looking information that is provided by the Company in this call represents the Company's outlook as of today. And we do not undertake any obligation to update the forward-looking statements made by us. Subsequent events and developments may cause the Company's outlook to change. Therefore, this conference call will include time-sensitive information that may be accurate only as of the date of the live broadcast, which is February 17, 2010.

With that, let's begin with the opening remarks from our CEO, Jerry Fishman.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Well, good afternoon, and thanks again for joining us on this afternoon's call. As you can see from the earnings release that we put out earlier, the first quarter was another very strong quarter for ADI, and the beginning of what we hope will be a strong year for ADI.

The recovery, which began in our third fiscal quarter last year, and picked up momentum in our fourth quarter, has carried over into our first fiscal quarter of 2010. Our revenues grew 5.5% sequentially during a quarter that's typically a seasonally slow period at ADI, after growing 16% sequentially the prior quarter.

We're very encouraged that our industrial revenues grew significantly this quarter. This business spans many different applications, in factory automation, process control, instrumentation, automatic test equipment, energy management, military and aerospace, and also healthcare. And is comprised of literally tens of thousands of customers around the world.

Revenues from communications infrastructure and automotive also grew during the quarter. It is important to note that we're now breaking out automotive from the industrial category, where we typically reported automotive, beginning for the first time this quarter. Given the fact that automotive has now become more important strategic focus for ADI, and is now getting to be a meaningful size relative to the rest of our business.

Importantly, our lead times have remained short, and we continue to deliver over 99% of our shipments to our OEM customers within six weeks or less. This is consistent with our performance of the previous quarter, and represents what is typical lead times for ADI. Maintaining short lead times reduces the chances of excess ordering by customers.

In addition, distribution inventory has remained stable at approximately eight weeks, which is also consistent with the prior quarter. This, of course, is positive in the short term, as it allows us to meet our customers' requirements on a short-term basis. But I think equally important is the lasting impact that we believe it will have as it ensures ADI remains a trusted and reliable partner to our customers for the longer term.

During Q1, we continued progress towards making ADI a structurally more profitable company. Our gross margins improved by approximately 480 basis points sequentially, and operating margins excluding restructuring costs are now 270 basis points higher than our most recent peak, when quarterly revenue was approximately $60 million higher. We expect to continue to expand operating margins in coming quarters through gross margin expansion and continuing very tight control of operating expenses. We believe that we can retain approximately 50% of our expense reductions as permanent cost reductions, which is in line with our earlier estimates.

As we entered this downturn, we set in place a strategy to be more focused on products and our markets that value innovation, and also to become a more profitable company. In some cases we increased investments, in others we slowed or ceased investments in areas where innovation was no longer the primary driver. As a result, we believe we're very well-positioned for solid growth and exceptional profitability going forward, as the economies around the world continue to improve.

So, now, I'll turn the call over to Dave, who will provide more detail on our financials.

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

Thanks, Jerry. Revenue was $603 million, a 5.5% increase from the prior quarter, and a 26.5% increase from the first quarter of 2009. Our order strength continued last quarter, and we finished the quarter with a higher backlog and a book-to-bill ratio above one. Gross margins were 61.1%, a 480 basis point increase from the prior quarter, and a 470 basis point increase from the first quarter of last year. Although there are many different factors that impact our gross margins, the increase was primarily due to lower infrastructure costs, higher utilization and a more favorable mix of revenue.

Factor utilization was in the low 60s in the first quarter, as we ramped production to match increasing order rates. Should business levels justify it, we can have significant amounts of internal manufacturing capacity quickly, and with relatively little additional capital expense. Our goal continues to be to keep our lead times short and reliable.

Operating expenses in the first quarter were $219 million, including a $16.5 million restructuring charge, or $203 million excluding the charge. This charge, along with higher variable compensation expense, resulted in higher operating expenses. The restructuring charge included approximately $5 million related to the final closure of our Cambridge, Massachusetts facility, and represents the costs associated with decommissioning of that facility. The other $11.5 million reflects actions taken during the first quarter to continue to sharpen our focus in product development and reduce infrastructure expenses. When fully implemented, we expect these actions will result in savings of approximately $4.5 million per quarter.

The remaining increase in operating expenses was due to higher variable compensation expense, in line with significantly higher operating margins in the first quarter. Variable compensation is primarily based on operating margins, which we believe tightly aligns the interest of our shareholders and our employees given the historical relationship between operating margins and share price. Excluding variable compensation restructuring, operating expenses were flat with the fourth quarter of 2009. Operating margins excluding restructuring charges, were 27.5%, a 500 basis point improvement from the prior quarter.

Excluding restructuring charges, our tax rate was approximately 20.3%, more typical for ADI than the unusually low tax rate booked in the previous quarter. We expect the tax rate for the remainder of the year to continue at approximately this level.

For the first quarter, excluding restructuring charges, we earned $0.43 per diluted share, which was an increase of 19% from the prior quarter on a 5.5% increase in revenue despite a change in the tax rate quarter to quarter.

Weighted average shares outstanding increased by 4% to 305 million shares. This is the result of the exercise of stock options that were due to expire in the first quarter, and a higher average stock price for the quarter as compared to last quarter.

Now, turning to the balance sheet, for the quarter we generated approximately $200 million in free cash flow, or 33% of sales, and finished the quarter with approximately $2.2 billion in cash and marketable securities, with $380 million of debt.

In line with the higher revenue, accounts receivable increased slightly in dollar terms this quarter. However, our days sales outstanding declined by one day to 47 days.

Inventory declined $10 million this quarter to $243 million, and the days of inventory remained low at 95 days. As I've mentioned before, we believe that an inventory level between 90 to 100 days is an optimal level given our mix of internal and external manufacturing. This keeps our carrying cost of inventory low, but allows us to meet the short lead-time requirements of our customers. Inventory distribution increased slightly this quarter, in line with the increased sales in that channel, however on a turns basis, inventory remained flat from the prior quarter.

In summary from a financial perspective, this was another excellent quarter for the Company.

Now, I'll turn the call back over to Jerry.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Well, thanks, Dave. With regard to what happened in the end markets for the first quarter, our industrial business, which is now approximately 43% of sales, grew 16% sequentially. You should recall, as I explained earlier, that industrial category no longer includes the automotive sales. We saw a broad-based growth across many applications, including instrumentation, process control, test equipment healthcare, defense and aerospace.

Our revenues from our automotive customers, which now represent in the first quarter 12% of sales, grew an additional 5% sequentially after a few previous quarters of very substantial growth. While certainly some of the stress that we've experienced over the last few quarters is likely inventory replenishment, we're also the beneficiary of increasing electronic content per vehicle, and also a very strong automotive product portfolio.

The increased content in automobiles for ADI is driven by applications in entertainment, in safety and in power train electronics. In the area of safety, for example, the widespread deployment of stability and control systems is driving growth for our MEMs gyroscope products. It also appears that consumers are gaining interest in advanced driver assistance features such as lane departure warning and reverse camera console views, many of which use our DSP, our data converter and also our RF products.

Our communications business, which is primarily products for infrastructure and to a lesser degree handsets, is now approximately 22% of our revenues. Revenues from communications customers increased 12% sequentially. The growth of this market is being primarily driven by the ramp in deployment of 3G bay stations worldwide.

While last year growth was nominated by heavy capital spending in China earlier in the year, in Q1 this year the growth was much more diversified. In the developed countries the need for higher data transmission capacity is the main driver. While in developing countries, the need to increase coverage is driving demand. We also saw an increase of revenues from the wireline communications market. Although today this is still a smaller piece of the communications business, it has had very steady growth now for many quarters at ADI.

Revenue from consumer-related products declined 18% sequentially, which is generally in line with the typical seasonal patterns that we see in the consumer business for analog, given the months in our first quarter. Our main focus areas in consumer continue to be in home entertainment products, digital cameras, and also many portable products.

On a regional basis, revenues grew in all our regions except Japan, in line with the consumer business decline, and of course, Japan in that sense was down sequentially.

So, I would like now to make some closing comments on the outlook, and look at it really in the short term and also take a slightly longer term perspective on at least our view of what's happening around the world. In our Q2, which we've just now begun, we expect industrial sales to be both cyclically and seasonally strong. We expect further strength in the communications infrastructure as a result of additional bay station deployments, including what we hope will be a resurgence in our growth in China. We expect consumer sales to be approximately flat sequentially.

In total, we're expecting our revenues, as we mentioned in our press release, to increase to $635 million to $650 million, which would represent a 35% year-over-year increase in our sales at the mid point of this estimate. We're finding for gross margins to increase sequentially to 62% to 63%, and that would produce operating margins in the range of 29% to 31% in the quarter, and earnings in the range of $0.48 to $0.51.

For reference, in the fourth quarter of '08, before the recession began, revenues were at a similar level to our Q2 forecast, but our operating margins were approximately 5 percentage points lower. So, overall, we believe we're executing well on our plan to deliver good sales growth, at attractive and at increasing margins.

I think there's very little doubt that there continues to be instability in most economies around the world, as in many locations around the world unemployment levels remain high, and credit is still tight. Nevertheless, our business has broadly strengthened over the past few quarters. And order rates and backlog levels are now approaching pre-recession levels.

While the amplitude and the timing of the order recovery suggests that some of the order strength is likely due to a more confident supply chain as the economy recovers, we believe based on feedback from many of our customers, in many, many different industries and many countries around the world, that companies are generally more confident about the future and have begun to shift from a fear of over-investing to a fear of under-investing and losing global competitive position. As a result, many of our customers have begun to ramp new product programs at a pretty significant rate, and certainly that will benefit ADI in coming quarters.

Despite these changing attitudes, which are generally more positive than three months ago, the bar for new investment at many of our customers is still set pretty high. Our customers are looking for partners who can consistently innovate to make their products more appealing and more competitive, and also those who have a flexible supply chain to respond to changing business conditions.

From productivity improvements in factories around the world, to medicine, to entertainment, to transportation and many other applications, our customers want products that allow their products to always be connected, to be easy to use, and to conserve energy. These trends play very well to ADI's business strategy, which continues to be, as it has for many years, to focus on being the very best signal processing company in the world.

In March, during our analyst day, investors will learn a little bit more about the trends we see, and how they're driving many, many new opportunities for ADI. So, I hope you'll all be able to join us for the webcast of that event.

So, that's all of the formal comments we're going to make today. We'll now open the line up for questions from analysts.

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

Thank you, Jerry. During today's Q&A period, please limit yourself to one primary question, and no more than one follow-on question. We'll give you another opportunity to ask additional questions if we have time remaining. Operator, we're now ready for questions from our Analysts.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question comes from the line of Romit Shah with Barclays Capital.

Romit Shah - *Barclays Capital - Analyst*

Thanks, guys, and great quarter. Jerry, you had a few quarters now of pretty substantial growth, yet your revenues are still below the prior peak. At what point do you think you'll catch up with demand or see the business return to more normal or seasonal growth rates?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

That's sort of hard to predict into the future. Our sense right now, particularly in the way that we're managing the distribution channel, is that consumption and the demand we're seeing is not terribly unaligned. I think over the last couple of quarters we've caught up with what had been under-consumption. There's probably another quarter where that's going to be a little bit above the top. But I think ultimately, once we get back to sort of where we were, which we expect to be approximately next quarter plus or minus a little bit, I think we'll be in reasonably good balance between what underlying consumption is and the demand we're seeing.

Romit Shah - *Barclays Capital - Analyst*

Are there any segments within your business where you feel there's still a pretty big supply demand imbalance?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

I think for ADI, I don't see that. There certainly was a supply and demand imbalance last year. But no, I think customers' inventories, at least what they tell us, are reasonably low. The distribution inventories that Dave was saying, are relatively flat in terms of turns and weeks of inventory. Our lead times are short, so they don't have a lot of inspiration to be loading up inventories. So, at least for ADI, I don't see that patterns are very unique here.

Romit Shah - *Barclays Capital - Analyst*

Okay. Thank you.

Operator

Our next question comes from Jim Covello with Goldman Sachs.

Jim Covello - *Goldman Sachs - Analyst*

Great, good afternoon, guys. Thanks so much for taking the question. Congratulations on the great results. This cycle so far you guys have clearly demonstrated better operating margin leverage than in past cycles. What can you do over the next few quarters as business continues to improve to make sure you keep that margin discipline, and not let some of the expense creep come back in, like it might have in other cycles? Thanks.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

I think as far as the expense creep, we, early in the cycle said that some of the expenses that were reduced, were going to come back with sales, and those are mostly related to variable compensation commissions, others were permanent. And I think our sense is that about half of those things, which is consistent with the way we've been thinking about it, are permanent and half of them are going to come back, as the sales go up. So, that basically allows us to operate the Company at about $100 million a year of less expenses than we had when we went into this cycle, which is not insignificant at our size.

As far as keeping our hands on the tiller here, doing the right things, we do have a lot more focus on products and markets that are higher margin and more sustainable than we've had in the past. I don't think we're going to revert back to having less focus. So, I think that focus is going to continue. I think the entire management group and the employee base is pretty committed to keeping discipline on the expense line. And I think with the goal that we've set of keeping half the gains on the operating costs, I think we have a good shot of doing that.

I believe the gross margins of the Company are structurally higher. Part of that is, of course, due to volume and utilization. But another part of it is just due to a much richer product mix, and us exiting businesses that had very poor returns over many years, over the last two or three years.

So, it is always challenging quarter to quarter to predict whether the gross margins are going to be up a point or down a point. But I think we're up there at levels which are about the best we've ever been. We have a forecast for next quarter which will exceed that by quite a bit. And I don't think there's anything in there other than the world falling apart, unless having to bang down utilization and things like that, which are always possible, although not probable in the short term. Other than that, I think we have a good chance of not only keeping these margins, but as we are forecasting for Q2, the margin's likely to expand again in Q2.

Jim Covello - *Goldman Sachs - Analyst*

Terrific. Thanks so much.

Operator

Our next question is from Stacy Rasgon with Bernstein Research.

Stacy Rasgon - *Bernstein Research - Analyst*

Hi, guys, thanks for taking my question. Quick question again on the OpEx. I know you said you're going to keep half of the gains. Do I define the gains at this point as versus Q4 '08. So ex restructuring, you would be down $37 million quarterly? And then does that mean that basically you would be keeping about -- I would call it $19 million or $20 million a year of those cuts going forward?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

No, I think the way you have to look at it is, we were at $240 million in Q4 of '08.

Stacy Rasgon - *Bernstein Research - Analyst*

Yes.

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

What we're thinking is that we brought the OpEx down to about $187 million. So we roughly took it down by a little over $50 million. And what we're saying is that we'll be able to keep half of that difference as we resume back to the revenue levels of Q4 of '08. Basically, we feel like we permanently took out from the $240 million run rate we were in Q4 of '08, we permanently took out somewhere in the $25 million plus of OpEx expense. Or on an annualized basis, a little over $100 million.

Stacy Rasgon - *Bernstein Research - Analyst*

Got it. So some of that has already started to come back. So this quarter you're, ex restructuring, your OpEx was up about 4% or so versus last quarter, which was almost about what your revenue was up at this point. Revenue was up 5.5%. How do we think about OpEx trending through the year again as revenue goes up. Because I know more variable compensation is going to kick in as the operating margin continues to increase potentially.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Well, I think one way to think about it, at least I'll give you my view, Dave can give you his, is that we've been on a very steep part of the margin improvement curve. We've raised the margin five points in one quarter. That tends to -- given that most of the bonus payments are tailored to that statistic, tends to drive it really hard, I think we have more margin upside as we're predicting for next quarter. But we're not going to keep getting 500 basis points of margin improvement every quarter.

So, I think the rate of increase on the variable side is going to start trending downward. Still going to go up in dollars but the rate is going to go down from where it is. The thing that we're focusing on more than anything else is everything except that, and if we can do what we're trying to do, which is to keep that part relatively flat through the year, I think the operating margins will keep going up and everyone will be very pleased with the operating margins that we're running in the Company.

Stacy Rasgon - *Bernstein Research - Analyst*

Got it. Thanks. And for my follow-up, I notice now that you're providing the end market breakdown with like a pure industrial. If I compare where you are this quarter to where you were two years ago, so Q1 '08, I notice that for a lot of these, particularly in the broader industrial, you're almost back to those levels. I thought you would only be down about 4% in Q1 2010 versus Q1 of 2008. I'm not so sure that the industrial markets themselves are only down 4% from that point to this point. What's actually driving -- I mean is it share gains or is it -- we've talked about the customers moving back to replenishment mode and so forth. But what do you think is actually driving what seems to be probably a greater increase for your industrial sales, and even some of your other product categories versus where the market probably is these days.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Well, I think -- it is always hard to look at one quarter two years ago versus a quarter now to try to garner any specifics. But I think generically, some of the segments within the industrial area for us, which have always been a source of significant investment, are just growing faster than the average of the industrial market. If you take areas like the healthcare products, historically in these numbers here, the automotive stuff has been in there. That's been growing very well for us. And a few of the other segments where we just have very rich, new product cycles going on in that market.

So, I would say that that business for us is doing a lot better than many outsiders, investors thought. And certainly even better than we thought it was going to be a couple of years ago. And part of that is just that we're investing a lot of money in segments within industrial that are pretty high growth relative to most other segments. So, I think we have a pretty good outlook for that business over the next couple of years.

Stacy Rasgon - *Bernstein Research - Analyst*

Thank you, guys, appreciate it.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

It is certainly not the stodgy old growth business that some people once thought it was.

Stacy Rasgon - *Bernstein Research - Analyst*

Got it. Got it. Thank you, guys.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

And it makes pretty good margins, too.

Stacy Rasgon - *Bernstein Research - Analyst*

Yes, indeed.

Operator

Our next question is from Terence Whalen with Citigroup.

Terence Whalen - *Citigroup - Analyst*

Hi, thanks for taking my question. The first part relates to, I think last quarter, you had talked a little bit about some restructuring and reorganization that you had done internally with regard to the sales force and how your sales force is interfacing with customer accounts.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Yes.

Terence Whalen - *Citigroup - Analyst*

And in addition, talked a little bit about how that improved some of the granularity of your rolling up of the individual business unit financials. I was wondering if you could go into a little bit of detail of what you have learned over the past quarter after implementing that reorganization, and also what metrics now that you're looking at it on an individual business unit level, what you're learning from looking at those new metrics. Thank you.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

That's a very broad question. Let me try to give you a broad answer to it. I think from the way, the experience that we've had over the last couple of months, we've learned something that we -- doesn't sound like rocket science and we probably knew all along, but has really become true is that customers really value when we approach them from a single point with the breadth of our technology. And that's the way they prefer to deal with us. They don't like dealing with many, many different product lines that are basically trying to sell various products to them, and compared to really trying to understand how to make them more competitive. And therefore, what solutions can we bring them to do that in a very cohesive fashion.

So, I think what it really has done is it makes the customers believe that we're a much more strategic partner to them in their particular business. It allows us to focus the resources towards customers in a way that we haven't been able to do before. And it really focuses the sales force on where it is that they ought to be spending their time and attention, as compared to trying to react to the request for 47 different product lines for more sales in the quarter. So, those are things that, when you listen to, you say well that is sort of elementary. But for a Company that's grown up as a product-oriented company, it really -- this new organization has really helped focus what we're doing a lot more than it used to.

Now, is that changing our sales in the quarter right now? I don't think so. But I think over time, if the sales force is better focused on the right accounts, if they go into the customers with a much more cohesive plan, a much more cohesive road map, a much more ingrained understanding of what the customers are trying to accomplish, I think that's going to help us greatly. And we've gotten that kind of feedback from some of our very largest customers that, in applications where they just found it is too complicated to deal with. They really appreciate the fact that we understand their application. We know how to make them more competitive. And we're approaching them from a single point.

From the internal metrics standpoint, it gives us a much clearer sense of where we're making money, and what the investment levels are relative to the returns in the market segments. And when you are a product-oriented company, somehow harder to understand that by market segment. Now, we have a tremendous amount of data that really shows which of the segments are growing faster, which of the segments are taking more investment. What are some of the returns we're getting on the R&D in each of the segments. And as a result of that, not in the quarter to quarter numbers but certainly as we put together the yearly plan, we take that into account in what we do about allocating resources to various market segments.

So, I think in aggregate, it really helps us deal with customers, and it helps us figure out how to more productively allocate resources in the Company, which in companies like ADI is a very hard job sometimes because of the complexity in 10,000 products and 60,000 customers. I think that's really going to sharpen our focus. We're ready to see the benefits of that.

Terence Whalen - *Citigroup - Analyst*

Thanks for answering comprehensively the broad question. As my follow-up, I would like to be a little bit more specific. With regard to gross margin, we've got utilization in the low 60s. We're looking at a 62% to 63% gross margin. Specifically, is the longer term gross margin model then going to be closer to 64% to 65%? Thanks.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Are you asking that or stating that as a conclusion?

Terence Whalen - *Citigroup - Analyst*

That was a question, thanks.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Well, when we get to 63%, maybe we'll talk about higher numbers. But we're certainly a lot more enthusiastic about gross margins we can generate in this business than we were when we were really struggling. And I think investors were struggling to really think, could we ever get to 60%. And I think now we're comfortably past 60%. We certainly would be very comfortably past 60% next quarter. And I don't think that's a one-time event either. Given that we're still operating the growth at typically low utilization. We'll see how that goes after another quarter. We'll update you next quarter.

Terence Whalen - *Citigroup - Analyst*

Thanks. Nice job.

Operator

Our next question is from Uche Orji with UBS Warburg.

Uche Orji - *UBS Warburg - Analyst*

Can you hear me?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Yes.

Uche Orji - *UBS Warburg - Analyst*

All right. Thank you very much. I wanted to first of all understand one thing, Jerry, what was your peak utilization rate, and I know there's all sorts of things that go into gross margins but I just wanted to try to get a handle, if we were to get back to big utilization rates. Just what could be the upside to gross margin.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

The utilization rate relative to the past is somewhat complex at ADI now since we had two more fabs last time we were at this thing. One of the reasons the utilization went up this quarter, there are really two reasons. One is, we started more wafers, but the other part is we've taken a lot of capacity off-line. We took the Cambridge fab off-line and we took the six inch fab in Ireland off-line. So, those comparisons relative to the past are a little bit more challenging to make.

I would say that if utilization goes up, our gross margins will go up. That's intuitive. It is very hard to quantify that any more definitively than that. We are at the low 60s, we can easily run fabs up into the mid 80s. I think that will have a positive impact on margins. As Dave mentioned earlier, we can increase our capacity relatively quickly with relatively low capital expenditures. So, I think relative to capacity and the margin implications of that, I think we're in reasonably good shape.

Uche Orji - *UBS Warburg - Analyst*

Great. Can I just ask you about power management. We've started to see some numbers then, close to $40 million of revenue for the quarter just ended. Can you talk about your expectations for this business now? What will be the drivers? What's allowing you to gain traction now, and what should we be expecting from this going forward?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Well, our power management business grew this quarter pretty well. It grew fairly substantially year over year. And I think there is a couple of reasons for that. One is, the fact that the team has been working at it for a couple of years, and it has congealed. And we've got a pretty good group of people that are developing some products that our customers say are pretty good.

I think another part of it is we have focused our product development at areas that we really think we can offer something very unique, and that customers value as compared to trying to do things that a lot of other companies can do, and just in a margin war with them to get those sockets. And I think the more that we align our power management business with our vertical market segments, where we can go into customers where we already have a substantial part of the signal processing bill of materials, and we can say, by the way, we can either integrate power management on the signal processing chain or we can offer power management alongside of the signal processing chain.

And the customers already respect us for our prowess in developing products, and they like working with us, and that becomes an important ingredient in the overall solution. And the more that we focus our product development efforts in those areas, as we have for the past year or so, I think the more traction we're going to get in that business.

So, I think like everything, it is a combination of things. But overall, we're doing better in that business than we have in the past. I think there's good expectations that if we continue to really focus, that this is -- the areas I just suggested, we can do even better in the future.

Uche Orji - *UBS Warburg - Analyst*

Great. Thank you very much.

Operator

Our next question is from Christopher Danely with JPMorgan.

Christopher Danely - *JPMorgan - Analyst*

Hey, thanks, guys. And I'll add my congrats on hitting new peak gross margin. It seems like the mix and the focus is changing a little bit via the end markets, end products. So, can you just give us your sense on where you would expect the highest and lowest relative growth rates for your end markets for the rest of this calendar year?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

It is hard enough to predict what the sales are going to be. The market segments are even more challenging with more granularity. Because we just don't have all of that much visibility out into the second half of the year. But I would say that we expect that we'll get growth across the board, which is where we've been seeing it.

We've seen good growth in industrial. We've seen good growth in communications. I think in the second half of the year, the acceleration and communications is hopefully going to come from China, is what we now expect. We're seeing good growth in automotive. The consumer business is relatively cyclical, in these quarters they're low. They'll pick up again when the season changes.

So, I don't think it will be anything unique, Chris, in any of the segments. I think it will be more typically of what we usually see. Certain quarters, we get higher industrial growth. Certain quarters, we get higher consumer communications growth. But I don't think it will be anything unique for the balance of the year that at least we understand right now.

Christopher Danely - *JPMorgan - Analyst*

Okay. Thanks. And then my follow-up for Dave, I think you cited three reasons that the gross margins went up. Were any of those I guess having a bigger factor than the others?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

No, they all had a meaningful contribution of the gross margin improvement.

Christopher Danely - *JPMorgan - Analyst*

And then can you give us a sense of what your incremental gross margins will continue to be as the utilization rates climb?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

It is challenging to do that because we do -- some of the revenue will come from external manufacturing, and that you don't get an incremental benefit from, versus the internal. So, it is kind of a tough metric to really quantify.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

There's not, because of that, there's not an entire -- we can't draw the curve between gross margins and utilization. So, it has a lot to do with product mix. I think right now, sort of what I consider to be pretty aggressive guidance for Q2 on gross margins after what we've just achieved, it gives you an indication of at least directionally where we're thinking it is going to head.

Christopher Danely - *JPMorgan - Analyst*

Thanks a lot, guys.

Operator

Our next question is from Tristan Gerra with Robert W Baird.

Tristan Gerra - *Robert W Baird - Analyst*

Hi, just another question on gross margin. You've given us the mix of the gross margin sequential increase. If I look at your revenue guidance, which is very close to what you posted in the second quarter of 2008, your gross margin guidance is also 150 basis points higher than two years ago. How much of this do you think will be mix and then within this, bay station play a role in this?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

I couldn't answer that question. What really drove the comparison from Q4 '08 was we took a lot of infrastructure cost out. We took out our Limerick six inch facility, and that contributed a lot to our gross margins, and then going forward, we'll start to see the benefits of shutting down Cambridge and that will show up in our P&L. That is going to be driving the future performance. So, I hazard a guess that it probably didn't have a meaningful impact from mix or utilization. It was really about fundamentally lowering the cost per unit of our product.

Tristan Gerra - *Robert W Baird - Analyst*

Okay. And eight weeks of inventories at the distributors is probably unusually low, even though that's stable with the previous quarter. Is your guidance assuming any type of inventory replenishment, and what type of feedback do you get from distributors over the next -- for the next few quarters?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

On a guidance perspective, it doesn't really matter because we recognize the revenue once the distributor shifts it out of their inventory. So -- .

Tristan Gerra - *Robert W Baird - Analyst*

I meant for the gross margin.

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

I'm sorry. What was that?

Tristan Gerra - *Robert W Baird - Analyst*

I meant for the gross margin. So, are you -- is your guidance building the fact that you're going to ramp production to replenish inventory to distribution as well?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

Well, as we indicated, we thought some of the drivers in gross margin improvement next quarter would be from utilization. A higher utilization this quarter versus last quarter. But we're also fundamentally lowering the cost per unit. We'll start to see more benefit from the closures of the two facilities. So that will help as well.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

We tend to work very closely with the distributors to keep the inventory in weeks at about a constant rate. Certainly, if the sell through in distribution keeps going up, the dollars of inventory and distribution will go up, and that will load utilization a little bit. But that -- we're trying to keep the weeks or the turns in distribution about constant, as we have over the last couple of quarters. That's how we deal with distributors, and that's how we're planning to continue to deal with them in the coming quarters.

Tristan Gerra - *Robert W Baird - Analyst*

Great. Thank you.

Operator

Our next question is from Craig Ellis with Caris and Company.

Craig Ellis - *Caris & Co - Analyst*

Thanks, guys. Nice job. On the gross margins, with margins above 60%, what options do you have as you look ahead given the tailwinds on utilization, mix, what have you, with either new end markets or new application penetration.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Well, we continue with analog despite our better focus to have a lot of irons in the fire. I think what we're going to continue to do is invest in the things that we're investing in. That's sort of occupying most of our bandwidth. We think if we execute on those things, we can have a pretty attractive growth rate. We're going to talk a little bit about, more detail about that at the analyst meeting next month here in Boston. What the segments are, where the growth drivers are, and so on. But I think the thing that we're going to really try to do is keep focused on the things that we're committed to. And I think if we do that, if we execute, I think the growth rate will take care of itself.

Craig Ellis - *Caris & Co - Analyst*

Okay. And then it's the follow-up. Dave, you mentioned an action that triggered an $11.5 million charge in the fiscal first quarter. How many other efficiency actions like that do you foresee as you look out over fiscal 2010?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

Well, it is hard to predict. I would say that we're not really anticipating any additional actions like that. But I do think that there are things we can do on the infrastructure side to continue to more efficiently spend our money that will help offset some of the increases we'll see on the variable comp side, and will help us fund other development actions that we might want to take advantage of.

Craig Ellis - *Caris & Co - Analyst*

Okay. Thanks, guys. And nice job.

Operator

Our next question comes from the line of David Wong with Wells Fargo.

David Wong - *Wells Fargo - Analyst*

Thank you very much. Your guidance, does that include restructuring charges or are you assuming there won't be restructuring charges in the coming quarter?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

We're assuming there won't be restructuring charges in the coming quarter.

David Wong - *Wells Fargo - Analyst*

So, your OpEx does go up by a fair amount, equal -- at least to offset that falloff in restructuring charges, $16.5 million, is that right?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

It is not going to go up by $16.5 million, if that's what you're asking.

David Wong - *Wells Fargo - Analyst*

Right, okay. My second question, have you been able to supply product for the increase in demand you've seen in all areas, or are there some segments of product types where there are shortages?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

In general, we're able to supply pretty much all our products. I think I mentioned the statistic that, to our OEM customers, which are about half our sales, our largest customers, our lead times are within six weeks. And I think that's where we like them to be. And that's where they are. So, we don't really have a lot of shortages going on in the product group.

David Wong - *Wells Fargo - Analyst*

Right. Thanks.

Operator

Our next question comes from Doug Freeman with Broadpoint AmTech.

Doug Freedman - *Broadpoint AmTech - Analyst*

Hi, guys. Given I'm playing ping-pong between two calls, I hope I don't step on a land mine here, but has anybody gone into the details on what caused the other section of analog to be down 22%? Can you give us a little insight into what's happening there?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

It was mostly to do with consumer products, and that tends to bounce around a lot with the quarter to quarter numbers. So I don't think there's any real data there. If you look at the history of that thing, it bounces around quite a bit. Because it is much more, sort of market specific and customer specific products as compared to the broader categories.

Doug Freedman - *Broadpoint AmTech - Analyst*

Okay. And is a fair amount on that business still coming from the MEMs segment, and are you guys still pretty bullish on your MEMs outlook?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Yes. A lot of the MEMs products are in there. That tends to be very lumpy quarter to quarter. The previous quarter, we had a very large one up in that business as a result of a particular program, and one very large customer and he bought enough for the whole next couple of quarters because it was a ramp of a new product he had. And we didn't get much business on that last quarter, but our position with that customer for the future is very, very good. So, it is mostly, as I said, lumpy demand, heavily consumer, and that's why you saw those numbers.

Doug Freedman - *Broadpoint AmTech - Analyst*

Great. And then if I could, one last one, sort of trying to focus on end market demand. Are you guys able to see if the demand spectrum is broadening? Are you seeing a larger number of customers coming in and ordering, or are you just seeing demand from your existing customer base return to more normal levels?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

I think it is a pretty broad base, Doug, at least as we're hearing through the distributors, where the breadth is. And I can't really say if they've increased their customer base or what the exact details are of the order patterns, but we're seeing it in new products and old products, we're seeing it just across the board in many, many different product areas, and I really don't know the specifics of that. If there's any real data and are there more customers or the same customers. I just don't know.

Doug Freedman - *Broadpoint AmTech - Analyst*

All right. I guess my last one, are you feeling or thinking that there's any impact to any of your end markets from supply constraints in one direction or another?

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Well, you always worry about that when some of the lead times out there in the industry are pretty long, and you always worry a little bit about it. Is that causing people to buy everything faster than they normally would. But we're trying to keep pretty good track of that. And it is not obvious that that's really impacting things a lot, although that's something we always worry about. And we watch it pretty carefully. We'll have to wait and see how that develops. But it's certainly not what the customers are saying to us and what our distributors are saying to us. But on the other hand, we're always the last to know. So, it is really hard to predict.

Doug Freedman - *Broadpoint AmTech - Analyst*

All right. Terrific. And congratulations on strong results.

Jerry Fishman - *Analog Devices Inc. - President & CEO*

Thank you.

Operator

There appear to be no further questions at this time. Mr. Zinsner, Mr. Fishman, do you have any closing remarks?

David Zinsner - *Analog Devices Inc. - VP Finance & CFO*

Yes, so, thanks for participating. We're looking forward to talking to all of you again at our analyst day, and just as a reminder, that's scheduled for March 11, 2010 and it will begin at 7:30 AM Eastern. So have a good day.

Operator

Ladies and gentlemen, this concludes today's Analog Devices conference call. You may now disconnect.
