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ADI.OQ - Q3 2025 Analog Devices Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good morning, and welcome to the Analog Devices third quarter fiscal year 2025 earnings conference call, which is being audio webcast via telephone and over the web.

I'd like to now introduce your host for today's call, Mr. Richard Puccio, Executive Vice President and Chief Financial Officer. Sir, the floor is yours.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Thank you, Josh, and good morning, everybody. Thanks for joining our third quarter fiscal '25 conference call.

Joining me today on the call is ADI's CEO and Chair, Vincent Roche. For anyone who missed the release, you can find it and related financial schedules at investor.analog.com.

The information we're about to discuss includes forward-looking statements, which are subject to certain risks and uncertainties, as further described in our earnings release and our periodic reports and other materials filed with the SEC. Actual results could differ materially from the forward-looking information as these statements reflect our expectations only as of the date of this call. We undertake no obligation to update these statements, except as required by law.

References to gross margin, operating and non-operating expenses, operating margin, tax rate, EPS, and free cash flow in our comments today will be on a non-GAAP basis, which excludes special items. When comparing our results to our historical performance, special items are also excluded from prior periods.

Reconciliations of these non-GAAP measures to their most directly comparable GAAP measures and additional information about our non-GAAP measures are included in today's earnings release. References to EPS are on a fully diluted basis.

Okay. With that, I'll turn it over to ADI's CEO and Chair, Vincent Roche.

Vincent Roche - *Analog Devices Inc - Chairman of the Board, President, Chief Executive Officer*

Thank you, Rich, and a very good morning to you all.

Well, our third-quarter revenue and earnings exceeded our expectations. And for the second quarter in a row, we achieved double-digit year-over-year growth across all of our end markets.

While geopolitical and macro uncertainty continues to cloud the outlook, we believe ADI's innovation-driven, resilient, highly diversified business model positions us to continue to successfully navigate these challenges. The accelerated recovery of our industrial business, encompassing instrumentation, automation, healthcare, aerospace and defense, and energy management, is a case in point.

As you've heard us detail on prior calls, our industrial recovery began in the aerospace and defense and instrumentation sectors, driven by our strong product and customer portfolio positions, as well as spending growth in defense and AI infrastructure. We're now seeing double-digit year-over-year growth across the entire industrial portfolio.

For today's call, I'm going to focus on our $1 billion-plus industrial automation business, which was the last sector to return to double-digit growth. Its market dynamics and trajectory are expected to bring long-term expansion.

Companies have long invested in automation systems to gain first-order productivity, efficiency, and quality benefits. Today, a new wave of adoption is being driven by economic and demographic pressures and enabled by the potential to transform and accelerate business through leverage of real-time Intelligent Edge data.

ADI's high-performance technology stack and deep domain expertise are crucial to customer success in this highly sense, securely connected, software-driven era and the new robotic modalities that are emerging. It's predicted that the convergence of compounding macro and AI-enabled technology factors will drive robust double-digit growth within robotics market for the foreseeable future.

ADI's ability to deliver exceptionally accurate physical representations that enable faster insights of the edge will become even more essential as the market migrates to next-generation autonomous robotic systems. Our long history of robotics has given us a deep understanding of the sector's hardest problems and the greatest opportunities.

We're investing to maintain our performance in edge and analog while capturing increasing levels of system value. In addition, we're building ecosystem partnerships and deploying experts and an increasingly broad suite of technologies to enrich and deepen our customer collaborations. We expect this multi-pronged approach to unlock significant ASP and some expansion for our automation business, following the proven path we've successfully executed in other markets such as aerospace and defense and healthcare.

Now let me share a few examples of our strategy in action. Earlier this year, we partnered with Teradyne Robotics. Our solutions for precision positioning and dynamic motion control are helping Teradyne increase their value proposition to the logistics industry through higher-performance cobots and autonomous mobile robots, or AMRs.

In the agricultural sector, where labor shortages are chronic, high-precision robotic systems are increasingly filling the gap. In addition, these systems' enhanced collection capabilities are enabling higher crop yields while reducing water and chemical usage levels. A growing portion of our robotics revenue is coming from this sector as we help customers solve their toughest challenges through our sensing, connectivity, and energy management solutions.

In the healthcare sector, robot-assisted surgery systems minimize invasiveness and improve patient outcomes through enhanced system precision. And we're leveraging our leading precision technology franchise to successfully attach more of our power management, connectivity, and sensing content to the more innovative systems being designed and employed. This year, we're achieving robust growth and expect continued momentum as the proliferation of automated surgical procedures further expands our opportunities in this space.

Overall, the near and medium-term outlook for robotics is compelling, supported by increasing revenue and the burgeoning opportunity pipeline. From this strong foundation, we're extending into the next promising era of robotics, namely humanoid and other highly dexterous robot form factors; and creating a potentially exponential growth opportunity for ADI.

Our content in the humanoid robot is likely to be several thousands of dollars, and that's basically a 10x increase over the content in today's cutting-edge AMRs. The primary reason for this content multiplier is the explosion sensor and actuator counts. Every joint and point of contact requires accurate sensing and precision motor control, and every sensor and actuator drives the signal chain and power management opportunity for ADI.

To further capture this flourishing opportunity, we're investing in higher-level application-specific solutions that integrates multiple sensing modalities, such as pressure, vibration, depth, acoustics, vision, and positioning with high accuracy, ultra-low power signal chains, functionally safe power management, and AI algorithms powered by robotics foundation models.

Simultaneously, we're collaborating with NVIDIA on a range of digital twin simulation programs and reference designs for humanoid and other robotic systems to accelerate development and AI training for our customers. This work is particularly relevant for high-value applications such as dexterous manipulation of cable assemblies in data centers and, of course, in automotive manufacturing, to name just one.

We are combining ADI's unique sensor expertise and our latest advances in robotics policy training techniques to enhance realism in NVIDIA's Isaac Sim and substantially shorten our customers' innovation time lines.

So in summary, we're capitalizing on growth in advanced robotics today and investing to capture even more value in the future. Ultimately, the strategy, investments, and customer impact of our robotics business is a microcosm of our approach across ADI mainly on covering and tackling the hardest innovation challenges at the intelligent physical edge and leveraging our industry-leading technology portfolio and expertise to solve them.

As we turn our attention to the end of fiscal '25 and the beginning of the new fiscal year, we're focused on executing our strategy and capitalizing on cyclical and idiosyncratic momentum. Despite the geopolitical and macro turbulence, we remain undeterred and excited by the tremendous growth opportunities that we see over both the near and long terms.

And with that, I'm going to pass it back to Rich.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Thank you, Vince. Now on to our third-quarter results.

Revenue of $2.88 billion came in above the high end of our outlook, up 9% sequentially and 25% year over year. Industrial represented 45% of our third-quarter revenue, finishing up 12% sequentially and 23% year over year.

Our industrial recovery has continued with sequential growth across all subsectors and regions. Year-over-year growth accelerated across all major applications led by our automatic test equipment business, fueled by increasing AI investment. Additionally, our aerospace and defense business had a record quarter.

Automotive represented 30% of quarterly revenue, finishing down 1% sequentially and up 22% year over year. Double-digit year-over-year growth continues to be driven by our leading connectivity and functionally safe power solutions.

Communications represented 13% of quarterly revenue, finishing up 18% sequentially and 40% year over year. Our wireline and data center business, which is roughly two-thirds of total communications, grew double digits sequentially and year over year as increasing AI demand continues. Wireless also grew double digits both sequentially and year over year.

And lastly, consumer represented 13% of quarterly revenue, finishing up 16% sequentially and 21% year over year, marking the fourth straight quarter of double-digit year-over-year growth. We continue to see strength across handsets, gaming, hearables, and wearables.

Now on to the rest of the P&L. Third-quarter gross margin was 69.2% and operating margin was 42.2%, up 100 basis points sequentially and year over year. Non-operating expenses finished at $57 million, and the tax rate for the quarter was 11.9%. All told, EPS was $2.05, above the high end of our guided range and up 30% year over year.

Now I'd like to highlight a few items from our balance sheet and our cash flow statement. Cash and short-term investments finished the quarter at $3.5 billion, and our net leverage ratio remained virtually flat at 1.1.

Inventory increased $72 million sequentially in support of the cycle recovery. Days of inventory declined to 160, and channel weeks ticked lower. We are continuing to execute our strategy of keeping leaner channel inventories while maintaining higher levels on our balance sheet.

Over the trailing 12 months, operating cash flow and CapEx were $4.2 billion and $0.5 billion, respectively. We continue to expect fiscal 2025 CapEx to be within our long-term model of 4% to 6% of revenue.

Free cash flow over the trailing 12 months was $3.7 billion or 35% of revenue, and we have returned $3.5 billion in cash to shareholders over the last four quarters. As a reminder, we target 100% free cash flow return over the long term, using 40% to 60% for our dividend and the remainder for share count reduction.

Now on to our fourth-quarter guidance. Revenue is expected to be $3 billion, plus or minus $100 million. On a sequential basis, at the midpoint, we expect industrial, communications, and consumer to increase with the fastest growth in industrial. Automotive is expected to decline.

Operating margin is expected to increase to 43.5%, plus or minus 100 basis points. Our tax rate is expected to be between 11% and 13%. And based on these inputs, adjusted EPS is expected to be $2.22, plus or minus $0.10.

In closing, our strong results and outlook for continued growth, especially in the industrial market, reinforce our view that 2025 will close as a strong recovery year for ADI. However, we are mindful of the continued uncertainty facing customers with respect to tariffs and are monitoring the impacts closely.

We believe we are well positioned to successfully navigate an evolving global operating environment thanks to the optionality enabled by the diversity of our markets, applications, and products and the resilience of our hybrid manufacturing strategy.

With that, let's go to our Q&A session. (Event Instructions) Operator, can we have our first question, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Timothy Arcuri, UBS.

Timothy Arcuri - *UBS AG - Analyst*

So industrial last quarter was up 7%. It was up 11% this quarter, and it sounds like it's going to be very strong again in fiscal Q4. Can you just talk -- do you think you're now shooting above consumption in these markets?

How do you view where we are? Are we now in inventory build mode in those markets? And how do you assess how long this can last?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So since we called the bottom back in Q2, so industrial has been our most profitable business and has grown sequentially every quarter. More recently, as we talked about, the growth has accelerated. And our outlook for Q4, which is normally a seasonally down quarter for industrial, we expect it to grow in the low to mid-teens quarter over quarter. So very strong outlook there.

And what's important is growth is happening across all of our industrial sectors, including instrumentation, automation, aerospace, defense, healthcare, and energy infrastructure as well as across all the geographies. Again, an indication that we are in the cyclical upturn.

At the same time, for us, we've talked about this in multiple quarters. Our channel inventories continue to be very lean, and we believe end demand is still double digits below consumption.

Now we are going to start seeing some catch-up to the end demand in the fourth quarter. As I mentioned in my prepared remarks, we did see the channel inventory weeks tick down a little bit as the end demand was a bit higher than we had planned.

So on top of that, as we look forward, we are continuing to see green shoots across aerospace and defense and ATE. And so we feel pretty good about where we are both near and long term from an industrial perspective.

Operator

Harlan Sur, JPMorgan.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Great job on the quarterly execution. Look like you guys had anticipated last earnings call gross margins for Q3 to be closer to 70%. But actually, actuals were actually closer to 69%. I assume it's because of the upside and the lower-margin communications business, which was up 17% sequentially.

So potentially, mix related. Is that a fair assumption? And then on Q4 at the midpoint of your guidance range, are you guys assuming that gross margins are improving sequentially?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Yeah, so I'll take that one. So yes, we did have an implied increase in the margin. However, we did have an unexpected lower utilization during the quarter, which kept us from growing our gross margin on a sequential basis.

However, the utilization is back on track, and we expect it to resume its increase. And in Q4 at the midpoint, we do expect to get back to a 70% margin.

Had we not had the disruption in the utilization in the third quarter, we actually would have grown sequentially. But the mix piece as you mentioned, because we still are only at 45% industrial mix in the third quarter, would have kept us from fully getting to 70%.

Operator

Tore Svanberg, Stifel.

Tore Svanberg - *Stifel, Nicolaus & Company Inc - Analyst*

Congrats on the continuous recovery here. Vince, I had a question on the automation revenue. I think in the past, you've talked about this being a 15% grower, and that's certainly above the corporate average.

I'm just curious, given everything that you're seeing now in humanoids, in robotics, reference designs with some key GPU plays, and so on and so forth. Are you starting to see perhaps an acceleration to that 15% growth target going forward?

Vincent Roche - *Analog Devices Inc - Chairman of the Board, President, Chief Executive Officer*

So yeah, the automation business for ADI is multiple hundreds of millions of dollars on an annual basis. And it's our sense that by 2030, we can double the size of that business given the strength of the R&D pipeline, the opportunity pipeline that we have, as well as some of these new modalities that are coming into play.

As demographic and macro pressures lean on putting more and more manufacturing capability closer to points of consumption, there's obviously a security issue as well as supply chain security issues. So all those factors, I think exogenous and endogenous factors, point to a strong growth in that business.

Also, as I pointed out in the prepared remarks, we're seeing a lot of these sensing modalities come to bear. And every one of those sensors or actuators that our customers are putting in place require very precision -- very, very precise sensing, control, and data processing. So for all those reasons, we feel very optimistic about the state of this business and the potential to grow and double its size over the next five or six years.

Operator

Vivek Arya, Bank of America.

Vivek Arya - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

I think in response to a prior question, you mentioned that you're seeing green shoots in different parts of industrial, right, despite the strength that you saw in Q2 and Q3. Does it mean that as we potentially look out to Q1 -- is ADI still capable of growing at least seasonal or above seasonal? And if yes, what is normal range of seasonality so we can calibrate our models?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Vivek, I'll start. From a Q1 perspective, as we've said before, we don't guide to Q1, but we do expect that we'll be able to grow that seasonal. And obviously, for us, on an overall perspective, first quarter tends to seasonally be down in the low single digits.

Vincent Roche - *Analog Devices Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. So I think as we look into the new year, I believe industrial will be a very, very strong part of our momentum in the coming year.

And as Rich narrated in part of Q&A here, from just the supply-demand side of things, we're seeing still, customers are in digestion phase, their excess inventories -- and particularly in the broad market, which is a piece of -- has been a significant piece of the industrial business in the past where we're still seeing the demand there quite light.

So there's still a normalization to take place, which should boost the industrial sales in the coming quarters as well as our position with new products and our position with customers and new applications, so -- in the automation space.

So we've got aerospace and defense, which has been incredibly strong. In fact, in some ways, we're supply limited in that business. So I think that will be the bedrock of the next several quarters of the company's performance.

Operator

Jim Schneider, Goldman Sachs.

James Schneider, Ph.D. - *Goldman Sachs Group Inc - Analyst*

I was wondering if you could provide a little bit more color on what you're seeing in the automotive market. I believe last quarter, you referenced some pull in activity. Did you, in fact, see that occur in the quarter? And from -- if so, from what regions?

And then going forward, maybe talk a little bit about what's driving sequential decline you expect in the next quarter? And any color you can provide on regions or customer OEM types would be helpful.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So obviously, we continue to perform very well in automotive, particularly in our connectivity and power management doing auto revenue. As we said, we expect to record record levels of auto revenue for '25.

In addition to our content broken share gains in the next-gen ADAS and infotainment systems, we do believe our auto revenue has been aided by some order acceleration, which we talked about in Q2. We do think there was some additional acceleration in Q3.

However, we do see an unwinding in Q4, which is why we expect to see Q4 come down. We think that that will be the close out of that line. And this is what we actually talked about when we released our last quarter results was -- we expected that the pull-ins were likely going to come from our Q4 or Q1 period. Based on the way it's settling out, it looks like it's unwind in the fourth quarter.

And if you think about that somewhat just from a sizing perspective, in the current quarter, we were obviously above our high end of our guide. And I think largely, that part of the -- that we were above the high end of our guide was likely related to auto pull-ins.

And what's different this time actually is the auto pull-ins we saw at this time in Q3 were in China, whereas when we talk about them in Q2, that was for North America and Europe.

It's impossible for us to know how this will shake out. But we do think that given the behavior we've seen from our auto customers, EV credits expiring and a risk of tariffs could curtail production.

We are taking a bit of a more conservative view to automotive in the near term. But stepping back again, you'll have our third record year in Ottawa in the last four years, which is reflecting our content and share gains.

And we've talked about this before, we tend to outpace the SAAR volumes with content gains where we're getting about a double-digit benefit from share and content. So we feel really well positioned there as we go into the medium and long term.

Operator

Stacy Rasgon, Bernstein Research.

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

So on the auto points, and I guess relative to industrial. So I mean, you're guiding auto implicitly down 15% sequentially as those pull-ins ease. But industrial, you're guiding up. I don't know, you said low to mid-teens, which would put it up in the mid-30% year over year.

What are you seeing differently on the trend in industrial versus what you saw in auto that gives you confidence that the strength you're seeing industrial has not also pull forward?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So what we talked about last time was the indicators, Stacy, for what we thought were pulling where we saw unplanned growth in areas around -- and we saw the anomalous bookings behavior that happened around the tariff announcements; and in the ensuing reversals, things normalize.

We have not seen that behavior in industrial. In fact, the bookings trends have followed the trends we were expecting. It's impossible to say there isn't some minor amount maybe in any of the businesses, but we haven't seen anything outside of auto that would give us an indication as any meaningful pull-in in our business.

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

Industrial is well above seasonal, though. So I mean, is that just -- that's just increased demand in channel fill or what?

Vincent Roche - *Analog Devices Inc - Chairman of the Board, President, Chief Executive Officer*

It's nothing to do with channel. Channel is very lean. We're still under shipping real consumption of the market. Parts of industrial have been just an inventory digestion mode for actually a couple of years. So we're starting to get that behind us.

But if you look at the strength of our aerospace and defense business, I mentioned there a little while ago, we're actually supply line there; very, very strong backlog. ATE, which is supporting the build-out of AI chips and infrastructure, very, very strong, strong demand. And we've begun to see the recovery of the automation business in the -- over the last couple of two, three quarters.

When you couple that a while with healthcare, which has been really damped in terms of demand ever since the peak of the pandemic there, that should come good as well, and we're seeing signs of stabilization. But that should come good over the next few quarters.

So I think you pull that together, the breadth and the depth, the customer count, the product counts, some of the idiosyncratic trends that we've captured, as well as just the overall rising tide in demand across the board bodes well for the industrial business.

Operator

Chris Danely, Citi.

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Christopher Danely - *Citi Infrastructure Investments LLC - Analyst*

Can you just give us a little more color on why the utilization rates came down, and then where utilization rates are, where you expect them to go, and any other gross margin drivers going forward as well?

Vincent Roche - *Analog Devices Inc - Chairman of the Board, President, Chief Executive Officer*

I think we had, as Rich said, a one-time event in our European fab during the last quarter. That was the primary dampening effect on the gross margin. So it became an absorption issue.

I will say as well, pricing has been very, very steady. And as our mix improves on the industrial side of things, we get the benefit of that in the gross margin. And I don't expect a repeat of what was a one-time event in one of our factories in the last quarter to repeat.

Christopher Danely - *Citi Infrastructure Investments LLC - Analyst*

What are utilization rates now? .

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So I know you always like to ask me this question. They're increasing. We're not yet back to utilization levels we were obviously in the pandemic era, nor do we expect to get all the way there.

But we are continuing to increase, as I mentioned, other than this one-time hiccup, which is now behind us. We are back increasing as -- given the growth we're seeing and the planned starts in the factories, we're getting higher utilizations.

Vincent Roche - *Analog Devices Inc - Chairman of the Board, President, Chief Executive Officer*

I think as well, we have talked many, many times about the CapEx that we've deployed to strengthen the resiliency of the internal fabs at ADI. So we have built -- we've more than doubled the footprint of the internal fabs that support largely the industrial business.

So we're absorbing that cost. And as the industrial business continues to increase strength, that absorption strengthens as well. So I think you've got to bear those things in mind.

Operator

Joe Moore, Morgan Stanley.

Joseph Moore - *Morgan Stanley - Analyst*

A couple of minutes ago, you talked about seeing some supply limitations in aerospace and defense. And I wanted to just follow up on that and talk -- ask where those supply constraints might be coming from. And are you seeing any supply constraints in any other part of your industrial business as things get stronger? .

Vincent Roche *- Analog Devices Inc - Chairman of the Board, President, Chief Executive Officer*

No, I think -- we've just seen a tremendous upsurge in the man. It just takes time to lay in the capacity, the tooling in the aerospace and defense area. And it's a highly diversified business with an incredible array of product complexities. So it's really just the case of each quarter, we're laying in more capacity.

But the demand keeps interesting. It's a very, very high-quality problem that we have. Demand is surging ahead of our ability to manufacture right now. But we've been laying into CapEx, the tools to make sure that we capture the opportunity.

And pretty much everything we do there is sole sourced. I mean, these are proprietary products. And we see this -- we've increased our footprint with an internal factory that's very, very important to the manufacturing of our aerospace and defense solutions. So we've been tooling that facility as well.

So I think generally speaking, we're in better and better position. But really the problem, it's a high-quality problem of surging demand.

Richard Puccio *- Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Yeah. So I'll put a finer point on it for you, Joe. We're actually deploying tools into the aerospace and defense manufacturing in the third and fourth -- some in the third quarter and more in the fourth quarter to alleviate some of the stresses just described. And from an overall business perspective, we certainly have supply right now to cover all of the near-term demand that we have on the books.

Vincent Roche *- Analog Devices Inc - Chairman of the Board, President, Chief Executive Officer*

I think the rest of the industrial business is in good shape overall regarding supply.

Operator

Joshua Buchalter, TD Cowen.

Joshua Buchalter *- Cowen and Company LLC - Analyst*

Congrats on the good results. I apologize for being nitpicky in an objectively good quarter. I did want to ask about gross margins, though.

I think a couple of quarters ago, you had mentioned $2.7 billion being the level at which you hit 70% gross margin. It looks like that's seemingly around $3 billion. I guess -- can you maybe walk through what's changed and how we should think about follow through from here going forward?

Richard Puccio *- Analog Devices Inc - Chief Financial Officer, Executive Vice President*

And we have talked about this a lot, and I think that the part two of what we've said all along is getting to $2.7 billion and getting back to a 70% margin would require us to get back to a more normal industrial mix. So near term, as you saw, we're only 45% industrial. When we were building all those models, we were a much larger percentage. So we have said we would need to have that mix.

And obviously, the mix is shifting as the industrial grows. And if you look to our -- where we expect our Q4 to go with the industrial growth we've talked about, we will probably exit Q4 with more like a 49% industrial mix, which is part of the reason we think we'll get back into that 70% range in our fourth quarter. So it is -- as we talked at the beginning a little bit, it is also mix constrained given the industrial piece is our most profitable business.

Operator

Ross Seymore, Deutsche Bank.

Ross Seymore - *Deutsche Bank AG - Research Analyst*

Just wanted to pivot over to the OpEx side of things. Any color for your fiscal fourth quarter? And probably more importantly, as we look into fiscal '26, I know you guys have a big variable component to your OpEx. This year, it looks like it's up, I don't know, high teens and something like that in fiscal '25. Any color on how the FX would relate to revenues in fiscal '26?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So yeah. So from a fiscal '25 perspective, assuming the midpoint for Q4, we expect we'll deliver about 100 basis points of operating leverage versus '24, which I feel very good about.

Because when we started the year, knowing we were going to have a pretty significant headwind on the variable comp, we thought we might have a pretty flat operating leverage year. But we are going to deliver some additional leverage.

Now a lot of that is coming from the gross margin expansion, as we've talked about. Because of variable, our OpEx is growing at a higher rate than we would normally expect. And that is as we've talked about, right?

In the prior year, given our bonus pays on revenue growth and profitability and the fact that '24 had no revenue growth and margins were muted, bonus was very low, which was part of the reason we were able to hold our 40% operating margin in the trough year. Now with a return to significant growth, our variable comp is normalizing to a much higher level from a very low payout in the prior year.

So if you look forward to '26, I would expect that acceleration piece that we saw from the variable comp to decline. We obviously expect to have variable comp in a growth year. But given the new baseline of '26, we would expect in the revenue growth that we would get some continued leverage as the operating -- as the variable won't increase as radically as it did '24 to '25.

And excuse me -- obviously, all of these points of view are contingent on revenue growing, which we're assuming from a top line perspective.

Operator

Chris Caso, Wolfe Research.

Chris Caso - *Wolfe Research LLC - Analyst*

Just a question on business in China right now. And you mentioned in some of your earlier comments that China auto was strong last quarter. Could you give us some sense of what the totality of the China business look like? And again, in that case, even outside of auto, is there any fear of any pull forwards within that business or any anomalies that you may have seen within the China business in the last quarter?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Sure. So obviously, as we've talked about China, is a very competitive place for us. I continue to be very confident in our ability to win and to grow in China, which we've done for decades.

Now if you think about how we're positioned in the market, right, we tend to get a premium for our performance. And that's the innovation premium you've all heard me talk about. Where performance matters, they're going to continue to pick us, right, which is why we tend to get higher ASPs.

It also makes it very challenging for those that make products that are good enough to compete with us in that market. So we feel -- from a competitive perspective, we feel very well.

Obviously, the other thing for us is significant is scale is really important, especially in Analog with the broad base of components. We've got six decades of experience building that with 70,000 SKUs. It's really -- especially through an industrial given the diverse nature of that product.

As we've talked about now for a number of quarters, China has been leading our recovery, right? We've talked about achieving record auto results this year. We had record design wins in '24. We've continued growth in design wins in '25. And our outlook for China is pretty positive over the next three to five years based on the things we're seeing here.

Now it is interesting. We spent a lot of time talking about how strong China auto is. We've started to see year-over-year growth in China across all of the industrial end markets. But outside of auto, all of those other end markets are well off their prior peaks.

So north of 35% at least, and some of them are still 50% off their peaks. So we think there's still runway there for us from a medium and long-term perspective as that market continues to rebound.

Operator

I would now like to turn the call back over to Mr. Richard Puccio, for any closing remarks.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

All right. Thanks, everyone, for joining us this morning. And with that, a copy of this transcript will be available on our website, and all available reconciliations and additional information can also be found at the Quarterly Results section of our Investor Relations site at investor.analog.com. Thanks again for joining us and your continued interest in Analog Devices.

Operator

Thank you. This concludes today's Analog Devices conference call. You may now disconnect.
