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EDITED TRANSCRIPT

ADI.OQ - Analog Devices Inc at Citi Global Technology Conference

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OVERVIEW:

Company Summary

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

PRESENTATION

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

Great. Thanks, everyone. What a crowd. I'm still Chris Danely, still the semiconductor analyst here at Citigroup. It's our pleasure to have the dream team from one of our top picks Analog Devices up here. We have Prashanth Mahendra-Rajah, the CFO; we have Jim Mollica, who's VP of Finance; and then we have the Grand Poobah of Investor Relations, Mike Lucarelli. So Prashanth, since you guys were, I believe, the most recent semi company to report, maybe start by sort of repeating what you guys said a few weeks ago on the general tone and outlook and then we'll take it from there.

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

Absolutely, yes. Thanks, Chris. So earnings call was 2 weeks ago now, Mike? Yes, 2 weeks. And I won't go through the numbers, but just sort of give you a context for what we're seeing is as we have been signaling now for a couple of quarters, we began starting to see some softness in the numbers that reflected in the guide we've given for the fourth quarter. That softness is very broad-based. I would say that it is across all end markets and all geographies. The broadness of that softness is what gives us confidence on kind of 2 parameters: one, that it is macro driven versus being a share loss issue; and then the second is, it's lining up quite well with the improvements that we've done on lead times.

So I know we're getting a lot of questions from folks over the last couple of weeks on trying to understand ADI's outlook versus other companies out there. And I think our advice to you would be just keep an eye on lead times because we have pretty high conviction that as lead times are getting back to normality, customers are getting more confident in their ability to hold off ordering until they need something sort of within the stated delivery period, which is helping as we kind of work through some of the inventory correction.

I think the other comment that we've had a lot of questions on, so I'll just jump into it now is my boss made a comment on how we are undershipping end market demand. So folks have asked a little bit to expand on what we meant by that. And I'll give it to you in 2 pieces. First, on the distribution side for our distribution partners, both in the third quarter results and in the fourth quarter guide, we are selling into the channel less than they are selling through. So in the third quarter, we'll range it for you kind of [sub-$50] million in the fourth quarter reflected in the guide is an undershipment of, call it, [$50 million to $100] million. And we'll see where we land on that. It's hard to be so precise. So that's on disti.

On the end market side and the comment that Vince was making is we have the benefit of being able to look at our revenue sales to all of our individual customers, whether they go through disti or whether they go direct. And we can see the growth of our revenue to those end customers. And then Mike's team can pull from FactSet or [Bloomy], the reported revenue growth for each of those publicly traded companies. So we're able to look at a pretty large data set over several years to see how are our customers' revenue growth and how is our growth to those customers and what does that relationship look like.

And if you look at that relationship over different periods of time, but a reasonably long period of time to give you confidence that it's not a near-term anomaly. We can see that third quarter actuals begin to show a good deviation and fourth quarter will be even more. Now fourth quarter is based on sell-side consensus. So wherever those individual customers, analysts have them for the revenue growth for the fourth quarter. But that is sort of what underwrote Vince's comment on, we feel good that we're getting this inventory behind us because we are fixing the channel ourselves and our customers are fixing their end market inventory. So long answer to a short question, Chris.

QUESTIONS AND ANSWERS

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

That's okay. I specialize in those. How about -- the first one would be, and I received this from some folks wandering the halls. You guys have had, I think, for the last year, you've been in the sort of sign curve of things are weaker and then were stable, things are weaker and then were stable. I guess what gives you confidence that your guidance for the next few quarters is low enough? Or is that accurate?

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

Good. I'm going to let Jim Mollica take that and just as background, I also get a chance to do an introduction here. Jim is a 35-year veteran of ADI. He has been a right hand for me for my 6 years here in the CFO role. We are very likely heading external with the CFO search, and Vince will share an update with you on that in the Q4 earnings call, but I want to bring Jim with me, so you get a chance to see sort of the depth of talent that we have and give you reassurance that this is a very strong and very deep finance team.

Jim Mollica

Thanks. I think the -- one of the differences we've seen, if you think back a year, if you step back and from a lead time viewpoint, we were shipping about 1/3 of our products a year ago within a 13-week period, 13 weeks and less. And that got a little better in the first quarter, a little better in the second quarter. But in the third quarter, we kind of leapfrog that up to now we're shipping 85% of our products within 13 weeks. And from a customer viewpoint, although we have been doing a lot of customer checks on their backlog is the demand rail. It's not until that you see those -- that stock reduction in lead times where customers now have confidence that, hey, look, I don't have to actually place as much backlog on the books now and the signal that we're getting from them is [sharper].

So that lead time reduction for us is a key metric for determining what the end customer signal is doing. And we saw a lot of improvement in third quarter. Our goal is to get to something around 90%. And hopefully, we'll achieve that by fourth quarter, but it's really that lead time reduction that gives us confidence that we can actually get to that guided (inaudible).

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

And maybe a quick one on kind of some of the false signals we got from China, which also created a little bit of that sine curve that Chris was talking about.

Jim Mollica

Yes. On the China side, we got, I guess, Prashanth, kind of a false signal at the start of 3Q, if you will, of the latter part of 2Q. So on the China side there, on the channel side, we've actually saw -- from a shipment viewpoint, we're undershipping the channel now so that we can actually work off of that inventory that was actually built up there. And we had basically started that in 3Q, and we'll continue that in the fourth quarter. And that gets, I think, more or less the macro level there going into fourth quarter or certainly not as strong as it was going into the second half of the year if you step back 3 to 6 months.

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

Yes. So a question for the brain trust over here. It sounds like the trigger was the sort of big time step function down in lead times that really triggered the clearing of the backlog. Was there a specific level you saw that when I guess you hit 50%, 60%, 70% of lead times were less than 13 weeks? Or was it a time period? Or was it -- was there anything else more specific that you saw that once we broadcast this to customers, then, okay, they felt more comfortable about taking down their own inventory or maybe it was like anything on the macro side?

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

Yes, yes. Chris, I'd be careful that I wouldn't want anyone to think that it was purely a catalyst of the lead time reductions. I think that was -- we had a multitude of things going on. The economy was clearly softening, everyone expected that given kind of the interest rate environment. The hope that China was going to return to growth, I think, faded over the summer, right? We were all -- we all started the year thinking we're going to come out, they're going to reopen post COVID, and it's going to be boom times. And by the time we got through summer, where we realized that was not happening. Lead times got better and also the efforts that we've been making for a while now to ask for cancellation of orders and kind of the folks to really look through what they really were in need of all of that sort of came together towards the tail end of summer.

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

Yes. I wanted to touch on that as you were the first analog company a year ago to, I guess, proactively manage and start to see some weakness. So can you talk about what caused you guys to go out there and scrub the backlog because it was probably at least a quarter or 2 before anybody else started saying it?

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

Yes. I think a little bit of just sort of the reflection of how we run this company, and we run it really with the long term in mind. It is -- the nature of analog is that it takes a -- from the time you win a stock, it takes a long time before you get the revenues. But once you have the revenues, you hang on to them for several years, in some cases, decades. So it gives us the privilege of not really being worried about kind of the quarterly ups and downs. It's a very durable business with tremendous cash flow generation. So as we saw order cancellations start to pick up last year, there was no reason not to kind of in the spirit of how we've always been very transparent with our investor base to share with you what we see. You can have as much information as we have, and I don't know that it will help you anymore in your decision-making because the world has a great deal of uncertainty out there.

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

Yes. So given that 85% of lead times are within 13 weeks, and we're probably, I don't know, maybe within a quarter or so of whatever the heck is approaching normal these days. Do you feel like the worst is over in terms of the correction for ADI while there might be some little speed bumps or potholes out there? Do you feel like the worst is over for you guys?

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

I would break that into 2 elements. There's sort of true demand, and then there is the inventory correction. We have high conviction that the inventory correction will be behind us by ideally end of our Q1, but maybe stretch it a little bit into part of Q2. And remember, our Q1 ends in January. That means we'll have taken our finished goods down roughly $100 million, we will have undershipped for 2 quarters of distribution, Q3 and Q4. We haven't really made a call yet on what we're going to do for Q1 disti, but I know we're not going to increase. We're not going to ship in above where we are. And then customers will have a chance to do that inventory correction. So I think we will be at normalcy there. What I don't have a sense for, and Mike and Jim can jump in here is there's still this macro element. The rates are up, activity is down. We are really feeling it on the industrial side. I think, Mike, maybe you want to comment since it's easier for them to hold you accountable than me at the end of next year about the industrial outlook.

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

Sure. I mean, I guess, to your first point, the inventory correction (inaudible) done by kind of 1Q, 2Q time frame. The question is resumption of demand, like what is the shape as you return to demand. There's a lot of demand, whether it's industrial, auto, comms, consumer, there's demand everywhere. But it's just unsure as you get through this inventory reconciliation period, how does that demand pick back up? Is it snap back? Is it slow? We don't know that. And that's the big question we have. If you look at next year, I guess, I'm making a prediction for next year on behalf of Prashanth, so you can blame him if it's wrong. He won't be here. Industrial will probably one of the weaker markets next year -- we'll find you.

Industrial will probably one of the weaker markets next year, but that's not a bad thing. I mean, it's been one of the stronger markets. So I think Industrial is probably down the most next year. But it's not to say there's going to be growth pieces within industrial. And if you fast forward past the next few months, and you get into the back half of next year, we're starting to grow nicely on a year-over-year basis. So the long-term growth is unchanged for ADI. You just have a period of reconciliation given the past 3 years of supply crunch.

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

Okay. Just to touch on that. So you said industrial should be weakest for '24. I would imagine auto is strongest. And then where would comm and consumer fall?

Unidentified Company Representative

Between them.

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

You should run for office. You should run for office. I've seen what we've got coming up next year.

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

There you go. But you're right, industrial by the (inaudible) of the best. I would say consumer -- I won't say, plus/minus, could grow maybe depending -- a lot of unknown in consumer. It's been the weakest. It's probably corrected, and the bottom is behind us. [We're unsure and opaque] there. In communications, I'll say I've been in that market now for 8 years. Whenever it's terrible, it surprise you to the upside. And whenever it's awesome, it's probably to the downside. So it's been terrible. So I'm hopeful that does okay next year, but I'm not going to put my badge on the table for that one. That's it. So I joke in between the 2, but that's kind of where I think.

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

That's fair. And then Prashanth, Mike or Jim, you mentioned that 85% of the products have lead times within 13 weeks. What percentage or figure would you give as normal? Is it 90%, 95%? I know I would imagine it's never 100%.

Jim Mollica

Yes, it's a great question. We got a pretty fragmented tail of products. So it's -- our goal is to get to about 90%. And anything above that, we have a lot of products too that are at 8 weeks. So -- but at the aggregate level, it's hard to get that number really above 90% or in that range just due to the fragmentation of the products. But the good news there is, once customers actually see that, now they start to behave and the orders they put on the books are basically -- we have their inventory at (inaudible) and it basically flows to the back end nicely. So that ratio for us is -- that's really -- like I said, that's a big improvement for us in third quarter. We do a little bit better in 4Q, and I think it's more or less steady state, yes, normal by early next year.

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

And then I had another question from one of your holders on shortages. Are there still any out there? Should we expect at any given point, some shortages just because of the nature of the fragmented business? How would you sort of quantify that for ADI?

Jim Mollica

Yes. There's always a few hotspots. But for the most part, the shortages are behind us. I think the inventory strategy we had of basically maintaining these buffer stocks in finished goods is actually during a shortage time period. It worked out very well for us so that we were able to maintain that flexibility and reduce that shortages out there. The flip side of that is if you had more inventory in the channel and those types of things, you have less flexibility. So that strategy we had of keep the channel inventories low, maintain that buffer stock in finished goods, I think, served us well over the shortage time period. And there will always be a few hotspots here and there, but for the most part, that's behind us as well.

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

Great. Next, I want to delve into the long-term margin target. It's a favorite topic of mine since years or so high. What would you say your latest and greatest long-term sort of revenue growth target is? And then we'll go to margins after that?

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

Sure. We're not changing it, right? When Mike built the long-term model in his FP&A [hat for] -- that we shared with you at Investor Day, we had built in a recession scenario in that. And we, of course, built in what this business usually sees is a relatively strong snap back after that. So we still feel kind of that 7 to 10 is the right way to think about this business over the long term. It will do well in a strong GDP environment and then we have a number of great secular drivers that are [goosing] particular aspects of the business. We've talked about auto as well as the -- some of the health care and some other areas that we feel very strong about. I think that the risk to that revenue growth will largely be based on how long this sort of a macro softness is out there. And China's impact, not as a market, but just China's impact on the global economy.

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

Okay. And then how about -- or how should we think of gross margins in terms of the long-term range? And then maybe for the folks out here, reiterate what you said about gross margin on the bottom on the (inaudible)?

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

Sure. Sure. So we have -- we have an extraordinary gross margin profile for a hardware company. We've set the floor at 70%. In the third quarter, I think we printed 72%. The model that we shared with you was that in a peak to trough decline of 15%, we would be able to hold the margins at a 70% floor. So as you think about 2024 and I'm not sure what 2024 would look like, but our view is that we should still be kind of north of 70% for the year. Because of the inventory correction that we are driving in the first quarter, I think it's unlikely we're going to be able to hold 70% in the first quarter, but I do expect us to be in the very high 60s. I'll let Jim and Mike comment on that since -- again, they'll be here to be held accountable for that answer. The -- but the trade-off that ADI always is making is where do we need to be a little more flexible on pricing of new products or pricing in selected opportunities to make sure that we are driving growth because it's -- there's still plenty of drivers that we have that can drive gross margin up, but we want to trade that off the growth.

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

I had another question, but I wanted to ask about that. So would you guys trade-off a little bit lower gross margin, say, I don't know, high 60s or something like that for a few more points of revenue growth? Or is that (inaudible) can't go below 70%?

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

It's in the model mix, but I want -- I certainly want investors to understand that 70% is how we think about running the floor of the company, right? So it doesn't mean that there may be pockets where we make some trade-offs that are sub-70%, of course. But the overall aggregate level of the business, 70% is how we think about the floor. And that's really not at risk. I mean, it's an extraordinary number to have a company of our scale that is in the hardware business that's printing 70% gross margins, but it's not really at risk.

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

Okay, great. And then how about the high end of that range? Any confidence -- supreme confidence that we'll get back to the high end of the range? What should we think of is -- if the floor is 70%, what should the peak be? 74%, 75%, (inaudible) 76%?

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

I mean you saw us in the good times, we did just about 74%.

Unidentified Company Representative

Yes.

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

That's not a bad way to think about it. We didn't give an upward target on our long-term model. We said 70% floor. But to think of a range of 70%, 74% is not a bad way to think about it. And now there's part for our business that's above 74%, and we could do more business above 74% and get 75%, 76%, 77%, but there's very minimal growth in the area. But Prashanth laid out, it's a balance between driving growth in the business and maintain kind of that low 70s percent gross margin through cycles.

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

Yes. But no fear, we're at least going back to the previous peak for gross margin, just to confirm.

Unidentified Company Representative

None.

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

Okay. Great. And then just a longer-term question on the end markets. You sort of sketched out what's going on with the cycle. But over the next, let's say, 5 to 10 years, how would you rank -- especially the auto and the industrial end markets, but how would you rank the relative growth rates of the end markets longer term like 5, 10 years out?

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

Do you want to take it?

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

Me or Jim?

Unidentified Company Representative

Take it Mike.

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

Sure. I think in our long-term model, which is a 5-year model base that we said by 2027 was kind of a long-term target of $15 EPS and 40% free cash flow, built in with that is auto is the fastest grower at low teens. Auto is #1. Industrial is #2. In industrial, we said high singles. I think industrial could surprise. I mean, if you look back over our history, even though it's our biggest market in most diverse market, it's one of our fastest-growing markets. So I feel very good about high single-digit growth in the industrial market, which is great from a standpoint of longevity of our business and margin profile for our business over the long term. Comms, consumer is probably kind of in the mid- to high single digits, mix there. So I would say, if you look at our business, industrial and auto is 75% and put those 2 together, you're probably about 10% growth for those 2 markets over the long term.

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

Just a slight [tweak] on that. I'm not as -- again, on a 5- to 10-year basis, I'm not as optimistic on auto if we don't fix the infrastructure charging issue. I think that just from a macro standpoint, and it's not an ADI specific concern that I think that many of you have some pretty aggressive assumptions in there for EV growth and that those aren't sustainable numbers unless we address the charging infrastructure.

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

(inaudible) will expand on that. I was going to start talking about autos and EVs, but what do you think are the main issues there? And would China be able to fill that gap or perhaps not with their economy starting to hurt a little bit as far as EV growth?

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

And again, this is a long-term comment. So I don't want anyone to read into that I'm trying to make a call on 2024 or '25. But I believe that the growth rate for where folks have access to charging, we've had good penetration; where we don't, we are not seeing it. What is the lens that ADI has is we know almost all the EV models that are coming out, right, because we've got high -- we've got north of 65% market share on electric vehicles in the BMS. So we know everyone that's got something on the design, who's cooking up something, we can see the quantity movements and the growth rates that our customers gave us of what they expect their business to do versus what's actually materializing are not where our customers thought they would be. Now when you are -- when you have as much market share as we have, it's -- you're a little indifferent to who are the winners and losers. But there's clearly a gap there in their expectations.

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

Okay. Can you give us a sense of your content on an EV versus a hybrid versus an ICE car?

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

Sure. Mike?

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

I'll start [a little] backwards, go ICE to EV. We don't need much in the hybrid market because if you want ADI's BMS technology for EVs, you want the best performance, you want the most miles per charge. On ICE powertrain, we probably had about $20 per car. If you move to EV car with BMS, wired BMS is probably around 50 plus or minus. If you take that to wireless BMS, we also had to do the exact same -- all the performance you get in wired now wirelessly, it's 2x the content. So you're probably about $100 plus or minus. So you have a 5x kicker going from an ICE car to a wireless BMS car. And then we talked about on the last earnings call of this new onboard charging that we're designing, sampling today.

The onboard charger basically helps to have the car charge faster with less silicon carbide. Now this is not silicon carbide, you think about -- all the guys talk about the inverter side. This is actually in the charging where you're plugging the car. It allows you to use less and charge faster, and that technology has the ability to double our content from $50 to $100 [on wired] BMS. So what you're going to see is fast forward 3 years on the powertrain, now we're talking about $150 of content. So you're seeing a step function increase, and we didn't play much on the ICE powertrain. So from $20 on the ICE to up to call it $150 as you add more and more content on the electric vehicle.

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

Any risk of shortages or lead time extensions as these products ramp? How do you feel about the supply?

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

No, I think we feel good there. Just to comment on what Mike said. We have 4 wireless BMS wins out there. On the earnings call, Vince indicated that we expect a fifth win, call it, in the next 12 months. I think it will be sooner than that, but give ourselves some [coverage] there in the next 12 months. And then I'd give you 40%, 50% odds (inaudible) should be 2 announcements in the next 12 months.

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

Okay. Sorry to go back to the gross margin comment. But you guys mentioned that you're going to lower your own inventory and taking the utilization rates down. What are utilization rates now? And so what do you expect that -- will they sort of hold flat for the rest of the year and then bounce back up whenever growth regains?

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

Sure. The way to think about utilizations for ADI, and Jim, feel free to jump in here, is that ADI has, like some of our peers, we have this hybrid manufacturing model, which simply means that we have internal fabs as well as we use foundries. In addition to the hybrid, what is more unique for ADI is we have swing capacity. Swing capacity means we can run the exact same product inside ADI or at a foundry. That is extremely unique to my knowledge, and Chris can jump in here. We're not hearing many of our peers. We're not hearing any of our peers talk about swing. We've had swing in Limerick, Jim for many years -- many, many years. And now with the addition of Maxim -- after the Maxim acquisition, we now have a facility in Oregon, where we have added in substantially more swing capacity. And what does that do is it allows us to create a buffer to the utilization rate.

So normally, as you go through these semiconductor cycles when the revenue falls, if you can't move product out of the foundry into your fab, you run your fabs underutilized and you're sucking up all of that fixed cost without any products to apply it to. It gives us, call it, 10% to 15% higher utilizations when we activate our swing. So at the -- again, these are very aggregate numbers in a non-swing environment at the trough, think about utilization levels being a little bit north of 50. And then you add another kind of 10 to 15 on top of that because we have activated our swing.

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

Got it. So some of the foundries have talked about having their customers on long-term contracts and such. How does that work with you guys in the swing capacity? Do you (inaudible) the contract? Or do you have to take on some more inventory? Or how is it work with ADI [and the foundry]?

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

We don't have -- with the exception of some very rare instances, we don't have volume commitments with our foundry partners. And for -- one example that is probably our most meaningful volume commitment, that is because our customer wanted us to give them a volume commitment. So we did a back-to-back on the foundry, which is extremely rare for us. It's not -- it's something that I think Vince feels very personal about from a value standpoint is we don't want to tie up our customers in long-term supply agreements. And similarly, we don't engage in them with our suppliers.

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

Got it. Before I jump to the next manufacturing question...

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

Do you want to jump in, Jim?

Jim Mollica

I'll just add one thing there, Chris. We talked about the swing capacity on kind of the trough period. There's also a tremendous benefit on the upside. So when business is going well, now we have the opportunity to take some of these swing products and swing them back externally so that we're getting the value from a revenue viewpoint on those products and able to complete the loading of the internal fabs on other products. So it's got -- as Prashanth said, it's a unique benefit that we actually carry for protecting the downside and allowing us a nice growth opportunity on the upside.

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

Okay. So I wanted to make sure that if anybody in the audience has a question, feel free to raise your hand or forever hold your peace and then I'll keep going in case anybody does not have a question going once, going twice.

Unidentified Company Representative

We (inaudible) a couple.

Unidentified Analyst

Yes, it sounds like you took (inaudible) grow next year in auto (inaudible). So auto (inaudible) that's representative of the semi-auto industry or (inaudible).

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

Take it, Mike.

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

Sure. Consumers in micro, I'll clarify that. Let's say, would grow. On auto, same idea. I would say, why would we grow in auto next year? And if SAAR is bad, it comes with the growth drivers. It's the stuff we talk about BMS for the EVs. It's in-cabin connectivity with the GMSL, which connects radars and cameras in the car. A to B which connects infotainment system in the car and functional safe power as it goes on the radar system or in the display. Those 4 areas, they go half auto. Those 4 areas should continue to grow even in a bad macro environment. I don't know how bad the macro is going to be if it would offset the growth or not. That's kind of where we are because inventory and growth drivers, the mix of that would determine if we'll grow next year. So it's our exposure to the secular growth areas and why I'm more confident in auto growing than other markets we play in.

Unidentified Analyst

Just want to follow up, just as new trends come in, how is pricing going up (inaudible)?

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

Pricing for ADI has been stable for decades now, right? I mean we -- it's a very unusual circumstance where once you are designed in, it is extremely inefficient for a customer to design you out until they go to the next iteration or the next generation of their product. So because of that stickiness, we don't face sort of the same kind of pricing pressures of, hey, we can swap you out for somebody else if you don't lower your price. Customers' opportunities to have a price discussion with us happen when they're making their next generational design decision. But that's also where we have an opportunity to upsell them on our next generation of design. And that's what keeps the -- kind of keep the balance (inaudible).

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

Great. Anybody else from the audience? Otherwise, I'll keep flapping my gums in the back.

Unidentified Analyst

Just a quick question on capital allocation. And I guess, maybe a year or 2 ago, you all kind of shifted to a 100% free cash flow return model. And with EBITDA growing over the next several years, the balance sheet will continue to kind of naturally delever. Is there an opportunity to recapitalize the balance sheet? Or are you comfortable with seeing that leverage number continue to fall?

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

Yes. That's -- so let's recap what we've done, right? We are -- over the trailing 12 months, we've given back roughly $5 billion. I think Mike is going to correct me here, but I think $3 billion plus on repo and $1.8 billion on (inaudible). And for a $90 billion market cap company, we're pretty proud that we've given you that much back. On a go-forward basis, I think really that's -- unfortunately, that's a question that no one here should really be answering because I think that's something that my successor should opine on. But I'll share kind of Vince's view on that, and Vince's view is that he does not object to leverage, but believes it should be used for strategic moves. So all else being equal, more likely to keep rolling the outstanding debt that we have. And with the EBITDA growth, you'd see continued deleveraging from that. But unlikely that he would be looking at adding debt to simply do a repo. But again, I think my successor will have the opportunity to have that conversation with him.

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

Great. I wanted to jump in on a question that I've been getting, especially since we've had a lot of your competitors here today, and it seems like half of them are saying, yes, we're in a downturn and auto and industrial is rolling over and the other half, we're saying everything is fine or we're seeing a little bit of weakness on the consumer front, but auto and industrial is strong. Any sense as to why this exists in the industry right now?

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

Yes, I'm actually going to make a plug for you, Chris. I think a few months back, you put out a research piece where you scrape some data on lead times. And I wouldn't be surprised if you looked at that lead time data that you scraped into the correlation between where our lead times and who is feeling more optimistic versus who is not.

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

Yes. Obviously, I agree with that. I write my own research. One other question on manufacturing. So you and your main competitor have taken a bit of a different path, even though you guys both outsource. They're going more in-sourcing and your -- you have gone more outsourcing. Maybe compare and contrast why you guys went more outsourcing versus building the 300-millimeter fab internally?

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

Yes. Look, we try not to comment on competitors, but I will say that they're an extremely well-run shop and a priority for them and how they deploy their capital is in manufacturing. The priority for us is innovation. And we deploy our capital into R&D. We are a high-SKU, low-volume [shop] and that innovation that we create doesn't come in the same type of high runners that you would see in more standard products. It is where we are solving very unique challenging problems for our customers, and that's reflected as I started out this discussion in gross margins that are north of 70%.

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

Well said. One more question on the earlier one on capital usage. You guys have been very active and very successful in M&A. So the first part is, is there anything left to do with Maxim? Or is it pretty much on autopilot. And then would we rule out more M&A in the future?

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

Yes. I'll do the second part of that and then give the first one to Jim. So on M&A, I think Vince has been pretty clear that he thinks about M&A where it adds scale and where it adds scope. I do not think ADI needs more scale, but I wouldn't exclude Vince from thinking about is there a scope that he thinks would be beneficial to our customers. But it's really, again, a conversation I think my successor should have with you. On the Maxim side, Jim, maybe just hit on the revenue synergies, which are still to come.

Jim Mollica

Yes, on the Maxim side, the cost synergies are pretty much at this stage complete, and we've switched gears to now look at revenue synergies over the next 5 years, which we have a lot of work going on in terms of looking at customers and portfolios and that type of thing. So that's kind of where the gears have actually switched to. And we've been positive on the cost synergies, and we're positive on the revenue synergies as well in terms of hitting that goal that we outlined last spring.

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

That bogey, Jim was $1 billion recurring revenue by (inaudible).

Unidentified Company Representative

That's right.

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

And Jim is on track to exceed that goal.

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

Yes. We're all very aware of the margin improvement at Maxim since you guys bought them. One last question maybe for Jim, since you've been there for a while. You guys bought Linear 10, 12 years ago or something like that?

Unidentified Company Representative

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

Yes. It feels like 10, 12 years ago in semis. They were known for the highest gross margins in the industry. Just curious as to how those gross margins are like 6 years later.

Jim Mollica

They're still pretty strong. They are -- I think what important lesson there is when you combine companies and you look at the totality, there's always opportunities to basically be a bit more efficient. And Linear was a great run company. Analog is a great run company and you put a lot of smart people together, and you look at -- compare and contrast how things are done. And basically, you'd be amazed from a cost efficiency viewpoint what we can actually do there. And I think you can say the same thing about Maxim too.

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

I'd add, 3 of us and the rest of the finance leadership team, we worked on that model for Maxim. We underestimated how much scale matters.

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

All right. Thanks, guys. It's all we have time for. Thanks, everyone.

Unidentified Company Representative

Thank you.

Unidentified Company Representative

Thank you.
