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EDITED TRANSCRIPT

ADI - Analog Devices, Inc. at Sanford C Bernstein Strategic Decisions Conference

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Operator

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PRESENTATION

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Good morning, everyone. I'm Stacy Rasgon. As most of you know, I cover the US semiconductor sector at Bernstein. It is a great honor to introduce our guest, the President and CEO of Analog Devices, Mr. Vincent Roche.

Of all the companies that I cover, ADI is probably one of the most respected among investors. It's got an extremely high quality franchise in the analog space, particularly as it relates to signal conversion and processing. And over the last decade or so, the Company has embarked on a rationalization program of both their product portfolio, as well as their manufacturing footprint. They were smart enough to exit mobile early enough to actually get paid to do it, unlike some of the other folks we see today. They've increasingly focused their product offering on high-value applications, whatever the end market, as well as greatly increasing their presence in new markets like automotive and healthcare over the last few years. And they took early steps before many of their peers to shutter unnecessary capacity.

And then it's also been a company with steadily improving economics, trough margins that are now higher than their peak margins used to be. I see the investment controversies today, at least from the calls I get, tend to focus on how much more margin expansion, if any, could remain in the model, and what it might take to get there, whether the Company can return to sustainable growth and where that growth might come from, and whether a renewed focus on cash return is truly going to be sustainable for the long haul. So to answer these and hopefully some other questions, it gives me great pleasure to introduce the President and CEO of Analog Devices, Mr. Vincent Roche.

Vince, thank you so much for being here today. Appreciate it.

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Thanks, Stacy. Well, good morning everybody. Thanks for coming here this morning.

So what I'd like to do maybe is just give you -- some of you probably know ADI pretty well already, but what I'll do is give you a brief overview of who we are, what we do, talk to you about how we view the various markets in which we play, talk to you about as well about our product and technology philosophy, our philosophy in terms of how we manage the financials of the Company, and then obviously we'll -- I'll pick questions from you as you may have them.

So ADI is approaching 50 years. We were founded in January of 1965. So we've been around this business quite a while, and we are a \$2.7 billion company that focuses really at the intersection of the physical and the digital world, that's our space. Our basic philosophy -- the philosophy that underlays the Company and in fact I was at a large employee event last night, it was interesting to hear people who are long service employees where they talk about their understanding of the philosophy of the Company, but it really is that superior innovation brings superior results that's what we're all about as a corporation.

One of the things we've embraced, Stacy, touched on a little bit is diversity, and I'll talk a bit more about that in a while. We like to cover lots of applications, we like to build lots of products and deal with lots of customers. In fact, the franchise of the Company is built around 20,000 products, selling to about 50,000 or 60,000 customers.



So in terms of the market, I believe that we are approaching what we call the third wave of growth of the information and communications technology industry. The first wave was begun, mainframe computers, defense industry, industrial products. The second wave, which started in kind of the late 1980s, early 1990s, was all about mobility, personal computing, digital consumer. I believe that third wave is going to be about massive sensing and communications of massive amounts of data and I think that presents a great opportunity for ADI to be able to use the signal processing franchise we have to deliver rich high fidelity data streams into the healthcare sector, the industrial sector, the automotive sector. We look for areas typically when we think about the investment philosophy of the Company. We look for areas where the barriers to entry are high. So we play very much on the high end, where we can get sustainability and also get very, very good returns.

Now in the past few years, three or four years, we've begun to tilt the company away from consumer type applications into what I call the B2B space, including automotive, so industrial, healthcare, communications infrastructure, and the automotive sector.

And we are taking some questions over the last couple of quarters about the growth rate of the Company. And what I can tell you is that five years ago, we were spending 40% of the entire R&D of the Company in the consumer space. Now, we spend about 10%, 11%, 12% in the consumer area. We're picking applications, where we think we can make a big difference to the user experience. So, the lion's share of ADI these days in terms of R&D, in terms of the products we're building are really targeted towards the B2B space. Now in the past five years, our B2B business has grown about 6% or 7% compounded, which given the economic turmoil, I think, is a pretty good growth rate. The offset, of course, was that our consumer business dropped at a rate of about 8% by virtue of the short product lifecycles and the change in R&D investment strategy.

Our customers that said are really challenged in a couple of ways, they've got to get massive amounts of data into the cloud, into the Ether somehow. So they're trying to sense more real world phenomena and that's a great place for ADI, that's our business. We sense, we condition, we convert, we process, we communicate or actuate.

And as a company in this signal processing space, there are three or four big franchisees that matter there. One is converters. We have 50% market share in that area. High performance signal conditioning and linear products, we have about half the market there as well. And we have two growing franchises in RF and microwave and also, MEMS and sensor products in general, that's another area of potentially very high growth for ADI.

It's a -- when you're playing like ADI on the leading edge of the industry, R&D injection is very, very important. So we're spending, we think, the kind of the right level of spend for the Company on a steady state basis is in the region of 16% to 18%. We're running a little higher than that at the present time, but yes, I think that's the model that's served us well over the years. We take a very long-term view to where we play, how we win, where we'll invest, and my sense is we've got a great crop of products coming behind us now that we've been investing in in the last four or five years in these B2B applications to offset the lots of the consumer market, as we've essentially designed the model to be.

So in terms of the profit margin of the Company, we finished our -- we did our second quarter earnings last week of our fiscal 2014, and we reported a very good sequential revenue increase. Our gross margins are at the 66%-plus level at this point in time. And it's my belief that the margins of the Company are much more reflective of the level of innovation that we produce. The business mix that we now got, I think we're in the right places where we can actually just get better margins by virtue of the types of applications we're playing in, and also the efficiency gains that we've built into the Company over the past five or seven years in terms of changing the footprint of manufacturing in the Company, we did a lot of consolidation. So I think we've got footprint nicely sized now. Utilization rates at the present time are running in the low 70s. So we have a lot of upside capacity to allow us to stretch the output -- get the output to meet the opportunity growth that we see in the quarters ahead of us.

Our business model is generating very strong cash flow in the best of times and the worst of times, and I believe that will be the case in future. About a year ago, we decided as well to return about 80% of our free cash flow to our investors in the form of dividends and buybacks in particular. So we will continue to do that. In fact, since 2004 and up through our last quarter, second quarter, we've returned about \$7 billion to our shareholders. About \$4 billion of that in buybacks and the rest in dividends.

So I believe very much in the opportunity ahead of the Company. I think we've got a great brand position, our customers are asking us to do more and more and more for them. And I think, as I said, we like diversity. We like big customers, small customers. We like a lot of standard products and big products that we do specific for applications. We'll continue to push the edge of innovation, and I -- when I look across the markets, I talk with



a lot of customers, I pay a lot of attentions in the markets and how technologies are moving. My sense is that there is a growing need for performance in future, particularly in cars and machines, in healthcare and we'll be on the forefront of that building, enabling technologies.

I focus very much on growth. The things I care about in the Company are innovation, I care about growth and I care about profitability. And I believe we can accelerate the growth of the Company without suffering any degradation in our margin structure across the Company. And most of all, I think we've got the right strategy in place now to steer the Company I think in the right direction. And we've got just a terrific trove of talent across the industry to execute the strategy.

So that's pretty much it from my side in terms of the monologue. I'm looking forward to getting your questions. Thank you.

QUESTIONS AND ANSWERS

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Thanks, Vince. I'm going to have some questions I'd like to ask. There are also question cards on your chairs, if you can fill those out, if you feel so inclined. I'll pass those out and we'll leave some time at the end to ask those as well.

So Vince, I want to dig a little bit first into the growth and some of the market dynamics, and so you mentioned over the last few years obviously, the Company has, at least, at the top -- very top level undergrown peers in a tough environment. I think you talked about the mix issues where we had the kind of the core piece of the Company growing reasonably well, the consumer piece a headwind. Two, I know obviously you've done a fair amount of exits, there was a large one I think a year ago.

Vincent Roche - *Analog Devices, Inc. - President & CEO*

The microphone.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Exactly. So, to what extent whether, I guess, this -- the consumer business exits, whether the drawn-out stuff, or the sharp, was that by your choice versus the choice of the market itself? What actually drove that?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

I think that's a great question, Stacy. Thanks for asking it. We've -- there are many, many places that we can play as a Company, and as I said, we like to pick spots with really hard problems to solve that we can sustain positions in over the long-term and make good returns. And so I think one way to look at it is in the B2B space, we're struggling to invest enough there. So we have to make big choices. We moved out of the mobile telephony business, the digital mobile telephony business, a couple of years ago, we divested that to a Taiwanese company. We've moved out of the PC power business, and we've essentially re-steered the investments into the core businesses that we think have the attributes that I just talked about.

So last year, we divested our microphone business. Again, it was an outgrowth of our MEMS technology. So basically, steering the Company towards the B2B sector, and if you like the emphasizing consumer -- just focusing consumer in the areas where we think we can make good returns, where we're playing with the right players, where we can see multiple generations of opportunity for the Company and sustainability, that's where we're trying to play. So it's been very much a choice rather than a needed from the market.



Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Got it. And do you think that that shift is primarily complete now, is your portfolio -- I think you have 12% or whatever it is, still on consumer, is there room for more of the business to continue to shift? Are you now like it's broadly in the markets where you want to be in?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Yes, I think over the coming quarters. What you'll see is, I believe our consumer business is bottoming out now at this point in time. It really has two pieces to it. It has a broadcast, what we call the prosumer audio and video portion of our business, which looks a lot like our B2B business actually, it's got long lifecycles with lots of products, and the other half of the business is really centered around portable applications, digital imaging portable applications, where we've picked some spots in the audio and the imaging demands in particular where the products make a big difference.

So my sense is that we're bottoming out in consumer and as long as the macro sentiment continues to improve or at least stabilize, my sense is that we will see tailwinds in the B2B no longer the headwinds that we had been seeing on the consumer side.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Got it. And do you think that's what we're seeing now? Obviously, over the last couple of quarters both you guys and I think many of your peers have finally started to see a bit of a lift on the demand side and it's, interesting for me, because I started doing this in June of 2009 (multiple speakers).

Vincent Roche - *Analog Devices, Inc. - President & CEO*

It can only go up.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Yes, so -- but do you think what we're seeing right now is this evidence of a purely cyclical recovery, is this secular, is this content increases the share gains on your part? What is actually starting to drive this and how sustainable is that going forward?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Yes, I think there's a number of things, Stacy. Number one, the macro situation is better. I think when I talk with customers now, let's say, versus this time last year or the beginning of last year, with our large industrial customers, our communications infrastructure customers, the sentiment is better. I think there is a capital upgrade cycle in place in terms of rejuvenating the capital infrastructure in general or on plants and equipment. And sentiment here also, as I said, sentiment is better, there is an upgrade cycle, the macro situation is more stable. And if you look at areas like communications infrastructure, which is running about 20% of the Company's business, it's been well publicized that the 4G build-outs that was to take place two years ago, three years ago is taking place now. And I think that'll be a two, three, four year phenomena in terms of ramping there in 4G before the next generation starts to (multiple speakers).

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Yes, so that's interesting. So I mean you touched on that in your earnings call a little bit, but you really do believe that this is more than just a purely cyclical bump and then I guess a leveling off, you think this is, particularly in comm infrastructure, this is a multi-year upgrade cycle, what's drive -- just stage rollouts in China, is this followed by Europe with --.



Vincent Roche - *Analog Devices, Inc. - President & CEO*

Yes, if you look at 4G, the rates of consumption of data or usage of data is doubling at least every year. Mobile data, video, driven by video and gaming. So my sense is, aside from China, America is going through a massive upgrade phase. America builds the basic footprint over the last five years and it has been intensifying the network node just to get more and more and more capacity, you get quality of service levels where they need to be. Also Europe is beginning to -- the carriers are now running trials in Europe on 4G. So over the next year, couple of years, I think Europe is going to start consuming 4G technology as well at a pretty fast clip.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

How do you think about potentially deflationary forces offsetting or playing off against the insatiable increase in bandwidth demand? Certainly, we've looked historically bandwidth demand has skyrocketed, hardware growth for this actually, that hasn't come anywhere near, obviously. So how do you play off the deflationary forces?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

There's all this deflation. When you look at the IC industry, it's been -- to some extent been driven by both the blessing and the curse of Moore's law, all right, where there's been an expectation of productivity gain, price reduction. That's been a factor in the industry forever, it'll be a factor, it's been a factor last year, this year, it'll be a factor, next year. But we are getting more content persistent in these 4Gs, per antenna basically, you're getting more content and there's just more units available.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

So, do -- I don't know if you still think about the Company this way, but you -- there was a time when you have sort of the core markets, you have the new business opportunity, I think you were running that consumer business at that point.

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Yes.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Is that still how I guess ADI thinks about driving growth going forward and which of those new markets, I -- something you're currently -- is there something else that you're looking at, where do you see that driving the most like long-term opportunity for the Company?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

The way we view the world, we've tried to focus this Company very, very hard in the last number of years. We used to plan the investments and execute the investments through the lens of the technology units many, many years ago. In the past four or five years, we've shifted towards a system of -- business system of planning investments and planning our go-to-market activities through the lens of the market segments and applications. So that's the -- that's the primary business unit and management effort inside the Company. So we have -- let's take communications infrastructure, for example. We have a series of product developments we do there that are more of application-specific, customer-specific around which we can pull a lot of standard product content. So the Company still has a strong standard product thrust, and we've been very carefully placing bets on application-specific and customer-specific products, where we think we can get the growth and sustainability overtime. That's the basic units of management and how we view.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Got it. That's actually a good segue, I think, under the operational side of things. And so particularly around that point prioritizing investments, I had an interesting conversation with your predecessor once. We were at an investor lunch, and somebody ask him the question, how do you play off like growth versus margins, the quintessential question? And Jerry kind of listened, would you reject business that doesn't meet your margin target? Jerry kind of looked at him and sat back and said that's an idiotic way to think about it. That's stupid. If you win business, you always take it, always, because you've already made the investment. The question you need to ask is what businesses do we want to be in, and that's the question that we ask ourselves every single day.

And see, just touch on a little bit, but I mean, specifically, what are the factors that you're using to determine, which businesses you want to be in? Is this -- are you looking at growth prospects, are you looking at competition, magnitude of profitability, size of the profit, what are the ways for you to decide what is a good business for ADI to be in and what time frame?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

It's a very, very good question, Stacy. So I think being a company that pride itself on being on the bleeding edge of technology, we care about the market space first and whether or not our technology is relevant in a given market's opportunity, is it sustainable? We think about that more so, and we are working with the right customers. Do they really care, do we make a difference to what they're doing in the end application? We care a lot more about that than what our competition is doing. So our job is to build a lead to setting up a daylight between ourselves and our competition. So I care much more about that as I said. The whole pieces of the Company is based on superior innovation being able to deliver superior results. So if we pick the right spaces, we bring the products to market on time, that's what determines ultimately whether we can grow and whether we can get the kind of returns that we expect. We think about growth and profitability.

We also by the way have a big portfolio, as I said, we've got 20,000 products, 60,000 customers, and many, many of those customers are buying products in a very [price insensitive] way. There is a legacy there, there is a long lifecycle on many of these products. So those are part of our business where we don't have to care as much about that. We care about growth fundamentally.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

How hard is it to find, I guess, enough talent to design engineers to actually drive that innovation -- is that the most -- I've heard it claims and that's what is the biggest barriers sometimes in analog to finding growth is finding enough talented engineers to drive. Would you say that's an accurate statement?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Look, I think in any sector of these days, whether you're in software or whether you're in digital design, analog design, I think it's a problem everywhere. But one of the things we've done very, very well over the years is, we've retained our best engineers for decades. We've many engineers working with ADI for three, four decades. And we bring a large crop of very young talented people in every year. So we build organically the talent pool within ADI. And one of the things we've done very well over the years is retain that talent through thick and through thin. So would we like more talent in different areas? Of course, we would. But we have with the method of growing the talent organically, we've also bought some capabilities over the last couple of years.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Like what?

Vincent Roche - Analog Devices, Inc. - President & CEO

We bought a company called Lyric Semiconductor, which is a very unique algorithmic technology and they're contributing very well to some of our core initiatives in areas like communications infrastructure for example. We bought a plucking company called Multigig a couple of years ago, and they're building climbing and plucking technologies to support many of the diverse markets that we play, particularly communications. So that's something that were always on the scope for, kind of the other technologies where we don't have time, we simply don't have the capability, don't have the time to develop organically, we'll buy those capabilities.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Got it. Why have you not done something along those lines in the power management side then?

Vincent Roche - Analog Devices, Inc. - President & CEO

It's a very good question. We've had many attempts to build power management and as difficult as it is for say our competitors to compete with ADI in the converter space, it's equally hard for ADI to build a big franchise in the power space against the incumbents. We have the power management capability inside the Company that we've really targeted now in areas where we enhance our core technologies, they are very, very low lithography conversion technologies where noise management is important in terms of delivering clean supplies and also in building some signal chain of touch making our application signal chain stronger.

We've also got a franchise in power that's not a pure linear regulation, it's more control and supervision. But the way we view it, power is a parallel [or even orthogonal] technology. What we're trying to do is strengthen the data path, the signal chain more and more. And we think -- we still think we have a lot to do there on the sensing on the RF to microwave side of things there. So I want to strengthen that first and if -- customers, by the way are not asking us for power unit that much. So I think we've enough to get the job done, we're not looking to build a broad market in power. It's to support and strengthen the current franchise of the Company.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Got it. I think to drive that you mentioned some of the other [areas], RF or microwave, and you -- do you have good efforts and -- good, I guess, organic efforts going there, but are there -- what are the areas that you think maybe -- might be well suited to be plugged to something inorganically at this point bolt-on, if not necessarily transformative?

Vincent Roche - Analog Devices, Inc. - President & CEO

Certainly, I would say sensing, I mean sensing is going to become more pervasive in the industry. I think there is no doubt about that. So that's an area where we would certainly like to get more capability. It's a very broad space, you've got to pick your spots very carefully. But that's clearly an area where I would see ADI potentially do something. And I think you pretty much know that we're paying attention inside the Company now, we have a dialog running at the executive team level about M&A in a way that we didn't have before. I've got Dave Zinsner basically running that activity for the Company. So we're on the scout.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Okay, got it. One of the other businesses is the DSP business. How much of a focus is that? I think Dave, told me that this was years ago first time I met him, but I think he told me definitely the R&D intensity of that business is probably 2X what it was in the rest of the business, I don't know where it is today. You've taken the number, of course, your support from five or six down to one or two at this point, it's small, it's not growing that much, why -- what value do you get out of DSP, why stay in it?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

DSP, digital signal processing as a core technology is very -- it's more pervasive now than it's ever been, it's just being implemented differently than it used to be. But we have a -- we've a decent size DSP business that's highly profitable that many of our customers depend on us to support for many, many generations. Now to Dave's point five years ago, we had I would say --

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Five years ago, yes.

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Five years ago, I think you joined here five years ago. So we had a, I think, an unsustainable spend in the DSP business for the size of the opportunity and the size of the business at that time. We've dramatically changed the -- resized the business to a point where we've got a great core competence that we used to build DSP products to support automotive business, which is important, to support the healthcare business, the general industrial business and we're also able to use a lot of the talent that we have there in terms of algorithm development and digital signal processing expertise to help us build these new transceivers, these communications transceivers that are becoming an important part of being able to deliver these software defined radios, for example, across a multitude of applications. So I think the business is well sized. I'm very, very enthusiastic about supporting what we have and pushing growth and, but scale is there and it's a decent sized business for the Company.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

I want to talk about something that's a little, maybe farther out there, but we hear the term Internet of Things standard about all the time and I love it, because it's a term that can mean anything you want at this point. How does the ADI think about it, I think you mentioned for the first time with that terminology on the call a week or so ago, but how does ADI think about that opportunity kind of going forward? And I guess, how would you even define what Internet of Things is at this point?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

I have no idea, Stacy. Let me tell you, I hate that marker that Internet of Things or Internet of everything or Internet of analog, whatever you want to call it. I think what is actually happening, and I have a lot more conversations these days with big healthcare customers, big industrial customers who are saying, you know, we've got to get -- we've got to be able to sense in a lot more places, sense a lot more things, whether it's a clinical application in hospital where you're trying to a lot of vital science monitoring that kind of application of technology can be transformative in terms of how healthcare has delivered. But I think as well when you look at areas like plant automation, being able do prognostic on machines, right, to understand the health of machines, make the machine more efficient in a network of machines.

The reason I think whatever you want to call it, Internet of Things, Internet of everything, the reason I think it'll happen is that many of our customers are trying to re-architect their businesses around the cloud and Big Data and they need to get a lot of clean information, clean data into that cloud. So it's happening, we have customers drawing this into applications, where we use our sensing, we have photonic sensing, we have MEM sensing, using ultra low power signal processing technology and communications technology to enable a lot of these applications.

So I think that a lot of it's still ahead of us in terms of this massively sense machine environment in cars and healthcare and industrial products and that's the third wave that I talked about. We talk it within ADI about the third wave rather than the Internet of Things. So, we've been doing this for many, many years as well. Building the sensing and signal processing and communications technologies, but -- there will be a lot of growth, there will be a lot of nodes, billions of nodes, tens of billions of nodes and we pick our spots carefully there.



Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Do you think your business models exist to the point to drive that kind of adoption? I mean, I'm always suspicious about this like if my toaster is connected to the Internet, that's great. But, how do somebody make money? Maybe, I can make the argument that in something like industrial automation or healthcare, there is a real business case whether it's revenue, whether it's cost or efficiency whatever, but in general, do you think enough of those business models exist? Do you think it's up to the semiconductor companies themselves to help develop those business models (multiple speakers)?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

I think it's going to symbiotic. I've been talking with the executives of some of the bigger American corporations about sensing aircraft engines, environmental monitoring, petrochemical plant monitoring. So I think what you'll see is a symbiotic evolution of this thing. I don't think it's going to be today or tomorrow, it's going to take several years I think for companies to use what they call the digital exhaust and make sense of it in the -- the other you hear about the cloud brain being able to emerge Internet data with business data, with sensor data and deal businesses around. So I think it's several years of evolution before this becomes a really big thing, but it's already happening, starting to happen.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

So you're not going to name one of your groups see Internet of Things grow?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Well maybe, not may be the Internet of things, we'll call it something else.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

I do want to get to you a chance, there's actually quite a few questions here from the audience. I do want to get a chance to ask a few of those. I've got actually several here on cash and on the balance sheet, I'll read two of them. ADI is wonderful company, I wish I own more of it, but as an equity shareholder, my per share participations will be diluted by your cash balance. And the second one, why all the excess cash on the balance sheet? What can we do about that?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

It's a nice problem they have.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Sure.

Vincent Roche - *Analog Devices, Inc. - President & CEO*

What can we do about that? We have -- we opt the level of I should say, we've two primary uses for the cash, maybe three uses for the cash, but certainly stock buybacks, as I said, we bought back about \$4 billion worth of shares over the last number of years, since 2004, we'll continue to do that.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Share count is drifting up though.

Vincent Roche - Analog Devices, Inc. - President & CEO

It's drifting upward, yes. We've a very formulaic way of managing the buyback, which I think is fine for the moment. But we've increased the dividend pretty significantly in the last number of years and we look for opportunities to do more cash back I think through that means over time. And we've plenty of cash in America to be able to do, we've plenty of liquidity here to be able to do, I think we've \$1.3 billion in cash with a \$500 million line of equity here that we can tap into do things we need to do in America. And when the time comes and we need to use cash for maybe something inorganic, we have a -- we've a treasure trove in Europe that we can tap into as well.

So we're, certainly -- if you watch ADI over the last couple of years, we're certainly becoming, I'd say more and more active and more dynamic in terms of how we're managing cash. So our philosophy is to continue to give good dividend, keep doing buybacks and where we got good opportunity to create further share -- business and shareholder value through acquisition, we'll do it.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Got it. I wanted to ask -- is there such a thing as the semiconductor cycle in analog anymore?

Vincent Roche - Analog Devices, Inc. - President & CEO

I don't know if there's any existing as a semi-cycle anymore. I really don't. This has been a very strange five years, I mean that started with the -- I think the last 10 years actually been pretty strange. I don't think there're going to be any perceptible cycles actually. So for our business really what we're thinking about is invest at the edge in terms of quality of the technology we're building, depend on capital cycles essentially to help us -- once the macro is steady, capital cycles are strong, we'll get the growth, we'll get the upside. In terms of managing the -- the cycles are becoming -- I think the amplitudes are surely becoming more pronounced on the up and the down in terms of whatever cycles you want to talk about.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Do you think they are becoming more pronounced?

Vincent Roche - Analog Devices, Inc. - President & CEO

I think they are a little more pronounced than they've been. And we certainly saw that driven off course in 2010 or 2011 by the tsunami. But I think a lot of our supply chain these days is -- we've tremendous transparency, with a lot of the supply chain has run very, very lean way, there's a lot of consignments and with very short lifecycles -- very short delivery cycles in the business these days.

So for us, we are -- we have a philosophy of most of the products that we build inside the Company, we've very agile supply chain, but we have with long-life cycle products, it's always a question of when they sell rather than -- if they sell so. We've managed the supply chain well by keeping transparency through the channel throughout the contract manufacturers, staying close to our customers, and having enough capacity in place, and enough footprints to be able to meet the upside demands.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

And if I could follow up on that. So you talked about the supply chain running leaner, and you're certainly not the only company that is seeing that.



Vincent Roche - Analog Devices, Inc. - President & CEO

Yes.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

And that's been one unusual aspect of this cycle is or nearly as demand picks up you would start to see the channel fill, we haven't seen that.

Vincent Roche - Analog Devices, Inc. - President & CEO

Yes.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Do you think that that I guess the distributors in the channel generally is, is this something that is sort of structural and permanent, are they going to -- through better supply chain management, whether it's the semiconductor companies themselves taking [more of on themselves through] consignment or whatever? Do you think this is a permanent change in the industry, and would that be a muting factor potentially on the magnitude of the shorter -- the short cycle inventory driven kind of dynamic that we've historically seen?

Vincent Roche - Analog Devices, Inc. - President & CEO

Distributors -- I think we've talked about this overall the last couple of weeks, our distributors are certainly demanding more from us. We have a philosophy as a company of watching the end demand very carefully through the channel and then balancing our supply line based against what distributors want versus what the market tells us it wants. I don't see at this point in time any upside limitation through lack of supply, I mean we're sitting by the way on a 110 and 115-days of inventory. So if there is an upside demand, it'll have the huge upside to burn through that and deplete that inventory. So I think we're certainly in good position from that perspective.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Got it. How does -- how much value does ADI place from the distribution channel? I know I had conversations with Jerry at one point where he seem to be when the part of the -- few years ago, when you were looking to take cost out of SG&A and I think part of that was rationalizing the distribution channel. And he has seen that things at ADI at that point would be better able to go direct for a number of their products, and I was hesitant to believe it that point, but I don't know what your perspective is.

Vincent Roche - Analog Devices, Inc. - President & CEO

I look at it -- we've had distribution engagements in America and Europe for 25 years. I think we have good alignment with these distributors. We have a good understanding of what we're good at, what they're good at. Most of what we want from our distributors is really topnotch service in terms of being able to get the supply to our customers on time and across the breadth of ADI. So the way I have used we have as a company, I think driven by our customer needs, we fairly dramatically increased the amount of direct headcount that we put into the field over the last seven years. The design task is becoming more complex across the customer base. So we've deployed our own technical sales force -- we've doubled the size of our technical sales force over the last seven or eight years to be able to engage in a more direct way with our larger customers, but we're agnostic when it comes to how our customers want to fulfill the demand. So the design piece we manage pretty much directly, we depend on ourselves to a large extent, directly and through a terrific experience that we can deliver through online services as well. So that's the philosophy, ADI is the owner of the design process, which is becoming more and more and more complex and where the distributors can help us there, fantastic, but we depend on them more for fulfillment and logistic services than anything else.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Got it. Here is a good one. If Moore's law slows, is this good or bad for you or are you indifferent?

Vincent Roche - Analog Devices, Inc. - President & CEO

I think we're indifferent. I mean we -- the analog business -- one of the great things -- let me just describe something to you. There are really two meta phenomena in the IC industry, one is Moore's law, which has been fantastic in terms of delivering unprecedented productivity to the economies across the world. In the analog business, we talk about more than Moore, which is about diversity. So, in the digital technology space, it's about convergence of digital technology run really to process nodes.

In the analog business, it's about you've got to have a lot of stuff, you're going to deal with the real world. You've got to have high voltage, low voltage, you've got to have isolation technologies, you've got to have sensing technologies. Actually, within ADI, the number of process recipes that we're using in our business is increasing at a fairly aggressive rate both inside the Company and with what we do with our partners like TSMC. And so we're actually kind of indifferent to the whole thing.

The digital houses as Moore's law hasn't taught us towards some kind of norm, they'll find the way of producing the computing power that's required. So I'm more concerned about having and offer process recipes to be able to capture the big breadth of opportunity that we have over there. So if anything we're diversifying and not converging, which is what our business is all about.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

How many processes are you running now?

Vincent Roche - Analog Devices, Inc. - President & CEO

It depends on what granularity, but we have hundreds of processes inside the Company on the high-speed side, on the precision side. We're developing new sensor technologies inside the Company, isolation technologies, digital isolation technology. So it goes into the hundreds basically.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

And as founders, you're engaged I think across all processes, don't you, from the very lagging edge to the leading edge?

Vincent Roche - Analog Devices, Inc. - President & CEO

Yes, we -- inside ADI, we go through a [180 nanometers] inside the Company, but we are doing 28 nanometer developments now, mixed signal development, and a lot of microwave technology, RF technology on external foundries.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Got it. How can you get the same sustainable competitive advantage in sensing versus your core business?

Vincent Roche - Analog Devices, Inc. - President & CEO

Again, you pick your spaces very, very carefully. We've built up a MEMS business that is -- yields got a good scale to it that we targeted at the automotive sector. We've got good high G, low G inertial sensing, very good gyro sensing. So there are hundreds or thousands of spaces that you can play in the sensing area, but it's got to be first of all aligned -- whatever sensing we do, it's got to be aligned with the businesses that we care about. And again, we are going to pick our spots very, very carefully there.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

It's my question on the alignment is interesting, because it sort of falls in the next one. Did ADI try to re-purposefully use their technology, innovation, R&D across products, across verticals? Is this a strategic priority and how do you do it?

Vincent Roche - Analog Devices, Inc. - President & CEO

Yes, it's a great question, and thanks for asking it. And let me give you an example, we have -- we've developed some software defined radio technologies that we purposed. We designed it for the communications infrastructure market to be able to manage very flexibly the spectrum of the frequency choices that our customers have to utilize to be able to go from microwave down to base band. What we tried to do is solve a core challenge that our customers are going to deal with across multiple segments. We designed that technology around the communications infrastructure area, but now we repurpose the technology with software driver things and tools and we deployed it into things like software instrumentation, into other satellite systems, into multiple applications. So it's something I talked about diversity earlier on, that's an important part of what we do as a company. We tend not to like one product, one customer. We tend to look for multiple customers per product across multiple spaces. So that's a core philosophy in terms of how we think about running the business.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

Got it. In terms of margin expansion -- to paraphrase, is the opportunity here revenue growth only or there are further structural levers that you can pull?

Vincent Roche - Analog Devices, Inc. - President & CEO

We are -- I think the biggest lever, we've pretty dramatically changed, we run from five manufacturing plants inside the Company to two over the last seven years. So we have greatly changed the way we manufacture inside the Company. I think for ADI, the business mix that we have going more and more into the B2B space is -- gives us still more leverage over time, because I believe our B2B business will grow and become a more significant part of ADI. So that's one big part. And the other part is utilization. We're running in the low 70s at the present time. So as the revenue grows, for every 100 basis points of utilization improvement, we got 10 points -- 10 basis points of margin improvement. So we've got more leverage built in based upon scaling the business, and I think with the improving business mix, things will get better there.

Stacy Rasgon - Sanford C. Bernstein & Co. - Analyst

But the B2B piece is now almost 90% of the total.

Vincent Roche - Analog Devices, Inc. - President & CEO

It is, yes. So growth I think is going to be the big driver of margins.



Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

So you get sort of incremental fall through and then utilization (multiple speakers).

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Exactly.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

I was going round, do you think you could see 70% margin at some point?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

I can see it. Look, we're going to talk in a few weeks time at the Investor Day we're going to have here in New York, we'll talk in more depth about how we view all the pieces of the P&L from growth to margins and operating profits. And is it possible? I mean, part of the businesses due on that. What ADI has is a portfolio of businesses that give us the diversity, the stability, the diversity and the growth opportunities, and different businesses naturally attractive on margin structures.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Can you talk about, you said CMOS versus non-CMOS processors, is there any interest in extending non-CMOS and would M&A in that area be a consideration?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Most of our processes actually inside the Company are non-CMOS, and we continue to have development efforts in non-CMOS technology. There are areas where CMOS technology actually benefits the Company. If you learn how to do mixed-signal design on 28 nanometers, you get terrific opportunity to improve radio frequency in microwave offerings. So we actually pick -- we don't actually say, is it better to do, we look at the task and we try to figure out what the process technology option is, but whatever process we pick, we tend to run it very, very hard right to the edge. So I think it's a matter of what problem you are trying to solve, more so than is it -- are we limited by CMOS or non-CMOS. We use whatever technology is best for the job.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Can you talk about the opportunity in self-driving cars?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Quite a scary thought, isn't it? Self driving cars.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

I think Google is starting a little test fleet now.



Vincent Roche - *Analog Devices, Inc. - President & CEO*

Yes, it's out there. What I see are several steps along the way to that point, if it ever happens. We are working with many of our automotive customers now. Automotive is virtually 20% of ADI of the revenue and one of the things we've been working on is the safety space is developing sophisticated radar technology for predictive safety. So I think when those technologies are more prevalent in the automotive sector in that industry, people get to play with the technologies more, become more familiar, begin to depend on those technologies, and when automotive companies learn how to build communication systems as well as to be able to manage the network of the interconnection of cars and automobiles around the grid, I think that's still several years away, because you've got to mix the sensing and the processing of the communications altogether. Though car companies are essentially becoming IT centric now, they have a long way to go in terms of learning how to build communication systems. We don't have a grid necessarily either of that said fully formed to allow fully automated vehicles. But the old saying goes, if you can imagine it, it'll probably happen.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Yes, I've always thought that the biggest issue is actually maybe not technological, but much more behavioral and legal.

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Yes.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Right? Do you want to sit in the car and who do you sue if it gets (multiple speakers)?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Exactly. I think getting comfortable with the technology improving is going to take several years, and as you say, the legal aspect of that is going to be not insignificant.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Got it. I think a follow-up to are there other, I guess, parallels or read-acrosses or technology uses from these kind of areas to things like automated manufacturing, automated distribution of these areas that ADI is focusing on or looking at?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Yes, I mean the core technologies that we develop have multiple applicability. A good example would be in the MEMS space, where we designed products for the automobile. We are now able to repurpose those technologies for areas in healthcare for vibration sensing of machines to allow prognostic health management. So, there are many, many areas. I mean, when you look at ADI, we have really number of franchises with converters, which we sell into everything that we do, we've linear products that we sell into everything we do, we've growing our microwave franchise with multiple applications. So, those core underlying technology is the foundation of everything that we do essentially.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Got, it. So, we have about 30 seconds left, a room full of investors, I'm going to give you your soap box, why should investors buy Analog Devices stock?

Vincent Roche - *Analog Devices, Inc. - President & CEO*

I think ADI's proven over the last 50 years that we can manage, we can sense, and we can manage transitions very, very well. We have -- this company I think pointed in the right spaces, we're in the -- we're playing in the right places. We continue to improve the talent base that we've got at the Company. Our customers, I think the blend we have with our customers now is better than it's ever been, big customers and small customers. So we're playing in the right place -- at the right spaces, we're more focused, we're more clear in terms of how we win, and we're intensively driving innovation in this corporation to keep us on the forefront, and I believe the next 50 years will be even better.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Fantastic. Thank you, Vince.

Vincent Roche - *Analog Devices, Inc. - President & CEO*

Thank you, Stacy. Thank you.

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