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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 2023 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. Michael Lucarelli, Vice President of Investor Relations and FP&A. Sir, the floor is yours.

Michael C. Lucarelli - *Analog Devices, Inc. - VP, IR and FP&A*

Thank you, Michelle, and good morning, everybody. Thanks for joining our Third Quarter Fiscal '23 Conference Call. With me on the call today are ADI's CEO and Chair, Vincent Roche; and ADI's CFO, Prashanth Mahendra-Rajah. For anyone who missed the release, you can find it and relating financial schedules at investor.analog.com. on to the disclosures. 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 other 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 at the date of this call. We undertake no obligation to update these statements except as required by law. Our comments today will also include non-GAAP financial measures, which exclude special items.

We are 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.

And with that, I'll turn it over to ADI's CEO and Chair, Vincent Roche. Vince?

Vincent T. Roche - *Analog Devices, Inc. - CEO & Chair of the Board of Directors*

Thank you, Mike, and a very good morning to you all. ADI executed well in the third quarter and delivered results within our expectations despite the challenging operating environment. Revenue was nearly $3.1 billion, led by growth in our Industrial and Automotive markets once again. Gross margin remained strong, above 72%, operating margin was nearly 48% and EPS was $249 million. This continued profitability reflects our portfolio's resilience as well as the innovation premium that it commands. I want to turn to the current business environment now just for a moment. As we shared last quarter, we believe we're in a period of customer inventory reconciliation following 3 consecutive years of steady growth. Through our customer conversations, it's evident these accelerating inventory adjustments relate to the weakening macro backdrop and ADI's rapidly improving lead times.

Importantly, we believe we shipped below end market consumption in the third quarter and expect to do so again in the fourth. This will help normalize our customers' inventory more quickly and position us to return to growth more quickly in the coming quarters.

Stepping back, while near-term dynamics or turbulence, our long-term confidence remains undiminished. Over the last several decades, we have enhanced the resiliency of our global business, defined by our diversified customer and product portfolio and flexible hybrid manufacturing model. This enables us to ensure softer demand periods while sustaining strategic investments to ensure that we capitalize on the upside when the business inflects. It's these characteristics and our alignment to numerous concurrent secular growth trends that give us confidence that ADI will deliver on our long-term model of 7% to 10% revenue CAGR.

Now one area underpinning this growth outlook are the applications tied to sustainable use cases, which currently represents about 1/3 of our total revenue. And today, I want to unpack a vital part of this, the evolving electrification ecosystem that is driving growth in our industrial and automotive markets. As the world marches to net 0, we need to eliminate 51 gigatons of global greenhouse gases emitted every year. Fossil fuels are by far the largest contributor accounting for more than 75% of all emissions. And at the same time, global energy consumption is forecasted to increase by 50% by 2050. A major unnecessary energy transition is underway and an upgraded and expanded energy grid is foundational to support a decarbonization pathway.

Making the shift through renewable energy sources in both commercial and residential infrastructure as well as electric vehicles and global transportation will reduce greenhouse gas emissions. These moves also create new challenges in the generation distribution, consumption and smoothing of energy supply. ADI solutions are embedded across all phases of this electrification journey from upgrading the grid infrastructure to forming and managing the vehicle battery.

The common thread woven through all these applications is the high-performance precision signal processing, control and power management capabilities they require, capabilities in which ADI excels.

Now today, I'll bring the story to life at the application level, starting with grid infrastructure. Overall, today's electrical grid is undergoing modernization to meet current and future demands. Historically, traditional energy sources like coal, oil and gas were centralized and distributed in one direction from the grid to the consumer.

Today, renewable energy sources like wind and solar are more distributed necessitating a dynamic bidirectional flow of energy. To achieve this, the grid must be able to adjust performance across the network in real time, which requires an exponential increase in monitoring and storage capabilities. And for example, our collaboration with the Enel Group provides smart meters and grid digitalization solutions for distribution system operators.

Here, ADI's control and sensing technologies are enabling high-performance, precision monitoring and data creation at the heart of the digital substation. And we're leveraging our mixed-signal digital and algorithm technologies to enable greater intelligence at the grid's edge.

Now moving to energy storage systems, which are critical to mitigate intermittency issues across the network. ADI is a leader with our technologies used in 60% of energy storage systems across residential, commercial and grid scale networks. Leveraging our battery management system technology or BMS. We're increasing capacity and improving energy utilization in energy storage systems, which maximizes the battery's lifetime value. These monitoring and storage challenges extend to the grid's edge as well, including EV charging stations, ADI's energy metrology, isolation and sensing technologies, help enable a broader range of applications in AC and DC charging equipment.

In addition to these important applications in our highly diverse industrial segment, our high-performance signal processing platforms and domain expertise are helping to electrify the automotive market. Here, our technology is a key enabler in the transition from combustion engines to cleaner electric vehicles by increasing range and lowering cost. And I'll start with BMS.

As we've shared before, we are the leader in this area with our BMS solution designed into 16 of the top 20 EV manufacturers. We're currently sampling our eighth generation solution, which utilizes software and algorithms to enable physical measurement capabilities all the way into the battery cell. These advances in edge processing change the game in how the internal battery health is managed, supporting faster charging and better range prediction. An extension of this is our wireless BMS solution, a first in the industry. It has all the benefits of our wired solution and enables a scalable battery architecture, with quicker and more cost-effective production cycles.

Currently, our wireless BMS is designed in at 4 OEMs, and we expect another large OEM to adopt it in the coming quarters. Given this momentum and the cutting-edge value proposition, we believe the wireless platform will represent a large portion of our BMS revenue by the end of the decade. And looking ahead, we're broadening our EV capabilities beyond battery management and storage to power conversion solutions. Specifically, we're developing a silicon carbide-based smart switch for bidirectional onboard charging that significantly reduces charger size and weight by over 50%, thus driving down cost. Notably, this intelligent integrated switch enables the EV to transfer energy back into the network, creating a more reliable grid. And this innovation solution more than doubles our content opportunity per EV powertrain.

So in summary, ADI is driven by a deep sense of purpose and a desire for our innovations to positively impact all stakeholders. We're immensely proud of the role our technologies play to improve the well-being of humanity and indeed the planet, and I remain very confident in our future. Our portfolio of cutting-edge technologies, world-class talent base are aligned with an unprecedented number of attractive secular trends, where the semiconductor content per dollar of CapEx is increasing tremendously. This presents ADI with continued profitable growth opportunities as well as the ability to shape the future of industries.

And so with that, I'll hand it over to Prashanth.

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

Thank you, Vince. Let me add my welcome to our third quarter earnings call. My comments today, with the exception of revenue will be on an adjusted basis, which excludes special items outlined in today's press release. While demand continued to soften throughout the quarter, ADI delivered nearly $3.1 billion revenue, in line with our guidance. This was driven by continued year-over-year growth for both Industrial and Automotive.

Looking at our performance by end market. Industrial, which represented 53% of revenue, finished down 7% sequentially after a tremendous stretch of 13 straight quarters of sequential growth. On a year-over-year basis, revenue increased 4% with most applications up, led by sustainable energy as well as aerospace and defense, which each grew double digits. Automotive, which represented 24% of revenue, was down modestly sequentially in line with our expectations. Year-over-year growth of 15% was broad-based. We saw continued outsized growth for ADI's leading battery management and in-cabin connectivity solutions, which collectively increased nearly 30% year-over-year. Communications, which represented 12% of revenue, decreased double digits, both sequentially and year-over-year due to the broad-based inventory correction we flagged previously.

And lastly, consumer, which represented 10% of revenue came in stronger than expected, finishing up 15% sequentially, but down 21% year-over-year. We remain optimistic that our second quarter marked the bottom for this business despite the ongoing inventory correction.

And now on to the rest of the P&L. Gross margin of 72.2% remains industry-leading, but declined sequentially due to lower utilization and product mix. Operating expenses of $752 million were roughly flat year-over-year and up sequentially. This quarter's OpEx reflects the full impact of annual merit increases. Operating margin of 47.8% contracted 230 basis points year-over-year, roughly in line with the gross margin decline. Non-op expenses were $57 million, and our tax rate was 11.2%. All told, EPS came in at $2.49 within our guidance range.

Moving to the balance sheet. We ended the quarter with over $1.1 billion of cash and a net leverage ratio of 0.8. Given the revenue pressures and our decision to hold more finished goods versus restocking the channel, inventory dollars increased and the days of inventory moved higher to 179. As a result, channel inventory remains below our target level and slightly declined. Specifically, we strategically undershipped Asia, especially China, due to weaker demand trends. CapEx was $325 million for the quarter as we invest to enhance ADI's global resiliency and offer our customers options on where their products are sourced. 2023 should represent the high watermark for CapEx, and we expect it to decline in 2024.

Importantly, our investments do not include the benefits of tax credit and grant funds that we anticipate from both the U.S. and the European Chips Act. Over the trailing 12 months, we've generated $3.7 billion of free cash flow or 29% of revenue. And over the same period, we've returned nearly $5 billion to shareholders or over 130% of free cash flow via more than $3.3 billion in buybacks and more than $1.6 billion in dividends.

Now turning to the Q4 guidance. We expect the fourth quarter revenue to be $2.7 billion, plus or minus $100 million. This outlook assumes sell-in to be below sell-through. At the midpoint of our outlook, we expect all markets to be down sequentially given the broad-based inventory correction. On a relative basis, Auto and Consumer should perform a bit better than Industrial and Comms.

Operating margin is expected to be 44% plus or minus 70 basis points. This margin outlook embeds planned utilization reductions and a decline in OpEx. Our tax rate is expected to be between 11% and 13%. And based on these inputs, adjusted EPS is expected to be $2 plus or minus $0.10.

As our outlook is lower than expected, let me provide some context on what we're experiencing and how we will navigate. Our revenue outlook reflects the broad-based macro softness across all end markets, all geographies and customers both large and small. We are also strategically improving lead times to get a better view into demand and enhance customer satisfaction. Today, we're shipping over 85% of our products within 13 weeks, and this is up from 35% a year ago. As Vince mentioned, we are seeing customers accelerate inventory adjustments due to both the softer environment and our lead time improvements. And as such, we're taking measures to preserve the integrity of our balance sheet, cash flow and income statement. This includes further reducing utilization and lowering external wafer purchases with a goal to decrease inventory meaningfully in the coming quarters.

And importantly, as we've outlined before, we expect gross margins will maintain a 70% level on a trailing 12-month basis. This gross margin resiliency is a testament to the flexibility of our hybrid manufacturing model and our unique swing capacity capability.

In addition to the naturally lower variable comp, we're also taking steps to reduce total OpEx by roughly $50 million sequentially. So stepping back, we're not ready to call the bottom yet but our history shows that we cycle up quickly. And when we do, we will achieve higher highs. ADI has built a very resilient business, rich with opportunities. Our diversification and exposure to numerous secular trends drives our durable earnings stream and solid free cash flow, enabling us to consistently return capital to shareholders. And to that end, over the trailing 12 months, we've returned $5 billion to shareholders or more than 5% of our market cap.

As this is my last ADI earnings call, I'd like to give a quick thank you to Vince for his mentorship and counsel over the past 6 years to the ADI Board, including our audit chair, Karen Golz, for their unwavering support and most importantly, to the world-class finance staff, including young Mike here for always reminding us of our commitments to you, the company's owners. I look forward to seeing many of you in the coming weeks as we get on the road. Mike, let's go to Q&A.

Michael C. Lucarelli - *Analog Devices, Inc. - VP, IR and FP&A*

Thanks, Prashanth. I don't think I've been called young in some time, but I appreciate that. Now let's get to our Q&A session. We ask to limit yourself to 1 question in order to allow for additional participants on the call this morning. You have a follow-up question, please requeue and we'll take your question if time allows. With that, can be our first question, please.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first question comes from Tore Svanberg with Stifel.

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

I have a question for Vince. So I know you're not ready to call a bottom. But some industry observers would say that this sort of inventory build started maybe late 2021, early 2022 based on your guidance for the October quarter, you're sort of back to that level. So then you've seen these cycles, you've seen many of them. They're all different. But just wanted to get a sense for you what you think we're getting close, especially given what I just said about that inventory adjustment now sort of being complete?

Vincent T. Roche - *Analog Devices, Inc. - CEO & Chair of the Board of Directors*

Yes. Thanks, Tore. When I look at this current cycle, the symptoms are always the same in these cycles, but the causes tend to have different components. And I think right now, there are 2 kind of inputs to this particular correction. I think one is the inventory in digestion that exists out there that has been building for 18, 24 months now. And the second, of course, is the macroeconomic situation, which is a major governor as well. But I think if you look at what we understand from the direct side of our business, for example, when we look at our largest customers revenue growth and their forecast compared to our growth at these very same customers, we believe that we've been shipping the low-end consumption in the third and will in the fourth quarter.

So I think one way to look at this is how long will the inventory correction take? My sense is it will be 2 to 3 quarters before we get through the inventory digestion cycle, and I think we're positioned as a company to get beyond it quite fast because we've been managing our factories very carefully, managing our inventories, both on our own balance sheet as well as our distribution channel. So we've also, I think, taken a long-term view to the demand patterns of our customers. We haven't, in any way, forced them into, for example, long-term supply agreements, essentially, at this point in the cycle, that will be forcing them to take products that they don't really need.

We've been managing our channel aggressively. So as I said, we're keeping more inventory on our own balance sheet. So again, we will get to distribute the supply ultimately where we think it's needed when the recovery gets underway here. So that's my sense, sorry. I mean, in the industry, if you look back to the dot com cycle, you look at the 2008 financial crisis cycle, most of the downturns tended to last 3 to 4 quarters. So my sense is over the next 2, 3 quarters, we begin to see a recovery here, at least on the inventory side. And then it's really a question of how does the macro-economy perform?

Operator

Our next question comes from Vivek Arya with Bank of America Securities.

Vivek Arya - *BofA Securities, Research Division - MD in Equity Research & Senior Semiconductor Analyst*

Best wishes again to Prashanth on his next adventure. You said that you're not ready to call the bottom yet and Vince, you mentioned that the inventory digestion period could last for some more time. How should we think about Q1 seasonality? It tends to be down kind of mid-single digit. Do you think we should be prepared for something different than that? right? And if it is worse than kind of mid-single digit, do you still think that ADI can maintain gross margins above 70%. So just kind of puts and takes to help us align our models would be very useful.

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

Why don't I take that, Vivek. So first, quick comments just to make sure everyone has the Q4 guide, correct. So on the channel, as I said in the prepared remarks, we are shipping in below the forecast we have from our channel partners. So we are intentionally bringing channel inventories down to help set us up for some better strength.

The -- included in the guide is the backlog coverage has some turns, but less than normal given the higher level of uncertainty. So we would need some more turns and positive book-to-bill, which Vince mentioned is likely to be a quarter or 2 out. And then just from an end market standpoint, we've got all end markets down quarter-over-quarter.

So as you know, we don't guide out further than the current quarter, but some color is I think you essentially have it right. There's no reason to think that first quarter would not be down seasonal on a, which would call it, mid-single digit quarter-over-quarter. But that we -- our view is going to be driven by the holidays and the customer decisions to reduce inventory as they go into the year-end.

So we're not, at this point, seeing a more meaningful step down in Q1 based on what we can know today. And I will just remember to plant and everyone as you start to model out Q1 that every once in a couple of years, we have a 14-week quarter, and that will be Q1 of '24.

And then on gross margins, I think we're actually quite proud of our gross margin story here that we've been -- we've messaged a number of times that we would have the ability to maintain a 70% gross margin in a -- on a trailing 12-month basis with a peak to trough decline of 15%. Q4 is down about 17% from the Q2 peak. And while we didn't give you a gross margin number, if you impute it from the OpEx math that I gave you, you'll see that we are able to hold that north of 70%, and we'll continue to work that. For Q1, gross margins, my best sense now would be that we are likely to face a little more challenge on the utilization level as we bring inventory levels down, but we have been very successful in activating our swing capacity.

We're actually doing about 10% better on utilizations because we have swing than if we hadn't activated it. So it's been a very powerful lever for us. And and we need to see how the math on all of that works out for Q1, but I wouldn't expect Q1 to be notably different from kind of where we are for Q4.

Vincent T. Roche - *Analog Devices, Inc. - CEO & Chair of the Board of Directors*

Yes. I'd like to add one other comment, Vivek, to what Prashanth has said. So the other side of margin is pricing, and pricing is very stable. It's very, very stable, resilient. I don't expect that to change. And our products are very, very sticky. We've got tremendous life cycles and that part of our business, this is really a unit correction in the business rather than price or share.

Operator

Our next question comes from Ambrish Srivastava with BMO.

Ambrish Srivastava - *BMO Capital Markets Equity Research - MD & Senior Semiconductors Research Analyst*

This is old Ambrish, Young Mike, can feel free to chime in. I was looking at the year-over-year comms, and I look at TI as your closest peer rival competitor. Vince, they started going into a year-over-year decline in 4Q '22 and you are just starting, and you said 2 to 3 quarters. So in the past history does suggest that usually on a year-over-year basis, we see roughly around 4 to 5 quarters of year decline. Is that the right way to think about your business? You said 2 to 3 quarters of digestion and I'm assuming that means year-over-year decline in reps, right?

Vincent T. Roche - *Analog Devices, Inc. - CEO & Chair of the Board of Directors*

Yes. Good question, Ambrish. So yes, look, I mean, Comms is just a piece of ADI's overall story. We've actually seen -- I mean, we have 2 components as well. We've got wire line, we have wireless. I would say on the wire line side of things, we've seen the malaise going back into the late part of '22, early part of '23. So that's really things like optical control for data center and carrier networks, and power. We've got a power business there as well. So we think we'll see that, we expect to see CapEx somewhat recover in that space to be able to catch up with the needs, for example, driven by the explosion in computing power that's required to handle the AI inflection here, for example. So -- my sense is the wire line part will probably start its recovery in the first -- second quarter of the year.

Wireless is a little harder to call. It's very, very dynamic. We all know that. The developed countries, particularly North America, 5G deployments, which have really been focused on coverage rather than capacity. They're going to be weaker than we thought. So that's probably going to give us headwinds for how long, we don't know, but I think it could be several quarters during our FY '24. India has been very strong this year, of course. And I think we're expecting to see more commitments to lay in both coverage and capacity in India during our FY '24.

So look, we've got leadership in many of these areas, like optical control systems, 5G, software-defined solutions. It's really a question of timing in my mind. But -- there's a lot of uncertainty in the communications market in totality and particularly in wireless at this point. So hopefully, that gives you the answer to your question.

Ambrish Srivastava - *BMO Capital Markets Equity Research - MD & Senior Semiconductors Research Analyst*

Well, I was asking about the overall business, Vince, not just about the Comms, sorry.

Vincent T. Roche - *Analog Devices, Inc. - CEO & Chair of the Board of Directors*

Okay. yes. Look, I think, Ambrish, the overall business. We see some trends, for example, that will transcend the inventory digestion problem. And even the macro-economy areas like digital healthcare, like aerospace and defense, the sustainable energy theme that we spoke to a little while ago. So again, I will just reiterate my sense is the inventory digestion problem will last probably 2, 3 quarters, and then we'll get back into a unit volume increase from there on.

Operator

Our next question comes from Stacy Rasgon with Bernstein.

Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Prashanth, I don't want to be pedantic on Q1, but I know you said right now, down seasonal, but also as an extra week. That extra week, if I just linearize it is like a plus 7. So do those cancel out? Or is it like it's the week between Christmas and New Year, so it's not a lot of revenue? Or just how do I think about the balance of those 2 things into Q1, assuming a Q1 that was...

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

So when I gave you my comments of down seasonal that was on a 13-week basis, the 14-week was just a reminder as you model it. So Mike, do you want to do the math, but I think you're essentially thinking about it right.

Michael C. Lucarelli - *Analog Devices, Inc. - VP, IR and FP&A*

Yes. So as Prashanth said, let's take a first 13-week quarter. What happens normally in 1Q and a 13-week quarter our business is down, call it, 5%, plus or minus, total business. Now with an extra week, that adds about 7.5%, both on the revenue side and the OpEx side. So there's 2 pieces, normal, down 5% total company, in the 14-week quarter, you can add 7.5% of revenue and OpEx. That's the best way to think about it.

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

And thank you for clarifying that, Stacy, I wasn't clear in my answer.

Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Okay. And then that would drop off into Q2, though, you go the other way in Q2. So Q2 under like normal circumstances would be worse than seasonal because you have that extra week drop off?

Michael C. Lucarelli - *Analog Devices, Inc. - VP, IR and FP&A*

Yes. So again, you can parse it in normal times, 2Q is up, call it, 2% to 5% and a 13-week to [13-week] quarter, if you take away an extra week, yes, you have a 7.5% headwind. They have got 1Q.

Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Got it. Okay. That's helpful. I have another one, but I guess I don't want to get that band next time, so I....

Michael C. Lucarelli - *Analog Devices, Inc. - VP, IR and FP&A*

I'll allow another question because that's a good clarifying question, Stacy.

Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Okay. I just wanted to ask about OpEx into next year. So it sounds like you're guiding it to about $700 million in the Q4. How do I think about it next year into a revenue year that's likely to be down potentially reasonably materially. Like how should we think about OpEx just year-over-year for fiscal '24 versus '23?

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

Yes. I think, Stacy, as we've always said, we run this business for the long term. So we're going to make the adjustments that are prudent to make on the discretionary side, adjusting the variable comp and where we can, but the value of this company comes from its innovation. So I wouldn't expect meaningfully more attack on the spending into 2024. But remember that our variable comp is designed to be highly accordion. So if '24 plays out as a down year, you will see that meaningfully unwind for us. Anything else...

Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Is that $700 million runway Mike, is that like the right run rate to think about?

Michael C. Lucarelli - *Analog Devices, Inc. - VP, IR and FP&A*

That's not a crazy level to think about for the year. I think if you take a step back and look at kind of what we're trying to manage within our control. We talked about gross margin maintaining at 70% a trailing 12-month basis. So for the full year, I think we can do 70% gross margins, and our goal is to maintain our operating margins within our long-term target and the low end of that account 42% to 45%. So that's kind of some guardrails we think about as you're modeling out next year and what would be a down year for revenue.

Operator

Our next question comes from Chris Danely with Citi.

Christopher Brett Danely - *Citigroup Inc., Research Division - MD & Analyst*

Congrats Prashanth on retirement. I wish I was joining you. I just had a question on the Auto end market. So you're saying that you expect it to do, I guess, better relatively than Industrial. Given how much inventory has been built there, and the upcoming UAW strike, do you think it's possible that Auto could get materially worse? Are you baking that into any kind of forecast? And then are you I guess, Auto supply chain customers talking about a potential strike and the impact on their inventory.

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

Yes. All right. So thank you for the question. Chris, I think we're going to see you in a couple of weeks in New York. So on Auto, I guess some context first, we've grown for 12 consecutive quarters year-over-year. And including the fourth quarter, we're going to be up again. We said in the prepared comments that the lead times and the confidence supply is driving some of that acceleration in inventory adjustments and that's happening across all our markets. When we look specifically at Auto in the quarter and our growth rates there, the same strong growers, BMS, GMSL, A2B. They grew in the third quarter and both on a sequential basis and year-over-year. We expect kind of the similar strength from them into the fourth quarter.

So I think that our outlook is, as Vince said, is really end market units driven and we have not yet put in a number nor have we received indicators from our supply chain partners that we should be making adjustments based on any disruption that could come from the negotiations that are going on right now.

Vincent T. Roche - *Analog Devices, Inc. - CEO & Chair of the Board of Directors*

Yes. I think one other thing, Chris, to note is that, in general, there's more and more silicon value in cars every year, and that's true of ADI. We've got the switch to the electrification, which is, again, in pretty much the early stages of adoption. So there are some great growth drivers that will somewhat transcend the malaise, the economic malaise. But we still expect, overall, as Prashanth said, we've got many growth drivers that Automotive will continue to be the one of the better growth areas for ADI for the foreseeable future.

Operator

Our next question comes from Harlan Sur with JPMorgan.

Harlan L. Sur - *JPMorgan Chase & Co, Research Division - Executive Director and Head of U.S. Semiconductor & Semiconductor Capital Equipment*

Sorry about that. So in Q3, disti was down, was about 62% of sales. It was down about 4.5% sequentially. So that's less than the total business. Shipments to our direct customers came down around 8%. So maybe you guys can just discuss the shipments and excess inventory dynamics around both for Q3 and here in Q4. Is the excess inventory situation a little bit more pronounced than direct customers? And maybe similar to your disti customers where you have systems in place to monitor sell-through? Like how do you monitor the levels of sell-through and inventories at your direct customers?

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

Yes. Great. Okay. So let's do a couple of pieces on that. First, as a reminder, for a distribution company to do business with ADI, you have to give us your sell-through data on a weekly basis in arrears via electronic data feed. So we know exactly where our distribution guys are doing business, and we use that to run the company, as Vince always said, we run it on a POS basis. We said in the third sorry, in the second quarter earnings call, we said that we had gotten a little ahead of ourselves in China and that we intended to undership China. In the third quarter, we have done that. We are now intending to undership all markets generally in the fourth quarter to continue to bring the channel level inventories down.

We have limited direct data visibility into our end customers inventory levels, except for those customers where we have consignment. But what we do have is the which you don't have access to is we can see the sales data of our products into our broad set of (inaudible) external customers and their corresponding revenue growth. And our team builds correlation data based on that to tell us how we're doing versus how their growth is. And that's what Vince was referring to that we have seen that their growth is accelerating versus our growth to them, which is why we have confidence that we are undershipping their end market demand, allowing them to pull inventory levels down, which, of course, it is safe to do so because now we can get our products to them within 13 weeks.

Michael C. Lucarelli - *Analog Devices, Inc. - VP, IR and FP&A*

Yes. Prashanth that's a great point you made the less lead times is the best indicator of what our customers' inventory levels need to be. if a customer can get product quick, they need to hold a little less inventory. So our lead time is improving is helping us give us better visibility into what the customers need to hold and what they're holding.

Vincent T. Roche - *Analog Devices, Inc. - CEO & Chair of the Board of Directors*

Yes. I think Prashanth said earlier, 85% of our total portfolio now is available in less than 13 weeks. Big, big change since this time last year.

Operator

Our next question comes from Toshiya Hari with Goldman Sachs.

Toshiya Hari - *Goldman Sachs Group, Inc., Research Division - MD*

I had 2 quick ones, if I may. One on pricing. Vince, you mentioned that in the near term, it's more of a unit correction as opposed to a correction in pricing, which makes sense. To the extent foundry pricing improves into 2024, would you be in a position to share that sort of cost down, if you will, with customers the same way you've sort of passed on higher costs over the past couple of years?

And then a second quick one for Prashanth. DOI 179, I think that's up, call it, 50, 60 days vis-a-vis pre-pandemic. How should we think about the new normal going forward? And how quickly can you get there?

Vincent T. Roche - *Analog Devices, Inc. - CEO & Chair of the Board of Directors*

Sure. Let me answer the pricing piece first, Toshiya. There are really 2 parts to it. One is we have 75,000 product SKUs that are established and are the bedrock of the franchise of the ADI. They're very sticky. The product life cycles tend to be very, very strong. And they tend to be once they're designed and fairly price insensitive. And we're actually -- we're also, by the way, increasing the value of our products each year. We're managing the portfolio in terms of pricing. We're looking for elasticity, which is just a normal part of portfolio management. But -- we're also adding more value to the products that we're introducing to customers, the new products.

I think the benefit of lower costs will come at the design-in phase if we do get lower cost, which from our third-party which, by the way, I think, is very, very unlikely. So I think the message is pricing is stable and very, very franchise is very durable.

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

And I'll do the DOI one very quickly here, Toshi. So 179 days, balance sheet inventory grew call it, low single digits sequentially on a dollar basis. We have high confidence that we will exit Q1, taking out at least $100 million of inventory value. and the production plans are being oriented to allow us to do that. The days target, we have a model, but we've agreed that it is appropriate for the next CFO really to bless that model because they're going to own that and they need to kind of go through that map. So I can tell you that it's not going to be at 180 days, but I don't think we get back to 120 days. So we'll come back to you at some point on what that looks like.

Operator

Our last question comes from Josh Buchalter with TD Cowen.

Joshua Louis Buchalter - *TD Cowen, Research Division - VP*

And Prashanth, congratulations on the great run. You mentioned a few times under shipping in the print and the guidance. I was hoping you could maybe quantify the extent or maybe provide any sort of guidance to the amount that you're under shipping? And then given it sounds like seasonal fiscal first quarter isn't off the table. Does that mean we kind of expect you could be shipping to end demand exiting the October quarter?

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

I'll let Mike take the second part of that question because I'm not sure I fully comprehended it. But on the first one, so we have our business that goes through the channel and the business that goes direct. Business through the channel, we have the demand forecast from our distribution guys, and we are under shipping into the channel to help them pull inventory levels in the channel down. We said that in the second quarter earnings call that we were going to do that for China. This quarter, we're going to do it across the globe for all distis.

Your second question on how to think about the under shipment into end demand that Vince referenced to. All I can really do is refer back to sort of the data analysis that we do. There's not a real way to aggregate that, except to say that we have a relatively good correlation between our end customers revenue growth and our growth to those end customers on an individual basis and when we look at how they grew in third quarter versus our shipments to them and how they're forecasting or you guys or consensus forecasting their fourth quarter growth versus our shipments to them, we know that we're going to be helping them to pull inventory levels down, which again makes tremendous sense because lead times have improved. And Mike, I didn't...

Michael C. Lucarelli - *Analog Devices, Inc. - VP, IR and FP&A*

Sure. on the first -- it's good question. If you look at the first quarter, we always typically undership consumption in the first quarter, why? You see a lot of our customers reduce their working capital going into end of the year-end. So the down 5% in our -- seeing the seasonal first quarter is below consumption. I think after that, you get back to kind of what Vince was saying you get coming back to demand and consumption, all kind of imbalance. And then it comes to a question of macro, what's happening in macro in our second quarter.

Thanks, everyone, for joining us this morning. We once again will be on the road a lot this quarter. You'll find us in New York, Chicago, Florida, London and San Fran. Reach out to IR team to be notified when we are in your ZIP code. And with that, thanks for joining us and the interest in ADI.

Operator

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