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EDITED TRANSCRIPT

ADI - Analog Devices, Inc. at Morningstar's Management Behind the Moat Conference

EVENT DATE/TIME: SEPTEMBER 18, 2014 / 4:20PM GMT



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PRESENTATION

Brian Collelo - Morningstar - Analyst

Hi, everyone. We'll get started now. I'm Brian Colello, hardware semiconductor analyst with Morningstar. With us today is Ali Husain, the Director of Investor Relations at Analog Devices. ADI is a \$16 billion market cap company, and a leader in the analog chip space.

The company pays out close to a 3% dividend today and has established a policy to pay out 80% of free cash flow over time. We assigned ADI with a wide economic moat based on its intangible assets and switching costs around its proprietary analog chip designs.

So Ali has a short presentation for us, and after that we'll go with Q&A and we'll turn it over to the audience. So Ali, thank you for joining us today.

Ali Husain - ADI - Director of IR

Good afternoon, everyone. So thanks for dropping by for the presentation. I promise I'll keep it short.

The requisite forward-looking statement supplied by our lawyers. Normally every earnings call, I'm the guy responsible for reading this, so thankfully I won't have to read it today.

So ADI, we're a \$3 billion a year high-performance analog semiconductor company. Our technology really focuses on bridging the gap between the real world of analog where we all live, and the world of digital, or what we call the world of processors. So every sensor that gets deployed out there in the world represents an opportunity for ADI to really bridge that gap between that sensor, and the processor.

So we're focused on sustainable innovation to drive profitable growth. To that end, we have been refocusing our business over the last few years, so just three or four years ago, consumer was a much larger piece of our business than it is today. And so we've really focused in on sustainable innovation, and for us that means focusing in on B2B space, and that means industrial, automotive, and communications infrastructure, which taken together, today account for about 88% of our total sales.

Now what that refocusing has done in the near term, it has impacted our total top line growth. If you look at the core business, industrial, automotive and comms, that's been growing quite nicely. But certainly when you defocus some areas that does impact your total growth rate.

Our sense now is that consumer is about 10% of our sales, so that's a good mix of business for ADI, and that the headwinds that we were facing from exiting some of these commodity areas within consumer are largely behind us.

So we have a diverse business in terms of our markets, our customers, and even in the regions that we operate. So for example, we sell over 20,000 SKUs to over 100,000 customers. There's no one customer that accounts for more than 2% or 3% of our total sales, and in the case of some of our largest industrial customers, we may actually be selling well over 1,000 SKUs to them. So a very diverse business.

In terms of cash generation, and return of cash to shareholders, our cash flow model is to generate free cash flow in the range of 28% to 32% of sales, and as Brian mentioned in the introduction, our goal is to return 80% of that cash flow to shareholders, largely in the form of dividends.



So a quick walk through here our industrial market, or our end markets, as you can see the industrial end market is the largest market for ADI, it accounts for about half our sales. You can see automotive and communications infrastructure also make up a good chunk of what we do.

Within industrial, you see it there, it's a large piece of the pie, it seems to be a big old monolith. It really isn't. When you bury down between that business, we have five different sub-segments within there, and probably 25 businesses beneath that level. So that's where we have our tens of thousands of customers, 20,000 parts that go towards servicing them. Industrial instrumentation and automation together make up about half of what we're doing in industrial today. And clearly the title says it all, 88% of revenue is now from the B2B space.

Now from a product or technology standpoint, 72% of our total sales are derived from two product categories where we lead the market, and as you can see here, converters and amplifiers are really, when you think conceptually about that bridge, from the sensor to the processor, converters and amplifiers really form the concrete blocks, as you might call them on that bridge between those two areas.

And really it forms a fantastic moat around their business, which is really the theme of our conference. We've been in business for 50 years, we've been working very hard to perfect this craft, where today I can stand in front of you in Chicago, and point out to you that well over 2/3 of our sales are coming from these wide moat areas.

Every sensor that gets deployed out there that captures a real-world signal represents an opportunity for ADI signal processing.

So this really crystallizes a lot of what we do at ADI. And I mentioned earlier the diversity of our business.

This is a chart showing our quarterly sales broken out by the year of product release. I know it's hard to tell, on the right-hand side it gets very small, but we are selling parts that we put out in the early 1970's, which is -- I don't want to date myself, but it's around the time I was born, probably similar to the folks in this room.

And so these products have very, very long life cycles, they generate a lot of cash. At the same time, you can see from this chart that we're constantly having to refill that pipeline. So approximately 1/4 of our sales are from new products, by that I mean products that we put out within the last five years.

Now the interesting thing about these products, they take several years to ramp, but when they do, as you can see from this chart, it's almost like a bond portfolio, where you put your innovation, it takes a while for the revenues to ramp, but when they do, they pay off for decades in certain cases here.

So over the past few years, as I mentioned earlier, we've been refocusing our business. Clearly this has impacted our overall growth rate, but if you look at ADI on a trailing 12-month basis here, on a five-year CAGR, our core business in the B2B area of industrial, auto, and comms, has grown compounded 9%. Similarly on a year over year basis, we've also grown 9%.

But as you can see, the top line has been impacted by our exit from the commodities area of consumer. I'd say we are only now really starting to see -- because what we ended up doing was taking those R&D dollars out of the consumer space and putting those R&D dollars into the industrial, auto and comm space, that have longer design cycles, that obviously pay off the nice revenue stream over the years that those products are out there. But we're now starting to see the benefits of those investments. The design cycles are long, we've been refocusing for the last three, four years, and we're now starting to see the revenues from that. So I think the best clearly is going to be yet to come here for ADI.

So this next chart, while we were reshaping our business, we've also been very busy returning a lot of cash to you, our shareholders. And as this chart will show, since fiscal 2004, we've returned over \$7 billion in cash to shareholders. We also have a target, as I mentioned earlier, to return 80% of our free cash flow to shareholders.

So we actually recently closed on a deal, on an acquisition. We acquired a company in Massachusetts called Hittite Microwave, which represents a \$2 billion enterprise value. It adds great technology, helps us with our growth rate as well, also fills in a bunch of gaps here on the frequency spectrum, as you can see from the bottom of this chart. Again, driving towards this goal of sustainable, profitable growth.



So given where our business looks today, we laid out these financial targets earlier in the summer, and we feel that we can generate gross margins in the range of 65% to 68%. Our recent quarter, we had gross margins of about 66.5%, so we're firmly there.

Operating margins and cash from operations in the 32% to 36% range, and free cash flow as I mentioned earlier of 28% to 32%. What that does on the leverage side of the house, is we feel that we can easily grow our business to generate earnings growth of 8% to 15% annually, and for dividend growth of 5% to 10% a year.

So this was a little new for semiconductor companies. Again, when you look at ADI, we are termed as a semiconductor company, but we really straddle the edges of industrial and semiconductors. So this was a little new for our historical investor base, but we really wanted to lay out a target for what we think we can do in terms of earnings growth.

And so based on the inputs from the prior slide, and our refocused business, we believe we can get to \$4 to \$5 in EPS by 2020, or by the end of 2020, and based on the estimates for fiscal '14, of earnings to be in the range of about \$2.40, or in that range. We have quite a task to get there, but again, I think the way the business breaks out today, given the leverage in the model, we think we can achieve this target.

So overall, we believe our innovation will drive profitable growth. We play in diverse markets with diversified products, and the combination of all of that we believe will continue to drive returns to shareholders.

So that's my prepared piece of today of the presentation, and we can hop into Q&A, Brian, if you'd like. Unless, you have any question (inaudible)?

Brian Collelo - Morningstar - Analyst

No, I think that was perfect.

Ali Husain - ADI - Director of IR

Great.

QUESTIONS AND ANSWERS

Brian Collelo - Morningstar - Analyst

I'll start with the first one, and then I'll open up to the audience first. Can you just give an overview of your near-term business conditions and what you're seeing today?

Ali Husain - ADI - Director of IR

Sure. So we just recently reported our results, that was for July quarter. Our industrial and communications infrastructure businesses grew quite strongly. Sequentially, the entire business was up 4% on an organic basis. Year over year, the business was up 7%.

Looking forward to our October quarter, it's our best sense that industrial, which is, as you saw in an earlier slide, about half our sales will be down slightly, but that we will see growth from the areas of automotive, communications infrastructure, and consumer.

So in total, we think the organic business will grow about 1% next quarter. Growth seems to be accelerating here as we grew 7% organically in the July quarter, our estimate is we'll grow 8% organically in the October quarter.



Inventories are in good shape. The distributor channel which accounts for a little more than half our sales - a good proxy for the industrial market. Inventory in the distributor channel is at 7 1/2 weeks. That's within our model, that number has been 7 1/2 weeks now for several quarters. So things are getting better in our sense. There's a modest curve, I guess, to this recovery, and things seem to be in good shape.

Brian Collelo - Morningstar - Analyst

OK, great. I'll open it up to questions if anyone has it. [Dan] has a microphone in the back, he can bring it around. Otherwise, I'm happy to keep going. Yes?

Unidentified Audience Member

Industrials are going to be down year over year, you're thinking of next quarter?

Ali Husain - ADI - Director of IR

Well, I think industrials will probably be up on a year over year basis, but my comment around the sequential, and why we guided it down sequentially slightly, was when you look at the broad base of the industrial customers, they're doing quite well. And those are the guys that are really tied to PMI and GDP and the macro. They've actually done quite well, and our sense is that they'll continue to do well in the October quarter.

What's maybe a little anomalous is that the fourth quarter for ADI, the October quarter, we have an ATE business, semiconductor ATE business, and that's seasonally down in that quarter. We also had a particularly good performance in some of the more programmatic areas of industrial in our July quarter. So for example, aerospace defense and energy. And our sense is that it was a great quarter, but it's probably going to be a little weaker in the fourth. But taking a step back, it's really the broad base of customers within industrial are doing quite well.

Unidentified Audience Member

We're hearing now that hybrids and electric vehicles are not selling well.

Ali Husain - ADI - Director of IR

OK.

Unidentified Audience Member

Comments? It seems to me you're going to rely on those new businesses in the automotive area?

Ali Husain - ADI - Director of IR

No, that's a great question. So for ADI, automotive is about 18% of our total sales. We have three sub-businesses, we have an infotainment business, a safety business, and a powertrain business, so your question is really specific to the powertrain business.

And the question, if you didn't hear it, the question was will -- I guess there's been some impact on the growth rate of hybrid and electric vehicles, and whether that would impact ADI sales. So for us, interestingly enough, we've taken a bet that the hybrid and electric vehicle market is interesting, and certainly there are growth opportunities there. It is an area that drives more and more content in vehicles.



But our bet has actually been largely on the lead acid battery monitoring side. So internal combustion engines, which are much more widely used, where consumers have really said we like cars that have good performance, just try and make them more efficient.

The areas of diesel engines for example that would be a good example. But just purely gasoline engines, you're getting more and more efficiency, more and more power out of smaller engines, 4-cylinder engines today are doing what maybe 6-cylinder engines did 10 years ago. And that's really our focus. We do certainly have some piece of our businesses tied to HEV, but a lot of what we're doing on the powertrain side is actually the regular engine and trying to make it more energy-efficient.

So what we actually have there is a very interesting technology that marries a bunch of things that we do in automotive, and frankly we do in the rest of ADI. We're able to take a converter, we're able to take a sensor, and we're able to embed an ARM microcontroller within this IC, that basically is able to sense when the car stops, and then shut down all the internal systems of the vehicle, and we use it for start-stop technology, and that in Europe right now, where it's more prevalent than the United States, has unbelievable market share.

And our sense is that as that technology flows down and flows obviously throughout the world to really hit some of these fuel efficiency mandates that are out there, that should benefit our business. I think there's a stat out there that by 2017, Ford is looking to have 70% of its fleet outfitted with start-stop technology, and if the business comes to ADI I think we'll do quite well there. That was a good question.

Unidentified Audience Member

(inaudible -- microphone inaccessible)

Ali Husain - ADI - Director of IR

Is that the question, or was that the pre-amble?

Unidentified Audience Member

No, that's true, maybe I'm missing something. How do you differentiate yourself from your competitors?

Ali Husain - ADI - Director of IR

No, that's a great question. I think what's happened over the last few years is particularly as you've gone through this great recession, is I think companies have really focused in, and I think that's the general case, not just the semiconductor industry.

But I think companies have really focused in on their core offerings, and saying what are you really, truly good at? And for ADI that's been doubling down on the signal path, which is sensor to processor. For the other folks that are out there in the industry, their focus is on power management. And it's a fundamentally different way of looking at it.

Now there are parts of our business that overlap with theirs, but overall I think companies are really focused in on, as I mentioned earlier, the areas they're very good at, either that's power in the case of some of the other names you mentioned, or a bigger focus on the consumer space. But for us it's been on the signal path that's really been doubling down on industrial, auto, and communications infrastructure.

So if you look at our market position here, I didn't put that slide up there, but we have about 50% of the market on data converters, and we have about the same number on high performance amplifiers, and those two product categories together, we derive 72% of our sales from there. So I think we're fairly well protected from a moat standpoint.

Unidentified Audience Member

That segues into my next question, how did ADI -- because ADI is the only -- Analog is very fragmented, ADI is the only firm with such a substantial market share lead -- in any sub-segment of the market. How did you develop such a commanding market share lead in signal path, and how do you maintain it over time?

Ali Husain - ADI - Director of IR

Yes, that's a great question. So ADI's been around for 50 years. This is not a company that was formed in Silicon Valley two years ago by two guys on a computer. We've been doing this for a long time. A lot of our business is actually what looks like a pure industrial business.

And so for us it's been a question of focus. Where do you focus your R&D, because God knows R&D is not infinite, you've got to really target the areas you feel position you for the best growth, for profitable growth, and where you can sustain your advantage over decades.

And so for ADI that's been on data converters, amplifiers, really creating that bridge between the real world and the digital world. Other folks have focused in on other areas, but for us this has been the focus.

I think over and above the technology piece of it, which clearly every year we're going to roll out new technology, and obviously we spend to do that, but it's a question of brand recognition, it's a question of high levels of service to customers, it's a question of you've just been doing this so long, and you've been doing it so well, that you get the first call when customers are building out their systems.

It's very interesting, when engineers sit down -- sit out there, and actually whiteboard these things, the first thing they think about is obviously the sensor that captures the signal. They think about how am I going to get that signal, which is in a very noisy environment trying to pick out the real signal that you're looking for, and get it over to the processor.

These are very, very hard things to do. And then the last thing they tend to think about is how do I power up the solution. And so I think from our point of view, getting the signal out of all that noise that we're constantly bombarded with in this world, is the area that we've really focused in on.

I think the other interesting piece of it, and I may be stealing your question from later, but one of the other interesting things in this story is that the schools out there, right, universities are no longer teaching analog engineering. They're focused on digital, because by the way 10 years ago everyone said well why are you called analog devices, it should be called digital devices, analog seems like it's so old and stale.

But as the world goes more and more digital, there's going to be a need for more and more analog. But the universities tend to teach whatever's cutting edge, and analog tends to be lagging edge. And so when we get folks out of school, we have a program that regardless of what's happening out there in the great recession, or whether the world is falling apart, we hire 50 to 150 new hires from the top schools throughout the world.

We bring them in, and for a period of five to seven years, they work under very, very senior folks in our company. These might be folks that they've actually read about in their school textbooks, actually. Some of them even might have been a professor in one of their early engineering classes, and really kind of the gurus of the analog space.

And so we bring these folks in, train them up for five to seven years, clearly there is some element of attrition, but it's quite low, and after five to seven years, they tend to stay with ADI for a very, very long time. And I think that's something we've focused in on very hard, because I think at the end of the day, the lifeblood of this company are the engineers, and that's really been our focus.

Unidentified Audience Member

Another question related to R&D, and this is probably pretty naive, but when you're innovating, is the innovation around taking an existing product and making it smaller? Is the innovation around taking an existing product that processes a particular signal, and processing the signal in a sharper



way? Or is it "Oh, we have this new sensor out here, let's make a product that works with that sensor, takes that signal, and puts it to a processor?" Or all of the above, or some other area, more color around the innovation?

Ali Husain - ADI - Director of IR

Absolutely. That's a great question, and I think you probably answered half of it, which is it's certainly all of the above. But there is an interesting dynamic. So when the new folks come out of schools these days, they don't know how to do analog engineering, we bring them in, we train them.

When you come out of school, and you want to be a great analog engineer, there's probably only two companies on the planet you want to work for. ADI is one of them. And yet, we have a very hard time filling our pipeline of engineers.

If we have a hard time doing it, you can imagine how the customers that we deal with, what they're doing. So increasingly, customers are saying you guys take care of the entire conversion process, you guys give me the hardware solution that I need. I'm going to sit back, I've got engineers that focus in on software, and I'm going to focus in on the areas I'm good at. I don't have the capability on the hardware side, you guys do it. Which is great, from our point of view, we tend to get early line of sight in terms of their systems, their road maps 10 years down the road. It certainly impacts our R&D investments because we have some level of visibility in terms of what they're going to do.

The interesting thing in all of that then is you're not just talking about a converter or an amplifier. You're really thinking systems. There is a fundamental shift underway. It will be interesting to see how it all plays out. We're certainly investing ahead of that trend, but to your question, it's all of the above, and the backdrop to that is we're just being asked to do more. We'll happily do it, because when customers are pulling technology from you, rather than you pushing it on them, I think the dynamic is very positive.

Unidentified Audience Member

If I could ask a follow up on that similar question, is it -- part of the way I've thought about R&D is spending in new areas. And when I think about even M&A, and a lot of the larger analog companies, like you, like Hittite is a relatively larger deal. But typically it's bolt-on acquisitions, it's filling parts of the product portfolio. Is some of this R&D a similar signal path and similar products for new application, like maybe start-stop, or hybrid vehicles, or how much are you able to leverage your prior R&D versus how much of it, if you're going into a new application, is coming from scratch?

Ali Husain - ADI - Director of IR

Yes. Well the thing is I don't think you look to ADI as being the company that's levered to the killer app or the killer smart phone, or 20% growth opportunity, where the market where is small -- there's very few competitors out there, and very few suppliers.

We tend to be very, very broad-based. So I think in and of itself, no one thing is going to move the needle. We've been doing this for 50 years, we've got an unbelievable amount of technology in R&D and IP already built up. And we tend to basically have very, very good core technology, and then taking pinpoints and harnessing that technology in particular spots. The start-stop technology is a great example where this product category didn't exist 10 years ago. What was start-stop? Nobody knew what the heck this thing was. And now it's going to be rolled out, and probably our kids one day won't even know when their car stops, because they'll just be used to it. That's just how it is, that's how things progress.

So I think there is certainly an element of new product categories that come out in certain areas that we're interested in pursuing, but it's a question of being able to take what you're already doing around signal path, maybe tweaking it a little bit to really hit that solution.

But for ADI, we're so diverse, and we're so broad-based, that for every 10 customers that we have like that, that are very kind of focused in on a particular application, we might have another 50,000 customers that they don't care. All they want is that that product from 1972 is in the mail when I order it from ADI, and I'll probably be looking at a catalog because I don't want to use a website because I'm buying stuff from 1972.

Unidentified Audience Member

Perfect. So I'll throw another buzzword out there, as you think about Internet of Things, more often than not, it sounds like this is -- the sort of companies that want to play in this space, whether it's home security, or industrial, and it's much more likely than not going to ADI and your sales, your field engineers showing the customer what you have already rather than going back to the drawing board.

Ali Husain - ADI - Director of IR

Well it's so interesting, this whole dynamic, particularly in the industrial space, customers in the industrial side are asking us what is this stuff? How do we connect up all our machines? How do we get all of that rich data flowing back to some kind of a central hub so we can do data analytics? These are conversations that are happening. I mean part of the reason we did this acquisition with Hittite Microwave is that we had customers in industrial and automotive and comms infrastructure saying, we need more microwave and millimeter wave technology.

The spectrum is limited, folks are not, governments aren't auctioning off spectrum every day, so you're limited by spectrum, yet at the end of the day, things are getting more and more and more connected, and things are requiring more and more precision and performance, and the only way to do that is to scale up the frequency spectrum. So I think look, at the end of the day, this Internet of Things is going to require all kinds of connectivity, and I think we have the entire frequency spectrum now on the IoT, everything from RF to microwave, to millimeter wave. And at the end of the day, it requires some sensing, it requires connectivity, and it requires processing, and I'd argue that ADI has a play in all three of those areas.

Where are we today in terms of the Internet of Things? Or I guess we call it the internet of signal processing, or whatever you call it? Probably quite early in the business to business area. I think that consumers are probably going to have ice trays that talk to them, and toasters that tell them when to cook their bread or whatever, but that's probably going to happen sooner than it happens on the industrial side of that. I think usually industrial takes its time, but once it cranks in, it tends to do well for a longer period of time.

An example would be in the area of automotive. Today, something like 10% of vehicles are connected. By 2020, the estimate is that it move up to be about 90%. So those are the kinds of timeframes we're thinking off, kind of two to five years, but hey, we've got the technology, our doors are open, we'd love to sell this stuff.

Unidentified Audience Member

Terrific.

Unidentified Audience Member

Could you talk a little bit about the percent of your sales that go to distributors, and what your relationships are there? Because I remember the industry, and you always had problems with the distributors, over-supplying and over-stocking, and then your business goes away because nobody's buying.

Ali Husain - ADI - Director of IR

Yes, no, I think that dynamic has perhaps changed. So a good chunk of what we do is through distribution, probably 55 odd percent of our sales are going through the distributor channel.

I think what the distributors have gotten very good at is managing their working capital. They tend to keep inventories for what they believe they'll have end customer orders for, and I think that's what they call the turns and earns business, which is basically it comes through the door, next thing you know, it's shipped out.

I don't think there is a lot of incentive for the distributors to carry more than they need, and we haven't really seen -- I think in the old -- maybe going back several years, they maybe wanted to keep more inventory. What we've seen over the last few years is they keep what they need, and they don't tend to order much more.

Now of course for ADI, it makes no impact, because our revenue recognition is only when the distributors sell through to their end customers, so we are completely agnostic, and it goes to this philosophy at ADI, our basic position is quite conservative to start off with, and so even our revenue recognitions through the channel is also pretty conservative.

Unidentified Audience Member

(Inaudible) willing to put out a 2020 earnings target, does that mean that the business itself is not highly cyclical?

Ali Husain - ADI - Director of IR

So I think that's -- I mean certainly I guess it depends on who you talk to, , but what we've seen over the past few years is there's not been much cyclicity in this business. You certainly -- you get some periods of growth, and it kind of flat lines a bit, and then it will grow a little bit.

When you get a cycle is when there's too much inventory out there, people double order and do all kinds of silly things. For ADI, we keep very short lead times. Our lead times are four to six weeks, and we deliver somewhere around 97% of our orders within four to six weeks. Those lead times don't tend to stretch, and we carry pretty good levels of inventory in our balance sheet. Part of why we do have good brand recognition and high levels of service, is that we do keep three, three and a half months worth of inventory on our balance sheet just to make sure that we're servicing our customers.

So if anything, I think maybe suppliers like ADI would be carrying a little more inventory just to be on the safe side. But there is a lot of chatter, is this the new normal? And I think what we've seen over the last few years seems to suggest that if folks don't need it, there's no incentive to carry more than they need.

Unidentified Audience Member

(Inaudible) you're feeling left out.

Unidentified Audience Member

I was going to say -

Unidentified Audience Member

I have one question. So basically when you talk about EPS targets and your growth, other than the operating leverage targets, when you talk top line growth, it sounds like this will really come more from the signal processing side and it's (inaudible) but your organic growth will be more staying in your lane, growing the signal processing side, rather than trying to diversify out to other products, is that a fair statement?

Ali Husain - ADI - Director of IR

So from our point of view, we have 100,000 customers, so I think we're in the customers and the markets that we want to play in, that we want to be partnering up with, and so on. On the product side, clearly you're always going to have something that you're going to need to add. The question



then becomes do you do it organically, or do you go out and you buy it? And I think our base position is that we prefer to do it internally, and to the extent that the buy versus make decision doesn't make a lot of sense, that we would look to acquiring a company.

But Peter, to come back to your earlier question about the cyclical nature of the business, it certainly feels like it is more muted, but calling 2020 is obviously very hard when you're sitting at the tail end of 2014.

So if I was to asterisk that EPS target, I would say well look, there is a cycle -- a so-called thing called a cycle, all bets are off. But at the end of the day, the reason we put that number out was it really crystallizes how we want to run this company. We've got great technology, we've refocused the business, but what does that mean on an earnings number, and how do you run that business in accordance with those targets? And we're not going to be a business that goes out there and cuts its way to that EPS number. It's a question of sustainable, profitable growth, and certainly if you have a cycle, all bets are off, but we're not planning for it, clearly, we're planning to build this business, and grow it profitably to get there.

Brian Collelo - *Morningstar - Analyst*

We probably have time for about one more question.

Unidentified Audience Member

All right, well I'll start with this, you mentioned half the business is industrial, another key area is communications infrastructure, and particularly the signal processing is key in the base station. What is your view of that end market? Certainly, you have the China LTE build-outs helping today, certainly there's also the build-outs, and even 3G in the emerging markets as well. How should we think about that market long-term? Is this -- I understand that it's lumpy from time to time, are we at a big lump where in, where maybe flat lines thereafter, do we still see tremendous growth over the next few years? How should we think about that long-term?

Ali Husain - *ADI - Director of IR*

Well let me bring out my crystal ball here, and I'll tell you all about it. The problem, or challenge with that market, is that it is extremely lumpy. For ADI, we really are all about the radio solution, so as more and more of these base stations out there are getting built, and even if there are refreshes of existing infrastructure. That's great for us, because that just means more radios. Again, that is driven by a customer or a carrier at the other end, that's looking to drive that, and so you're kind of at their whims. It's very unlike the rest of the things that we do in ADI, but we like this market.

The reason we like it is at the end of the day, you should never bet against the consumer. Because at the end of the day, there is a person behind that device, on their phone, maybe even in the case of industrial customers for example, things are getting more and more connected.

There's loads of consumers out there that's driving this. And so consumers are engaging in more and more high bandwidth applications, be it video, or gaming. There's more and more devices getting connected up, and they're all limited by spectrum.

And so the beauty of ADI is we tend not to bet against the consumer. We say "Okay, well that's the trend, we're going to invest ahead of that trend." We might not be in that consumer device, chances are we are not in that consumer device, but we make all the infrastructure behind that experience possible.

So in this case, we are in base stations, the radios are going out there, our sense is that this has been a great year for us. Do we kind of tap out here, and then flat line from here? I think you're going to see periods that are lumpy.

Looking to 2015, I think our best sense is that the capacity deployments to the U.S. will continue, but Europe switches on and already has in its coverage phase for 4G LTE, and then China continues its TD and FD builds as well in 2015.

And so again, it's hard to call the timing on these things, but the fundamental thesis of why we're playing in the space is still there: that there's going to be more and more things that get connected up, and you're going to need folks to go out there and put these radios on there so that all of this communication can happen.

Now the other thing that we did investing ahead of this trend is that five years ago we invested quite heavily in what we call these integrated transceivers. These are software defined radios, they're wide band radios, we're absolutely agnostic to the band chosen in China or the U.S., these radios will work basically no matter where.

And what they do is they're able to integrate, to your earlier question, they're able to integrate a whole bunch of different functionalities. So for ADI, our positioning is everywhere from, the signal capture that comes in from a phone, for example, all the way down to where the processor does its work. So that can be the converter, the amplifier, there's some clocking, there's some digital, there's some power. All of that stuff gets put on to one IC at 65 nanometer. It's very low power, this is stuff that's very, very hard to do. And it's particularly well-suited for these higher bandwidth type applications and technologies. So as we move from 3G to 4G, we tend to get a higher piece of the bill of materials on a blended basis. So all these deployments are good.

And the other thing is when you look out to the world, there's only about 180 million users of LTE today, and that's expected to obviously shoot much higher over the course of time, as more and more folks come into the fold. And of those 180 million users, they're all concentrated in three countries: the U.S., Japan, and Korea. So our sense is there's plenty of green fields out there, there's plenty of opportunity, but it's very hard to call the timing of these things. But the trend is good.

Brian Collelo - Morningstar - Analyst

Great, terrific. Well, Ali, thank you again --

Ali Husain - ADI - Director of IR

Sure.

Brian Collelo - Morningstar - Analyst

-- for your time.

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