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ADI - Q2 2020 Analog Devices Inc Earnings Call

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OVERVIEW:

Co. reported 2Q20 revenue of $1.32b and adjusted diluted EPS, excluding special items, of $1.08. Expects 3Q20 revenue to be $1.32b, plus or minus $70m and adjusted EPS to be $1.08, plus or minus $0.11.

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PRESENTATION

Operator

Good morning, and welcome to the Analog Devices Fourth Quarter and Fiscal Year 2019 Earnings Conference Call, which is being audio webcast via telephone and over the web.

I'd now like to introduce your host for today's call, Mr. Michael Lucarelli, Director of Investor Relations. Sir, the floor is yours.

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Thank you, Cheryl, and good morning, everybody. Thanks for joining our second quarter fiscal 2020 conference call. With me on the call today are ADI's CEO, 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. Information we're about to discuss includes forward-looking statements that involve risks and uncertainties. Actual results may differ materially from these forward-looking statements as a result of various factors, including the uncertainty regarding the duration of COVID-19 pandemic, and it's impact on our business, our customers and suppliers and the global economy and also those discussed in our earnings release in our most recent 10-Q. These forward-looking statements reflect our opinion as of the date of this call. We undertake no obligation to update these forward-looking statements in light of new information or future events.

Our comments today will also include non-GAAP financial measures, which exclude special items. In comparing our results to our historical performance, special items are also excluded from prior periods. Reconciliation of these non-GAAP measures to the most directly comparable GAAP measures and additional information about our non-GAAP measures are included in today's earnings release.

And with that, I'll turn it over to ADI's CEO, Vincent Roche. Vince?

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Thank you, Mike, and good morning to you all from Boston. I hope that you and your families are all staying safe and healthy during this period. First, we want to express our gratitude to the health care workers and the many other heroes on the front lines who are protecting the health and the well-being of our communities. Thank you all so very, very much.

When we had our last earnings call in mid-February, we were just beginning to understand the depths of the COVID-19 impact in China, and since then, the pandemic has had a profound impact on the world, putting tremendous stress in society and, of course, the global economy.

To counterbalance this, we've seen an unprecedented response from governments with the deployment of fiscal and monetary policies to soften the downturn and restart economic activity, whenever that may be. While our sector is not immune to the turbulent operating environment, it's my belief that technology will be what modifies the current weakness and drives new demand and business models post pandemic. That's not to say that we're standing still; we've taken actions to curtail spending and reinforce our cash position. And we are learning from this challenging period and adapting quickly while still investing to ensure that we are well positioned in the recovery and for the long term.

Our team has embraced the challenges with many of our employees working from home, but obviously, not everyone can work remotely, and I want to acknowledge and thank our manufacturing employees who've continued to perform at exceptional levels and deliver for our customers. For these employees supporting our critical operations, we've implemented safeguards to protect them, including more PPE, increasing social distancing and enhanced sanitization. And we provided them with additional incentives and benefits to allow for continuity during this very difficult time.

Our team has also done an excellent job staying close to our customers. We moved quickly to pivot manufacturing lines and prioritize our health care solutions that are needed in the fight against COVID-19. This has allowed us to expedite supply used in products such as ventilators, respirators, imaging systems and patient monitors to our health care customers. And I'm incredibly proud of the resourcefulness and commitment that we've shown in rising to this critical challenge.

Additionally, through the ADI Foundation, we've made multimillion-dollar donations to support both global and local pandemic response efforts. But our work goes beyond financial contributions. We're also partnering with hospitals and biotech start-ups to develop solutions, such as rapid point-of-care diagnostic tests and clinical-grade patient monitoring that leverage our technologies.

So now I'd like to discuss the current operating environment a bit. Given the reach and depth of the current crisis, global business activity has been disrupted, and to date, we have seen a deterioration in demand within our automotive, broad-based industrial and consumer businesses. However, our business is proving more resilient than during the global financial crisis. To that end, health care demand is at record levels and communications demand is robust across wireless and indeed, wireline sectors. We're also seeing strength in portions of our industrial instrumentation business and steadiness in our defense business.

Now this success is no accident. Through our organic investments and acquisitions of Hittite and LTC, ADI is a very different company than we were a decade ago with more diversity, a broader portfolio across high performance analog, power and RF and higher exposure to more profitable and durable end markets.

So now let me move to the other side of the equation and talk a little bit about supply. Across the world, supply chains were disrupted when many governments ordered shelter-in-place mandates and closed their borders. For ADI, capacity was reduced at our back-end tests and assembly sites in mid-March across the Philippines, Malaysia and Singapore. Once granted essential status, we acted quickly, yet responsibly to ensure employee safety and improve our capacity. And today, I'm glad to say we're operating at normal capacity levels. This demonstrates the agility of our global operations and the dedication of ADI's employees around the world.

Despite the fluid and uncertain demand and supply environment, we delivered revenue of $1.32 billion and EPS of $1.08. This was in line with the original range we provided on our first quarter earnings call, underscoring the resiliency and flexibility of our business model in any economic backdrop.

Now as we've mobilized preserve ADI strength in the near term, we're capitalizing on the many opportunities we see to fortify and expand our market position for the long term. Our team remains focused on our 3 strategic priorities, so let me provide you with a brief update on each.

First is the efficient use of capital. Importantly, ADI has ample financial liquidity to meet the needs of our business across critical investments, dividend payments and servicing our debt. Despite the current macro environment, we've generated $1.8 billion of free cash flow or 32% of sales over the trailing 12 months. This continues to place ADI in the top 10% of the S&P 500.

Throughout our 55-year history, we've encountered and navigated several black swan events successfully by taking a disciplined and balanced approach to financial management. Specifically, the first call on our capital is funding new product development. This means investing smartly in both our people and technologies to ensure we continue to deliver disruptive innovation. In the quarter just passed, we invested 19% of revenue in R&D, spending 95% on the most attractive opportunities across our B2B markets.

We also remain committed to strong shareholder returns, with our dividend as the cornerstone. In the quarter, we returned over $340 million to shareholders through dividends and share repurchases.

So let me turn to our second priority, which is about maximizing customer impact. We are continuously innovating to stay ahead of customer needs, and while COVID-19 has brought new challenges, it has also revealed new opportunities in a reordered world.

During the quarter, our customer engagement didn't slow down. We hosted hundreds of virtual seminars with thousands of customers in attendance, training them on new solutions and new technologies. These interactions were very productive. We saw increased design activity on new product development across markets and customers. For example, we partnered with a key electric vehicle customer to reimagine how audio is rendered across their fleet. As a result of this increased and focused collaboration, we added our high-performance audio digital signal processors to our A2B platform, more than doubling our content per vehicle.

And in our instrumentation test business for data center compute, we continue to work with customers on reducing their system complexity and getting to market faster. Our innovative solutions combine our analog mixed-signal and power micromodule portfolios. These solutions deliver 4x the channel density while simultaneously increasing throughput. While these are just 2 examples, there are many more across all of our markets. It's this current flurry of design activity that positions ADI to accelerate post pandemic.

Our third priority is capitalizing on secular trends to expand our addressable markets and drive diversified growth. While every downturn has its own unique characteristics, they all seem to have one thing in common, that is they drive tremendous change. Industries are prioritizing digitalization and connectivity more than ever, and new industries are emerging, focused on the physical and cyber. ADI, where the data is born, is at the center of these exciting secular growth opportunities, and I wanted to share some thoughts with you today.

As I noted earlier, our health care business is providing several of the technologies that are critical to the diagnosis and treatment of COVID-19. Taking a step back, ADI has been committed to this market for many years, as we anticipated the opportunity for innovation to deliver better patient outcomes. Now this crisis will challenge us to rethink and hopefully fast-track the accessibility, affordability and wellness focus of global healthcare. To achieve this, health care systems are going to need to be upgraded and clinical-grade patient monitoring will need to be extended from the hospital right down to the patient's home. Massive adoption of sensing, computing and cloud capabilities is going to be required, and we believe that ADI's technologies will be at the forefront of this transformation.

The communications market is moving at a rapid pace to keep up with the strains put on bandwidth and latency, as more people work remotely, transact business more digitally and consume media from everywhere. Here, ADI is playing a critical role in building out the infrastructure required for an always connected world. Our integrated transceiver, power and optical control portfolios are enabling customers to economically scale their investments to build the next-generation networks. We continue to innovate to meet future performance, size and power needs, positioning us to gain share and to capture additional value.

Another secular trend we're benefiting from is the rise of Industry 4.0. Now while this trend isn't so new, the pandemic is moving it to the forefront of our customers' minds. It's clear that post pandemic, supply chains will be reimagined, and new ones will be built, ones that are more flexible, automated and perhaps sovereign. To serve the economic burden that comes with this, customers will further automate their businesses with intelligent and connected factory floors and the increased use of robots, cobots and analytics. This creates additional demand for our precision signal chain and power franchises and extends ADI into new areas like software IO, depth sensing, condition-based monitoring and robust connectivity.

Outside of these secular growth trends, I'm also personally inspired by the tremendous sustainability benefits that we've seen in a short amount of time. For example, we've seen sizable decreases in carbon dioxide and nitrous oxide and carbon monoxide. I believe that ADI and the industry at large can and should be leveraging its creative brainpower to be better stewards of the planet. We recently published our comprehensive corporate responsibility report entitled Engineering Good, and I can assure you there will be more to come as I'm deeply committed to ADI's leadership here.

So in closing, the shape of the economic recovery is still very, very uncertain and dependent on many variables. While we're confident in our outlook provided today, this unprecedented macro backdrop will continue to influence supply and demand dynamics for some time to come. We're embracing these short-term challenges and by leveraging the collective power of our talent, our technology and customer engagements, I'm very confident we will emerge stronger.

So with that, I'd like to turn it over to Prashanth.

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

Thank you, Vince. Let me add my welcome to our second quarter earnings call. As a reminder, my comments today, with the exception of revenue and nonop expenses, will be on an adjusted basis, which excludes special items outlined in today's press release.

Back in March, we withdrew our guidance for the second quarter as the spread of COVID created an enormous amount of uncertainty and impacted our supply chain. However, we acted quickly and decisively, and I'm pleased to say that our second quarter results were within our original guidance, with revenue of $1.32 billion, operating margin of 38% and EPS of $1.08. Without those capacity limitations, we believe revenue would have been above our original midpoint provided at our first quarter earnings or approximately $50 million higher.

So let's get into the market results. Our B2B markets, while very volatile intra-quarter due to COVID-19, performed relatively in line with our expectations. B2B revenue increased 3% sequentially, and if not for supply constraints, we would have delivered on our outlook of growing mid- to high single digits sequentially. Notably, we achieved these results while reducing channel inventory by $60 million in the quarter.

Industrial, which represented 54% of revenue during the quarter, finished up 4% sequentially and declined 8% year-over-year. While we experienced broad-based weakness across most applications, our health care, memory test and energy verticals all grew from the year ago period.

Communications, which accounted for 21% of revenue, finished up 15% sequentially, and given the tough compare, decreased 24% year-over-year with weakness across both wireless and wired. This market is and will remain lumpy, but over the long term, will be a high-growth market for ADI, given our positioning in 5G and optical control systems.

Automotive, which represented 14% of revenue, down 12% sequentially and 23% year-over-year, with declines across all major applications. Not surprisingly, our auto business was impacted by low vehicle sales and a global slowdown in production as many customers were required to suspend their operations in response to COVID-19.

Lastly, consumer, which represented 11% of revenue, was down 14% sequentially and 5% year-over-year as lower consumer spending impacted both portables and prosumer. Notably, we continue to expect 2020 to be the bottom for our consumer segment.

Let's go to the P&L for the second quarter. Gross margin came in at 67.7%, down both sequentially and year-over-year related to low utilizations from reduced production levels and the factory closures I mentioned earlier. As a reminder, we expect to realize $100 million of cost of goods savings exiting fiscal 2021 through the optimization of our manufacturing footprint.

OpEx was $390 million, down 5% sequentially, marking the sixth consecutive quarter of decline. This was driven by a combination of the quick aggressive measures we took in response to the pandemic, as well as our continued focus on cost management. Operating margin finished at 38%, up over 100 basis points sequentially and down year-over-year. Non-op expenses were $49 million, up sequentially but down over $10 million compared to last year. Our tax rate for the quarter was approximately 11%, and all told, second quarter adjusted EPS came in at $1.08.

So now let's go to the balance sheet and cash flow. During the quarter, we proactively bolstered our strong liquidity position. We retired a $300 million bond and subsequently raised $400 million from the semiconductor industry's first ever green bond, and as a cautionary measure, we also temporarily suspended our share repurchase program midway through the quarter. As a result, we finished the quarter with approximately $800 million of cash and about $5.6 million in total debt. Our net debt-to-EBITDA ratio is 1.9x on a trailing 12-month basis.

Between cash on our balance sheet and the commitments under our revolving credit facility, ADI has more than $2 billion of liquidity, easily eclipsing our annual dividend payment and the debt due in January of 2021. Inventory was essentially flat from the first quarter. However, days of inventory fell to 126 from 133. Our sell-in revenue was well below our sell-through revenue at distributors. As I mentioned, we reduced channel inventory by about $60 million in the second quarter. This brings our total channel reduction to around $100 million in the first half of fiscal 2020. Channel inventory currently sits comfortably at the low end of our 7- to 8-week range.

So finishing on cash flow for the quarter, cash flow from ops was $429 million, and CapEx was $60 million. We expect CapEx to decline meaningfully in the second half and finish the year below our normal target range of 4% of revenue. In the quarter, ADI paid approximately $230 million in dividends and repurchased $114 million of our stock.

On a trailing 12-month basis, free cash flow finished at $1.8 billion or 32% of revenue. Over this period, we reduced debt by roughly $400 million and returned around $830 million to shareholders via dividends and an additional $500 million via repurchases.

As a reminder, our capital return policy is to return all free cash flow after debt reduction to shareholders. In fiscal 2020, we expect to reduce debt by $300 million to $500 million and return 100% of the remaining free cash flow.

Before moving to our outlook, I want to highlight what we are seeing in terms of demand and supply. As Vince mentioned earlier, our business is performing quite well under the current macro backdrop. Health care is very strong, and we expect this strength to persist into the back half of the year. We are seeing robust demand in communications across both wireless from 5G deployments and wireline from data center and networking upgrades. This strength is benefiting our industrial instrumentation business where we sell high-performance solutions used in both memory and 5G testing.

And lastly, defense is typically a steady business against all economic backdrops. All told, these markets represent almost half of ADI's revenue over the last year. From a supply standpoint, we enter our fiscal third quarter at normal capacity levels. This is quite remarkable, and I want to echo Vince's appreciation for the dedicated manufacturing teams across the world.

And that brings us to our third quarter outlook. Revenue is expected to be flat sequentially at $1.32 billion, plus or minus $70 million, which is a wider range than usual to account for the uncertain environment. This outlook includes approximately $50 million of revenue that was pushed from second quarter due to capacity constraints. We are assuming no change in channel inventory in this plan. We anticipate robust sequential growth in comms, modest sequential declines in industrial and consumer and a sharp sequential decline in automotive. All told, B2B should increase slightly sequentially and decline just under 10% year-over-year. We anticipate op margins to be approximately 38.3%, plus or minus 150 bps, planning for the tax rate in the quarter to be between 12% and 13%. And based on these inputs, adjusted EPS is expected to be $1.08, plus or minus $0.11.

As Vince said, we are confident in our third quarter outlook, but we are mindful of the tremendous uncertainty around this. Our operating model is to plan conservatively and execute aggressively to preserve free cash flow in the near term. At the same time, we remain focused on the long term, continuing to invest to capture and create value across several exciting secular growth areas.

Let me pass it back to Mike now to start our Q&A.

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Okay. Thank you, Prashanth. Now let's get to our Q&A session. Please limit yourself to 1 questions. After our initial response, we'll give you an opportunity for follow-up questions. Cheryl, can we have our first question, please?

QUESTIONS AND ANSWERS

Operator

Our first question comes from John Pitzer from Crédit Suisse.

John William Pitzer - *Crédit Suisse AG, Research Division - MD, Global Technology Strategist and Global Technology Sector Head*

Congratulations on the solid results given the backdrop. Vince, I guess the question that I'm getting this morning from investors is just relative to your July quarter guidance. Most of your peers have been guiding anywhere from 10 to 15 percentage points below seasonal. You guys are guiding about 5 percentage points below seasonal. And I guess the question that's being asked is, to what extent are you just not being as conservative as your peers? To what extent are there some idiosyncratic drivers? Could you help us parse that out?

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Yes. Thanks, John. So I think, first and foremost, we've seen tremendous strength in our health care business over the last quarter, and we expect that -- that will also continue. Also, generally speaking, with virtualized commerce, work from home, we're seeing, again, very, very strong demand for the communications products. The optical cable portfolios of ADI are doing particularly well. And of course, 5G, especially in China and Asia, the 5G build-out is moving at pace. So what we're seeing -- what we're predicting looking ahead is based on the order streams that we've seen. And whatever -- what others are predicting, we feel comfortable based on the strength in the areas I've just mentioned. Our defense business continues quite strong. Also, businesses attached to, let's say, the build-out of data centers and cloud, like advanced instrumentation test systems for memory, storage and so on and so forth, are also doing particularly well. So our -- the overall industrial business holds in there, as Prashanth said, probably see a modest decline or seasonal decline in the third quarter. So overall, they are the drivers. And as Prashanth said, we expect a steep decline in the automotive business. But when you look at the puts and takes, that's how we see the quarter shaping up.

John William Pitzer - *Crédit Suisse AG, Research Division - MD, Global Technology Strategist and Global Technology Sector Head*

That's helpful, Vince. And just maybe -- go ahead, Prashanth.

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

John, maybe -- I was going to give a little bit more background on kind of the orders and outlook, which may help investors as to why our guide came in where it is. So very quickly, kind of, as expected, Feb was weak. March came back very strong, largely driven by China, but also some pretty strong demand outside from customer concerns, and then it began to correct. So April was soft, continued into May. We finished with kind of book-to-bill above 1.0 in all of our markets, except auto. So as we thought about the outlook, we -- we built our outlook on the expectation that orders are going to continue to slow through the quarter or best case, stabilize. The guide that we have out there is built on 100% backlog coverage, which is much higher than we would normally use when we're at this point in the quarter. We're working terms with our customers, and we're enforcing them pretty stringently. So any customers or disty orders are noncancelable within a 35-day window, unless we agree to grant an exception. So that's helping to kind of clean through the backlog and limit order cancellations. So all in, I think the assumptions are reasonable given the amount of uncertainty. And we did put a little bit wider range on there, plus or minus 70 to reflect the uncertainty. You follow that, John?

John William Pitzer - *Crédit Suisse AG, Research Division - MD, Global Technology Strategist and Global Technology Sector Head*

That's great color, guys. And then, Vince, just as my follow-up. As you mentioned in your prepared comments, the concept of Industry 4.0 has been around for a while, but it does seem like COVID has the potential of actually shining a spotlight on that in a way that we have it. And I guess, in my mind, that probably also helps the 5G build-out because it's hard to have an intelligent factory floor without that 5G backbone. But I was hoping maybe you could help us define that market opportunity for you. When you look at sort of the intelligent factory floor, what percent of your industrial business is it today? And how should we think about potential growth rates 3 to 5 years out, if this really starts to accelerate?

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Yes. It's a good question, John. I would say today, what we would consider to be Industry 4.0 with a highly cloud connected industrial sector is quite small. I think today, it's probably less than 10% of the total installations of factory automation and process control systems. But the intelligence we're getting from many of our customers now is that there are 2 things driving the need for the deployment of industry -- probably 3 things. One, the need for them to understand how to gather and utilize data analytics to improve the outcomes for their customers. So that assumes automatically that you deploy 5G, you deploy optical connectivity, many forms of shorter -- shorter robust connectivity. I think also the -- we're seeing the fragility of the supply chain globally. And customers are telling us they're expecting to bring more machine capability into managing the supply chain. And I think thirdly is the regionalization or the suburbanization of supply chains, and we can see the pressures there globally. And not to mention the demographics. Many of the societies that are producing lots of capital goods and consumer good outputs like Germany, China and as America begins to regionalize supply chain, we're likely to see the adoption of cobotics and more robotics technologies in general. So I think it's a long way to go, John. We're in the early innings of the Industrial 4.0, the adoption of that.

Operator

Our next our next question comes from Tore Svanberg from Stifel.

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

Congratulations on the results.

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Thanks, Tore.

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

First question is for Vince. Vince, you talked quite a bit about sort of investing in this time frame. And you highlighted, again, medical and industrial. What about the automotive market? Are you seeing sort of a secular change there? Are you still investing? Or will you still be investing as heavily in automotive going forward?

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Well, we've actually been ramping, Tore, our investments in automotive, particularly in the infotainment, the power side of things, and also the electrification of the vehicle, the electric powertrain. So right now, it's a very, very hard market to read, both in terms of demand and, of course, supply. I think automotive has been extremely hard hit by the closures globally. So we see, I would say, the 2 areas of most interest to us, Tore, are the infotainment, the car experience, leveraging, for example, our A2B technology, our heritage and digital signal processing and audio signal processing in general adding, for example, active noise cancellation to the portfolio, and we're deploying that -- starting to deploy that now. So I think the whole infotainment side of things is an important part of the go ahead, and that's a place where we've a lot of heritage and where we're actually increasing investment. We just acquired a company actually during the quarter to enable us to bring more signal processing to the audio space.

In the electric vehicle area, I think it's got a long, long road ahead of it. As the electrification today, the powertrain, the -- as a portion of overall car sales, it's only about 1 -- certainly less than 2% of total car sales. So a long, long way to go, and that's an area where we have strong position. We're on our fourth -- our fifth generation of technology node product delivery to that sector. So I'd say in those areas, we are actually increasing investments.

Power is another area, the cross connective power into our business, particularly in Europe and the U.S., that's an important initiative. And we're seeing some very good green shoots there in terms of early-stage production of designs -- of power designs that we've attached to the single processing portfolio. I think it's also true to say, Tore, that probably on the safety side of things, we've been decreasing our investments over the last several years, particularly in MEMS, you'll recall 3, 4 years ago, we withdrew most of our investments in that area. So I would say safety is more opportunistic, infotainment and electric powertrain more strategic.

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Tore, do you have a follow-up?

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

Yes. That was very helpful. A follow-up for Prashanth. Prashanth, I do realize, obviously, right now, the orders are kind of all over the place. But if we start to see deterioration, what would be the company's playbook, especially on things like manufacturing utilization inventory because it seems like some of your peers have different playbooks? Just wondering what ADI's playbook will be in response to potentially weaker or continuous weaker orders.

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

Sure. Yes. So Tore, let's do that in 2 pieces. First, think about how we manage our costs. So right, in the near term, how we think about cost, and you've seen it in the OpEx results already. We have a variable comp structure that is intended to act as a shock absorber and that unwinds as revenue falls. On the discretionary side, we've already frozen hiring, we've essentially got travel at 0, we've exited consultants and any discretionary contractors. And perhaps most impactful is we've deferred our merit increase, which is usually 2% to 3% year-over-year. We are on track to realize about $35 million of synergies that we announced last year in November, and we still have $100 million of cost synergies that will come through by the end of 2021. So there are some more permanent actions that we can take, and we have taken in the past, such as furloughing employees until demand returns. We did this back in 2008, 2009. It would certainly put activities like temporary actions on the table. So there are all items we'll think about.

The -- on the manufacturing side, I would emphasize that our utilizations are fairly low right now. So we're kind of at the trough levels. Inventories are, we feel, at a good position. So I don't think we have kind of the same inventory exposure that we would have had at the same time last year. We've reduced on the balance sheet as well as in the channel. So overall, I think we're well positioned if this breaks up or should it break down. Maybe, Vince, do you want to talk a bit more about kind of longer term?

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Yes. So I think, Tore, we feel good about the stability -- the diversity and stability of our business and what the profit margins we generate as a company. We're investing to make sure we come out of this trough, as stronger company, both in terms of product development as well as customer engagement. So we also believe very strongly in the persistence and the pervasiveness of our technologies. So I believe that the story for ADI gets stronger with the tailwinds that we have and the portfolio that we have for the future. So look, overall, our goal is to take advantage of the disarray. And while -- I think Prashanth said in his prepared remarks, we're preparing for the worst, but we're executing aggressively for the future.

Operator

And our next question comes from Vivek Arya from Bank of America Securities.

Vivek Arya - *BofA Merrill Lynch, Research Division - Director*

Congratulations on the good execution.

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Thank you.

Vivek Arya - *BofA Merrill Lynch, Research Division - Director*

I'm curious, Vince, what in the communications segment, just near term, did you see any level of pull-in from China or Huawei in either April or July? And then as we get beyond the current environment, do you see any further impact from all the restrictions on Huawei? Or do you think that share will be shifted over to Huawei's competitors, so longer term, you can start to regrow your communications segment?

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Well, Vivek, let me answer the second part of your question first. So we have tremendous coverage. We've got very strong market share across all the providers, all the OEMs of -- for 5G across the globe. So irrespective -- I mean, the networks are going to get built, and whoever builds them will be using our stuff, our transceiver technologies, our microwave portfolios, many, many other ancillary analog technologies. And -- so I feel good about the position that we're in. If share shifts from one to the other, we will pick it up. And -- so the -- yes, in terms of demand, I would say we have reconciled. So it's pretty clear what the carriers are saying about the deployment of 5G globally right now. Our reconciliation in terms of how we balance the demand of the carriers is with -- it is very tightly tied to our supply. So we have a good sense for what the carriers are looking for, and that's how we're planning essentially the factory loadings to support this particular area. So I don't think -- I mean you asked about are we seeing double ordering and so on and so forth. What is characteristic in the base station infrastructure market over many, many years is that you get generations. When a set of contracts are coming due, you see some level of, I would say, core need and a certain amount of redundancy built in, but it's pretty typical. What we're seeing right now in terms of 5G is no different to what we've seen in terms of the dynamics how 4G operated in terms of demand.

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Vivek, I remember on the call, what we said publicly about that large customer in China. A year ago, we talked about them being a mid-single-digit customer. They've been reduced meaningfully since that time. They're more around the low single-digit percent of sales today. As we look forward to our third quarter and beyond, we don't see that changing from there. Do you have a follow-up with that?

Vivek Arya - *BofA Merrill Lynch, Research Division - Director*

Yes, very helpful. On gross margins, how should we think about the trajectory from here? Given all the puts and takes of mix, and I think, Prashanth, you mentioned fab under utilization, but then you also mentioned some of the cost synergies. So let's assume sales stay at similar levels even going into your Q4. What can gross margins do then?

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

Sure. Yes. Good question, Vivek. So our model is 70% long term. And you saw that in good times, we can get up to 72% plus. And in more challenging times, like now, we're sort of in the high 60s. So through and through a cycle, we can average 70%. Getting to 70% is very macro dependent. As demand gets better, we are going to get utilization tailwind. We have, as I mentioned, utilizations are near trough levels now. We have -- what we have in our favor is an additional $100 million of cost of goods synergies. So that should begin to give some tailwind as well to our gross margins. And then as 2021 returns to kind of growth numbers, then I feel that it's reasonable for us to kind of beginning to get back to that 70% level.

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Cheryl, on the call -- in interest of time, we're going to go to 1 question per caller to get through a bit more.

Operator

And our next question comes from Ambrish Srivastava from BMO.

Ambrish Srivastava - *BMO Capital Markets Corp. - Analyst*

Prashanth, I had a question for you on couple of quick ones. OpEx trajectory, how should we be thinking about it? And then on capital allocation, is it fair to assume that given all the volatility that share buyback stays paused for now?

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

So for OpEx, we are in our sixth quarter of consecutive improvement in OpEx. Some of that is clearly actively managing the spend levels down, but some of it is also the result of this COVID situation where travel is at a freeze. I think it's reasonable to expect that as businesses reopen and customer expectations start to change, and we need to get back in front of folks that some of that is going to climb and as well as some other discretionary spend will come back in. So I wouldn't run this level of OpEx out too long, but I think you've seen that we have been incredibly diligent with managing our OpEx over the last 1.5 years, and that's a muscle that ADI has built, and we're not going to let that go.

In terms of how to think about the capital allocation, our framework really hasn't changed. The first call is to invest in the business and whether that is organic or inorganic. And then after that, it's really 100% return of free cash flow after debt repayments. So the plan for 2020, we increased the dividend by 15%. We're still intending to reduce debt by $300 million to $500 million in this fiscal year. And then everything after that goes back to shareholders either through dividend or share repo. So I would expect that we would be if business holds out that we would be reactivating the share repo in the coming quarters.

Operator

Our next question comes from Ross Seymore from Deutsche Bank.

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

Congrats on the strong results and challenging times. I just want to go back to the automotive side. You said it would be down sharply. So just a couple of questions on that. Do you mean sequentially year-over-year or both? And given the timing of when the auto factories have been shut down and then are turning back on, how are you viewing the shape of that recovery? And how much of that turning back on dynamic influences your thoughts for both your July guide and your October outlook conceptually?

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Yes. Thanks for the question, Ross. So I think, first and foremost, we expect sequential and annual declines. It is extremely hard to read the automotive sector right now. I think it's easier to predict how factories will reopen and how supply will happen. I think the bigger question is what is going to happen with demand. And I think the way we view it is that we don't understand the pace of reopenings right now and to what level of utilization or capacity will they operate. So I would say we think it will be tough going for the remainder of this year in automotive. And perhaps, we'll start to see a recovery in the first half of the coming year. But that's how we're viewing it. So the area that we feel kind of most conviction around in terms of demand will be for electric vehicles where our portfolio is making very strong headway, which was originally centered really in China into Europe and, of course, America as well. So very, very hard to read, I would say. But my sense is that remainder of this year will be tough, and we start to see off a pretty (inaudible) bottom, I think, some recovery in the first half of '21.

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

And Ross, I would say that is reflected in our guide. We're relatively barish on automotive in our guide.

Operator

Our next question comes from Toshiya Hari from Goldman Sachs.

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

Congrats on the strong results. Vince, I wanted to ask about your BMS business specifically. How did that business trend in the quarter? What's the outlook into July? And if you can give us an update on customer traction with your wireless BMS solution into the back half of the year and potentially into fiscal year 2021, that would be helpful?

Vincent T. Roche - *Analog Devices, Inc. - President, CEO & Director*

Yes. So yes. Overall, in the quarter just gone, we saw a modest decline, I would say, in our BMS revenues, but our design and hit rates are very, very strong. We're set to -- at the present time, we have somewhere in the region of 45% -- 40% to 45% market share in BMS. And we believe that, that share will grow above 50% given the design pipeline that we have and the commitments that we have from customers across the globe. As I mentioned, in the previous answer there, we've managed to take what was a very channel-centric BMS business. We've been taking it across the globe. And that's for essentially the nonwireless set of things. The wireless battery, we're expecting to see our first production of that particular product happened in the kind of, I think, the second half of 2021. So that's how we see it. We're in a great position, I think, right now in North America, China, and we're also beginning to penetrate Japan. And Europe, I think, is in the early stages of adoption at any kind of meaningful level, and I feel good about where we are there. So our portfolio is highly differentiated. There are many pretenders out there. But when it comes to optimizing the miles per charge, we got more than 20% gain in that -- along that metric. So overall, it's a 1% to 2% penetration of the car sector. It will probably go to 25% over the next 5, 10 years. And we're in a very, very good position to see the tailwinds from that as time plays out here.

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Thank you, Toshi. We'll go to our last question.

Operator

And our last question comes from Chris Danley from Citigroup.

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

I guess, more of -- I guess, more of a clarification than a question. So you mentioned that you've seen a little bit of weakness in the April-May bookings. Does the guide take into account further weakening in the bookings, i.e., did you build in any cushion? Or are you assuming stability from here on out?

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

Yes. So I think we feel good about our guide. Chris, we don't put a guide out there that we don't think we can -- based on what we know today, we can get to orders were down in April. May was at a slower pace. Our expectation in the guide is that orders continue to slow through the quarter or best case might stabilize. We've got good coverage from the backlog, more than we normally do. So we're prepared for some cancellations or push-outs because we would have -- we always have some turns of business in there. We're trying to control those cancellations or push outs, as I mentioned, by being pretty tough on the terms that we have for direct or disty customers. And we've also assumed that the channel is relatively flat, inventory levels sequentially. So we think we've calibrated the guide as best as we can, knowing what we know today.

Operator

Thank you. And I'll turn the call back for closing comments.

Michael C. Lucarelli - *Analog Devices, Inc. - Senior Director of IR*

Thanks, everyone, for joining us this morning. A copy of the transcript will be available on our website, investor.analog.com, and you can also find our recently published ESG report, Engineering Good there as well. Thanks again for joining us and your continued interest in Analog Devices. Stay healthy.

Operator

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