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ADI.OQ - Q2 2022 Analog Devices Inc Earnings Call

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OVERVIEW:

Co. reported 2Q22 revenue of $2.97b and adjusted EPS of $2.40. Expects 3Q22 revenue to be $3.05b plus or minus $100m and adjusted EPS to be $2.42 plus or minus $0.10.

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PRESENTATION

Operator

Good morning, and welcome to the Analog Devices Second Quarter Fiscal Year 2022 Earnings Conference Call, which is being audio webcast via telephone and over the web. I would like to now introduce your host for today's call, Mr. Michael Lucarelli, Vice President of Investor Relations. Sir, the floor is yours.

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

Thank you, Katrina, and good morning, everybody. Thanks for joining our second quarter fiscal 2022 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 related 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 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 as of 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. When comparing our results to our historical performance, special items are also excluded from prior periods. Reconciliation of these non-GAAP measures to the most directly comparable GAAP measures and additional information about our non-GAAP measures are also 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. Well, I'm very pleased to report that ADI delivered another quarter of record revenue, profitability and earnings, driven by continued insatiable demand for our products, strong operational execution and accelerated synergy capture.

Moreover, amidst a dynamic macro environment, we're operating from a position of remarkable strength, supported by our record backlog, robust bookings and ongoing capacity expansions, which position us favorably as we enter the second half.

Now moving to a summary of our results. Revenue was $2.97 billion, above the high end of our outlook and up 28% year-over-year on a pro forma basis. Strength was broad-based with all segments up double digits year-over-year. Impressively, adjusted gross margin expanded to 74% and operating margin to 50%. Adjusted EPS was $2.40, exceeding the high end of outlook and increasing over 50% from the year ago period.

Overall, I'm very excited with our performance and our team's outstanding execution. Today, I'd like to reinforce what we shared at our Investor Day around how our markets are evolving and how we're investing to solve more of our customers' problems while also improving on our business model that's both rich with growth opportunities and, indeed, resiliency.

The next wave in the evolution of the ICT sector is the nascent intelligent edge revolution. It will be characterized by ubiquitous sensing, hyperscale computing and pervasive connectivity, pushing processing and intelligence closer to the edge. Semiconductors are the bedrock enabling this next wave. And ADI, where data is born, is at the center of this revolution.

At our core, we're an innovation-driven enterprise. Over the last decade, through both robust organic investments and strategic M&A, we've built the industry's broadest and highest performance analog, mixed signal and power portfolio. Our offerings span from microwave to bits, nanowatts to kilowatts, sensor to cloud and increasingly, from components to subsystems. Our vast arsenal of technologies, along with the deep level of engagement and support we provide our customers, has earned us the #1 positions in analog, mixed signal, RF and high-performance power.

This, coupled with our focus on customer success, awards ADI with an innovation premium that is reflected in our ASPs that are more than 3x the industry average and also industry-leading gross margins. The growing scope of our customers' products is dramatically expanding in complexity and pressuring their product development teams and innovation cycles. To meet these challenges and deliver the next wave of disruptive innovations, we're investing over $1.6 billion in R&D annually. These investments strengthen our broad market franchise and enable us to expand our SAM and vertical applications where more complete solutions are necessary. We achieve this by integrating our core analog technologies with increasing levels of digital algorithms and software.

Now let's look at how our technology is intersecting with our markets. Industries like transportation, energy, telecoms, manufacturing and health care are prioritizing digitalization. This is driving new generations of applications and fueling a host of concurrent secular growth trends, and I'd like to touch on just a few now.

Starting with automotive. Here, ADI is the market leader in battery management systems, for example, for EVs. Our battery management systems, or BMS, solutions offer customers the highest levels of accuracy, reliability, safety and security. Our wireless BMS solution offers all the benefits of wired but also enables rapid battery pack configurability and cost-effective scaling of our customers' EV fleets. This innovative solution continues to gain traction in the market and adds to our content per system by up to 2x.

Moving to communications, where ADI is the market leader in radio signal chains for 5G with a majority share across the ecosystem. Our latest generation transceiver includes a fully integrated digital front end and grows our SAM by 2x. This innovative radio architecture reduces system cost and waste and improves power efficiency. Further, the flexibility of these software-defined solutions allows them to be used across traditional 5G networks as well as in emerging Open RAN and LEO satellite networks.

Lastly, health care. We have a #1 position with dominant share in medical imaging, for example. Subsystems like our photons-to-bits module are used by the top CT players in the world. Our solution delivers the highest-fidelity images while decreasing radiation dosage. And in the process, it allows us to capture 4x the SAM compared to offering just components alone.

In addition to expanding our innovation edge across these secular trends to amplify growth, the Maxim combination creates a $1 billion revenue synergy opportunity for us over the next 5 years. The first opportunity arises from customer cross-selling, leveraging our complementary relationships to pull through our extended portfolio. Second is fusing together the new product road maps of these 2 premier Analog portfolios to push the boundaries of what's possible. And third is power management. Here, the combination with Maxim increases our breadth of power capabilities, creates a more cost competitive portfolio and adds to our engineering talent pool. As a result, we unlocked $4 billion of additional power SAM and look to double our power revenue in the years ahead.

The proliferation of the intelligent edge and our revenue synergy opportunity gives me great confidence that we can bend the growth curve upwards, moving from our historical mid-single-digit growth rate to our new model of 7% to 10%.

Now I'd like to speak a little to the unique resiliency of our business. The diversity of our portfolio is a source of great strength. We ship 75,000 product SKUs, which support thousands of applications to over 125,000 customers. Notably, 80% of our revenue is derived from products that individually contribute no more than 0.1% of total revenue. And the longevity of our products is unmatched. On average, our products have life spans of a decade or more, effectively delivering recurring revenue streams for decades. It's these characteristics that create a high barrier to entry and an enduring business model.

Finally, we utilize a geographically diverse hybrid manufacturing strategy to tame the complexity and fragmentation of the analog market. This strategy provides us with a broad array of technology and packaging necessary to create innovative solutions from 7 nanometers to 7 micrometers. At the same time, this model creates a diverse network of internal and external partners to best manage our operations through economic cycles.

As we mentioned at our Investor Day, we're investing in our internal manufacturing operations to build a more robust and cost-effective model. To that end, we're doubling the capacity of our internal factories and adding significant capital to our product test operations. These investments will grow our output this year and into 2023 and increase our swing capacity across our network to over 70% of revenue.

So in closing, ADI is a leader in innovating at the edge, and I believe that our best days are still ahead of us as we drive increased value for our customers, shareholders and society. And with that, I'm going to pass it over to Prashanth, who will take you through the financial detail.

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

Thank you, Vince. Let me add my welcome to our second quarter earnings call. It was great to see and hear from so many of you at our Investor Day last month, and it was also exciting to welcome so many of our customers to demonstrate our technologies in action.

As usual, my comments today, with the exception of revenue, will be on an adjusted basis, which excludes special items outlined in today's press release. We printed another very impressive quarter with record revenue, profitability and earnings. These strong results reflect increasing demand for our highly differentiated products aligned to multiple secular trends as well as our ability to leverage our hybrid manufacturing model, offset inflation and accelerate synergy capture.

Second quarter revenue of $2.97 billion finished above the high end of our outlook, with every B2B end market exceeding initial expectations. This marks our fifth consecutive quarter of record revenue and our ninth straight sequential growth period.

So let's look at the performance by end market. Industrial, our most diverse and profitable end market, represented 51% of revenue and hit another all-time high. We experienced broad-based growth with digital health care, automation, instrumentation and test leading the way, underscoring increasing content and our strong position in these secular markets. Industrial has now grown more than 20% year-over-year for 6 straight quarters.

Automotive, which represented 21% of revenue, also achieved another record with all applications growing double digits year-over-year. In BMS, where we hold the #1 position, our quarterly revenue eclipsed $100 million for the first time. We expect strong growth to persist, given the momentum in the market and our continued design wins. Additionally, our A2B and GMSL solutions, which together make up roughly 20% of automotive, continued on their secular growth path fueled by the digitalization of the automobile.

Communications represented 16% of revenue with robust broad-based growth. In wireless, we experienced growing demand across our RF portfolio as 5G deployments, particularly in North America, gained momentum. ADI's latest generation transceiver, which Vince spoke to, is ideally positioned to capitalize on the virtualization trend. In wireline, demand for our optical and power products remained strong as carriers and hyperscalers invest to meet the ever-growing demand for bandwidth. And lastly, consumer represented 12% of revenue and has now grown year-over-year for 6 straight quarters. This consistent growth is a function of our product and customer breadth, which better insulates us from the typical fluctuations associated with PCs and portable devices.

Now on to the P&L. Gross margin was a record 74.2%, increasing 230 basis points sequentially and 330 basis points year-over-year. Favorable product mix, high utilization and revenue growth and synergy fall-through were key drivers of the increase. OpEx in the quarter was $710 million, better than anticipated, owing to faster synergy execution. Record operating margins of 50.3% grew 450 basis points sequentially and 860 basis points year-over-year. At the end of the second quarter, we've realized over $250 million of cost synergies. We look to quickly achieve the remaining synergies and hit our recently increased target of $400 million in savings exiting fiscal '23.

Non-op expenses were $41 million and the tax rate for the quarter was 13.2%. All told, adjusted EPS came in at a record $2.40, up more than 50% versus the second quarter 2021.

And now on to the balance sheet. We ended the quarter with approximately $1.7 billion of cash and equivalents. Days of inventory increased sequentially to 122 and channel inventory remains below the low end of our 7- to 8-week target. If we look at cash flow, CapEx for the quarter was $119 million and $447 million over the trailing 12 months or 5% of revenue. To support our accelerated 7% to 10% long-term revenue growth outlook, we are strategically investing to expand internal capacity while enhancing the resiliency of our hybrid model. To that end, as we stated at Investor Day, we expect CapEx as a percentage of revenue to be in the high single digits during fiscal '22 and '23 before reverting back to 4% to 6% over the long term.

And over the trailing 12 months, we generated $3.2 billion of free cash flow or 33% of revenue. Included in our free cash flow are onetime transaction-related costs amounting to about 3% of revenue. Given the recent market weakness, we accelerated our repo activity to $776 million during the second quarter. This brings our total share repurchase to approximately $3.5 billion since the close of Maxim. And we look to maintain this accelerated buyback pace this quarter and achieve our $5 billion commitment by the end of our fiscal year. As a reminder, we target 100% free cash flow return. We will allocate 40% to 60% of our free cash flow to support a 10% dividend CAGR throughout the cycle, with the remaining cash used for buybacks to reduce share count annually.

And now on to the outlook for third quarter. Revenue is expected to be $3.05 billion, plus or minus $100 million. We expect all end markets to grow sequentially. Given our higher-than-normal annual merit increase, operating margin is expected to be 49.5%, plus or minus 70 bps. And our tax rate is expected to be between 13% and 14%. Based on these inputs, adjusted EPS is expected to be $2.42, plus or minus $0.10. While we are very mindful of the current economic trends, our demand indicators remain very strong and our customer conversations remain upbeat, giving us confidence for continued growth for the remainder of 2022 and likely into 2023.

Importantly, as a result of our vast diversification, leadership in numerous secular growth markets, additional synergies and our resilient hybrid manufacturing model, we believe ADI has never been better positioned to transcend cyclical downturns and accelerate long-term growth. Let me now give it back to Mike to start the Q&A.

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

Thanks, Prashanth. Let's get to our Q&A session. (Operator Instructions) With that, Katrina, can we have our first question, please?

QUESTIONS AND ANSWERS

Operator

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

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

Congratulations on all the record results, especially on that 50% operating margin. My question is for Vince. Vince, towards the end of your remarks, you talked about growing output to increase swing capacity to 70% of revenues. Could you perhaps elaborate a little bit on that? And what is sort of the time line exactly for when you would hit that number?

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

Yes. So as you know, Tore, we've been investing in our internal semiconductor manufacturing operations from 0.18 micron upwards, and we're doubling the output there over the next year or thereabouts, a year or 15 months. And of course, we cross-license technologies with some of our foundry partners. So when we talk about a 70% swing, it means that because we will have cross-qualified so many process technologies between ADI internal fabs and the external fabs that are controlled by our foundry partners, we got the ability to move utilization, if you like, from one place to another, depending on what part of the cycle we're in, in terms of managing utilization inside ADI and being able to meet the demand as it surges or declines.

Operator

And your next question is from Stacy Rasgon with Bernstein Research.

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

I wanted to ask about the gross margins. You mentioned a bunch of drivers, but you actually didn't mention pricing at all in your outlook there for the driver side. I mean, what impacts has pricing had either to offset inflation or to potentially reprice the Maxim portfolio after the closure? And I guess, how do we think about the forward gross margin trajectory at these current, like, revenue levels? I mean, is there room for it to even go up from here, assuming the revenue levels kind of stay on the current trajectory?

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

Thank you for the question. So as you know, we, along with the rest of the industry, has been passing along the higher costs. We have been very focused on not using this environment to take advantage of our customers but to really maintain our gross margins. So in '21, we had some headwind from the timing of inflation versus when we were able to enact the pricings. This has really abated in '22. So really, the gross margin percentage and the growth in gross margin percentage that you see is really being driven, as I mentioned, by the synergies, great utilization at the internal fabs and some mix benefits. I think in my prepared remarks, I talked about industrial hitting 51% of the overall revenue mix.

So for the forward look, we updated our model just a couple of weeks back, and we feel very comfortable that in a typical cycle trough, we are going to be able to maintain a 70% floor. Beyond that, we will continue to make the right trade-offs with opportunities to expand the top line and -- at some trade-off on gross margin. So really, the focus for the team is deliver the revenue growth and let that leverage drive all the way down through cash flow. So I wouldn't encourage folks to look for significant margin expansion. These are already pretty incredible numbers.

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

If the revenues kind of stay at this trajectory, can at least the gross margins stay where they are or will they just fluctuate around? Will like mix be the biggest driver from here?

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

Yes, that's the right way to think about it, yes.

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

He's right. If you look at our gross margins at this point going forward, it's mix, utilization and then we also have the $125 million of synergies, some of that will be on the cost of goods sold side. As Prashanth laid out, we'll balance both gross margins really to drive operating margins and free cash flow.

Operator

And your next question is from Vivek Arya with Bank of America Securities.

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

Vince, I think you or Prashanth mentioned that industrial sales have grown over, I believe, it's over 25% for the last 6 quarters and seem like they could be strong for another 2 or 3 quarters. I'm curious, how do you think about the normalized growth rate? And what macro indicators do you look at to say this is what ADI's industrial growth should be? Like what are the early signals that you get to give you a sense whether you're over- or under-shipping end demand? Because from the outside, we look at all the turmoil in China, we look at all the turmoil in Europe, but then we look at this very strong industrial growth number and it gets harder to kind of reconcile, right, these 2 narratives. So give us a sense for how do you feel about specifically your industrial business right now?

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

Yes. Thanks, Vivek. So first and foremost, it's a highly diversified industrial business that we've been diligently investing in from an R&D perspective, from a customer engagement perspective over the last decade or 12 years with a renewed focus. We've been gaining share very, very clearly. I think our portfolio, particularly combined with the power activity as well from the LTC and Maxim acquisitions puts us in even better stead to capture more SAM essentially.

And to your question on growth, I would say that we -- during the Investor Day, we said that the new model is 7% to 10%. So I think industrial is going to be right in there somewhere over time. And we feel more confident now, I think, about our industrial growth than we've ever done, just given the strength of the portfolio, the customer engagements and so on.

And in terms of the signals we watch, obviously, we have a lot of conversations with our customers. I personally have had a stream of conversations with many of our largest industrial customers over the last quarter. And I think what they're all trying to convey to us is that things are different. We're moving into a new industrial cycle, Industry 4.0, 5.0, IoT, or -- I beg your pardon, IT and OT, if you like, colliding in a new partnership for the future, driving a lot of new technologies. So that's one, obviously one stream of input we get. The other signals we look at, obviously, are the PMIs, the machine tool builders indexes and so on and so forth. So and I think the greatest source of insight for us is our own knowledge of the end applications coupled with our customers' insights.

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

Vivek, maybe I'll just add. I think I said it in the remarks, but to be clear to everyone, our growth in industrial was broad. All applications hit record results in '21 and are on track to hit another record in '22.

Operator

Your next question is from C.J. Muse with Evercore.

Christopher James Muse *- Evercore ISI Institutional Equities, Research Division - Senior MD, Head of Global Semiconductor Research & Senior Equity Research Analyst*

I guess a comment on my side. With these results, I'm surprised you didn't have Big Papi and Tom Brady at your Analyst Day. So next time. So to my question, your results are much better than your peers. Your B2B business, I think, up 11% versus your peers at mid-single digits. How do you think about the outperformance there? Is a part of that your ability to source incremental supply, market share gains, right mix? Would love to hear your thoughts there. And then as you think about the future going into the second half of this year and next, how does that inform your vision for continued outperformance?

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

Yes. Maybe I'll start and then hand to -- hand over to Vince. So on the tactical side, we are working on getting additional capacity both from our external partners as well as the investments we're making internally. So you'll see that continue to play out over the course of the year, which is why I mentioned in the prepared remarks, look for us to continue to grow sequentially through this year and likely at least into the early part of next year.

We talked about pricing that has been a little bit incremental to the revenue growth. So that's certainly a piece of it. And the demand has just been very broad-based. And again, I said it in my remarks but to be clear, we are seeing demand across all end markets and all geographies. It's very evenly spread in strength across all end applications. So we do feel, to Vince's remarks here, we do feel very well positioned and our technology is really starting to hit the sweet spot across all of our customers. And then maybe I'll pass here to Vince to add some more.

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

Maybe just a little bit of color on the markets, C.J., to try and answer your question. So we have so many vectors of growth now, for example, in industrial, where we're basically playing on all the high-end applications. And as I said, we've been tuning the R&D continuously, the customer engagement.

And if I just pick out health care as an example, that's beginning to get on to a $1 billion run rate now. It's been growing consistently for the last 7, 8 years in the -- at the double-digit level. Aerospace and defense, we see that actually, no matter what the cycle will be over the next few years, this is going to be an area of great strength for us.

And in the communications area, great position in 5G. But interestingly, our wireline and data center business now is on a par with the wireless sector in terms of revenue contribution. So it's kind of half-and-half. So we see that again as a source of strength, buttressed also by a lot of the technologies that Maxim are bringing to that wireline area.

Automotive, we have a great story on the in-cabin experience with A2B, road noise cancellation, premium sound systems being more and more deployed, electrification. We're on a [$100 million] a quarter run rate now, revenue run rate. And we have design-ins at virtually all the electric car companies at this point in time. So we see that on a trajectory to $1 billion-plus in the foreseeable future. So that's just some of the examples to complement what Prashanth has narrated as well in terms of the vectors of growth and the prosperity for the company.

Operator

Your next question is from Ambrish Srivastava from BMO.

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

I had a question on the cost synergies, Prashanth. How should we be modeling these on a go-forward basis? You said exiting fiscal '23, but what's the breakout? And then kind of related to that is when we're talking about gross margin, I was a little bit surprised that you said the inflationary pressure would be abating as we go into -- as we continue through this year. Did I catch that right? Because inflation, the headline numbers seem to be -- they haven't -- maybe they have peaked but definitely higher than where they were last year. So would love some color on that comment as well.

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

Yes. Thanks, Ambrish. Two good questions, and thanks for giving me the opportunity to clarify. So first, on synergies. We had talked, when we did the Maxim close, that we had some great learnings from LTC on how to get to synergies and that was to move fast and hard, and you're seeing us execute against that strategy. So we captured basically the entire $275 million that we originally committed to as we exited our second quarter. And that at Investor Day, we said we're raising that target to $400 million, and we'll hit that number coming out of -- or as we exit 2023.

That first $275 million was a little more tilted towards cost of goods, and the following piece will sort of be balanced between cost of goods and OpEx. So as you look forward, that's how to think about the balance of that. To your question on the comments I made, thank you for giving me a chance to clarify. We have used our pricing opportunities to maintain gross margin. So to be clear, we're not looking at pricing as an opportunity to expand gross margin but really as a way to offset. So when I said abate inflation, I meant versus the historical inflation that we had experienced in 2021. It took us a little bit longer to get those pricing actions in place. So now we have neutralized them and you see that benefit in the current year. And of course, if we do continue to see price increases -- sorry, cost increases in the coming quarters, expect us, like the rest of the industry, to respond by pushing those through.

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

So there's no artifact in the 74% that you reported this quarter for pricing? We should expect kind of that level on a go-forward basis, maybe bounce around based on mix and also the utilization rate?

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

Ambrish, this is Mike. Yes, as we had talked about earlier, going forward, that 74% will bounce around, like you said, mix and utilization, the 2 drivers. And then as Prashanth outlined, that $125 million does have a COGS element in it that will also help gross margins. But if we can go forward 74%, plus/minus, I feel pretty good about that.

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

With the caveat, again, I want to make it clear for everyone, with the caveat that we are focused on growth. So where it makes sense for us to be a little more flexible to drive top line, we will do that. So I wouldn't want folks getting too laser-focused on modeling in mid-70s on the gross margin. We've given you a floor and we will give the management team the flexibility they need to drive the top line.

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

Right. You've been very consistent about that.

Operator

Your next question is from Chris Danely with Citigroup.

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

So with all this talk on revenue growth, your forecasted sequential revenue growth for July is the slowest in a couple of years. Can you talk about why that's happening? And is that because of COVID shutdowns or something else? And then as part of that, with all this focus on increasing capacity, I would assume your capacity is growing faster than the 2% or 3% sequential revenue growth. So can we assume that the lead times are coming in this quarter as well?

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

Yes. So Chris, the sequential growth is constrained by capacity. But we've indicated that we will see sequential growth through the year. So look for a more meaningful change as we get past the third quarter, which we've been saying for a while. So if you look back at prior comments, we've been very clear that we've ordered the tools and the equipment. We know our position in the queue. We know when those are coming in, and they go to revenue generation fairly quickly. So we are maintaining our outlook that we will exit the year at a much higher run rate -- an even higher run rate than where we are now. And that is all driven by our ability to produce. And what was the second question?

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

Perfect. Thanks for the clarification.

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

Yes. Chris, I'll also add one thing. You're right, the sequential growth is, I'll call it, decelerating now. What happened in the first half of the year, we talked about -- we added pricing and that added to the growth. So we had volume and pricing in the first half of the year that's driving sequential. Pricing is really in the model now, now that the growth in the back half here on a sequential basis is really driven by capacity and volume. And if you zoom out and don't look at sequentials and look at year-over-year, we're growing our B2B business in our fiscal third quarter by over 20% year-over-year again. So it's a fantastic result, I think, and it shows the strength of this franchise.

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

Yes. I think we can give everyone the data point that on a sequential basis, think of it as 50-50. The growth is coming from pricing versus units. So that falls into the baseline sequentially as we go forward. The pricing falls into the baseline.

Operator

Your next question is from William Stein with Truist Securities.

William Stein - *Truist Securities, Inc., Research Division - MD*

I'll add my congratulations to the very strong revenue and profitability and the outlook as well. That was great. But despite all that good stuff, there's a few factors that investors are certainly concerned about potentially disrupting bookings and potentially revenue performance, of course, the war in Ukraine, the COVID shutdowns in China and raising rates.

But there's also a concern, maybe not as prominent, but -- that we've picked up on, which is customers adjusting orders, potentially canceling or pushing out because they're very challenged from a kitting perspective. You highlighted yourself that you're capacity constrained. Can you help us understand how those factors are affecting your business today and how you anticipate them playing out in your business over the next few quarters?

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

Yes. So I think, first and foremost, cancellations on ADI are very, very low. They're very muted. Customers -- we've been very equitable in terms of how we have moved our supply across the markets, across the geographies, across the customer sizes. And I think that still is in very, very good stead. So my sense is we have -- because of the equitable distribution of our goods, so to speak, we've got a better, more true read on demand. And I think what we're shipping reflects what is true demand, I think better than most, I believe, based on feedback I'm getting from customers. So I think those are the facts, cancellation's low, equitable distribution of goods. And we don't see any -- our backlog is still, actually during the last quarter, increased so demand continues to remain strong.

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

Yes. Just the numbers. Well, the book-to-bill is above 1 in the second quarter, and that was, again, by all end markets and geographies. Because of that, the backlog continued to grow. You asked specifically about China. So real quickly, that's about 20% of our revenue. And the lockdowns had some impact on customer production, but it was really more severe around logistics and the supply chain related to the greater Shanghai area.

Our China revenue was up quarter-over-quarter and year-over-year and no notable impacts to demand. Again, cancellation's normal, and as I mentioned, book-to-bill above 1 for China. So when our guide reflects that most customers are operating at relatively normal levels and we consider this dynamic, so we think that at least for the third quarter, it's going to be a negligible impact.

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

Yes. Just to add a little bit of color. Also, we have no internal manufacturing operations in China. And from a logistics standpoint as well, we have very, very modest operations also in China.

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

We'll go to our last question, please.

Operator

Our last question is from Toshiya Hari with Goldman Sachs.

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

Toshi, are you on? Toshi may be on mute. Do we have one more in the queue?

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

Do we have one more in the queue?

Operator

Our next question is from Gary Mobley with Wells Fargo Securities.

Gary Wade Mobley - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

I wanted to ask a follow-up question on backlog. I think you mentioned that based on the backlog and adding incremental supply, your expectation is for sequential revenue growth for at least maybe the next few quarters, maybe 3, maybe 4 quarters. Wondering to what extent have you stress tested your backlog to see, I guess, under the most bearish of circumstances, how that may trend if perhaps we see further deterioration in the economic backdrop and whatnot.

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

Yes. Gary, a fair question. The -- as Vince mentioned, we look at a number of external indicators. So we are mindful of what's happening in the macro environment. But as you mentioned, the conversations that he has with our customers continue to support their need for our products and that we are attached to the right secular driver. So I do want to clarify, you had said sequential growth for the next 3 to 4 quarters. I can't see out that far, Gary. I feel good about the next 2 to 3 quarters' sequential growth, but I'm not sure I want to go out further than that at this point.

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

Thanks, everyone, for joining us this morning. A copy of the transcript will be available on our website. Thanks again for joining the call and your continued interest in Analog Devices.

Operator

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