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PRESENTATION

Operator

Good afternoon. My name is Jennifer, and I will be your conference facilitator. At this time, I would like to welcome everyone to Analog Devices' third-quarter FY14 earnings conference call.

(Operator Instructions)

I would now like to turn the conference over to your host for today, Mr. Ali Husain, Director of Investor Relations. Please proceed.

Ali Husain - *Analog Devices, Inc. - Director of IR*

Thank you, Jennifer, and good afternoon, everyone, and thank you for joining our third-quarter FY14 earnings call. If you would like to view our press release, you can find it and all relating financial schedules on our Investor Relations page at investor.analog.com.

We have a couple of unique items this quarter that I'd like to call your attention to, before we begin today's call. The most important is that we closed the Hittite acquisition on July 22, which was about 10 days before the end of our fiscal Q3. Thus we have about 10 days of activity with Hittite in our third quarter.



During today's prepared remarks, we've generally excluded Hittite's contribution to our third-quarter results, unless we otherwise specify. We've done this in order for investors to better understand our performance during the third quarter. At a high level, Hittite contributed approximately \$5 million to our third-quarter sales, and there are three relating schedules on our investor page that I would like to highlight.

First, for the revenue and end market disclosure. We have classified \$3 million of \$5 million revenue contribution from Hittite into our communications infrastructure business, and \$2 million of the \$5 million contribution from Hittite into our industrial business. Second, for the revenue by product type schedule, we have classified almost the entirety of the \$5 million from Hittite to our amplifier radio frequency product group. Third, we have provided a summary P&L, including reconciliations for the 10 days of Hittite's contribution to our fiscal third quarter across the main line items of the P&L, and all of these schedules can be found on our investor site at investor.analog.com.

Today's call will include non-GAAP financial measures that have been adjusted for certain special items, in order to provide investors with useful information regarding our results and outlook. As I mentioned earlier, unless otherwise specified, today's discussion about our third-quarter results will exclude Hittite's performance. Where applicable, the acquisition-related costs and expenses associated with the transaction.

We have included reconciliations of these non-GAAP financial measures to their most directly-comparable GAAP measures, in today's earnings release, which is posted on our IR webpage. In addition, today's discussion about our fourth-quarter outlook excludes acquisition-related expenses and transaction costs, as outlined in our earnings release.

Please also note that the information we're about to discuss, including ADI's objectives, plans and goals, and our fourth-quarter outlook includes forward-looking statements. These forward-looking statements include risks and uncertainties, including, but not limited to, those described in our Form 10-Q filed earlier today. Our actual results could differ materially from the forward-looking statements made on this call.

Subsequent events and developments may cause our outlook to change, and except as required by law, we do not undertake any obligation to update the forward-looking statements made by us today, to reflect subsequent events or circumstances. Therefore, this conference call will include time-sensitive information that may be accurate only as of the date of the live broadcast, which is August 26, 2014.

Now, let's get started. With me on the call today are Vincent Roche, ADI's President and CEO; Dave Zinsner, ADI's Vice President of Finance and CFO; and Maria Tagliaferro, Director of Corporate Communications.

During the first part of today's call, Vince and Dave will present our third-quarter results, and our outlook for the fourth quarter. The rest of the call will be dedicated to Q&A. So, let's get started, and I like to turn the call over to Vince for opening remarks.

Vincent Roche - Analog Devices, Inc. - President & CEO

Thank you, Ali. Good afternoon, everyone, and thank you for joining our call this afternoon. As you likely have seen from the press release, ADI had a very good third quarter.

In addition to our strong financial performance, which I'll talk about in a moment, we're also extremely pleased with our acquisition of Hittite Microwave, which we closed toward the end of our third quarter. This acquisition of RF microwave and millimeter wave technology fits our growth strategy perfectly, allowing us to provide more complete solutions for our customers, and deliver stronger returns to our shareholders.

As I visit our customers and employees, there is clear momentum and enthusiasm for how this addition to ADI's capabilities strengthens our long-term position and demonstrates our commitment to doing what it takes to keep our customers and our Company out in front.

Now, we closed this transaction within about six weeks of the announcement, a very quick pace that we aim to maintain as we continue to integrate our two companies. As Ali noted previously, Hittite contributed only about 10 days to our fiscal third-quarter, so I'll exclude Hittite's results and acquisition-related items from my comments on our third-quarter performance.

In the third quarter, ADI revenue totaled \$722 million, increasing 4% sequentially, and 7% year-over-year, which was near the high end of our third-quarter guidance. Diluted earnings per share, excluding special items, were \$0.63, growing 7% sequentially, and 11% year-over-year, which was also near the high-end of our guidance.

Now, let's take a look at how each of our end markets performed during the quarter. Revenue from communications infrastructure customers, at 23% of total sales, increased 5% sequentially and 17% year-over-year, which was in line with our plan for the quarter. Wireless infrastructure sales were the primary driver of this growth, as ADI's radio offerings benefited from continued 4G deployments in the US and in China, and emerging regions also built out their wireless networks across virtually all communications standards.

Our communications infrastructure business is well-positioned, and diversified across all key players and key regions. Today, for example, well over two-thirds of our wireless communications infrastructure revenue relates to base station deployments outside of China, even though deployments in China tend to grab the majority of the headlines.

Our wireline business also grew sequentially, primarily as a result of our strong pipeline of designs in 100-gig optical applications. Year-to-date, communications infrastructure has grown 17% over the same nine-month period in FY13, as carriers worldwide continued building out their mobile service networks, helping drive demand for ADI's wide range of high-performance radio transceiver solutions.

Now, turning to industrial. Our highly diversified industrial end markets, at 48% of total sales, turned in a better than planned performance, growing 7% sequentially in the third quarter, and 11% year-over-year. All subsegments within industrial grew sequentially, and grew year-over-year.

Now, among the sub segments, the strongest sequential revenue growth was in the industrial automation, instrumentation, aerospace, and energy sectors. The aerospace and energy sectors were responsible for about half of our industrial growth in the third quarter, and were key drivers of our better-than-planned industrial sales. Within the instrumentation subsegment, electronic test and measurement drove most of the growth.

Revenue from the balance of applications within instrumentation, including semiconductor ATE was stable to the prior quarter. Year-to-date, industrial has grown 7% over the same nine-month period in FY13, reflecting an improving macro environment, and increased capital spending. These trends are combining to drive demand for ADI's suite of high-performance sensing, signal conditioning, data converters, DSPs, and RF and microwave technologies, and are being used by our customers to create more intelligent, connected, and energy-efficient products.

Automotive revenues decreased 4% in the third quarter, which was in line with a seasonally slower period for ADI in this market. Year-over-year, sales in this segment grew 8%, reflecting continued strength in North America and China vehicle markets, increasing content per vehicle, and growth in worldwide premium vehicle sales. Automotive, in total, represented 18% of our total sales in the quarter.

Year-to-date, automotive has grown 11% over the same nine-month period in FY13, during a period when the underlying rate of vehicle unit growth has averaged about 4%. This revenue performance is in line with our goal of growing our sales in this market, by at least twice the rate of vehicle unit growth. ADI's strength along the entire signal chain is particularly well-suited to the automotive market, where our auto-grade sensors, signal conditioning, data converters, RF and microwave, and DSPs are increasingly enabling car manufacturers to deliver more efficient engines, intelligent collision avoidance and mitigation systems, and in-cabin infotainment systems, all of which we believe will help drive sustainable, long-term growth for ADI.

Finally, consumer revenues, which accounted for 11% of total sales in the third quarter, grew 4% sequentially. This quarter's revenue performance was largely due to an increase in prosumer audio-video applications, while digital cameras and portable applications were flat to the prior quarter in the aggregate. Year-to-date, consumer revenues have declined 24% over the same nine-month period in FY13, primarily as a result of the divestiture of the microphone product line.

So, with that, I'll turn it over to Dave, who will take you through some of the details of our financial results.



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

Thanks, Vince, and good afternoon, everyone. The third quarter was another solid quarter for ADI. As Vince mentioned, since the acquisition of Hittite closed near the end of our third quarter, Hittite's contribution to ADI's results were limited to approximately 10 days, and my prepared remarks will also exclude Hittite's results and the acquisition-related items, unless I specify otherwise.

Sales in the third quarter increased to \$722 million, and diluted earnings per share grew to \$0.63. Gross margins in the third quarter were 66.5%, up 40 basis points from the 66.1% we achieved in the prior quarter, due to a better mix of business, as our sequential revenue growth this quarter was led by the industrial and communications infrastructure markets.

Compared to the prior year, gross margins increased 200 basis points on higher factory utilization, and a better mix of business. Approximately 50% of our revenue is from wafers produced in our internal fabs. In the third quarter, utilization rates in our fabs remained stable to the second quarter, at mid 70s levels. We expect our factory utilization to be down slightly in the fourth quarter.

Excluding acquisition-related inventory, days of inventory increased to 117 days from 115 days, and are expected to remain at similar levels in the fourth quarter. On a dollars basis, inventory increased by \$13 million over the prior quarter, as we took a proactive approach to external wafer purchases this quarter, and we plan to take the same approach next quarter.

Weeks of inventory in distribution were approximately 7.5 weeks, consistent with the prior quarter. Our revenue recognition policy is to recognize 100% of our distribution revenue, only when our distributors sell out to the end customers. Total end customer orders increased in the third quarter compared to the second quarter, and our book-to-bill was slightly above 1. Lead times remained similar to last quarter, with virtually all of our shipments occurring within our stated lead times of four to six weeks.

Operating expenses in the third quarter increased 3% sequentially, compared to the 4% sequential increase in sales. This was primarily due to a range of short-term items, and as we move into the fourth quarter, we expect expenses to be relatively flat, excluding Hittite and acquisition-related items. Operating expenses as a percent of sales in the third quarter declined 30 basis points, compared toward the prior quarter.

Operating profits before tax increased to \$235 million or 32.5% of sales, which is 80 basis points higher than in the prior quarter, and 160 basis points higher compared to the same quarter in the prior year. Other expense of approximately \$4 million was flat to the prior quarter.

We are planning for interest expense in the fourth quarter to be approximately \$6 million, which is lower than our prior expectation of \$8 million, as we anticipate repaying the short-term debt financing related to the acquisition earlier than initially anticipated. In FY15, we expect net interest expense to be approximately \$5.5 million per quarter.

Our third-quarter tax rate was 13.4%, we expect our fourth-quarter tax rate to be approximately 15.5% to 16% as a result of income from the Hittite acquisition being taxed at a higher rate. For 2015, we expect the tax rate to be approximately 14.5%. Excluding special items, diluted earnings per share in the third quarter was \$0.63.

Cash flow in the third quarter continued to be very strong. Excluding an \$18 million use of cash by Hittite, primarily related to the acquisition, we generated \$232 million, or 32% of sales in operating cash flow, and CapEx was \$42 million, resulting in free cash flow of \$190 million, or 26% of revenue.

Our FY14 plan is for capital spending to be approximately \$180 million, of which about two-thirds, or 4% of sales, relates to ongoing capital equipment spend, and about one-third, or 2% of sales, relates to new facilities and upgrades to existing facilities. In line with our capital allocation strategy during the quarter, we distributed \$116 million in dividends to our shareholders. In addition, we repurchased 1.1 million shares, or \$57 million of our stock, with approximately half the repurchases occurring towards the end of our third quarter, as our stock buyback program responded to a lower stock price.



On August 25, 2014, our Board of Directors declared a cash dividend of \$0.37 per outstanding share of common stock. This will be paid on September 17, 2014 to all shareholders of record, at the close of business on September 5. At the current stock price, this dividend represents an annual yield of approximately 2.9%.

Including Hittite, our cash and short-term investments balance increased by \$125 million over the prior quarter, and stood at \$4.9 billion, with \$1.1 billion available domestically. During the quarter, we raised approximately \$2 billion in additional debt financing to fund the acquisition of Hittite. It is anticipated that the \$2 billion in short-term debt financing will be repaid by the end of this week.

This is expected to bring our gross cash and short-term investment balance to approximately \$2.9 billion, with \$870 million in debt, resulting in a net cash balance of \$2.1 billion. Following the repayment, we expect our domestic cash and short-term investment balance to remain at \$1.1 billion. Lastly, including Hittite, total sales in the quarter was \$728 million, and diluted earnings per share, excluding acquisition-related items, were \$0.63.

Notably, Hittite revenue grew 9% sequentially and 12% year-over-year in the three-month period, which ended June 30. In addition, over the 12 months ended June 30, Hittite generated \$100 million in operating cash flow, and \$87 million in free cash flow, which of course, are great results, and highlight the strength of this RF and microwave franchise.

Now, I will turn the call over to Vince, will discuss ADI's outlook for the fourth quarter. The fourth quarter outlook Vince will discuss will include a full quarter's contribution from Hittite, and excludes acquisition-related items, as we outlined in today's earnings release.

Vincent Roche - Analog Devices, Inc. - President & CEO

Thank you, Dave. In general, we are expecting a stable environment across all our business. In industrial and communications infrastructure, we will have higher overall sales in the fourth quarter, as we had a full quarter's revenue contribution from Hittite to these end markets.

On an organic basis, we are planning for industrial to decline somewhat from third-quarter levels, and for communications infrastructure and automotive to exhibit modest sequential sales growth. We're planning for consumer sales to be higher in the fourth quarter, in line with typical seasonal patterns. In total, we're planning for sales in the fourth quarter to be in the range of \$790 million to \$820 million.

We are planning for gross margins in the fourth quarter to be approximately 66.2%, given our plan for lower utilization rates, and a slight mix shift. We're planning for operating expenses to be in the range of \$268 million to \$271 million. Based on these estimates, diluted earnings per share in the fourth quarter are planned to be in the range of \$0.66 to \$0.70, which includes an estimated 8% contribution from Hittite, and excludes acquisition-related items.

So, in closing, at the midpoint of our fourth-quarter guidance, ADI's FY14 is expected to finish with year-over-year sales growth of 8%, and diluted earnings per share growth of 11%, excluding special items. We are focused on driving earnings growth, and to that end, we are running the company to achieve annual EPS growth of 8% to 15%, and our target EPS of \$4 to \$5 by FY20. I, along with all the employees at ADI are committed to this goal. Thank you very much.

Ali Husain - Analog Devices, Inc. - Director of IR

Great. Thanks, Vince and Dave. I'd like to remind everyone that during today's Q&A period, please limit yourself to one question, so we have a chance to talk to all our callers this evening. We intend to keep the lines open until 6, so after we get through the first round of questions, we will give you an opportunity to ask another question if time remains. Operator, with all of that, let's start taking some questions.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

David Wong, Wells Fargo.

David Wong - *Wells Fargo Securities, LLC - Analyst*

Dave, following this acquisition, do you foresee the need for any restructuring, involving material cash charges going forward?

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

Related to the acquisition in particular?

David Wong - *Wells Fargo Securities, LLC - Analyst*

Yes.

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

I don't think so. I think we have essentially accrued most of it. There might be a small de minimis charge for a few items here or there. I think for the most part, we have spent the lion's share of the cash, already.

David Wong - *Wells Fargo Securities, LLC - Analyst*

So, you don't see any significant reduction in headcount on the combined company?

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

I think -- to the extent -- from a cash flow -- obviously, we do expect some synergies. So, I think that there will be some cash flow associated with those synergies. But, I think relative to the cash flow payments we've made to date, which mainly related to legal and bankers and so forth, that will be relatively small.

David Wong - *Wells Fargo Securities, LLC - Analyst*

Okay. Great. Thanks very much.

Operator

Jim Covello, Goldman Sachs.



Jim Covello - *Goldman Sachs - Analyst*

On the gross margins, Dave, I know you said factory utilization would be down slightly for calendar Q3. Is that the only impact, in terms of margins going down a little bit quarter over quarter? Is mix part of that, too? Thanks.

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

Good question, Jim. I would say it's probably three components. Two going negative, and one going positive.

My guess is that mix will contribute negatively about 50 basis points from an organic standpoint. Because, on an organic basis, we do think industrial is coming down, and that does affect mix. We think that mix will probably impact us by 50 basis points.

On top of that, we are expecting some impact from utilization, which probably will be in the neighborhood of another 10 basis points. So, those two items will negatively impact us by about 60 basis points.

Offsetting that, to some extent, is Hittite, which obviously has gross margins that are higher than our corporate average. So that will be accretive to the Company's gross margins by about 30 basis points. That's how, on a net basis, we get down around 30 basis points.

Jim Covello - *Goldman Sachs - Analyst*

Very helpful. Thanks so much.

Operator

Vivek Arya, BofA Merrill Lynch

Vivek Arya - *BofA Merrill Lynch - Analyst*

Vince, I'm curious about your commentary on the overall demand environment, because there is a school of thought that perhaps things are overheating. When we look at the 17% growth that you mentioned in comms infrastructure, or the double-digit growth year to date that you have in the automotive market. Obviously, I understand that there are very strong content gains as part of that. But, as you look out over the next couple of quarters, how do you -- where do you come out on this overall view of where we are in the cycle and the growth rates, that we are seeing, are they sustainable over the next one or two quarters?

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

We've paid a lot of attention -- thanks for asking the question -- we have paid a lot of attention to inventories through our channel, our indirect channel, and also with our customers. It's our sense that across our business in the industrial, automotive, and communications infrastructure spaces, in particular, that there is actually a good balance between supply and demand, and I think you'll have seen that as well, from the comments made by our large distributors in their fairly recent earnings releases, as well.

The book-to-bill is even through the summer months, here, is very, very healthy. The book-to-bill is above unity at this point in time, and that, coupled with the distributor inventory, which is running at a very, very normal level of around 7.5 weeks, makes us believe that there is a very, very good balance between supply and demand. That's essentially our thinking at this point in time.



Vivek Arya - *BofA Merrill Lynch - Analyst*

I see. As a follow-up, I know that your attention is obviously more to fundamentals, and your business. But I can't help but ask about the stock. Since you have acquired Hittite, the stock has sort of been under pressure, it has underperformed the stocks and the broader market this year. Do think that something investors are not getting yet? Basically, what would be the catalyst for the stock to start reflecting the value accretion from this acquisition?

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

I think we are new into the acquisition game. So, a think we do have to put up the numbers first, to get their stock to react. We are very confident that we will get -- in fact, I think the accretion in the fourth quarter is up around high single digits, now, as a percent.

We do expect to get around 10% accretion in 2015. I think we will get mid-teens in 2016. We are confident of that fact. To some extent, we have to show that we can execute to that level.

Given that the stock has been a little bit weaker, and we do have a buyback program in place, we did take the opportunity, obviously, to buy back more stock than we have in the last two quarters. We took -- we at least took the opportunity that was presented to us, vis-a-vis a lower stock price and get some shares off the market and bring down our share count and hopefully, accelerate the earnings through that.

Ali Husain - *Analog Devices, Inc. - Director of IR*

Thanks Vivek, and we'll move on to our next question, operator.

Operator

Ross Seymore, Deutsche Bank.

Matt Diamond - *Deutsche Bank - Analyst*

This is actually Matt Diamond on Ross' behalf. I want to talk about your automotive results in the quarter. They were down about 4% sequentially. I know that it's a little bit of a slower time here seasonally, but it still appears as though it's a little bit below those of your peers, the results of your peers. If you could give your thoughts about why that might be and what ADI needs to do to potentially catch up with the peer group?

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

I think the way to look at this business, first off, the third quarter for the automotive business, typically -- we have seen this over the last three years -- has been down seasonally. So, I don't think that was a massive surprise. I think, as well, you can't really look at the business on a quarter sequential basis.

It's a very program-driven business. I think the way to look at ADI's performance in the automotive segment, over the entire course of FY14 here, is that year-to-date, we are up 11% against an end market that's up about 4%. So, there's almost 3X in terms of ADI content per car growth, per car unit growth.

I think, as I said, we will see an improvement in the fourth quarter. We will see a sequential improvement. So, there are essentially the facts as I can present them to you.



Matt Diamond - *Deutsche Bank - Analyst*

Thanks so much.

Ali Husain - *Analog Devices, Inc. - Director of IR*

Thanks, Matt, and we'll move onto to the next question, operator.

Operator

Steve Smigie, Raymond James.

Steve Smigie - *Raymond James & Associates - Analyst*

I was hoping you could talk a little bit about how you see gross margin progressing over the next several quarters, just in the context. It seems like there's some wafer buying here, had some maybe utilization impact. Also, the impacts of the mix. As we get some stronger seasonal periods in wafer buying, would we expect to see a pretty decent chunk, two or three quarters out?

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

The wafers that increased the inventory levels were external wafers. So, they had little to no impact, in terms of our factory utilization, and didn't really impact our gross margin levels. I think, and of course, we don't have a crystal ball as to how the first quarter is going to progress -- but, typically, seasonally, the first quarter is down 5%, 6%, 7%, sequentially. Ordinarily, that quarter -- we do see a lower gross margin number, because we start to reduce production starting earlier -- or later in the fourth quarter and rolling into the first quarter.

Although, however, I expect that to recover in the second quarter. Usually, the second quarter is a really good quarter for industrial. We start to get the benefit of not only the mix improvements in that quarter, but also the fact that the factory is kicking back in at a pretty good rate. So, we'd start to see the gross margin pick back up again and help elevate those margins, hopefully, beyond the levels that we are even at today.

Additionally, there are always things that we do, and we've been doing over the past 8 or 10 quarters, to incrementally improve the gross margins through more discipline around pricing and some focus in terms of cost of manufacturing. And, the costs of -- call it external materials, I'd guess you'd call it, to improve the gross margins. I think that we are starting to hit on all cylinders in that regard.

So, there should be some reasonable momentum there, as well. So, I'm optimistic that we can improve gross margins from these levels. I think 66.5% to 66.2%, depending on what quarter we are talking, are pretty darn good gross margins, anyway. They are the envy of probably almost all of the S&P 500.

But, we're looking to try to get them up from here, as we talked about at the analyst day, given that we have a model at the high-end to be at 68%. That's certainly the goal. I think we will make progress towards that goal over the course of next year.

Ali Husain - *Analog Devices, Inc. - Director of IR*

Steve, as Vince mentioned in his opening remarks, we are running the business to grow EPS at the rate of 8% to 15%, so that's important for us. And we will move onto the next question. Thanks for calling in from vacation, by the way, Steve.



Operator

Tore Svanberg, Stifel Nicolaus.

Tore Svanberg - Stifel Nicolaus - Analyst

Vince, I was hoping you could elaborate a little bit on the industrial market. You guided that business to be down sequentially. Is that just seasonality, or is there anything else going on in that market, at this point?

Vincent Roche - Analog Devices, Inc. - President & CEO

It's mainly seasonal. Typically, we see a decline in the fourth quarter. The primary reason for the sequential decline there is really the ATE markets. It's not a huge surprise that, as you will have seen from the large manufacturers of ATE equipment, that they are expecting their fourth quarters to be somewhat dull -- or the same period that coincides with our fourth quarter to be dull.

I think overall, it's been -- it will have been a great year for ADI. We will be up 11% in the quarter year-on-year, and we're up 9%, over the year-to-date nine months, we will be up 7%. So, I think that's a very strong performance, and there's nothing untoward or novel in the fourth quarter. Overall, we will have had a very, very good year, here.

Tore Svanberg - Stifel Nicolaus - Analyst

Thank you, and congratulations on closing the Hittite deal.

Ali Husain - Analog Devices, Inc. - Director of IR

Thanks, Tore. Operator, we'll get our next question, please.

Operator

Ambrish Srivastava, BMO Capital.

Ambrish Srivastava - BMO Capital Markets - Analyst

Thank you. Ali, I'm not going to call in from my vacation, sorry. I might have missed this, if you gave it up. In your guidance, what is the contribution from Hittite?

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

In the fourth quarter?

Ambrish Srivastava - BMO Capital Markets - Analyst

Right. In the guidance provided.

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

It's somewhere in the \$76 million to \$78 million range.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Maybe just trying to step out of the quarterly Q-over-Q. If you look at the design activity within industrials and autos, what is different this year versus a year ago? Where are the major segments that you are seeing new design opportunities for ADI? That was it. Thank you.

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

It's a great question. We obviously pay a lot of attention to what's happening in the opportunity space, because that's essentially the future of the Company. If you talk with our sales force, you talk with our marketing people, and you look at the engagement between the engineers of ADI and our customers' engineers, I'd say this point in time, the activity is up very significantly over this time last year, and certainly two years ago.

We are basically engaging on bigger programs everywhere. We are pulling more of the bill of materials together for our customers. Of course, with the Hittite acquisition as well, there's a tremendous desire from our customers to combine the strength of ADI's mixed signal with the very, very high-performance analog signal processing component from Hittite. I think overall, there's great strength in the industrial sector.

As a Company, we have made a huge amount of progress over the last four or five years in meaningfully engaging with our very large customers on programs that are mission-critical to them, across America, Europe. Interestingly, for ADI, in the past couple of years, an area that we're particularly pleased with our performance in the industrial sector is in Asia. We are seeing strength in the automation sector, in the instrumentation sector. Those two areas in particular. Energy, of course, in areas like China.

So, overall, the activity is up. The scale of programs, the scale of engagement we are talking about with our customers across automotive, industrial, communications infrastructure, puts us, I think, in a whole new game and I think, bodes well for the future of the Company.

Ali Husain - *Analog Devices, Inc. - Director of IR*

Great. Thanks, Ambrish, for the question. And we will move to the next question, operator.

Operator

Craig Hettenbach, Morgan Stanley.

Benayak Trahol - *Morgan Stanley - Analyst*

This is [Benayak Trahol] calling in for Craig. My question was on the Hittite acquisition. I know it's been just a month. Could you comment on how the integration is progressing? Any negative post-deal surprises along the way? Also, like any plans for in-sourcing the manufacturing on Hittite?

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

Thanks for asking the question. I think, overall, the integration is very smooth. There's geographic proximity between the companies, largely, about 70% of Hittite's people are here in Massachusetts. Of course, we center our RF and microwave activity largely in Massachusetts, as well, from the ADI site.



I think we knew before we acquired Hittite that the cultural match would be very, very good. So far, we have seen tremendous engagement between the engineers on both sides, in terms of creating a joint vision to use the capabilities of both sides in a very synergistic way, and to build a road map that starts putting this Company on the growth back towards \$1 billion. We've got a \$500 million business now, and we believe we can grow this business to \$1 billion in the not too distant future.

Customers are very excited. Customers -- particularly in the aerospace area, I'd say, aerospace and defense area, that's where Hittite, I think, had a lot more focus than ADI, and we are being drawn in to bring all the pieces of the combined companies together. That's very, very encouraging.

Our field activity, there is, I think if you talk with the ADI field sales force there, there's tremendous acceptance of the possibilities and we are starting to see the opportunity pipeline get loaded up with a lot of new opportunities that the ADI sales force, which was about 15 or 20 times bigger than the Hittite sales force, is now able to create leverage on the 1,000 products that we've gained. So, overall, I think we are opening new doors.

There's a lot of excitement on the engineering side. Now, we are at execution phase and we are keeping a very close eye on the growth and the cost synergies. I'm very, very optimistic, at this point in time.

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

And answer to your second question on the wafer volume. At the moment, we have no plans to move wafers away from any of the foundries, internally. That could change over time, but right now, our operating assumption, and what we assumed in terms of accretion, by 2016, assumed that the wafers remained pretty much at the foundries they are currently being sourced from.

Benayak Trahol - *Morgan Stanley - Analyst*

Got it. That's helpful.

Ali Husain - *Analog Devices, Inc. - Director of IR*

Great, thank you Benayak, and we'll move on to the next question, operator.

Operator

Steven Chin, UBS.

Steven Chin - *UBS - Analyst*

First one is on Hittite. If I can drill down a little deeper in terms of the quality of the design wins that Hittite has. Is there much seasonality in their business? Or, is the growth largely a design win ramp-based tech growth?

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

I think you've got to separate it between the industrial business, which is largely a defense business, which is definitely very programmatic, and then the communications business, which will largely, I assume, track with our communications business, which generally necessarily doesn't have a seasonal pattern to it. It's more or less trends with when there's big deployments of wireless technology across the globe, or in any one area of the globe. That's when it starts to pick up. I would say, in both cases, it tends to be more product specific and market specific, as to how those markets are behaving on a cyclical basis.

Steven Chin - UBS - Analyst

Got it. As my follow-up, just in reference to the higher inventories in the quarter from the externally-sourced wafers. I was wondering if you could provide more color on that? Is that due to some big product launch that you made sure you had supply for? Is there tightness in terms of supply at your foundries for that process node? That's helpful. Thanks.

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

There are a couple of products that could be ramping over the next couple of quarters. So, we are, in some cases, anticipating that a little bit, and making sure we have that volume in-house. Because, sometimes, those ramps can be unpredictable.

On top of that, there is some concern that wafers might get tight over the course of the next quarter. We're are not certain that will happen, but the way we operate is very much focused on lead times. We try to keep lead times very, very short, and so for us, it's better to err on the side of having the wafers in-house, ready to react when demand is there, and not impact lead times in any way, and that's our approach.

My guess is that will carry us through the fourth quarter. After that, I think we'll have a very good sense of both what we can expect, in terms of wafer capacity, and how various products will ramp over the course of the next four or five quarters. So, I would expect that gets to a normalized level within a quarter or two, beyond the fourth quarter.

Steven Chin - UBS - Analyst

Thank you.

Ali Husain - Analog Devices, Inc. - Director of IR

Thanks, Steven. We'll move on to our next question, operator.

Operator

Ian Ing, MKM.

Ian Ing - MKM Partners - Analyst

Not on vacation, here. You've got good exposure now to some new wireless opportunities, things like microwave infrastructure, and small cells. When we talk to OEMs, it looks like mainstream adoption of these topics is going to depend on big capacity upgrades happening. Right now, the focus is more on expanding 4G coverage, which is more of a macro cell solution. Right now, when do you expect capacity upgrades, this 1,000 times, as you alluded to at the analyst day?

Vincent Roche - Analog Devices, Inc. - President & CEO

Clearly, when you look at the facts here, in the communications infrastructure sector, there's so far, by the way, there's only 180 million 4G LTE subscriptions on a worldwide basis. Remarkably, over 80% of those are concentrated in three countries, the US, Japan and Korea. So, I think, as the adoption rate of 4G starts to accelerate here, as it's doing in areas like China, for example, we are going to see the adoption of the smaller cells to really densify the network.



My sense, from everything we know from our customers, that will begin to happen, in fairness, sometime in 2016 onwards. So, I think, the largest part, surely, of our business at the present time, is macro. We are very, very well positioned with our transceiver technologies, and are enabling these smaller cell designs that are in trial, and starting to move into production over the coming year. So, I think the next year, year-and-a-half will be dominated by macro, and then it will be a mixture somewhere after that of macro and small cell.

Ian Ing - MKM Partners - Analyst

You think microwave is going to be driven more by capacity, also, more mainstream microwave applications?

Vincent Roche - Analog Devices, Inc. - President & CEO

Obviously, as the network densifies, and you've got to move a lot of data into the backhaul sector, I think microwave will scale accordingly with the increase in data bandwidth needs.

Ian Ing - MKM Partners - Analyst

Thank you very much.

Ali Husain - Analog Devices, Inc. - Director of IR

Thanks, Ian, and we'll get to our next question, operator.

Operator

Blayne Curtis, Barclays.

Blayne Curtis - Barclays Capital - Analyst

Dave, I'm assuming you're not going to back out Hittite going forward, following up on a previous question. Of that \$77 million, is the right way to think of the split by segment that 60/40 of that little stub period? And directionally, will Hittite mirror what you are seeing in your core business? Or maybe you can give kind of better color directional with Hittite, for those segments?

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

I think it's reasonable to assume it's basically 60/40, maybe 55/45, somewhere in that range. Then, Blayne, what's the other part of your question? I wasn't quite getting it.

Blayne Curtis - Barclays Capital - Analyst

In terms of the guidance, is that Hittite business going to be directional with what you got in your organic business into Q3?

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

I think so. The fourth quarter is certainly behaving very similar to what we see in communications and industrial. I'm going to guess that next year, we start to see very similar patterns with Hittite, relative to those two specific end markets, which are the communications and industrial space.



Blayne Curtis - *Barclays Capital - Analyst*

I was meaning your fiscal Q4, October. For the guide directionally. Should be similar to your quarter?

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

Yes. For the fourth quarter, for sure.

Blayne Curtis - *Barclays Capital - Analyst*

Thanks.

Ali Husain - *Analog Devices, Inc. - Director of IR*

Thanks, Blayne, and we'll get to our next question.

Operator

CJ Muse, ISI.

Ada Menaker - *ISI Group - Analyst*

This is Ada calling in for CJ. I was wondering if you could discuss your tax rate a bit, and maybe provide some of the color around what you are going to do in order to lower to reflect what your rate has been, historically?

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

The tax rate -- I will take a flyer at this. You tell me if I'm answering the question. We're going to increase our -- we're going to have our tax rate increase in the fourth quarter to 15.7%. That will have the effect of bringing our full-year tax rate up to 14.1%. That's because the Hittite income is taxed at a higher rate.

However, over the course of, really this quarter and next quarter, it starts to become infused into our worldwide structure, where revenue is generated, in the jurisdictions that it's generated in, and cash flow is retained there. So, the tax rate for Hittite should begin to come down to relatively similar levels, as compared to the ADI tax rate. Having said that, Hittite had a larger portion of their income generated in the US. So, on a blended basis, their tax rate is going to be a bit higher than ours.

So, that combination will have the effect of driving our worldwide tax rate for next year to be in the neighborhood of 14.5%. So, a little bit north of what we run as a company, because we've been running in the mid-13% level. But still, relatively strong. Really, by doing that, we've really taken Hittite's tax rate down from what was a US statutory rate of about 35%, down to something in the high teens.

Ali Husain - *Analog Devices, Inc. - Director of IR*

All right. Thanks, Ada. We'll move onto the next caller, please.



Operator

(Operator Instructions)

Stacy Rasgon, Bernstein.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

I first wanted to touch on the OpEx a little bit. We are running now, in Q4, at the higher rate, which is fully in with Hittite. How do you think about that OpEx trajectory trending next year? I was thinking that you would have -- your typical step-ups for comp and everything else maybe offset by a few synergies and reductions from the deal. How should we think about that trajectory trending next year?

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

We are in the process of doing our planning for next year. So, I will put the horse before the cart -- the cart before the horse, rather, too much, if I start throwing out numbers. I do think that some of the momentum or the increase we see in operating expenses this year had to do with the fact that we finally rolled over, after a couple of years of declining revenues, we've rolled back over to revenue growth.

That had the effect of, really, a relatively big step up in operating expenses, to handle the additional bonus payments or variable compensation that gets paid out when that happens. As growth rates level off, hopefully at levels around these levels or maybe a little bit higher, I would expect that the pressure on the bonus starts to subside. We start to not see headwinds associated -- increasing headwinds associated with variable compensation.

For the most part, because I think what we are going to have a mantra here, is that we will pretty much keep our core expenses relatively flat, notwithstanding inflationary increases that happen for salary increases, and so forth. So, there won't be the pressure on OpEx that we have seen in the past.

Then, we are going to see some benefit from the Hittite acquisition, in terms of synergies, that will kind of bring those up -- those OpEx levels back in check. That was a long-winded way of saying we really don't know the number yet, but we are working on a. We are going to keep it pretty constrained.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

The reason I asked is your EPS target of 8% to 15% growth, if you back into the required revenue growth, it implies revenue growth of about 10% which to me, would suggest that you would still be reflecting increased variable compensation from that revenue growth. Are you looking to get that revenue growth, or aren't you? What effect do you expect that to have on the OpEx? It's got to be one of the other, doesn't it?

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

Correct. Yes. You'll see -- I don't know what revenue growth is going to be like next year, we haven't even worked up the plans, yet. Our goal for OpEx is to keep it really tightly constrained.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

Okay. Thank you, guys. Appreciate it.



Ali Husain - Analog Devices, Inc. - Director of IR

Thanks, Stacy. We will get to our last question, here, I think. We have another question.

Operator

Doug Freedman, RBC.

Doug Freedman - RBC Capital Markets - Analyst

Congratulations on a strong quarter. My question has to do with your ability, or the Company's capacity to participate in additional accretive acquisitions. You still have plenty of cash on the balance sheet. Is there some sort of number at which you see is your minimum threshold of cash? How long do you think the integration timeframe is, that you can get back into the market?

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

I think we have a relatively accelerated integration plan that goes over the course of, I think, 120 days or so, that will get the lion's share of the integration complete. We'll still, obviously, have little nits and nats that we have to take care of over the course of the year. But I think the next four months or so will be pretty focused on the integration of Hittite into our operations.

From there, I think we have pretty good ability to go focus on something else if we want to. Or, quite honestly, focus on getting the revenue synergies out of Hittite and getting our own business in the right place.

From a minimum cash perspective, we generate cash flow as a Company, pretty much in every circumstance. I think in the first quarter of 2009, which is probably our most significant drop-off in revenue clearly in our history, we still generated somewhere and \$50 million of free cash flow that quarter. So, we can live on a very tight level of cash, without taking much risk.

I'd say, ideally, we would like to carry about \$1 billion of cash, just for dry powder's sake. However, we do also have additional debt capacity, to the extent we need to tap into that. That's pretty meaningful, what we have available to us, without impacting our debt rating.

So, we clearly have the flexibility to do M&A, when and if Vince thinks it's the right thing to do. We obviously have a very high bar in terms of acquisitions. I don't think we are going to go run off and do a ton of M&A.

This one was really the right business with the right set of products, that just gelled perfectly with the things we were doing internally, and, made unbelievably good strategic sense for us and for our customers. I think the bar on a go-forward basis would be that those characteristics would have to hold true in other deals.

So, we will see how it goes. We're always looking around and kicking the tires on things. But, I don't think you'll see us do one every other quarter or something like that. We're a Company that prides ourselves on our ability to develop innovation, internally, first and foremost. We do M&A when it's a perfect opportunity, that really meets the customer's expectations.

Vincent Roche - Analog Devices, Inc. - President & CEO

Just to add a little more color on what David said, we've been really focusing this Company more clearly on business-to-business type end applications. Whatever we do in the future, whether it's organic, whether it's through M&A, we'll have to address that kind of focus space that we have, and our mantra is, has been, that we grow this Company, and the whole future of this Company is based on the quality of the innovation that we have.



It's based on having diversity in the businesses, and the applications that we address. Ultimately, we've got to be able to produce great returns. It's the very, very high bar, and we think that Hittite certainly is well over that bar. That's, essentially, the lens through which we view any future activity in the acquisition space.

Doug Freedman - *RBC Capital Markets - Analyst*

Great.

Ali Husain - *Analog Devices, Inc. - Director of IR*

It looks like we have a couple of callers here that have re-queued, so I think we are going to go back. They're really earning their keep tonight. Let's see, would we have on the line, operator?

Operator

Ian Ing, MKM.

Ian Ing - *MKM Partners - Analyst*

Following the other analog products up 9% quarter-over-quarter, according to your filings, that's largely MEMS sensors for the auto market. But then again, auto was down 4%. So is there some new applications are for MEMS sensors? Something else going on?

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

Well, you know, we have -- obviously, we've built our MEMS franchise around the automotive space. That's how we essentially took a technology and started building products of high-quality, high standard. We have many new homes for the basic technology. We've developed, for example, the world's lowest-power, highest-accuracy MEMS inertial sensing device that gets used in, for example, healthcare applications, and industrial applications. Our focus has been really on automotive, but now, we are in a position where we are starting to expand the portfolio, expand our reach, and get into a new range of applications, specific to MEMS.

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

On top of that, on the other analog side, we lump almost anything we can't clearly define, because it's got all kinds of functionality, we dump into other analog, as well. Increasingly, more of our products are coming under that definition. I think that has driven a lot of the growth in other analog. And one of the reasons why, I just want to kill these product classifications, because they start to not have any meaning on a go-forward basis when all these core capabilities all start to get integrated into single systems.

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

For example, another area that falls under the banner of other analog is isolation technology. So, it started again, like MEMS, it started as a technology development inside the company that we start to build in products, specific products from. Now, those products, or that technology is being integrated into some of our conversion technologies, and linear technologies.

So, as Dave said, it's getting hard to classify, but the basic building blocks do their thing, and many of these things are classified under other Analog today, but there's more and more and more cross pollination between the technologies in our portfolio.



Ali Husain - *Analog Devices, Inc. - Director of IR*

Thanks, Ian, and I think we will get to our last caller of the night.

Operator

Blayne Curtis, Barclays.

Blayne Curtis - *Barclays Capital - Analyst*

I was just curious. You guided consumer seasonal. I guess, you haven't had really anything seasonal for a while. Just curious what you meant by that, and is there a chance that business isn't down year-over-year in October, and if so, what's the drivers?

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

Our consumer business really has two components. It's the broad-based prosumer, which looks a lot, actually, like our B2B business. It's got lots of applications, lots of products, lots of customers across the globe. For example, enterprise media processing systems.

The remainder of the business is pretty much portable type applications, such as cameras, portable devices, such as tablets and smartphones, and so on and so forth. They tend to be very programmatic, tend to be very large [pop] driven. It's our sense, based on our backlog, based on our knowledge of the applications, that we'll see some growth based on seasonality effects, as well as there's always new programs.

These programs are replenishing themselves, particularly in the portable type area, about every 12 months. There's always new stuff coming, and so it's a mix of those two components. The more enterprise-oriented prosumer, combined with the more volatile type of portable applications.

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

In answer to the second part of your question, Blayne, I do think that we probably will be down year-over-year in consumer, even though it's going to be sequentially up. But, I think that this may be hopefully the last quarter we are in the position.

It has been turning the corner, really, beginning in the second quarter of this year. But, still hasn't quite recovered back to levels of last year or the year before. So, hopefully this will be the last quarter that we see year-over-year declines, and we start to see some growth next quarter in the first quarter.

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

Yes. A big part of the decline we registered this year, incidentally, is because of the divesting of our microphone business, which was factored into our FY13 numbers. As Dave said, I think the strong headwinds that we had there through essentially refocusing our spend from consumer into more B2B applications over the last five years, we are starting to see the bottoming out and expect to see some tailwinds from here on.

Blayne Curtis - *Barclays Capital - Analyst*

Thanks for that.



Ali Husain - Analog Devices, Inc. - Director of IR

All right, thank you. Thanks Blayne, helping us finish stronger tonight. Just a reminder, our fourth-quarter FY14 earnings call is scheduled for November 25, 2014. That will begin at 5:00 PM Eastern. Thanks again for tuning in tonight, everyone. Have a great night

Operator

This concludes today's Analog Devices conference call, and you may now disconnect.

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