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OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Richard Puccio *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

CONFERENCE CALL PARTICIPANTS

Harlan Sur *JPMorgan Chase & Co - Analyst*

PRESENTATION

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Okay. Good morning, and welcome to JPMorgan's US all stars conference here in London. My name is Harlan Sur. I'm the Semiconductor and Semiconductor Capital Equipment Analyst for the firm.

Very pleased to have Rich Puccio, Executive Vice President and Chief Financial Officer at Analog Devices here with us this morning.

For those of you that don't know the Analog Devices team, leader in high-performance mixed signal RF and analog semiconductor solutions, strong position in power management, very strong position in signal chain processing, both digital and analog, which is the technology that bridges the real world to the physical world to the digital world. Best-in-class growth operating free cash flow margin, strong capital return program, very, very diversified business, right. Industrial, automotive, comms infrastructure, 85% of total revenues.

So Rich, thank you very much for joining us this morning.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Harlan, thanks for having me.

QUESTIONS AND ANSWERS

Harlan Sur - *JPMorgan Chase & Co - Analyst*

So why don't we just start off with sort of where we are in the semiconductor cycle. At the same time last year, second half of year fiscal '24, the team was in the second year of the industry's cyclical downturn. You're driving about 18% year-over-year declines in the second half of '24.

But you did start to see sequential growth trends, which continued into this year. You drove the positive year-over-year inflection in the April quarter of this year, expect to maintain that positive trajectory going forward. Take us through the dynamics over the past year and more importantly, your view on the cyclical dynamics in your business sort of going forward?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Sure. So if I rewind back to that Q2 '24 period for us, that was when we first called what we thought was our bottom of the cycle after what was -- in the words of our CEO, the deepest and longest down cycle he'd experience. And also accompanied by one of the worst inventory correction.

So at that point in Q2 of '24, we thought we were largely through the inventory correction with our customers. We did think there might be a few pockets, and I'll talk about that as we work through the trends. But we did think we had hit bottom, and we thought we would start to see some modest recovery in the back half of '24 with some single-digit increases sequentially in revenue.

And then we -- what we had thought at the time is as we start to see the broad market pick back up and some of the cyclical upturn happened, we would start to see some acceleration in '25. I think if you go back and listen to Vince's guide as we were exiting the year, we thought, I think he actually said '25 could be a growth year for us.

And in fact, we have seen that happen, right? We started to see bookings trends improve. And we certainly had some parts of our business that were very resilient and held up well. So look, we're -- at our core, industrial is 50% of our business. So it's super important from a growth perspective for us.

And early on, we had two parts of our industrial that were really doing well and have proven more resilient. That was our aerospace and defense piece and then our ATE business. So the aerospace and defense, obviously, for us is a really important area. They require very high performance and have very high standards and also you're seeing this now more broadly, the increase in defense spending that's happening all over the place in the US and around the world is continuing to create demand.

So that was an early leader and 1 we expect to continue to show growth. Similarly, on the ATE side, there's no -- it appears to be no let-up in the AI/data center CapEx spending patterns, which we also think helps us on the ATE side.

But as the year progressed, we started to see the other parts of our industrial business pick up. So we talked about automation was a real challenge. That was one of the areas where the inventory correction lasted a little bit longer. And in fact, we had a couple of down quarters in '24 on the automation front.

We've now had two consecutive quarters of growth in automation. So we feel like that part of the recovery is now underway. And we're also -- when we look at the results we just posted in Q3, we saw growth in all of our end markets inside of industrial across all of our geographies. And we had said from the get-go, we thought if the recovery was real and the cyclical was going to happen, industrial would lead the way, and it has. So that's been really important.

And then if you just look a little broader, obviously, automotive for us has been very strong. We're on track to do a third record year of auto revenue. Three of our last four years in auto have been record revenue levels. We are forecasting a little bit of a correction in the fourth quarter. But overall, still tracking to a record year.

You look at our consumer business, for instance, which we're relatively underweight there, but it's a really strong business for us after going into the downturn, it's come out with -- now we had four straight quarters of very strong growth in consumer. And that's reflective of a couple of things. One is we did -- our teams have done a really nice job diversifying our portfolio.

So we aren't as dependent on single sockets in that business. And we look across the breadth of our portfolio, it's now products in handsets, in hearables, wearables, gaming, so the expansion there has helped fuel the consumer growth, and we think that helps continue for our growth into '26.

And then the final piece that you mentioned is the comms infrastructure space. That's an area where we've benefited tremendously from the AI drive, and we expect that, that will also continue to grow. That business benefits from the fact that all of those data centers are using our power management products and our optical connectivity solution.

So those are two areas where we continue to see growth today. Those are also two areas where when we talk about our new design wins, we had two design wins in that data center space around vertical power and optical switching that will start to generate revenue for us in '26. So if you look, the trends have been very positive. The other thing that we noticed I've talked about this a bunch as we've been managing our inventory, and we'll talk about that later. One of the things we watch for is what happens in the broad mass market industrial.

And that did not come back as fast as the rest of the market, but we saw signs that was coming, and we've now had two straight quarters of the mass market part of our business growing, which again, is just more confirmation that we think we are into the cyclical upturn.

Now like anything else, the macros are still uncertain, given where we are in some of the trade and tariff stuff. So getting full visibility out to '26 is a bit challenging just given those trends. But we feel like from a market position across all of our end markets, we feel like we made a ton of progress, and you see it in the results we've been posting.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

We learned this past weekend talking about tariffs and geopolitical dynamics, where we learned this past weekend, the Chinese Ministry of Commerce announced antidumping investigations targeting US analog chips, alleging significant price declines between 2022 and 2024, which is kind of interesting because 2022 through 2024, by and large, a big part of that was the chip supply tightness in the industry where you and others are actually seeing stable to increasing prices.

But nevertheless, there was this Ministry of Commerce out of China, alleging these antidumping investigations. Has the Analog Devices team been notified by China officials of this probe, like what's your view on that?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So I'm unaware that we've been reached out directly on this probe. But just for context perspective and Harlan hit it right, I've talked about this in other sessions. In '22, a significant amount of the growth that ADI saw from a revenue perspective was price increases. So certainly, we weren't dropping prices.

'23, we had incremental price increases, not nearly as significant as what we did in '22. And then you've heard me say in '24, our pricing was relatively stable, and we are expecting we'll finish '25 with prices relatively stable. So big swings in prices in the last two years have not been part of our go-to-market. So we will continue to monitor.

Obviously, we do sell into China, but we do tend to play from a context perspective, we do tend to play in the higher end of the ASP bands in China because where we're at our best is in the high-end, most complicated solutions where you need to have application-specific knowledge and outstanding portfolio of Analog, we have a 60 years' worth of built Analog portfolio.

So I think that the fact that we play at that high end at the higher price points also as important context the sort of less than $0.50 ASP band in China is not a significant part of our business.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Yes. Let's talk about, you gave us a great overview of the trends that you've been seeing from a shipment and revenue perspective in your business over the past year. Let's talk about orders and bookings, which is a little bit more of a view on sort of the forward-looking trajectory of the business. And back last year when we hosted you, the team had already driven sequential order growth in three out of the prior four quarters. Those bookings trends continued into this year.

I think including the July quarter, which you reported not that long ago, the team has now driven sequential order improvements in six out of the last seven quarters. You're about midway through this quarter, have overall order trends continue to improve? And how do you see order trends by end market or geography.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So, I tend not to do in quarter updates to our booking trends, but I'll go back and remind you what we talked about at the earnings call. We continue to see good bookings momentum. We saw relative linearity over the course of Q3 from a bookings perspective. If you remember back, we did talk about we had some anomalous booking trends in Q2 that normalize pretty quickly in Q3 over a four week trail or a 13 week trail.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

I believe your turns business, which is orders that you get inside of the quarter through cycle has been about 15% of total sales. Typically, during the initial stages of an upturn, your turns business tends to be higher as more customers clear inventories and then they find that they have to place orders within lead times. What did you see last quarter and so far this quarter in terms of turns order activities?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So last quarter, we actually saw, as you described, as we saw the cycle upturn continue we did see higher-than-normal turns business in the third quarter. And some of that's reflected in us achieving over our -- over the high end of our guide was we got a bunch more turns in the quarter.

Our guide for Q4 anticipates a more normal level of turns, obviously, on a continuing growing revenue number. I mean if you think about -- if you just look at where we are coming off of our bottom of our cycle. I think if you take our Q4 guide, we're up almost 40% opposite off the bottom. So it continues to be strong. And like I said, confirming that we've been in the upcycle here.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Team has done a good job of shipping below your customers' channel consumption levels over the past six to seven quarters where you exited July with about 160 days of inventory on the balance sheet. How do you anticipate the trend on your inventory this quarter and you've been extremely disciplined on channel inventories, right, keeping channel inventories below your target range of seven to eight weeks. Where do you see that trending this quarter and maybe over the next couple of quarters?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

All right. That's a lot to unpack. So I'll start with the balance sheet inventory. So one of the things we've talked about during the supply shortage, we found there was a significant advantage to have more of the inventory on our balance sheet than in the channel, gave us more flexibility in how we address customers.

So there's two things happening. One is we spend a significant amount of time. On a better part of a year, reducing our balance sheet inventory because we have gotten up to a number of days that was very anomalous for us.

And we drove that down. But if you remember, about three quarters ago, I started to signal that we would start to put more inventory dollars on our balance sheet. So we were well positioned to capture the upturn in the cycle. So we have added inventory dollars, but given the revenue growth we're seeing, you've seen the inventory days come down, I think, depending on how you calculate it, roughly 160 days of inventory on our balance sheet.

And I do expect in Q4, we will add additional inventory, but probably days will stay relatively flat. Part of that is we start to see the increase in bookings and demands, whether returns over the next quarters is having sufficient inventory on hand to be able to turn quickly and fulfil those orders. So we will keep more.

We've also learned we can run our channel much leaner given the back-end improvements we've made in our -- and what we've now got for back-end cycle times, we can keep less inventory in the channel. I actually don't think we ever get back to the seven to eight-week model. We just don't feel like we need that. We have very good relationships with our distribution channel, and I actually meet with our biggest partner quarterly to make sure we are delivering what they need to satisfy our customers.

And we've been successful doing that at a lower level, given the improvements we've made in our ability to fulfil. So we've been running less than six weeks in the channel. If we continue on this growth pattern, we probably need a little bit more than six weeks in the channel as you think out medium term. But currently, we feel pretty good about where we're running. And I think that's -- it matters -- it's been something we've been super aggressive about and it positions us well going into the next year.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

I guess, one of the benefits of keeping a very tight control and lean inventories within the channel is that you can get almost real-time feedback from your customers, right, in terms of inflections up or inflections down. Has that been -- is that part of the reason why you're wanting to keep inventories relatively lean relative to your target levels?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So as I said, we've moved off the seven to eight weeks because of the improvement, but the lean has largely been so that we can keep more control on inventory on our balance sheet. So should there be challenges -- the next supply chain challenge, we have more control -- inventory once it's in the channel, we don't have the same ability to move it to a different geography, et cetera. So having more of that our balance sheet is important.

Now look, we're going to continue to be super prudent about the balance on -- in both places, right? So I don't expect we're going to see growth in our days because we're continuing to grow revenue. But I think having it on our balance sheet gives us flexibility in dealing with customers.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

And your ability to move very quickly, you guys put a lot of your inventory in die bank, right? Is that correct?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Yes.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

So from die bank to finished goods is relatively short cycle.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Yes. Our back end cycle times now run around six weeks.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Six weeks.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Yes.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Okay. So putting everything together, given your 13 week lead times, roughly, the team had qualitatively described a forward view that the January quarter was likely to be a seasonal type quarter, right? Revenue is down low single digits sequentially, with the seasonal pickup in the April quarter. Is that how the team still sees the business profile as you move into next year?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So interesting, we had -- the majority of our products are now at sort of sub 13 week lead times, as you mentioned, we we're getting a lot of turns. So we still sit in that same position where our visibility really is only a quarter out, which is why we guide a quarter and not beyond.

And I actually think what we said coming out of the quarter to help folks think about it was, look, we don't have enough data in our backlog or our numbers to give a hard look at what the next quarter would look like, but typical seasonality would be as described. So -- and that continues to be the best way to think about it at this point, which for us, typically, that fourth quarter is down seasonally in the sort of low to mid-single digits.

And that's a little different by end market. As you can expect, it's a bigger drop in the consumer market percentage-wise, given all of the inventory build that goes into the consumer season in the calendar Q4, but we would typically also see down across the other businesses.

If you think about what happens, we take a shut down. Many of our customers have a shutdown. So not unexpected to see that seasonal pattern, but we do think that allows us to get back into a more normalized seasonal pattern going forward.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Let's step back and take a look at the longer-term view and the longer-term profile and trajectory of ADI's business, right. So if I look back over the last 20 years, you've grown your revenues at about a 9% CAGR. That's about 30% faster than the overall semiconductor industry. Earnings, free cash flow per share, you've grown at 11% to 13% CAGR over that period of time.

Some of the growth has been inorganic, but majority has been organic. And on a go-forward basis, this was the last Analyst Day and a couple of years back, you were targeting to grow revenues at a 7% to 10% CAGR, earnings at a 10% to 11% CAGR, $15 per share of earnings power in fiscal '27. This was a target that was put out a number of years back. But given the severity of this past down cycle, how should we think about the team driving back to that sort of $15 of earnings power. Is that now maybe fiscal '28, fiscal '29?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So I'll go back to the beginning. So 20 -- at our Investor Day in '22, the company put out its new long-term model, which had 7% to 10% growth rate, which was a pretty significant step-up from sort of the historical industry growth rate that folks have seen.

And if you think about what we were describing and expecting there was three things we knew or thought would drive an increase up in that revenue from the historical lines. We figured we get an incremental point of growth out of our alignment with a lot of the cyclical megatrends. So whether it's the energy transition, whether it's the electrification of autos, whether it's more automation in the factories and warehouses.

So there were a number of those sort of macro trends that we were in leading positions. We thought that would give us about 1 point of growth. We also, as we've talked about historically, in our space, the industry, you would give back points plus of pricing every year. The old Moore's law, we get more efficient here too. That changed for us during the supply chain crisis and now the pressure -- inflationary pressure on almost all of the inputs in the semi cycle continues.

So we have not been giving back the price like we have historically, and we figured that was good essentially another point step up. And then the third piece that's really important is, when we did the Maxim acquisition, one of the things we said is by 2027, we pick up $1 billion worth of incremental revenue from synergies with Maxim.

So that was how we got that step-up, which is what's helped us obviously achieve some of the growth that we've been talking about. And then obviously, we continue to drive some leverage.

What we didn't contemplate when we did that model in '22, was that severity and the depth of the downturn. So obviously, getting something very unusual what have to happen for us to get back to a $15 share price in '27. But what we have demonstrated is continued accretion in EPS, right, in addition to getting more leverage from a gross margin perspective.

And certainly, in '25, most of the incremental leverage is from a gross margin perspective, given the growth we've seen in OpEx. If you remember, our OpEx is A significant driver of the year-over-year changes in our variable comp plans wherein last year, we didn't pay very much variable comp because we had no revenue growth. This year, we have a lot of variable comp.

But we do get leverage out of we've been getting leverage out of gross margin and you see that. So you're seeing the growth. So I do think you're right. It will take a few more years. I do think we still have the ability to get to that.

The other piece that contributes and has been helping is our capital return policy has allowed us to retire a fair number of shares, certainly since I've been here, and we continue to target returning 100% of our free cash flow to shareholders. From a framing perspective, tends to be 40% to 60% of our free cash flow goes into our dividend. And then the remainder were used to retire shares.

So we will continue to target that return policy, which will help us both on the -- will help us on the numerator and denominator to get leverage and have less shares.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

A strong driver of the faster than overall industry growth that the ADI team has put in over the past number of years, right, a strong indicator of that momentum is your design win pipeline, right? You grew your design win pipeline by a double-digit percentage in fiscal '23. You did it again, double-digit percentage growth in the design win pipeline in fiscal '24 across all end markets.

How is '25 tracking so far? What are the areas of your portfolio or end market exposure? Are you seeing the strongest expansion and revenue opportunity as you look at the design win capture?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So a great summary. So '24 was a record design win year for us and '25 is on path to exceed '24 from a design win perspective. And it is actually, thankfully very broad the design win success we've had, certainly have some of the heaviest and most significant growth in design wins has been in automotive space.

And that's clearly indicative of the -- we invested early to get in on some of the significant trends in automotive. If you think about connectivity, whether it's the A2B or our GMSL functionally safe power. So we continue to get design wins in those areas. And as more and more of those features going to more and more cars, we get more and more opportunities.

We've also seen design wins across industrial. And as I mentioned before, the broadening of our consumer portfolio is because we've had design wins that continue to ramp. So we feel pretty good that we're getting broad growth from a design win perspective.

On the comp side, we've talked about already the design wins we had on the vertical power and the optical networking. So pretty broadly across our portfolio. And for us, it's a really good indicator of where we are. And I think we've had strong design wins over the past two to three years and a good indicator of where we'd be three to five years out from the design wins.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Let's focus on your end market exposure. Industrial, 45%, 50% of total revenues composed of a set of diversified businesses across different markets, factory automation, health care, instrumentation and test, energy infrastructure, aerospace and defense.

Help us understand the sizing and growth of the different subsegments. And as the team moves to this potential upturn, right, what subsegments are likely to outperform going forward?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Sure. So from the key components from an instrumentation and test that tends to be in the 30% to 40% of our revenue. And we'll go back to the -- I'll do the growth factors after we go through. And then you think about ADEF and automation, those are both a little bit above 20% of our revenue. Our health care business is sort of in that 10% to 12% range, and the remainder is in our energy management space.

And so when you look at the drivers that we've been talking about from an industrial perspective going forward, right, we continue to see there space and defense as a growth vector, right, with the growth in spending on aerospace and particularly on the defense side of things, both domestically in the US as well as what's going on internationally. We think that continues to be a growth driver.

You look at the AI and data center growth, which does not appear to be slowing at all that will give us growth vectors, both in our industrial because of what we'll see in the test business. But it will also give us opportunity in the wireline part of our comms business. So that's pretty -- those are two areas where we expect to see continued growth going into the future given the macro trends that support those areas.

We are starting -- as we've talked about starting to see growth in health in the digital health care space, right, where we've got design wins there and products ramping. And then on the consumer side, as I mentioned, we have a bunch of new sockets that we expect will continue to grow going forward.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

So on the -- sorry, I missed that. So on the industrial breakout, so Instrumentation and Test is about 30% to 40%. Automation is how much?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Automation and ADEF are both a little above 20%. And then the health care sort of 10% to 12%, and the remaining is in the energy management.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Energy. Okay. Got it. Okay. One of the strong dynamics among several, which separates ADI from your peers is your strong exposure to ADEF, right aerospace and defense, strong portfolio and mixed signal, RF, millimeter wave, digital signal processing, compound semiconductor products, lots of customer initiatives here.

This has been a strong growth area for the ADI team during this last downturn. Has this business broken through? I think, based on the breakout, has this business spoken through the $1 billion annualized revenue run rate or 10% of overall revenues for the business?

And what are some of the ADI-specific product cycles within A&D that's going to continue to drive the strong growth into the next fiscal year or over the next few years?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So yes, on an annualized basis, it has broken through the $1 billion barrier. We -- as we said, that it's been one of the most resilient parts of our business during this cycle for us. As I mentioned, given the secular tailwinds from an aerospace and defense, we would expect that to continue.

One of the things that's been a big benefit for us is we've always -- first of all, that is a space where high performance and the criteria are very significant. And as we've talked about, our favorite place to play is the highest, most complicated part of the chip market. And so this is an area where that is really important. And when you combine the individual analog products that we sell with -- where we've made a ton of traction in that space is selling modules and subsystems where the ASP premiums are significant for us.

So you go from selling individual chips to selling the modules. You go into thousands of dollars per product. And that's one of the thing that is from a driver perspective for us, will continue to be a significant element is our ability to capture more value because we are able to do that at the modular and subsystem level.

So I think we've got a number of those drivers that support continued strength in the aerospace and defense business for us. And that's -- like you said, whether it's in the any of the categories you described.

The one you didn't mention in your list that is also an important part of it is our power portfolio. Also plays an important role. If you think about the requirements of things going into whether it's satellite or missile defense systems, pick your products, the power is also another element that I would add to that, Harlan, from a growth driver perspective.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Yes. And I think as a team over the years, has grown its portfolio organic and inorganically, right? You've been able to drive more dollar value per customer engagement within aerospace and defense and your A&D customers do appreciate the module/reference platform focused because it allows them to get to market faster as well.

Any areas within aerospace and defense, you've got SATCOM, you've got UAV, you've got weapon system development, radar, so on. Any specifics end markets -- submarkets within aerospace and defense where the Analog team has particular leadership in? Or is it kind of all of the above?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

I think we have got strong positions in all of the spaces you mentioned. But certainly, in the guidance area and in the microwave comps. Those are two really, really strong assets for ADI and important assets across that aerospace and defense business.

And look, what customers want from ADI is the -- and one of the things we got really good at during the supply chain strategy was getting closer to customers, we get invited in earlier. They want us to solve problems.

So oftentimes, it is, here's what we're trying to do, can you provide an elegant solution, whether it's a module or a subsystem or even individual components that help solve our problem. And our success doing that has positioned us really well in that space.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Let's shift to automotive. 30% of your revenues this fiscal year, your auto business will be, as you mentioned in your prepared remarks at record levels. However, here in the fourth quarter, you are experiencing some inventory normalization as you did see auto pull-ins in the first half of this year, right?

April quarter, it was a little bit of pull-in from auto customers in North America and Europe. July quarter was a little bit of pull-ins from China auto customers. Here in the October quarter, you and your customers are working down these pull-ins, right, with auto cells for ADI expected to decline by mid-teens sequentially do you anticipate you will exit this quarter with your auto business back to kind of shipping to consumption trends? Or do you see more inventory digestion maybe heading into the January quarter?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So if you think back to when we first raised the advanced buying Collins in auto in Q2. I had said I thought that the pull-ins were largely going to come from Q4 and-or Q1. And then we didn't expect to see any incremental pull-ins. We did actually, as you mentioned, see some pull-ins in China in 3Q. And the result is when we look at what we're going to expect for Q4 is well below seasonal.

And I think we said on the call, low double-digit decline. When you look at the magnitude of that decline relative to our prior expectations, I senses and our analysis -- geez, sorry, our analysis would lead me to believe most of the correction of the pull-in happens in the fourth quarter.

Could there be some small residual amount that flows through in the first quarter possible, right? Because we know we have a precise way, nobody calls to tell me they're pulling in inventory. But our -- but given the magnitude of the correction in the fourth quarter, we think we exit the fourth quarter with it largely behind us and then getting back into a more seasonal pattern.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Got it. And then relative to your broad auto portfolio, you've been driving outsized growth in leadership areas like connectivity, right? You mentioned both in cabin and ADAS. You talked about power management, functional safety. How are these areas of product leadership performing relative to the overall auto business?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So all of the areas you just mentioned are growing at a very strong clip. And in fact, that part of our business now represents almost half of our auto business. So it has been a significant contributor.

And again, it gets back to our early investment to have the right products in those areas, in advance of the market trends and the market trends continue, right? If you look at our auto story, especially over the last 10 years, we've outgrown SAAR pretty significantly.

So our content growth gives us over a 10 year period has given us round numbers, 10% growth above SAAR. And what's interesting, and you all see this in what's being put in cars these days. If you shorten that and look over the last five years, it's actually about a 15% premium to SAAR for content, and content and share gain, but a big piece of that is content.

Because you think about even a moderately priced car in the US and now even a very low-priced vehicle in China, has more in-cabin immersive experiences. They're moving Level 2 ADAS down into more vehicles. And those all create opportunities for the products you just said, right, whether it's A2B, GMSL, functionally safe power, and particularly when we get into the full EV vehicle production, and that's where we get more BMS share. So those are all real content and strong drivers of growth for us in the auto space.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

So when you mentioned these growth drivers being greater than 50% of the auto business that includes GMSL, A2B, functional safety. Does that also include BMS?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Yes.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Okay.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

I didn't include the BMS and the growth driver because as we've talked about, BMS has been working through an inventory correction this year.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Any visibility in terms of when inventories in BMS could potentially normalize?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

We think we're seeing normalization as we exit this year and should see return to growth in BMS in '26.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

In '26, okay. Let's talk about AI and accelerated compute. Obviously, it's a very topical. Not a lot of people understand ADI's strong position in AI and accelerated compute. For ADI, AI data center compute networking combination of testing and instrumentation power, optical networking connectivity solutions.

The team drove about $400 million in the AI revenues last year. You were targeting to grow this segment by about 30% to 50% this year. How is this subsegment trending relative to that target and you were anticipating the ramp of some 1.60 optical module wins in vertical power delivery end of this year and next year, are these programs still on track to fire as well?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So I'll go back to the beginning where we expect this year's number to be more in the $500 million to $600 million, which tracks the growth objective certainly growing well above the company average. And in fact, if you look at the pieces that are in our comps business. So the wireline part of comms, that part of our business has actually grown 50% year-over-year in each of the last two quarters.

So continues to grow very strong. And continue to be well positioned, as I said before, given the CapEx trends we're seeing in that space. And the two design wins, the vertical power and the optical modules, we expect -- now expect that revenue to start ramping in '26. We thought we might see some in late '25. But given customer schedules, it looks like it will be late '26. And those two wins combined when they get to sort of normal shipping volumes is approximately $100 million worth of incremental revenue in that part of our business. So we do continue to see growth above company average in that space.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

And then on the -- moving over to the comms infrastructure part of your business, right, strong leadership in signal processing, RF, power management, really strong exposure to 5G infrastructure, cloud, hyperscale, optical connectivity and AI, compute power management, as you just talked about, wired comm infrastructure, has been strong due to AI.

But wireless has been weak due to muted infrastructure spending trends by the cellular service providers. However, you did see sequential growth trends in wireless for the first time in a while last quarter, have the positive trends in wireless continued into this quarter? And how do you see the potential profile of recovery for the wireless infrastructure part of your business looking out over the next several quarters?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So we have been talking about the wireless part of our business being down and essentially being a bit of a drag on our comms business. So -- and I think I described it as bouncing along the bottom in the last couple of quarters. So we did see some growth you haven't heard me celebrate that anymore publicly because I do think a bit of that is just being, one, very easy compares to what we had from a revenue perspective in the prior year.

And yes, we are shipping higher amounts, and it is in the traditional sort of 5G space. But to your forward-look question, obviously, where we are, there hasn't been any broad expansion in the 5G market at this point.

So I wouldn't say that's necessarily a long-term driver for us as we see -- wait to see what the next turn of wireless looks like. But at this stage, at least it is a growing business and not detracting from the success we're having on the wireline side.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

I think the mix in the comm infrastructure business has changed pretty dramatically because of that, right? Is it 70-30 now wireline versus wireless?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

The wireline for us is at least two-thirds, yes.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

At least two-thirds. Okay.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

May flex a little bit around that, but it's typically above two-thirds right now.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Let's talk about the financials and maybe some of the manufacturing strategy. In the July quarter, gross margins came in slightly below expectations due to some undigitalization in your Ireland fab. I believe you had some supply constraints.

But you had anticipated your gross margins trending to the 70% level this quarter, a combination of utilization improvements and mix. Is the team still tracking to this target? And have you resolved the supply issues with the Ireland fab?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So in reverse, yes, we have resolved the supply issue. And I think we had mentioned that on the call, we thought that we'd get that worked out and be back on track in Q4 to get back up to our 70% margin. And again, the other piece of that, that's really important. One is that supply piece. The second is the mix issue.

And if we hit our guide industrial is back up to almost 50% of our revenue, which is an important margin accretive for us. Industrial, obviously, is our highest margin business. So that will continue to be really important for us in the fourth quarter and as we go forward.

So we -- as we said at the time of the earnings call, that's the expectation for 4Q and then positioning us for -- continuing -- assuming continued revenue growth, continued increase in utilization, which should also help us on the margin side.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

So utilizations are improving this quarter.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

We have had continuous improvement in utilization since we came off the floor in Q2 as we expected. We're still below an optimal utilization, obviously well below where we were at peak margins because we were running even then at what in hindsight, you'd say we're pretty unhealthy levels above normal during the supply crunch.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

So as you continue to move through this up cycle, could you discuss some of the key gross margin levels? And whether it's possible to approach the 74% gross margin levels that the team drove in 2022?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Sure. Two biggest drivers, the mix, which I won't repeat again, getting back to at least a 50% industrial mix helps us get back to margin levels more like what we saw because the peak margin you described was 53%. The other piece is continued expansion in volumes, gets better absorption and deal helps us reduce the variances because if you looked at the drop from peak to trough, it's split between the mix of business and the underutilization caused by the lower amount of factory production.

Now built into that sort of utilization and variance numbers we did double our internal capacity over that period of '22 to '24. You saw that in our CapEx numbers. You also see the benefit today of our CapEx coming back down to normal levels, which is a bit of a free cash flow tailwind for us. See that in our free cash flow margins getting up to 35% on a trailing 12. So those two areas, mix and utilization will continue to drive. Those will be the key to driving margin accretion for us.

Back to 74%. I absolutely think we can get back to 74%. We'll just have to be at an entire level than the last time because we're in a 12, three kind of revenue number given the doubling of our capacity, the number to get to 74% is quite a bit higher on the revenue side. And depending on what happens in the industrial mix, we'll determine how much higher it has to be.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

And the other driver of the strong operating margins and EBITDA margin improvements, again, as we move through the upper part of the cycle is the team has obviously got scale. And so how would you recommend is, again, as we look out over the next few quarters and couple of years as we move through the sweet spot, of the positive up cycle. How should we think about relative to, let's say, maybe that 7% to 10% long-term revenue growth rate, how do you think about the growth in OpEx relative to that framework?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

So one of the interesting dynamics we had is we have a pretty substantial increase in OpEx in '25 because of the return of variable comp. So the even in a high growth year, again, if we were to have a lot year in 2026. The incremental variable comp would not be nearly what we had this year. So for context, I think I've said this before, the growth in variable comps like 500%, '24 to '25, pretty significant headwind. That should give us some accretion.

It's also what's caused us to grow above our sort of historical norm of growing expenses at a fraction of what we grow revenue. So with that behind us, we expect to have continued opportunity to get more operating leverage. Obviously, the more impactful is getting leverage at the gross margin line, but we will also expect in a revenue growth environment.

Again, look, the -- what '26 look like is kind of largely be determined by the macro factors that are still unsettled. But there is some opportunity. We get a bunch of the trade and tariffs up done by the end of the calendar year. We may get some of the rate cuts that people think could be helpful, certainly would be helpful in the auto end markets.

So there's a number of those things still to settle that will help guide what '26 looks like. But if we have growth years, we would expect more accretion in both.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

I was going to ask you a question about the Maxim revenue synergy target, but you clearly told us in your prepared remarks that the team is well on track to hit that $1 billion of revenue synergies in fiscal '27. So I wanted to pivot more towards the consumer part of your business because we don't -- you don't often get questions on the consumer part of your business, but that business is growing strong.

So my question is, what has the ADI team done over the past number of years to inject strong growth? And it seems like it's very diverse, right? Smartphones, client, IoT, wearables, hearables, maybe a little bit of consumer digital health, but what has the team done on the consumer side to drive this pretty strong -- what it looks like to be sustainable revenue growth profile in the consumer business going forward?

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Yes, actually, I think you nailed it. We -- the team did a really nice job diversifying the number of sockets and types of sockets we have on the consumer side. So we're not nearly as dependent on a small number to drive growth.

And you're right, it's if you described it before, we still have a very strong position in power and touch in the handset world. But then we also have strong position now in hearables, wearables, whether it's your hearing aid, whether it's the monitoring the watches for vital signs, it's a lot of those things, plus also in the gaming platforms.

So those have been very strong growth drivers for us, and we expect that, that broader portfolio will continue to drive our growth. Obviously, consumer is not as important to a growth from a dollar perspective is in industrial. But from a percentage perspective, it has been an outstanding grower for us for the last 12 months.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Perfect. Well, we are just about out of time, Rich. Always insightful. Thank you for participating in our conference today. I look forward to monitoring the execution of the ADI team as we move to this year.

Thank you.

Richard Puccio - *Analog Devices Inc - Chief Financial Officer, Executive Vice President*

Thank you, Harlan. Appreciate it, everybody. Thanks.