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EDITED TRANSCRIPT

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PRESENTATION

Chris Danely - *JPMorgan - Analyst*

Great. Thanks. Good morning, everyone. I'm Chris Danely, the Semiconductor Analyst here at JPMorgan. Next up is one of our favorite names, overweight rated Analog Devices. Why are they overweight besides blowing away the quarter last night? We think it's one of the few stocks, not just in semis, but in all of technology that combines quality with leverage.

In terms of quality, you've got gross margins in the mid- to high 60s and a secular increase in margins hitting all-time highs. You've got operating margins in the 30s. And these are very stable margins. So, even during the bad times, you only see them dip a few percentage.

They pay a very nice dividend. The yield is usually around 3%. They've also had some of the highest dividend growth in all of technology and all of semis.

And in terms of the leverage, two things. Number one is they've got about 90% exposure to the three strongest end markets in semis. That's communications, automotive, and industrial, the highest exposure actually in the semi space to those three end markets. And you have some of the lowest utilization rates in semis, somewhere in the 70s.

So, when you combine the increased revenue and the higher utilization rates, you tend to get earnings upside, which is what they demonstrated last night.

So, here today to talk about it is Dave Zinsner, the CFO. We call him the Ben Affleck of semis. And he also has a special guest star, which is John Hassett, who's the VP of Manufacturing and Assembly and Tests.

And since you guys reported last night, Dave, maybe you could take a couple of minutes to just kind of tell us -- give us a brief recap of what happened.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, sure. It was obviously a good quarter this quarter. We came in at $695 million. That was $10 million or $15 million above the high end of the range we gave. That's up about 11% sequentially, 5% year over year.

We had great gross margins this quarter. We were 100 basis points better than last quarter and above the range we gave. I think we said we would be between 65.5% and 66%. We ended up at 66.1%. Most of that strength came from factory loading, so increased utilization. So, although it's one of the lowest I guess in the industry -- I didn't know that -- it has improved from last quarter.

OpEx grew at a rate that was less than half the rate of revenue at 5% growth I think to $238 million. That all translated into earnings per share of $0.59. I think we gave $0.54 to $0.58 as the range, so $0.01 above the high end of the range.

So, just about every metrics -- metric, we did better than expected. We also had a pretty good balance sheet report. Cash was up another $100 million to $4.8 billion. Days of inventory came down from 121 days to 115 days. So, that's in good shape. So, really, across the board, everything went well.

We had strength pretty much in every end market, certainly the markets that we primarily focus in, which is the communications infrastructure business, the industrial business, and the automotive business. All were up quite strongly in the quarter, which partly is a result of seasonality, but also has to do with some secular strength that we saw, given that we've made a lot of investments in these markets.

I think about 89%, 90% of our revenue now comes from what we consider the B2B space, so the businesses outside of computer and consumer, which is exactly where we want to be. So, that looked good.

We had -- we guided again for next quarter. We said -- thought revenue would be up again between 1% and 5%. I think, again, we'll see strength pretty much in every end market with the possible exception of automotive, which generally sees kind of seasonal weakness in the third quarter. But, other than that seasonal weakness, we think the businesses will be quite strong.

Gross margin should be up again another 50 basis points, this time not from factory utilization. More than likely, we'll get a little bit of a mix benefit, given the industrial and coms businesses will both be growing in there above the corporate average.

And all that would translate into an EPS between $0.60 and $0.64, so again, growing nicely. And the good news is both this quarter and our expectations around next quarter are that the growth in earnings will far outpace the revenue growth, which is kind of the leverage part of the model that we like to see.

That's the quick five-minute summary or two-minute summary.

QUESTIONS AND ANSWERS

Chris Danely - *JPMorgan - Analyst*

Great. So, just to dig in and start with the revenue upside, I think the original guidance was for revenue to grow like 7%. You ended up doing up 11%. The previous quarter revenue was down. So, maybe just give us some color commentary on the linearity. Did things just get better and better and better as the quarter progressed? Was there a particular month or week or certain driver of a hockey stick in increase? Just give us your thoughts there.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, so, I think, when we came into the quarter, we certainly thought that things would be better. We had hit kind of what I would've expected was a trough in the first quarter. It's usually a seasonally weak quarter anyway.

And so, we had some expectation that things would strengthen. I would say, through the quarter, we saw very good strength and a strengthening situation in the industrial and coms business beyond what we would've expected.

We have a decent read on coms because we do get forecast data from the OEMs in that space. But, even there, we saw some upside.

The industrial business is more of a run rate business. We're mostly reading kind of distributor inputs every week and trying to glean from what we think the trends going to be for the quarter. And pretty much every week, the data got better and better.

And quite -- actually, I knew it would get better in that it normally does for seasonality reasons. But, it got better at a rate that was beyond what I think we expected.

Automotive was generally in line. And consumer we kind of expected to be kind of flattish, and that worked out as we expected.

Chris Danely - *JPMorgan - Analyst*

And on the coms side, was that coming from Asia, North America, Europe, across the board, any particular incidence there?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, so, just to caveat this, our best visibility is obviously as we ship into the OEMs. It gets a little hazier as it goes from the OEMs to where it ultimately gets installed.

However, we have a decent read for the products that are going to go into the China market. So, clearly, China build out happened or is happening. And I think the first wave of base stations were manufactured and released. And so, that was somewhat expected, although I think the magnitude of it was bit of a surprise.

Also, we saw a good strength in what we believe ultimately ended up as installations in North America to kind of densify the network here in the US. So, that was maybe a little bit more of the upside in the results versus what we expected.

Chris Danely - *JPMorgan - Analyst*

And as you look at your com forecast for the year, has that caused your forecast for the rest of the year to strengthen a little bit, given the strength you've seen in com, or are you keeping it flat, or any changes there?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

No, I think we think it's going to be better than when we came into the year. I think, when we originally modeled, we expected a relatively short couple of month kind of upside for the Chinese build out or the China build out. That's -- I think, given the -- what they're talking about in terms of the number of base stations, it does appear like there's going to be strength perhaps through the year.

And in North America, we hadn't really factored in a lot, although we constantly believed that densification was coming. The question was when. And so, it does appear like that has kind of really rolled out. And my expectation would be that would continue through the year, too.

Chris Danely - *JPMorgan - Analyst*

And then how about product availability? Is there any issues, any worries with product availability, either the frontend or the backend?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

No, I got my VP of Manufacturing over here. Hopefully, he's got this all -- .

Chris Danely - *JPMorgan - Analyst*

-- Had to get John involved -- .

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

-- Planned out. I'll let him talk about it. But, I think we're in very good shape in terms of deliver and lead times.

John Hassett - *Analog Devices, Inc. - VP Manufacturing & Assembly & Tests*

Yes, no, I think we're in great shape in relation to that, Chris, I think from -- both from a frontend as well as from a backend perspective. From an external standpoint, we have great relationship with our suppliers. We have great access to capacity. And we've always been able to drive the responses in relation to that.

From a backend perspective, we're dealing with the main [O-set] guys that we've had relationships with for many, many years. And we've made -- we certainly have access to all of the capacity that we need to meet the demand. We've got great responses from the suppliers, so certainly no issues from that standpoint.

Certainly, there are always areas that are going to have a little bit of tightness that we'll encounter. But, we have a multisourcing strategy that allows us to leverage a number of our suppliers in order to meet the requirements. So, from that perspective, I don't see any significant tightness in relation to that. And we continue to meet the overall lead time requirements from our customers.

Chris Danely - *JPMorgan - Analyst*

Great. Just from a -- I guess a frontend manufacturing perspective, can you give us an update on what percentage of your manufacturing is outsourced? And do you expect that to change much?

John Hassett - *Analog Devices, Inc. - VP Manufacturing & Assembly & Tests*

Well, we have a hybrid mix. Really, our manufacturing strategy is anchored around a hybrid mix of both internal manufacturing capability as well as on the external side. We run approximately a 50/50 split between both. And certainly, looking out over the medium to long term, we certainly don't see any significant change in relation to that.

As I said earlier on, we work with a suite of suppliers. And we have very, very strong relationships with our frontend guys as well. And we're accessing a variety of technologies through the external stream and then obviously supporting some key specialist technologies internally.

Chris Danely - *JPMorgan - Analyst*

Great. And then how about on the backend? How much is in-house versus external?

John Hassett - *Analog Devices, Inc. - VP Manufacturing & Assembly & Tests*

Well, on the backend, we -- from an assembly perspective, you can regard us as effectively 100% outsourced from an assembly standpoint. We've got a small little bit of internal hermetic high-end capabilities. But, effectively, look at us as 100% outsourced.

From a test standpoint, though, we have a very significant test operation actually in one of our major manufacturing plants down in Cavite in the Philippines. And that provides us with a lot of test capability for our products.

We do leverage our O-set partners in terms of assembly and test capability to cover some of our other products.

Chris Danely - *JPMorgan - Analyst*

And so, you feel like your lead times are great. Have you seen any lead times stretch out from your foundry suppliers or your backend suppliers? Do you think that could happen this year, or do you feel like it's going to be pretty stable?

John Hassett - *Analog Devices, Inc. - VP Manufacturing & Assembly & Tests*

I think there's a little bit of tightness. You're going to start seeing some tightness, certainly in some of what I would classify as the more mature based packaging.

Chris Danely - *JPMorgan - Analyst*

On the backend?

John Hassett - *Analog Devices, Inc. - VP Manufacturing & Assembly & Tests*

Certainly, there's a lot of capacity out there still in terms of the packages such as the wafer-level CSP and technologies such as that. But, as you continue to build up on the more mature-based packagings that the industry has been built on, there's certainly some tightness coming there. But, again, the secret to that is in terms of having a multisource strategy that allows you to be able to access and service that capacity.

Chris Danely - *JPMorgan - Analyst*

Great. I'll give John a break now. So, just to talk about the end markets, you also said industrial was a source of upside, Dave. Any drivers there, or was it just a little bit better economy?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Well, normally, just to caveat this, normally, the second quarter's a pretty strong quarter for us. It's got the most number of manufacturing work days. And so, usually, across almost every geography, manufacturing facilities are humming along. So, we usually do pretty well in this quarter.

There was definitely strength beyond what we expected. I'd say a lot of that strength came in the instrumentation space. We just had a really great quarter in terms of instrumentation. Part of that was driven by the test equipment part of our business, which had been kind of the source of the headwinds for the last couple of quarters.

And so, finally, it was -- I always -- in talking to investors in prior quarters, said don't -- it will turn back around. And we will see a recovery in that space. It's just the nature of that business. It's kind of a feast-or-famine kind of model. And so, it does look like that business has come back quite a bit. And so, we're seeing a kind of resurgence of test equipment purchases. And we supply a lot of parts into that market. And so, I -- we've been the beneficiary of that.

Chris Danely - *JPMorgan - Analyst*

Great. And then just to touch on the automotive side, so you said it was basically in line. Would you categorize that as normal seasonality, and you're forecasting for normal seasonality in this quarter?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

I think, this quarter, certainly, seasonality was normal. Up 9% is actually pretty good strength for automotive. I think we do see some seasonal benefit in the second quarter from automotive. But, we also just have a really good position in automotive.

We focus on three key areas of automotive, safety, infotainment, and power train. And in safety, a lot of what we do is around MEMS technology or radar technology. And a lot of that stuff is getting mandated because it actually does improve mortality rates in automobile accidents and avoids automobile accidents in a lot of cases.

And so, governments are mandating that stuff. And that's turning around and benefiting us because we provide a lot of the systems, the semiconductor solutions that go into these high-end systems that are now not only in the high-end cars, but now into the more mainstream part of the market.

The other area that's doing particularly well for us is this start-stop battery capability. We make a semiconductor that helps manages the battery and senses what's going on with the battery. That I think has about a -- I want to say it was a 45% penetration in Europe. It hadn't been a big part of the US market to date. I think Ford just announced that they're going to start introducing start-stop technology. My guess is that that will be pretty pervasive across the world. It actually does do a pretty good job of improving fuel efficiency without having to do some sort of hybrid or electric kind of motor. So, it's a relatively easy installation for new cars.

And so, I think we'll start to see a significant portion of the car market have this start-stop technology within the automobiles. And we just have a really great position. We have a particularly good technology that fits well with that market. And so, I think that's been a good driver of growth for us, particularly in this quarter.

Chris Danely - *JPMorgan - Analyst*

Great. If you could make that for children, by the way, it would be like the best semiconductor product effort.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Have a button.

Chris Danely - *JPMorgan - Analyst*

Let's get to talk about the geographies. I think you guys are roughly a third, a third, a third between Europe, North America, and Asia.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

That's true, yes.

Chris Danely - *JPMorgan - Analyst*

Any color commentary? Anything better or worse than expected on a geographical basis?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Well, Europe did do quite well this quarter. I think it was up 16% this quarter. So, that might've been a little bit of a surprise. Having said that, it had been the one that was down a couple of quarters in a row and more significantly than a lot. So, a lot of this is just bouncing off the bottom.

The rest of it was I'd say more end market specific than it was relative to the geographies per se. For example, China did quite well, better than expected. But, that was because the China build out went better than expected for communications infrastructure.

North America was marginally better. But, that was because we just -- we did have some upside in the industrial instrumentation and automation part of the -- part of our industrial business. And a lot of that goes into North America.

Chris Danely - *JPMorgan - Analyst*

How do you feel about your geographies going forward this year? Any -- as you look at them, any of them you would expect to be above normal or below normal or roughly normal?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

No, I think it'll be pretty balanced, quite honestly. I think, clearly, China, if that build out really does continue to gain momentum through the year, China might be a little bit better than expected. The industrial business, depending on how that does, that's generally a European and US play. That might also do a little bit better than expected. But, generally, I'm going to guess that the balance, this third-third-third balance, is probably going to be the same by the end of the year.

Chris Danely - *JPMorgan - Analyst*

Sure. So, we've got -- that's the bottoms-up model. From a top-down perspective, how do you feel about your business right now? Is it seasonal? Is it a little better than seasonal? Then maybe compare and contrast this year versus last year. Last year, you undergrew your peers. This year, it looks like you'll be either in line or maybe even a little bit above. What's changed for ADI?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, I think two things are different. One, the consumer business, which has long been a headwind for us, has what we believe troughed in the first quarter. It rebounded a bit in the second quarter. And we think we'll start to see that business recovering for us.

The second area was this test equipment market. That was a headwind in industrial. That does look like that's rebounded. And so, I think that will be helpful in helping us hopefully outpace our peers.

And then lastly, we've made a lot of investments in communications infrastructure. This -- the build outs, both in China and the US market, were long promised and just hadn't materialized. And at this point, it does look like those things are gaining momentum. So, I think those three things should help us do better than peers.

Clearly, 11% growth in the second quarter is beyond what we normally see from a seasonal perspective. I think, even in our best years, it hasn't been any better than that. So, we feel pretty good in that we did grow better than seasonal in the second quarter.

In the third quarter, it's kind of a -- it kind of depends more on the cycle than seasonality a little bit. But, in general, the third quarter is usually up 1% to down 1%, depending on what kind of cycle we're experiencing. So, guiding up 1% to 5% is actually better than seasonal and I think reflects the strength we're seeing across a broad swath of applications and geographies.

Chris Danely - *JPMorgan - Analyst*

Then can you talk about your visibility? Is it better now than it usually is or about normal? And then some companies yesterday and the day before were talking about not just booking into the current quarter but booking maybe six months out. I think one company even talked about booking into the December quarter. Have you seen your visibility improve over the last three to six months?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, maybe marginally better. But, we still have four- to six-week lead times. And so, there's not a tremendous onus on our customers, not to mention a lot of them are buying through distribution, which has another kind of 7.5 weeks of inventory.

They can -- I think they'd probably feel pretty good about their ability to get supply from us. And so, the idea of layering in a lot of backlog unnecessarily is probably not what they want to do.

We do get a lot of forecast data. And I'd say, in the more recent period of time, that forecast data has been way more reliable. So, if that forecast data is right and our visibility is helped out by that, things should be pretty good through the year. But, I've relied on that forecast data in the past, and I've been burned for it. So, I would say -- .

Chris Danely - *JPMorgan - Analyst*

-- All of us have, unfortunately.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

I would say that, at this point, our best visibility is where we're -- where we think we'll come out for the third quarter. And the fourth quarter is a little bit hazy at this point.

Chris Danely - *JPMorgan - Analyst*

Yes, that's fine. You mentioned distributors keeping 7.5 weeks of inventory. What's normal? And then some other of your competitors -- actually, a lot of semi companies here at the conference have talked about the distributors increasing inventory recently because demand continues to improve. Have you seen any evidence of that? And also, maybe refresh us on your percentage of revenue through distribution.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, sure. So, percentage of revenue through distribution is 55%. And that's been relatively consistent at least since I've been there, which is five years.

The 7.5 weeks is -- I guess, now, maybe it's the new normal. We had always or they had always carried about eight weeks of inventory. But, I'd say, through these last couple of cycles, particularly the one that happened in 2009, it does look like they've become a little bit more conservative about inventory levels. And so, I think 7.5 weeks is probably kind of normal.

One of the things you might've seen in the balance sheet is our deferred income improved by 9%, yet the days of inventory stayed generally the same. So, we measure days of inventory at distribution based on what they have on their shelf. The fact that deferred income went up more significantly is due to the fact that there was quite a bit of shipments that were in transit on that last -- the last week of the quarter, where it didn't show up on their balance sheet, but it wasn't on our balance sheet either. But, we still defer it.

I think that's interesting in that it does indicate that distributors are kind of building inventory, at least in absolute dollar terms. And so, that does give you some confidence, at least if their visibility is as good or better than ours, that there is some good momentum in that.

And that's that -- got more of the broader mostly industrial part of the market, which if that -- when that is going well, that's a good sign for the entire economy, quite honestly, because that's a lot of kind of middle market and smaller electronics and industrial companies that are all just seeing a little momentum across the board. So, that is a good sign for us and for the economy, quite honestly.

Chris Danely - *JPMorgan - Analyst*

Yes, and so, you guys saw a bit of a surge from distis towards the end of the quarter. Has that continued into May? Has your bookings activity in May been as expected, worse than expected, better than expected?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

No, it has been -- it has continued to be strong. So, that's a good sign. Now, it's only been two weeks since the end of the quarter. So, it's hard to make a lot out of two weeks. But, at least for these couple weeks, it's been good.

Chris Danely - *JPMorgan - Analyst*

Yes, I'll take it. I think your incremental -- couple of little questions on the quarter. I think your incremental gross margins were maybe 75% or something like that. Is that about as expected?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

It was as expected. I'd say, probably on average, we run 80%.

Chris Danely - *JPMorgan - Analyst*

Any reason why it was a little lower than that?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

No, not really. A lot of times, we get a mixed benefit in these times where the revenues picked up a lot because the industrial business is usually doing better than the other pieces of the business. And that carries a little bit of momentum on the gross margin side as well. This time around, the mix was basically neutral to gross margins.

And so, really, the lift we got in the gross margins was strictly on utilization. Utilization went from mid-60s to mid-70s. And usually, when it goes up 10 percentage points, a rule of thumb is that the gross margins go up by about 100 basis points. So, it kind of jives with what you would've expected based on the upside and where the upside occurred and so forth.

Chris Danely - *JPMorgan - Analyst*

Okay. And then that would be mix driven to help it as well this quarter, right?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

So, next quarter, I think it's going to be more about mix because I think what we're going to try to do is keep utilization generally the same, work the days of inventory down further, and because coms and industrial have higher margins relative to automotive, given they're going to grow and automotive's expected to be flat to down a little bit, that blend should actually improve the gross margins from a mix perspective. And that's I think where we'll see the upside this quarter.

Chris Danely - *JPMorgan - Analyst*

Okay. Great. Switching gears a little bit to cash, you guys generated I think another $100 million in net cash or something like that during the quarter. The share count was roughly flat. Given that business seemed to be recovering during the quarter, you're coming off a trough. You have -- I think you have plenty of cash. Why not crank up the buyback a little bit?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, well, I can't really crank the buyback with information that no one else knows but me. That would be violating SEC laws. And I'd get to go to jail. And I don't look good in stripes. So -- .

Chris Danely - *JPMorgan - Analyst*

-- No.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

So, generally, what we do is we have kind of an equivalent of a 10b5-1 plan for the corporation. It's somewhat on autopilot. It basically buys when the stock goes below moving averages. And it doesn't buy when it's above the moving averages.

And the second quarter just happened to be a quarter in which a lot more of the days, the stock was kind of above these moving averages, which at the end of the day is probably the more desirable outcome.

I would say that the semiconductors and the Dow in general have kind of weakened through the last couple of weeks. And so, I think we bought more stock back in the first two weeks of the quarter or at least as much stock back in the first two weeks of the quarter as we bought all of last year -- or all of last quarter.

So, it's dependent on these moving averages. And it just so happened that last quarter was not a quarter in which a lot of the buybacks were triggered. But, it does look like there's quite a bit of triggering this quarter. So, my guess is that, when history's written on this quarter, we will have bought back quite a bit of stock.

Chris Danely - *JPMorgan - Analyst*

And I think your share count's gone up from 305 to 318 or something like that over the last six or seven quarters.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes.

Chris Danely - *JPMorgan - Analyst*

You guys have forecasted an 80% payout ratio.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes.

Chris Danely - *JPMorgan - Analyst*

With the current dividend, what would you need in terms of the buyback? And maybe refresh us on what the -- what has been authorized so far as far as the buyback goes.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, so, we have roughly now I guess $1 billion because I don't think -- we tore into only about $20 million of it last quarter. So, we have about a $1 billion buyback program in place. About -- of that, let's call it 60% or 80% payout, normally about 60% plus or minus is the dividend. So, there's another 20% that should come from a buyback.

And obviously, you're right. The share count has crept up. And that buyback hasn't triggered. And mainly, that's because the stock has had relatively consistent improving value over time.

Chris Danely - *JPMorgan - Analyst*

It's because you guys combine quality with leverage.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

So, exactly. And we have a great analyst supporting us. So, the -- and I do expect -- not that I don't expect the stock to kind of continually go up. I -- certainly, that is our goal. But, I -- my expectation is there probably will be volatility in that. There generally is. And there hadn't been I think over the last six quarters.

So, and to the extent that there's volatility, which I think there will be, the buyback will trigger. And we will fulfill the obligations of getting to the 80% payout ratio. I have -- and if we don't, I'll probably overwrite it at some point to make sure we do it.

Chris Danely - *JPMorgan - Analyst*

And I think you guys raised the dividend recently. Can you just talk about the dividend policy? What did it go up by last quarter I think, or was it this quarter?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, last quarter, we increased it from $0.34 a share per quarter to $0.37. So, I don't know what that is, like a 10% or 11% improvement in the dividend. We've consistently increased it, as you point out. We generally are trying to target a 60%-ish kind of payout ratio. We think that's kind of the optimal level. You get too much beyond that, and investors start to worry about, could you possibly cut it. If you're too below that, obviously, they're -- they want to see a more consistent cash return.

So, we keep it at that 60%. It -- not every year, it's 60%. It's somewhat dependent on how we go into the year. But, I think in general that this -- the end of the first quarter is the quarter in which you would generally see us increase our dividend based on kind of expectations for the year in terms of earnings.

Chris Danely - *JPMorgan - Analyst*

And then when you give that 80% payout ratio, is that in any given year? Is that over three years on average? What's the -- ?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

-- Yes, it's unlikely to be every year just because of the way we do the buyback. It has -- the stock has to kind of behave a certain way. But, certainly, over three years, as we look back, we'll see that we paid back 80%.

Chris Danely - *JPMorgan - Analyst*

Great. Now, I'd like to open up to the audience. In the front?

Unidentified Audience Member

(inaudible - microphone inaccessible).

Chris Danely - *JPMorgan - Analyst*

Can you just repeat the question for the people listening?

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, sure. So, the question is regarding why the growth hadn't been as robust in prior years and what our expectations are for -- on a longer-term go-forward basis.

So, part of the -- I think our growth rate was impacted by our move away from consumer. We made a concerted effort to move R&D resources away from consumer and into these business-to-business industrial, communications infrastructure, healthcare, automotive, those kind of markets, and away from consumer. We just weren't getting the ROI on the consumer business.

Now, there are pockets of that market that we can still participate in and we can make a return on. But, for the most part, kind of the wholesale market, we just don't see the returns.

So, the problem with when you move R&D away from consumer, you get kind of the instantaneous response of the revenue goes away. But, most of the cycle times or design cycles in those other markets are fairly long. They could be three, four, five years before you start to see the revenue that comes from the R&D efforts.

And so, I think there was just this period of time where we got a lot of headwind in consumer. And the offsetting improvements in industrial, com infrastructure, healthcare just hadn't turned on. And we kind of -- we had a view that, probably around this time, this is when we were going to start to see the ramifications of moving away from consumer kind of stop and the design -- all these designs that we had won in the other markets start to translate into revenue. And I think that's what you're seeing.

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So, I think we are in a place where we are starting to see a recovery. Now, everybody was weaker in the prior two years. So, it wasn't like we were unique in that. There was clearly kind of a malaise in the market in general. And I -- and part of that is just the overall kind of view from CEOs in terms of capital spending. I think they were all kind of constraining what they were spending. And when they're constraining spending, companies that are highly reliant on capital spending like we are feel the effects of that.

I think that also has kind of changed. I do think that, across the board, most companies are resuming spending. They are making investments now. They do want to grow over time. And so, I think we're starting to see some improvement in that space.

What the market's going to grow at or what our business is going to grow at, I think difficult to say right now. We are going to unveil a model at Analyst Day, which I think is June 17th. So, I'm going to reserve or table that answer until the Analyst Day. And I'll roll out kind of a model in terms of growth rates and profitability at that point.

Chris Danely - *JPMorgan - Analyst*

Great. In the back, [Jared].

Unidentified Audience Member

(inaudible - microphone inaccessible).

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, there's a desire to do M&A. I think, over the last couple months -- when was that? I think in January, Vince put me in charge of M&A. And so, I've -- it's taken me a while to kind of get a lay of the land. I would say that most of the M&A that we'll do is going to be a little bit more tuck -- it won't quite be the magnitude of Avago, LSI. It'd be more technologies.

There's a lot of companies out there that -- a lot of which are kind of pre-IPO that have good positions, good traction in terms of revenue probably that no one's ever heard of, but could be interesting to us. And I think that's probably the area that we'll do most of our M&A.

But, never say never. There could be a potential to do something a little bit more significant. But, all those things are on the table. And we do want to use our cash to grow. And so, we do -- we are looking for opportunities to make acquisitions.

Chris Danely - *JPMorgan - Analyst*

Great. And there was one over there.

Unidentified Audience Member

(inaudible - microphone inaccessible).

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, I think a lot of the test equipment improvement we've seen has been in the automotive space actually. I think the other area that we participate in is in the mobile testing. And that part of the market I don't think is as hot right now but is expected to pick up now on go-forward basis.

Chris Danely - *JPMorgan - Analyst*

[Mihael], you have a question in the back?

Unidentified Audience Member

(inaudible - microphone inaccessible).

Chris Danely - *JPMorgan - Analyst*

Question was on cash flow generation longer term. We have to repeat -- .

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

-- Like, in terms of what? You meant like how much do I think it's going to be, or -- ?

Unidentified Audience Member

-- (inaudible - microphone inaccessible).

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

Yes, I think it's going to be relatively similar to our net income. I think we'll -- what did we do, 34% this quarter? I think, in some quarters, we've done 25%. It's kind of probably averaged around 28% or so. And I think that's a reasonable number.

We actually are spending a little bit more capital than we ordinarily would because we're buying -- we're paying for some buildings right now. So, our capital spending, which'll run $180 million this quarter, is really more like $120 million plus some building outlays.

We may have another building, one or two buildings that we still have to build out that we're just taking a long time to get started on. But, after that, our normal run rate is more in the $120 million to $130 million.

So, if anything, that would shave off 1% or so from the CapEx as a percent of sales. So, you're thinking more in the 4% range. And that would probably push the free cash flow as a percent of revenue to -- I don't know -- something in the kind of 29% range or something like that.

Chris Danely - *JPMorgan - Analyst*

Great. Thanks, guys. That's about all we have time for.

Dave Zinsner - *Analog Devices, Inc. - VP Finance & CFO*

All right. Thanks.
