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PRESENTATION

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Good morning, everyone, and welcome to day 2 at the Stifel 2021 Virtual Cross Sector Insights Conference and the Analog Devices fireside chat. My name is Tore Svanberg, and I'm a senior semiconductor analyst covering analog, connectivity and processor semiconductors at Stifel. It is my great pleasure to introduce Prashanth Mahendra-Rajah, ADI's Senior VP of Finance and Chief Financial Officer; and also Michael Lucarelli, Senior Director of Investor Relations.

The format of this particular session is a virtual fireside chat. But if you do have questions, please type them into the chat function, and I will address them as we go along. With that, we'll just jump straight into it.

Prashanth and Mike, thank you so much for joining us again at Stifel CSI this year, and welcome.

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Good morning, Tore. It's great to be here, and great to join the Stifel team for the virtual fireside chat.

QUESTIONS AND ANSWERS

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. And I know most investors probably have more cyclical questions, especially these days, but I will start with a few more warm-up ones. So first of all, why is ADI a unique investment? And what are some of the 2 to 3 things that makes ADI different from your closest peers?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Thank you, Tore. So for investors who may be less familiar with the ADI story, the -- I think the way to think about Analog Devices is we sit at that interface between the digital and the physical world. And we provide the capability to take the measurements and metrics of real-world phenomena, flip them into a digital environment, which can take advantage of the explosion that we've seen in computing and processing on the digital side.

But to get data into that environment, to be able to come out with insights or action, it needs to pass through this analog interface, and that's where we sit. So we've got some great franchises that we can talk through as we go through the conversation today that represent ADI.

I would also highlight that we are a very diversified company, and that diversification is a great strength. We've seen that over the last years, particularly during this period of great uncertainty from the pandemic, our business held up very well as different parts of the business has responded differently to the pandemic. And really, what we're seeing today, as the economy continues to grow, that some of our more growth-oriented segments of the business are seeing some extraordinary numbers.

And then last, we are a cash flow machine, right? We have 70% gross margins, among the highest in the industry, and we convert that to very strong free cash flow. For the trailing 12 months, we're at 36%. That puts us in the top 10% of the S&P 500 in terms of cash flow conversion.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

That's great. Great summary, Prashanth. So moving on, can you discuss 2 or 3 things that have been transformational for ADI because of the pandemic? So I'm here thinking whether it's inventory management, business practices or any other pertinent things that are very different now versus perhaps pre-pandemic, specifically for ADI?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes. So for ADI, I think, what the pandemic has helped accelerate, and if I think about our end markets, I would certainly look to health care. I think that the health care industry has demonstrated that you can deliver high-quality health care through a virtual environment. And what that now enables is -- or what that creates demand for, is if I can have a conversation with the physician or practitioner virtually, then what's the next [keys] to help make that a more productive engagement is to measure vital signs on a remote basis with a high clinical-grade quality.

And so as we think about, and we see the interest from our customers now, that it looks like virtual health care is going to stay with us for the future. So the opportunity now to take vital sign measurements and do more remote management of health care, where you need to take those analog signals of the human body and provide that to your physician or your practitioner, is an area that I think we're going to continue to see tremendous opportunity over the coming years.

And the other area I would say that the pandemic has really made an inflection for ADI is, as our customers saw how the supply chain were really strained because of the pandemic, it has caused them to rethink about how they make their products and where they make them. And that has resulted in more onshoring of manufacturing or intent to onshore manufacturing, either here in the U.S. or in Europe.

And that onshoring of manufacturing means that our industrial customers have to address the fact that you won't get the great labor cost arbitrage that you would get when building something in Asia. So how do you make up for the higher cost of building in the U.S. or Europe? Well, you do that through more automation.

And ADI's portfolio of products fit very well into the automation growth, both in providing safety of equipment, robots and cobots, when they're working around employees, isolating the high-voltage equipment that people are working with from a safe, low-voltage environment; and then, of course, the tremendous amount of communication technology that's needed to manage these more automated factories. So there's 2 areas that I think we will see continued growth in ADI as a result of what the pandemic has shown our customers.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

That's very helpful. And maybe on that last topic there, Prashanth, and specifically for ADI, because you obviously outsource a major part of your wafer manufacturing. Are you rethinking that strategy given what's happened? I mean, obviously, TSMC is who they are, and they are the most advanced foundry in the world, by far. But could it mean maybe relying a bit more on TSMC manufacturing in the U.S.? Or are you even considering doing some of your own manufacturing again?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Right. I would say that, as we think about manufacturing today, and it will continue on a go-forward basis, it's really about where the products are made versus who is making them for us. So even today, as we think about our supply chain, yes, TSMC is a very important supplier for us. But we think about our manufacturing capabilities across geographies versus thinking about it as a partner-specific relationship.

So we do have manufacturing capabilities internally, both in Europe and in the U.S., and then in Asia, we typically rely more on a third party. But even in Asia, we have diversification beyond just relying on Taiwan. We do have facilities in other areas. And I think that will continue to play a role in how we think about it in the future.

I'm sure the audience knows that the U.S. Senate approved funding of the CHIPS Act last night, and it's going to the house now. Bringing manufacturing to the U.S. is good for the U.S., and it's good for the industry. And ADI will certainly look to participate. It may not be through directly manufacturing in the U.S., but it may be taking advantage of our business partners to bring capabilities to the U.S.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Yes, that makes a lot of sense. So maybe moving on to the sort of near-term environment. And on your recent earnings call, you expressed confidence in second half revenues potentially coming in higher than the first half, which was a very strong growth period for the company. What are some of the pillars sustaining this confidence? And could you please discuss some of the end market dynamics for the second half versus the first half?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes, definitely. So you're correct. We recorded a record quarter in Q2. An all-time high for the company for revenue, for profit dollars and for EPS as well as for trailing 12-month cash flow. And in our guide, we said that it gets better in third quarter and would get even sequentially better in fourth quarter. So that the second half will be stronger than the first half.

And frankly, it's a little bit of math. On the demand side, we see continued very strong demand across all end markets. Backlog continues to increase, book-to-bill well above 1, likely to be sustained above 1. And so we have this demand environment where there's continued great interest in ADI products as a result of both the secular drivers as well as the strong GDP.

And then on the supply side, we're matching that increased demand, or we're compensating for that increased demand with more capacity. And we made some decisions towards the end of last year where we're putting in more investments, particularly in the back end. Those investments come online and help increase our capacity, which is what allowed us to guide up sequentially for the third quarter. And we expect that, that will continue to help us in the fourth quarter. So by increasing supply in a very strong demand environment, we have confidence in a second half that is stronger longer than the first.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. And as far as end markets, any sort of visible -- do you have...

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes, they're very broad-based. I mean, I think that is -- it's a unique environment for us. And I think, perhaps, investors need to appreciate that the demand is all end markets. I think we -- our Industrial, which has a number of subsegments beneath it, had 4 of those subsegments record revenue in the second quarter.

Our Automotive business recorded record revenue in the second quarter. Our Communications business is expected to have a really strong second half as U.S. deployment of 5G begin to take place. So it's really across the board. It's unusual for us to be in this environment to say all end markets, all geographies are all up and to the right.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. And channel inventory continues to be exceptionally lean. Are you starting to see a refill there? Or is sell-through so strong that the channel is unable to build inventory at all? And would you say that will remain persistent through the end of this year?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes. So our model is to keep about 7 to 8 weeks of inventory in the channel, and the channel represents about half of our revenues. We are well below that today. We actually took a small step backwards in second quarter from where we were in first quarter.

We do not see us getting back to that model range in the second half of this year. Today, really, is about working both with our channel partners and our customers to ensure that we are getting products to customers, to keep their production lines running and to meet their most immediate manufacturing needs. So I don't see a restocking happening in this calendar year.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. And one of the topics that I don't hear investors talk a lot about, but you may have some great insights here because you're so broad-based. But there's this idea of most of your customers moving to a second line of inventory.

What we mean by that, of course, is there's on-prem type purchases, but then there's also online purchases, kind of like the Apple model, right? I mean they have a store, but then they do most of their sales online. And perhaps a lot of industrial customers are moving in that direction as well. Are you seeing evidence of that?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

What I would say is that the -- in trying to determine where our customers are in their inventory levels and what is most important for them, we have a significant increase in communications, and our sales force is helping to keep manufacturing apprised with that.

What we are -- what we're understanding is customers are needing to have predictability of when they're going to get their various components because they're managing very complex supply chains across multiple vendors. So the most frustrating situation for our customers is when they have 9/10 of a bill of materials, and it's that 1/10 that they can't get. And helping to keep communication lines so they're able to know what is important to them so they can complete their products.

Inventory levels at customers are still quite low. So I would not see customers looking to virtualize their inventory management just yet until they get their on-prem inventory back to more healthy levels. And it's not where they want it to be in general today. So we need to get customer inventory back to levels that they're comfortable with, and then they can rely on more of a virtual warehouse model that allows them to get what they need when they need it.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Very good. And the supply chain constraints are widespread, I mean, I think we've known about that many, many months now. But could you talk about some of the specific one -- specific bottlenecks for ADI and how and when you expect some of those bottlenecks to ease?

Prashanth Mahendra-Rajah - Analog Devices, Inc. - Senior VP of Finance & CFO

Tore, the constraints from an end market standpoint are equally broad. So maybe, first, to clarify that the constraints are not specific to 1 industry, they're quite broad-based in nature. From a production process, I would say they started out being a bit more on the back end. And as ADI has made investments and worked on optimizing test and arrangements with our OSATs, we've seen the back end be less of a constraint.

And now it's really moving to more wafer capacity, and that's probably what we'll see more of in the second half. But continuing conversations and discussions with our important vendors, to keep adding some of that wafer capacity as it comes available, will allow us to continue growing the ability to supply, but unlikely that we're going to get supply-and-demand imbalance this calendar year.

Michael C. Lucarelli - Analog Devices, Inc. - Senior Director of IR

So I'll just add one thing, for those that are new to ADI, kind of our manufacturing footprint. We do about 50% of the front end internally, in our own fabs. We do about 50% externally. On the back end, it's a little different. It's -- on the test side, we probably do 70% to 80% internally.

And on the assembly side, most of it is external. Probably 80% of our sales is external with the OSAT partners. So it's a very diverse footprint, both internally and externally for us across front and back end.

Tore Egil Svanberg - Stifel, Nicolaus & Company, Incorporated, Research Division - MD

That's very helpful. So those were kind of the obligatory cyclical questions that I had. So let me move on to some more interesting ones. And by the way, just as a reminder to the audience, if you do have a question, please feel free to type it into the chat function.

So moving on to the Maxim acquisition. How is the deal tracking? I mean is it still expected to close this summer, especially in light of regulatory approvals?

Prashanth Mahendra-Rajah - Analog Devices, Inc. - Senior VP of Finance & CFO

Yes. So for the audience that may not be familiar, ADI announced its intent to acquire Maxim products last summer. We've gone through regulatory approval in all jurisdictions quite fast, and we are waiting now on China. It is tracking very much to the schedule that we expected. And at the time of the announcement last summer, we said about a year, sometime in the summer of 2021, and we feel that, that's still a reasonable expectation.

Tore Egil Svanberg - Stifel, Nicolaus & Company, Incorporated, Research Division - MD

Great. And now that you've had the ability to sort of dig deeper into the Maxim organization, but what are some of the positive or negatives versus initial expectations? And don't be shy about mentioning some of the negatives.

Prashanth Mahendra-Rajah - Analog Devices, Inc. - Senior VP of Finance & CFO

Tore, I would say that we're -- we feel fortunate that the world is reopening around the time that we are going to be hopefully closing this transaction so that the actual integration will be a face-to-face process. What we've done quite a good job of is we've used the interim period, which has largely been done virtually, to do significant integration planning. And I would say that it's -- we probably -- we have certainly done more planning before the close of the deal than we did with Linear. We learned from Linear. But I think, also, allowing us to do it virtually made it a bit easier because you didn't have some of the travel burden that we had with Linear.

So both organizations are very excited. There is really good harmony on the power of this combination. The -- there is a tremendous amount of staff work that has been done in planning out the steps to be successful, both on day 1, but also how these organizations come together. I feel very good that the synergies that we identified early on are very achievable and have a good line of sight to how we're going to deliver that.

From a negative, I think that it is a tough demand environment because there's so much being placed on both companies to be able to supply to customers. So it is -- it's been a real strain on both sides of the organization to be running your businesses at full speed, be working on this massive integration and doing it all from your living room without some of the stress relief that you get from personal interaction.

So that's -- it's been a challenging period. And I applaud both teams for being able to stay so engaged and collaborative despite sort of the stress on the organization to do so much virtually. I would say that now we're starting to open up. We had a good number of our folks out there last week. Vince was out there the week before, in California. So the travel is restarting, and those engagements -- it's so much better when you can get -- meeting them face-to-face.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Right. No, and I'm sure already having that large Santa Clara presence certainly makes the integration easier. So what do you believe investors are missing when considering what Maxim means for ADI, both short and long term?

I think when you first announced the acquisition, the reaction, at least, from a stock perspective, was a bit lukewarm. Maybe because it was a stock deal, who knows. But what do you think investors are perhaps missing with this transformational transaction?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes. I would say a few things. First, that there was perhaps a lack of appreciation for the underlying growth of Maxim's business because of the amount of headwind they had from their consumer online. So the Nonconsumer business has had a nice growth rate, too, and that was clouded because of what's happening in Consumer. That fits really well with our kind of core B2B franchise.

Second, that the success that the Maxim team has had was despite not having real kind of core anchor franchises, ADI brings this tremendous franchise in RF, in data converters, in power. And these franchises will create a wake that really will help us bring more Maxim products into reference designs and onto the board.

And Maxim has been successful in getting their products designed in without being the first person you call when you need an RF or a data converter solution because, in fairness, folks are going to call ADI for those types of needs. So that ability to bring their portfolio into our basket, I think, is going to be huge.

And third, I think that investors -- although we've been saying this, we see the trend accelerating, and that is so much engineering talent is going into the digital world. It is really where all the focus is in the university environment. And as a result, the analog engineering expertise continues to be underinvested in.

And for us to be able to acquire such a large group of talented analog engineers, to add to our portfolio or our team and then to be able to work with customers who don't have those same analog engineering skills, it's just going to create that intimacy that we've been building even stronger with our customers, where we're going to really become sort of their default design house and allow us to take more of the board. I know Mike shared some numbers in the past, but I'm going to -- I may not get this exactly right, I think about 20 million digital engineers to about 1 million analog engineers?

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Yes. Yes.

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes, so it's a striking contrast.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Right. Yes. No, and certainly, from a capital perspective, when we think about the world today, I'm so glad you spent your capital there and instead of buying back your stock. So thank you for that.

So moving on to, perhaps, a few more longer-term questions. What are ADI's ambitions, both in the analog market and in the overall semiconductor industry? Should we expect the company to remain acquisitive, to gain share faster in analog? Or were the acquisitions of Hittite, Linear or Maxim more driven by sort of IP and technology considerations?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes. Well, let me, maybe, first reflect on kind of the strategy that Vince has taken this company through since becoming CEO. And he's picked up 3 premier analog franchises and put them all under the ADI umbrella. So very rare, unique franchises between Hittite, Linear and now Maxim. My focus now as CFO, really, is to focus on ensuring that we deliver the synergies that we've committed to shareholders, and that's going to be the focus for the next couple of years, in addition to the capital allocation return that we talked to our shareholders about when we put this deal together.

Longer term, I think Vince is going to continue to explore what is the right strategy for ADI. And I wouldn't want to predicate where that might be. But I can certainly confirm to investors that in the near term, our focus is getting this company integrated and driving the synergies, both at the top line and the bottom line, that are necessary to make this a high ROI for our shareholders' invested capital.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Got it. Got it. And ADI is a leader in data converters and power management and now increasingly also in high-end RF. As you have discussions with customers, do they also want you to offer other content? I mean I do know you offer some DSPs, but are they asking for more processor capability, especially as processing is moving closer to the edge, which is kind of where you are very, very strong.

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes. Tore, I would say, and we just had a conversation on this very recently, that the traditional sort of way that you think about processors are becoming less and less relevant to how customers are thinking about their design solution. They are -- the analog expertise is what they are short. And having ADI step in there to help them solve those problems continues to allow us to find a solution that multiple different process resolutions can be part of.

Separate from that, of course, is embedded processing. And embedded processing certainly is an area that we have made investments in, and we'll continue to invest in, like the significant value-add that comes from our wireless BMS, certainly the software-defined transceiver, some of our energy monitoring products.

We've got a pretty incredible technology that's being used by some of the airlines to use acoustics to measure the sound of engines and help them determine when is predictive maintenance necessary, or predict maintenance in advance of it being necessary. So there's a variety of areas where we do spend our R&D dollars to embed processing. But it's really -- it's built across our broad portfolio, and we view it really as part of the analog solution that we're bringing to our customers.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Got it. Got it. And B2B is obviously your business. That's what you guys do. And your 3 main segments here are Communications, Automotive and Industrial. But if you look at that Industrial segment, and I know it's got a lot of subsegments, but will you start maybe reporting those segments in a bit more detail?

Because I'm sure factory automation is becoming a pretty big percentage of your revenues. I think medical is maybe approaching sort of 10% of revenues. So are there plans to maybe start talking about those in a bit more detail from a reporting perspective?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Tore, we haven't gotten that far as we think about bringing Maxim in. But certainly, as we approach sort of \$10 billion in revenue on a combined basis, we will look at what's the right level of transparency to share with investors, while still providing the necessary opaqueness to keep our competitors from trying to target the markets that we're doing particularly well in.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Very good. And I can't have a session with you without asking a question about 5G. I know, from a sort of business perspective, you said you see signs that it's going to strengthen in the second half. But even from a technology perspective, I know you have a partnership with Marvell. They reported this week and sounded pretty bullish about their prospects. So how should we think about both the near-term and the long-term for your 5G business?

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Yes. Yes. So very quickly, for investors. We have an extraordinary high position in 5G, driven by the amount of technology and content that we have in the transceiver. The outlook for that market is that this 5G cycle is going to run much longer than I think we've seen traditional or historical generations, 4G, 3G and so forth. We are still in the build-out for mobile. And as we think about the balance of this year, you'll definitely see U.S. deployments now that the C-band auction is complete.

We'll see Europe can -- begin to make their investments next year. O-RAN continues to get traction. And we believe that O-RAN will be a source of growth for the industry, but also for ADI a few years out. And then private networks still remain a very reasonable solution to allow communication technologies as an alternative and more robust and reliable solution versus WiFi and other wired technologies for manufacturing or industrial applications.

So our view is 5G has years to run. It is only about 50% of our Comms business today, and we're very optimistic. Everything I've talked about has -- essentially, has China relatively derisked. So when China begins to spend again, and they will, then that all should be upside for us as well.

Tore Egil Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. So with that, we've run out of time. Prashanth and Mike, thank you so much again for attending the CSI 2021 Conference. I really appreciate it. Best regards to Vince and the rest of the team, and we hope to see you in person very soon. Thank you again.

Prashanth Mahendra-Rajah - *Analog Devices, Inc. - Senior VP of Finance & CFO*

Thank you.

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Thanks. See you.

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