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PRESENTATION

Operator

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

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

Thank you, Matt, and good morning, everybody. Thanks for joining our third quarter fiscal 2022 call. With me on the call today are ADI's CEO and Chair, Vincent Roche; and ADI's CFO, Prashanth Mahendra-Rajah. For anyone who missed the release, you can find it and relating financial schedules at investor.analog.com.

Now on to the disclosures. The information we're about to discuss includes forward-looking statements, which are subject to certain risks and uncertainties as further described in our earnings release and our periodic reports and other materials filed with the SEC. Actual results could differ materially from the forward-looking information as these statements reflect our expectations as of the date of this call. We undertake no obligation to update these statements, except as required by law.

Our comments today will also include non-GAAP financial measures, which exclude special items. When comparing our results to our historical performance, special items are also excluded from prior periods. Reconciliations of these non-GAAP measures to their most directly comparable GAAP measures and additional information about our non-GAAP measures are included in today's earnings release. Please note, we've also published our annual ESG report last quarter titled Future Forward. You can find it on the IR web page. And with that, I'll turn the call over to ADI's CEO and Chair, Vince. Vince?

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

Thank you, Mike, and good morning to you, all. Well, I'm pleased to share that we executed very well amidst a dynamic macro backdrop. We delivered another quarter of record results, driven by continued operational excellence, strong financial discipline and resilient demand for our diverse portfolio of innovation-rich products. Revenue was \$3.1 billion, up 24% year-over-year on a combined basis and above the midpoint of our outlook. Strength was broad-based with double-digit growth in every end market.

Our third quarter profitability reflects ADI's innovation premium and strong operating leverage with gross and operating margins of 74% and 50%, respectively. Adjusted earnings per share of \$2.52 finished at the high end of our outlook, marking another new high. I'm exceptionally pleased with our results, and I want to thank our employees for their continued hard work and dedication to our success, and importantly, to the success of our customers.

At ADI, innovation is ingrained in our culture, fueled by an unwavering commitment to robust R&D investments. Over the last 12 months, we've invested over \$1.7 billion in R&D. A key facet to our innovation-driven success is our dedication to extensive and deep customer engagements, which enables us to collaborate with them in solving their toughest problems.

Now I'd like to share some recent customer highlights. In Automotive, we reinforced our market-leading position in BMS with wins at 2 premium European auto manufacturers. One of these wins was with our wireless BMS solution. This marks the fourth OEM to adopt wireless BMS as customer interest continues to build for this unique technology. In sustainable energy, we announced a design win with Enel Group on the quantum edge device used to digitally monitor electric grids. ADI's unmatched precision measurement capabilities are critical to creating a more resilient and flexible grid to help advance efficient electrification globally.

In health care, the recently released wireless hospital monitoring system by GE Healthcare in Europe uses ADI solutions across signal chain, power, RF MCUs and sensors. This wearable system enables wireless continuous monitoring to detect patient deterioration earlier, helping to improve outcomes.

Today, I'd like to profile our \$1.5 billion-plus consumer franchise, a business that plays an important role in our long-term profitable growth strategy. Given the recent negative data points surrounding the consumer end market, one may wonder why highlight this market now. But that's just the reason our consumer business is built differently. In the third quarter, we posted our seventh consecutive growth quarter. And while we are not immune to macro slowdown, we have aligned this business to the high end of the market where performance really matters and into applications where our differentiation is truly valued.

The composition of our consumer franchise is indeed unique. Approximately 30% of our revenue comes from long life cycle prosumer applications, including next-generation conferencing systems, professional audio/video and home theater. The remaining revenue in consumer relates to portables, including fast-growing wearables and hearables as well as premium smartphones.

Taking a step back, over the last 5 years-plus, we have reconfigured our consumer business to increase diversity across customers, products and applications to better drive growth and limit volatility while enhancing profitability. The addition of Maxim further enhances our diversity and expanded our portfolio. Over this time, we've increased our product SKUs to just over 10,000 and expanded our customer count to more than 3,000. Importantly, the composition of this business is quite similar to our B2B markets, with no single product contributing more than a couple of percentage points to total ADI sales.

The velocity of innovation in the consumer market is appealing. It allows us to accelerate technology development and commercialize solutions quickly at scale. Over time, we take these breakthrough solutions into other markets to create new waves of growth and drive strong profitability and cash flow. For example, we have leveraged our consumer audio expertise into the automotive market. This capability was demonstrated at our Investor Day where we showcased an electric vehicle with Dolby Atmos that uses our SHARC DSP and software that was first proven in the consumer business.

Additionally, we've also leveraged R&D investments from our core franchises into the consumer market. To that end, our high-precision converters and industrial instrumentation, for example, have been repurposed to solve similar challenges for stabilization in smartphone compass and pressure

sensing in wearables. Not only have we created a highly diverse and profitable business but also one that is aimed at key growth drivers that position us to grow at a high single-digit rate over the long-term.

For example, our prosumer growth has been revitalized as companies implement future of work plans that encompass more immersive enterprise video conferencing. Here, the breadth of our portfolio across DSP, analog, mixed-signal and power management enables us to solve the entire customer challenge from high-bandwidth connectivity to video resolution and sound quality.

And turning now a moment to the portables market. In hearables, we shift into the majority of premium wireless stereo earbuds. Our newest offerings include software-augmented hearing algorithms and optimized power that reduces size and improves audio fidelity while increasing our value per system by over 3x. In wearables, we're a leader in personal wellness products with our sensing solutions designed into over 50% of products today. There is a convergence of these personal wellness products and clinical-grade vital signs monitoring solutions that could unlock new opportunities for ADI. And in premium smartphones, we're expanding our share and content at key customers, which is providing us additional diversification and stimulating new growth vectors.

An emerging opportunity is the Metaverse. ADI's breadth of hardware, software algorithms and domain expertise gives us an ability to provide complete sub-system solutions. While we're still in the early days, of course, momentum is building, and we have design wins in multiple next-generation AR/VR headsets. Across all these consumer applications, power management is becoming ever more critical. Customers are adding more features into smaller spaces, while consumers are demanding longer battery life. Maxim doubled the size of our low-power portfolio and increased our consumer power SAM by over \$1 billion. We're already beginning to see the cross-sell benefits of our complementary customer bases and synergistic portfolios with wins in both wearables and conferencing systems.

So in summary, I'm very encouraged with the strides we've taken to reignite growth in our consumer business, and with a record opportunity pipeline and significant synergy potential, I believe we're in a position to deliver consistent growth over the long-term.

Now before passing over to Prashanth, I'd like to make some comments on the current business environment. Obviously, the macro backdrop is dynamic and it's clear that we're at an inflection point. Economic conditions are beginning to impact demand with orders showing -- orders slowing later in the quarter and cancellations increasing slightly. Prashanth will provide additional details on these dynamics in his remarks.

ADI successfully navigated macro challenges many, many times before in our 57-year history. We've created a premier analog franchise with an unmatched diversity of products, customers and applications. And we've invested in a hybrid manufacturing model that better adapts to demand fluctuations. These characteristics instill a resiliency into our business to mitigate market weaknesses, sustain profitability and enable investment in our business through economic cycles to focus on playing our long game. And with that, I'll hand it over to Prashanth.

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

Thank you, Vince. Let me add my welcome to our third quarter earnings call. My comments today, with the exception of revenue, will be on an adjusted basis, which excludes special items outlined in today's press release. Third quarter revenue of \$3.1 billion finished above the midpoint of our outlook and marked our sixth consecutive quarterly record. If we look at third quarter end market performance, industrial, our most diverse and profitable end market, hit another all-time high and represented 50% of growth -- excuse me, 50% of revenue.

Growth was broad-based with each of our major applications increasing sequentially. Industrial revenue has now grown more than 20% year-over-year for 7 straight quarters, underscoring ADI's strong position and secular content growth across applications. Automotive, which represented 21% of revenue, achieved another record, increasing 28% year-over-year. The better mix of higher-content premium vehicles, combined with our growth engines of BMS, GMSL, A2B and better value capture is driving our outsized growth versus SAAR.

Communications, which represented 16% of revenue, achieved a quarterly record, with strong year-over-year growth in both wireless and wireline. Sequentially, wireline outpaced wireless with growing demand for our optical and power portfolios as carriers and hyperscalers invest to meet the ever-growing demand for data. And lastly, Consumer represented 13% of revenue and has now grown year-over-year for 7 consecutive quarters.

As Vince highlighted, the diversity and growing design momentum across portables and prosumer is enabling us to grow despite the consumer market slowdown.

Now on to the rest of the P&L. Gross margin was 74.1%, up 250 basis points year-over-year, driven by higher utilization, favorable mix and synergy capture. OpEx in the quarter was \$747 million, which reflects a full quarter of higher-than-normal merit increases. Operating margin increased 650 basis points year-over-year, finishing at 50.1% toward the high end of our outlook. Non-Op was \$48 million and the tax rate for the quarter was 13.2%. All told, EPS came in at a record \$2.52, up 47% versus the third quarter of 2021.

On the balance sheet, we ended the quarter with over \$1.5 billion of cash and equivalents. Days of inventory increased to 129, while channel inventory remains below the low end of our target range of 7 to 8 weeks. For cash flow, CapEx for the quarter was \$165 million and \$526 million over the trailing 12 months, just under 5% of revenue. We continue to expect elevated CapEx investments through 2023 to support the strategic expansion of our hybrid manufacturing model. And these investments will strengthen our resiliency and support our long-term growth outlook of 7% to 10% CAGR.

Over the trailing 12 months, we generated over \$3.7 billion of free cash flow or 34% of revenue. Included in our free cash flow are onetime deal-related costs which amount to about 3% of revenue. With the intra-quarter volatility, we opportunistically increased repo activity to \$906 million. And after approximately 1 year post the close of Maxim, we've repurchased \$4.4 billion worth of shares, putting us on track to exceed our \$5 billion commitment by the end of fiscal '22.

Including dividend payments, we've returned approximately \$6 billion to shareholders over the last 12 months or more than 6% of our market cap. As a reminder, we target 100% free cash flow return. We target to allocate 40% to 60% of our free cash flow to support a 10% dividend CAGR through the cycle, with the remaining cash used for share count reduction.

Now before we move to the outlook, I want to provide some additional details around demand. In third quarter, our order book remained strong and backlog increased to a new record, stretching well into mid-2023. However, orders moderated later in the quarter, and as a result, book-to-bill was down from a quarter ago but still well above 1. By market, we are seeing strength persist in both Industrial and Automotive, which together represent over 2/3 of our sales, while Consumer and comms were a bit softer. We also saw a modest increase in cancellations and was not specific to any end market or geography.

Given these dynamics, coupled with the macro backdrop, we believe it's prudent to take a more cautious stance. As such, we are only forecasting slight sequential revenue growth to \$3.15 billion, plus or minus \$100 million, despite bookings, backlog and higher supply that would all suggest stronger growth. At the midpoint, we expect all end markets to grow quarter-over-quarter. Op margin is expected to be 50.3%, plus or minus 70 bps. Our tax rate is expected to be 13% to 14%. And based on these inputs, adjusted EPS is expected to be \$2.57, plus or minus \$0.10.

More broadly, while the macro backdrop is dynamic, our business has several aspects that position us quite well to manage further headwinds. These include our diverse end market exposure, coupled with strong secular drivers that will help buffer our top line. The flexibility of our hybrid manufacturing model gives us confidence in maintaining our 70% gross margin floor. And we also have several OpEx layers to support our industry-leading margins and maintain a solid return of cash to our investors. So in closing, my confidence to our path of \$15 of EPS in the next 5 years remains high. Let me now give it back to Mike for the Q&A.

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from Vivek Arya with Bank of America Securities.

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

I just wanted to clarify how much conservatism is in the Q4 outlook. And then a little bit longer term than that. What happens to the pricing lever as you start to see these bookings start to decelerate? Is pricing holding firm? Is it flat or down as customers start to think about next year?

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

Yes. Thank you for the question, Vivek. Let me take the first part of that, and then maybe I'll let Vince speak to the pricing. So we've been talking for a couple of quarters now that we were expecting a more meaningful increase in our ability to supply in the fourth quarter, and we have been building that with the installations of equipment that we've been having over the course of this year. So our supply -- our ability to supply is in excess of the guide that we put out there.

In addition, our backlog actually increased sequentially from -- into the third quarter to a new all-time record. And given kind of the strength in the backlog, the book-to-bill was still above 1 and increased supply, it's very logical we could print a bigger number. Having said that, we are very aware of the macro environment and a bit more softening in order activity that we saw towards the tail end of the quarter. So that's why we kind of held back a little bit on the guide to ensure that if this order softness does continue, we're not disappointing. Vince, you want to address the pricing question?

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

Yes. Thanks, Vivek. Yes, so I think first and foremost, we are seeing tremendous stability. I don't expect to see any downward pressure on prices even in a recessionary environment. I think first and foremost, our products reflect an innovation premium for the kind of value that we deliver to our customers. Now we're never the long pull in the pricing [tent] either in the customer's bill of material.

The other thing I would say, particularly in the high-performance analog space, the substitution costs are very, very high. So the disruption to a customer system design way, way outweighs considerations for price reduction. So where we obviously compete most intensively on a price basis is to get the original socket, but we have long life cycle products with tremendous stability, very, very high substitution costs. So my sense is that pricing will remain very, very steady through the cycle.

Operator

Our next question will come from B.J. Muse (sic) [C.J. Muse] with Evercore.

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

I guess I'd like to focus on the slowdown in orders that you saw at the tail end of the quarter as well as the cancellations that you highlighted. Any more kind of detail you can provide there as it relates to sub-segment of end markets, geography? Any color would be greatly appreciated.

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

Yes. Thank you. Thanks, C.J. Let me maybe talk about kind of the bookings momentum in a couple of different pieces. So first, third quarter results, where we're clearly broad-based strength, all end markets were up quarter-over-quarter and double digits year-over-year, so our sixth consecutive record. The only geography/market that was down year-over-year was China consumer. But that's a very small exposure for ADI, low -- very low single digits as a percentage of revenue.

From a bookings health standpoint for the third quarter, orders were up. Again, as I mentioned, strongest trends were Industrial and Auto, which represent about 70% of the business. Comms and Consumer weaker, but again, we increased our backlog to another record, another new all-time high, and that covers us well into '23. Where we saw that change in demand was really cancellations ticked modestly higher, and I do say modestly. It is -- we want to be fully transparent on this call, so we're calling out but I wouldn't really put too much focus on the cancellation number. But again, in the spirit of transparency, we want to share that we did see that change in the demand profile.

And we also saw that the channel sell-through began to moderate towards later in the quarter. So that is the sell-through from the channel or POS began to soften a bit versus what we were originally expecting. Overall, the book-to-bill was still above parity but it was definitely lower than it was a quarter ago.

So as we set that guide for fourth quarter, given the uncertainty, changing trends in our business, we thought it's prudent to take a more cautious stance and therefore, we're guiding up only slightly on a quarter-over-quarter basis despite, as I mentioned in answering Vivek's question, despite having very strong backlog coverage, good bookings and better supply, which would all suggest higher growth. Go to next question.

Operator

Our next question will come from Ambrish Srivastava with BMO Capital.

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

I apologize for the background noise. I just had a question, Prashanth, on the floor that you have laid out for the gross margin, which is way above where margins bottomed out at in the prior real cycle and [financial crisis]. And I'm asking this because I get this question a lot. Hey, what's the downside EPS projection for ADI? And so if you could please help us understand kind of what are the underlying assumptions behind that as it relates to utilization inventory. And then more importantly, what are you assuming for revenues to go down to hit that level?

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

Sure, sure. Thank you, Ambrish. So maybe let's start with a reminder that this company is structurally more profitable than we ever have been. The addition of Maxim gives us the benefit of scale, and we have the benefit of that hybrid manufacturing model, which really gives us that flexibility to manage our production utilizations by being able to notify our supply chain partners in the event we need to, with essentially a quarter's notice, to bring the outside supply number down and focus on keeping internal utilizations higher.

As a result of that, we feel very confident that kind of through the downturn of a cycle, we can maintain that 70% gross margin floor, which from an investor model standpoint, is a unique metric that we put out there to give a floor. In thinking about a downturn scenario, and again, I want to emphasize, this is a projection to help investors model what it could be, not in any way a forecast of what we think is coming at us. But from a revenue standpoint, we have this great diversification, 75,000 products, 125,000 customers and thousands and thousands of applications, which are aligned to numerous secular growth markets. We have exposure to much stronger markets in a down cycle like aerospace and defense and health care, which are not going to be as cyclical.

On the gross margin side, I mentioned this flexible manufacturing model that allows us to really help manage utilizations. And then we have a very accordion-driven variable compensation program, which allows us to moderate OpEx. So if we were to think about a downside scenario that was

in a 15% down revenue market, we believe op margins would still have a [4] handle on them, probably be in the low 40s and gross margins would probably be, again, above 70%, but probably in the low 70s.

Operator

Our next question will come from Stacy Rasgon with Bernstein Research.

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

I wanted to delve a little bit more into the bookings and the order. So was it like bookings before were 150% and now they're 130%? Like where is that book-to-bill actually coming in? How far above 1 is it? And I guess what are you assuming happens to the backlog as we go into next quarter? Are you assuming that, that backlog gets drawn down at all or are you assuming it goes up? Or just what are the assumptions around that embedded in the guidance?

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

Yes. So let's see what can we say here, Stacy. So for the last couple of quarters, excluding the third quarter, book-to-bill was -- actually, you can do the math because you can see how the backlog has increased so substantially. It was kind of in sort of partway between a 1 and a 2, right? We're now still above 1 but we're at the lower end of that. Now industrial and automotive, strong, and that helped to compensate for -- I think I'm going for memory here, my Consumer was just about flattish and Comms was just a hair below.

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

Got it. What are you assuming in the next quarter for the backlog?

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

Yes, sure. I mean, the backlog is not that indicative of what happens for next quarter because it goes out into '23. So as you see these cancellations, this is a very small percent of the backlog and that's really into '23. So our assumption is backlog probably increases again because book-to-bill at an enterprise level is still above 1. It's really not going to affect the demand for the fourth quarter or probably even the first quarter at this point. And as Prashanth said, I say investments bookings used to be way above 1. Now they're nicely above 1. So we're still booking above what we're shipping.

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

So what would cause us not to come in kind of in line with supply, right? Why would we -- why would -- for the last couple of quarters, our revenue number has been purely a function of supply, and why could that not be the case for the fourth quarter? Why that could not be the case is if customers say, we'd like to reschedule the timing and we choose, in the spirit of customer satisfaction, not to push it to them although they've ordered it and give them that flexibility to move out.

And it could be, as I mentioned, from the channel standpoint, if the channel looks like inventory in the channel is building at a level that we don't think is healthy for the business. And we choose to keep that inventory on our books to give us more flexibility to make sure that we can match customer demand better.

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

I have 1 thing to that, that's important point Prashanth brought up on the channel is that [31 50] assumes really no channel inventory build. That's a sell-through number that we're guiding to.

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

Yes. Thank you, Mike.

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

That's 4 different parts to that answer, Stacy, so we'll go to the next question.

Operator

Our next question will come from Blayne Curtis with Barclays.

Blayne Peter Curtis - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

I just want to follow up on a part question in terms of just where you're seeing these cancellations. You said Consumer and Comms are weaker. I think you just said Comms book-to-bill is below 1. But I'm just trying to understand in the comments of I think channel sell-through was weaker as well. Can you dial us in, is it isolated to certain segments? Or is all of these comments kind of broad-based in terms of where you're seeing the cancellations and the weaker sell-through?

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

Everything is broad-based, and we -- I think that if we have overemphasized cancellations on this call, that's probably a true statement right now, is I don't want to mislead folks to think that cancellations are a meaningful concern. But again, in the spirit of transparency, we're saying that they were up modestly. But everything we've talked about has been pretty broad-based.

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

And on comms, I just -- maybe just 1 follow-up is this has always been a lumpy business. We know that the wireless guys have spent a big chunk of money buying spectrum. That spectrum has to be deployed, which will require the 5G hardware that we have the market share leading position on. So we're highly confident. This is purely a timing issue. Go to next question please.

Operator

Our next question will come from Tore Svanberg with Stifel.

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

Congrats on another record. As we sort of move through this softer environment, how are you thinking about the 3 big cost levers, utilization, OpEx and CapEx going forward?

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

Okay. So I think we've talked through some of that, Tore, but from at least certainly utilization levels, we're going to continue to see relatively good utilization levels across our internal factories for a few reasons: one is the benefit of the hybrid model is that we can bring more production in-house; second is that die bank levels are at very low levels, and we do need to get those die bank levels back to a healthy point. Die bank is an extremely cost-efficient place for us to hold inventory, particularly when you have 75,000 SKUs. You can hold it sort of think of it as \$0.10 on the dollar. So it is very economically efficient and allows us to improve customer satisfaction later on.

From an OpEx standpoint, as you've seen in the past, we have a very accordion-driven variable compensation program, which automatically unwinds if the financial performance of the company drives it to. And I think what's unique to ADI versus perhaps some of our peers is we have the cost synergies from Maxim, which are independent of the economic environment.

From a CapEx standpoint, expect us to be -- it is business as usual. We had committed at the Investor Day to a higher level of CapEx in '22 and '23, which is necessary to add the supply needed to hit our long-term model of 7% to 10% growth, which we are very much committed to, and that is on track. Capital spend for the current quarter -- sorry, for the current year, maybe a bit below what we expected. That's a consequence of revenue coming in stronger, so bigger denominator and also just a little bit of delay in the receiving some of that equipment, but all of that will drive through in 2023.

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

Yes. Sorry, Tore. On the OpEx side, we intend to -- we've been spending R&D at record levels. We intend to continue to ensure that we have properly funded all our critical programs. Innovation is a very, very important part of the value creation story of ADI. We are -- also we've been upping actually the spend in our go-to-market activities as well. So both of those, we will continue to keep our pedal to the metal on.

Operator

Our next question will come from Toshiya Hari with Goldman Sachs.

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

I wanted to ask a question on the supply side sort of the equation. Three months ago, you had talked about significant tightness, whether it be your internal supply or external foundry supply. I'm just curious if you're starting to see signs of supply easing. I guess test was a big bottleneck for internal supply 3, 6 months ago. Any changes there?

And in terms of foundry wafer supply, again, any signs of easing? And kind of related to that, there have been some headlines about foundry wafer pricing increasing again in late '22 going into '23. Is that sort of the indication you're getting from your suppliers? And if so, are you comfortable that you'd be able to pass those through to your customers?

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

Well, I think the last part of your question, first, on pricing increases, I believe that we are in the post-Moore's Law era and in a period of sustained structural inflation in this business for many, many years ahead. I think it's true to say that supply -- we've been increasing, of course. We've invested strongly in our own manufacturing capabilities to be able to secure supply and increase supply actually across the 4 wafer fabs inside ADI. So yes, supply is improving there. And thematically as well as supply has been improving actually right through the pandemic, right over the last couple of years from our subcontractors as well. So I think there is a lightening of supply across the board.

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

On pricing, maybe I'll just restate what we said in the past. We are not using this environment to take advantage of our customers, and we are really looking to maintain our gross margin model. And the rationale on that gross margin model, which is important to us, is we know, as Vince mentioned, we spend at a healthy clip on R&D to develop highly innovative products, and we need to capture that innovation premium from our customers. So as our costs may increase, it's important that we continue to capture those cost increases back with stable margins because it's a reflection of the value we're bringing to our customers.

Operator

Our next question will come from Harlan Sur with JPMorgan.

Harlan Sur - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Just 1 clarification. So I just wanted to verify, so you guys said that currently, quarter-to-date, your book-to-bill is still greater than 1. That's my clarification question. Then my main question is distribution represents about 60% of the team's revenues, right? And it looks like just the inventories are still below your target levels of 7 to 8 weeks. Obviously, the eventual catch-up should provide you guys with some cushion if the environment continues to weaken further. But that being said, it still feels like Auto and Industrial demand is still quite strong. So given your outlook, like what's your view on getting to target levels on channel inventories over the next few quarters?

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

Yes. Thanks, Harlan. Your -- first of all, say that you recapped it correctly, and there is some opportunity for us to continue to grow our revenue by bringing disti levels back to our healthy target level. But I want to emphasize that the guide, as Mike mentioned, the guide for the fourth quarter is on the basis of POS equals POA. One thing that ADI has been very consistent about for many years is we run our business on POS. So we need to look at end demand, and end demand drives how we end up manufacturing, and we want distis to be able to help us with access for those products, but we are not looking for distribution to be an excess buffer of inventory.

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

And the 1 other part of the question that you had, Harlan, was book-to-bill. Yes, for the quarter, book-to-bill was still well above 1 at enterprise level. That was driven by Industrial and Auto with the 2 strongest markets, while Comms and Consumer, we'll call about flat, around 1. And with that, we have our last question, please?

Operator

Our last question will come from Ross Seymore with Deutsche Bank.

Ross Clark Seymore - *Deutsche Bank AG, Research Division - MD*

Vince, a lot of questions about near-term cancellations, bookings, backlog, all those sorts of things. I wanted to ask a slightly longer one. You mentioned in answer to an earlier question about we're in a post-Moore's Law world. We're going to have an inflationary environment rather than deflationary. Can you just talk a little bit about how the customer conversations have changed? Over the last few months, we've heard a lot from last year, a lot from companies saying it's more of a partnership, longer lead times, et cetera, long-term supply agreements, those sorts of things. Do you still see that behavior continuing? Or do you believe that's a little bit more of a reflection of cyclical tightness and you expect some of that to unwind as well?

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

Yes, it's a very good question. I've had a lot of conversations, Ross, over the last couple of years with CEOs of the biggest enterprises in the world of information. And what I can tell you for sure is that everybody wants to get closer to their key suppliers when it comes to aligning product road maps for the long-term, particularly companies that are perceived as being critical to their innovation processes. So I can tell you that continues.

And the other side of the equation is everybody wants to understand at the customer side of things, what do they need to do to secure supply for the long term? And what kind of arrangements that they need to put in place? What kind of information flows? What kind of models that we develop between each other? So that continues. I think it has been firmly established now that semiconductors are the bedrock of the modern -- of modern socioeconomic life. So the conversations continue intensively, I would say, and I expect that to continue well into the future.

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

And with that, thanks, everyone, for joining our call this morning. I do want to flag that during these more uncertain times and consistent with our commitment to transparency for our owners, we'll be even more available. Vince and Prashanth will be in New York, L.A., the Bay Area, Chicago and across Europe in the next quarter, so it's a busy quarter coming up for us. Please reach out to myself or the IR team if you'd like to be notified when we're in your neighborhood. And with that, thanks for joining us and your continued interest in ADI.

Operator

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

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