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# EDITED TRANSCRIPT

ADI - Q1 2020 Analog Devices Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 19, 2020 / 3:00PM GMT

## OVERVIEW:

Co. reported 1Q20 revenue of \$1.3b and adjusted diluted EPS (excluding special items) of \$1.03. Expects 2Q20 revenue to be \$1.35b, plus or minus \$50m and adjusted EPS to be \$1.10, plus or minus \$0.08.



FEBRUARY 19, 2020 / 3:00PM, ADI - Q1 2020 Analog Devices Inc Earnings Call

## CORPORATE PARTICIPANTS

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

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

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

## CONFERENCE CALL PARTICIPANTS

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

**Craig Matthew Hettenbach** *Morgan Stanley, Research Division - VP*

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

**Jamie Rebecca Zakalik** *BofA Merrill Lynch, Research Division - Research Analyst*

**Mitchell Toshiro Steves** *RBC Capital Markets, Research Division - Analyst*

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

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

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

**William Stein** *SunTrust Robinson Humphrey, Inc., Research Division - MD*

## PRESENTATION

### Operator

Good morning, and welcome to the Analog Devices First Quarter Fiscal Year 2020 Earnings Conference Call, which is being audio webcast via telephone and over the web.

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

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

Thanks, Cheryl, and good morning, everybody. Thanks for joining our first quarter fiscal 2020 conference call.

With me on the call today are ADI's CEO, Vincent Roche; and ADI's CFO, Prashanth Mahendra-Rajah. For anyone who missed the release, you can find it and relating financial schedules at [investor.analog.com](http://investor.analog.com).

Now on to the disclosures. The information we're about to discuss, including our objectives and outlook, include forward-looking statements. Actual results may differ materially from these forward-looking statements as a result of various factors, including those discussed in our earnings release and in our most recent 10-Q. These forward-looking statements reflect our opinion as of the date of this call. We undertake no obligation to update these forward-looking statements in light of new information or future events.

Our comments today about ADI's first quarter fiscal 2020 financial results and short-term outlook will also include non-GAAP financial measures, which exclude special items. When comparing results to historical performance, special items are also excluded from their prior periods. Reconciliations of these non-GAAP measures to their most directly comparable GAAP measures and additional information about our non-GAAP measures are included in today's earnings release.

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



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

Thanks, Mike, and good morning to everybody. While our first quarter results were in line with our expectations, as you'll have seen, importantly, we managed our operating costs and working capital effectively to position ourselves to deliver margin expansion in the quarters ahead.

Before I discuss the quarterly highlights, I'd like to address the coronavirus outbreak. First and foremost, our top priority is the health and safety of those affected and, of course, our employees. We're doing everything we can to provide our customers with the support they need to minimize disruption to their businesses. While the situation remains fluid, we are monitoring it closely. Prashanth will expand on the financial implications in just a while.

So now on to the first quarter. Revenue was \$1.3 billion, down versus the prior year, but in line with our expectations. Operating margin was approximately 37%, a decline versus last year due to lower revenue and our decision to lower utilization. Adjusted earnings per share was \$1.03, above the midpoint of guidance. Over the trailing 12 months, we generated approximately \$2 billion of free cash flow, equating to a 35% free cash flow margin, and this continues to place us in the top 10% of the S&P 500.

On our call last quarter, we shared our priorities for 2020, and I'd like to give you an update on our progress so far. Priority 1 is the efficient use of our capital. The first call on our capital is funding new product development activities. In the first quarter, we invested over \$250 million in R&D, with more than 90% of this spend targeting the most attractive opportunities across our B2B markets. For example, an area of increased focus for ADI is our power franchise. Here, we've been increasing R&D to enhance our strong position in the broad market and to extend into new opportunities across areas like data center, automotive and 5G infrastructure. Our power design win momentum remains strong, and we expect to double the LTC historical revenue growth rates in the years ahead of us. At the same time, we remain committed to delivering strong shareholder returns. In the first quarter, we returned over \$300 million to shareholders and we just announced a 15% increase to our quarterly dividend.

Priority 2 is deepening customer centricity. As I've shared before, the combination of our broad product portfolio, domain expertise and manufacturing capabilities sets ADI apart. We're always anticipating the technology needs of our customers and engaging with them early in order to solve their toughest challenges.

And I'd like to share just a few examples specific to our automotive segment with you now. Our A2B platform continues to gain traction in the cabin electronics ecosystem. By leveraging our platform portfolio, we're opening up new applications for our customers such as active noise cancellation. In the quarter, Hyundai became the 14th auto manufacturer to incorporate our A2B technology. And together, we announced the industry's first all-digital road noise cancellation system. With the rise of active noise cancellation, we're creating stickier customer relationships due to the integration of our hardware and software capabilities while increasing our SAM per vehicle.

There's also a lot of intensity and urgency in OEMs moving towards electric powertrains. We were an early player in the market, partnering with industry leaders to improve the efficiency of the battery in electric vehicles. As a result, our BMS solutions are delivering greater miles per charge and monitoring battery health more accurately. In the U.S. electric vehicle market, we're benefiting from near-term strength as customers ramp production, and new design wins across future models will help us to deliver on our long-term objective of growing BMS revenue at a double-digit rate.

Priority 3 is capitalizing on secular trends to expand our addressable markets and drive diversified growth. We've previously discussed with you key secular trends across our company such as 5G, electric vehicles, factory automation and data center. Now today I'd like to spend some time on the space market, perhaps a more obscure subsegment of our industrial sector. Our space customers' challenges are not just around RF, signal processing and power management. Space solutions must also perform under extreme cosmic radiation and conditions of high temperatures. We solve these challenges through the combination of our comprehensive product portfolio and the passive knowledge base built over many decades of serving this market. While space represents a couple of percent of ADI's total revenue today, it commands stellar margins, and we see potential to double the business over the next 5 years.

Now let me share a little more with you about why this sector is exciting to us. The space market is rapidly evolving. Over the last decade, unprecedented levels of capital have gravitated towards this vertical, thereby increasing the number of privately funded space companies by 20x.

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Therefore, new technologies and capabilities are emerging that are leading to new opportunities for ADI. This includes the advent of low Earth orbit or LEO communication satellites. These satellites are becoming the new frontier in space with forecasts suggesting that by [2025] (corrected by company after the call), over 20,000 will be in orbit, up from just hundreds today.

To provide some context, LEO satellites differ from today's geostationary or geo satellites. Technologically, they provide lower latency and higher bandwidth, which enable real-time communication. Operationally, they continuously changed their position relative to the earth and only stay connected with a given terminal for approximately 10 minutes. As a result, the number of terrestrial terminals that communicate with these satellites, whether they're on the ground or in the air, will grow into the millions with the proliferation of LEO satellites. To succeed in creating this network, both satellites and terminals must be capable of being [steered]. So this requires an exponential increase in channel count enabled through phased array antennas, an architecture that is used in 5G networks already today. And as you can imagine, more channels packed into smaller form factors is increasing thermal and power hurdles. To help solve the engineering challenges of creating this ubiquitous and always-connected LEO network, our customers are increasingly turning to ADI, looking to us to not only be a supplier, but indeed, a key system architect.

So we're engaging with customers early in their design process to develop end-to-end solutions from antenna to bits, combined with power capabilities, to deliver the required performance and, of course, robustness. Our ability to provide a comprehensive portfolio of space-grade solutions across the entire analog spectrum from RF and signal chain to power is unique. And this cannot be completely replicated by any of our competitors, making ADI the go-to supplier for our traditional OEMs as well as the next wave of disruptors. All told, we see the LEO communications satellite plan becoming at least 4x the size of geo over the next 5 years. And with LEO's [shorter] refresh cycle compared to today's satellites, we expect our space business to deliver a steadier stream of revenue in the years ahead.

In summary, space has the potential to be a meaningful growth driver and unlock value across other verticals as well. Once fully operational, these LEO networks will provide real-time, reliable high-speed connections globally, ushering in opportunities from autonomous driving to telesurgery.

So in closing, and speaking broadly about ADI, I believe demand for our solutions will be unprecedented as technological innovation underpinned by ubiquitous sensing, hyperscale and edge computing and pervasive connectivity continues to grow rapidly. And as I look ahead, I believe we're very well positioned to deliver sustainable, profitable growth and, indeed, strong shareholder returns.

So with that, I'll hand it over to Prashanth.

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

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

ADI delivered a solid first quarter. Revenue came in line with our outlook as we meaningfully reduced channel inventory. And through our disciplined spending, operating margin and EPS were above the midpoint of guidance. We also raised our quarterly dividend to \$0.62, an increase of 15%, the high end of our target range of 7% to 15%.

The dividend is the cornerstone of our capital allocation policy, and this represents the 17th increase over the last 16 years. These consistent increases reflect our commitment to strong shareholder returns as well as our optimism about the long-term prospects for our business.

Before getting into the income statement, let me first cover the end markets. In line with our expectations, our first quarter B2B revenue declined 15% year-over-year as better-than-expected industrial demand was balanced by softer communications activity. Industrial, which represented 53% of revenue during the quarter, declined 7% year-over-year. As we forecasted, most applications within this highly diversified business declined, while aerospace and defense once again grew double digits year-over-year.

Communications, which represents 18% of revenue during the quarter, decreased 31% year-over-year as wireless and wired both declined. While communications is an inherently lumpy market, our position has never been stronger or more balanced across the ecosystem. We are at the early stages of the global 5G rollout, which we continue to expect will be a multiyear tailwind.



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Our auto business, which represented 16% of revenues during the quarter, declined 16% year-over-year due to weakness across all applications. As Vince highlighted, we remain confident in auto due to our strong pipeline of customer wins, especially in our infotainment platform and our market-leading BMS position.

And lastly, consumer, which represents 13% of revenue during the first quarter, declined 20% due to portable applications. As we said in our last earnings call, we expect 2020 to be the bottom for our consumer segment.

Now on to the P&L. Gross margin came in at 68.5%, up slightly sequentially and down 180 basis points year-over-year as favorable mix was offset by lower utilization. As a reminder, fab utilization was near trough levels this quarter in order to reduce our balance sheet and our channel inventories. OpEx in the quarter was \$412 million, down 4% sequentially and down 8% year-over-year. In light of the softer revenue environment, we've curtailed spending and have delivered sequential OpEx declines in each of the past 5 quarters. As a reminder, we plan to exit fiscal 2020 with \$50 million of annualized savings across cost of goods sold and OpEx.

Operating margin finished at approximately 37%, above the guided midpoint. Non-op expenses were \$47 million, down \$3 million sequentially and \$9 million year-over-year, driven by lower interest expense. Our tax rate for the quarter was approximately 12%. All told, first quarter adjusted EPS came in above the midpoint of guide at \$1.03.

Now moving on to the balance sheet. As we planned, inventory was reduced by about \$20 million or 4% sequentially. Despite this reduction, our inventory days increased to 133 due to the lower level of revenue. Recall that our target for inventory days is 115 to 125. But during the process of closing 2 legacy LTC facilities, we do expect to carry an additional 5 to 10 days of bridge inventory to support our customers.

We also reduced channel inventory by approximately \$40 million in the first quarter and plan to reduce channel inventory in the second quarter again but to a lesser degree. CapEx in the quarter was \$55 million or about 4% of revenue, and we expect to end fiscal 2020 slightly below our 4% long-term target. On a trailing 12-month basis, free cash flow finished at \$2 billion or a free cash flow margin of about 35%. Over this period, we have returned more than 100% of our free cash flow to shareholders through dividends and buybacks after debt repayments. We paid approximately \$200 million in dividends and repurchased \$106 million of our stock in the first quarter. We still plan to pay down between \$300 million to \$500 million of debt in fiscal 2020.

Now we'll provide some context on our recent business trends and our current view on the coronavirus. In the first quarter, we saw signs of stabilization as we expected. Orders trended better throughout the quarter and have overall remained relatively resilient into the second quarter. However, unsurprisingly, we have begun to see weaker demand in China related to the extended Chinese New Year and ongoing business disruption. As such, our outlook assumes that China demand for industrial, automotive and consumer is minimal for all of February before returning to a more normal level in the last 2 months of our second quarter. And we are assuming an impact on our communications business due to the high likelihood of a delay in the 5G rollout. So while forecasting business dynamics in China is very difficult today, our guidance reflects our best estimates.

So looking ahead to Q2, revenue is expected to be \$1.35 billion, plus or minus \$50 million. This includes an approximately \$70 million revenue reduction due to the near-term risks with -- associated with the coronavirus. And as I said earlier, we expect to reduce channel inventory again but to a much lesser degree than in the first quarter. At the midpoint of \$1.35 billion, we expect B2B revenue in the aggregate to increase mid- to high single digits sequentially with growth across all of our B2B markets of industrial, automotive and communications.

Based on the midpoint of guidance, op margin is expected to be up sequentially to approximately 37.5%. We are planning for our tax rate to be between 10% and 12% for the quarter, and we are improving our fiscal 2020 outlook to between 11% and 13%. Based on these inputs, adjusted EPS is expected to be \$1.10, plus or minus \$0.08.

While we are mindful of the uncertainty around this, I echo Vince's optimism. We are encouraged by near-term trends that point to a stabilization and improvement across end markets, and we are extremely confident in the long-term growth opportunities for ADI.

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

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

Thanks, Prashanth. Okay. Let's get to our Q&A session.

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## QUESTIONS AND ANSWERS

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

(Operator Instructions) Operator, can we have our first question, please?

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**Operator**

(Operator Instructions) And our first question comes from Vivek Arya from Bank of America.

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**Jamie Rebecca Zakalik** - *BofA Merrill Lynch, Research Division - Research Analyst*

This is Jamie Zakalik on for Vivek. So similar to peers, you guys noted some stabilizing and improving trends in end markets in the January quarter, but it seems that growth has actually decelerated across all the end markets. So I guess are the improving trends more in the -- in February, even with a lot of these virus headwinds? And is it specific to any end market or geography? Or is it more broad-based?

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

Yes. So Jamie, I think the first quarter was in line with what we expected. So there was deceleration going into the first quarter. Now remember that in this quarter we undershipped the channel. And as I said in my prepared comments, we undershipped by \$40 million. So on a revenue rec basis, [PO] ship in was \$40 [billion] below sell-through. As we go into the second quarter, orders were improving over the course of the first quarter, and we expect that to continue into the second quarter with this note that we made on a disruption in China where we believe some of this demand is going to get pushed out to future quarters. So I do think that our view here is that we've sort of bottomed out and it gets better from here through subsequent quarters.

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

Yes. Maybe I can add a little bit of color as well from a market perspective on that. So what we're seeing is -- in spite of what looks like a delayed 5G employment -- deployment in China, in the second quarter, we're expecting growth, actually quite good growth, in our communications 5G sector as well as wireline. And that growth is becoming a little more broad-based. We're seeing, I would say, green shoots in the factory automation and process control side of things as well, which is a significant part of ADI's industrial business, and also gathering strength in the ATE sector. And from an automotive standpoint, we're seeing particular strength in our business in America as well as Europe at this point in time.

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**Operator**

And our next question comes from Tore Svanberg from Stifel.

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

Yes. Vince, I was hoping you could elaborate a little bit more there on 5G. You said it's becoming a more broad-based business. Just trying to understand geographically where the growth is coming from, because, obviously, it's not coming from China near term. So if you could elaborate on that, that'd be great.

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

Well, I think, Tore, China has taken a pause. Asia is still, at this point in time, in terms of deployments today, Asia is by far the strongest in 5G. I think what we're seeing is the -- probably a faster roll off in 4G than we had anticipated. 5G has taken a bit of a pause in China but is set -- based on what we see in terms of demand, is set for a ramp during the second quarter. And also, I pointed out that wireline for ADI in general, whether it's data center, whether it's metro or long-haul networks, is doing quite well. So as we've come into the second quarter, our book-to-bill has been -- is well above 1, and that gives us the confidence in the growing strength of that business through the second quarter here.

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

Sorry. Do you have a follow-up?

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

Yes. Just a quick one. Prashanth, you did a good job lowering channel inventory. It sounds like you're going to lower a bit more again this quarter. Could you maybe give us some targets either by weeks or what dollar amount are you trying to lower than buy?

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

Well, I think, Tore, we had mentioned in the -- in our first quarter -- or fourth quarter call that our goal was to get back to our target range by the end of the second quarter. It may take us a little bit longer now given we didn't include the impact of the coronavirus in the top line. So we're still heading towards the same channel inventory target that we'd had before but with a bit of a softer top line. I think it might actually be end of third quarter before we're back in range.

**Operator**

Our next question comes from Toshiya Hari from Goldman Sachs.

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

Your automotive business was down 16% in the quarter, which was in line with your guidance. But relative to peers, a little worse on a year-over-year basis. Vince and Prashanth, you guys talked about your optimism around some of the design win activities in BMS and infotainment. But in the near term, what's driving kind of the double-digit decline in your automotive business? Is that obviously channel inventory reduction? Or are you losing share? I guess, more importantly, how are you guys thinking about kind of the through-cycle growth rate for our automotive business over the next couple of years?

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

Yes. Well, look, we have been very, very clear. The 2 growth drivers for ADI in the automotive sector are the infotainment area, A2B, active noise cancellation, audio signal processing in general. And of course, BMS has been over the last couple of years, a double-digit growth driver for ADI. I think in the quarter just passed, BMS, which has a route -- a strong route in China that suffered as a result of the virus. And -- but when we look into





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the second quarter, we expect our -- as I said, our second quarter has better trends in North America and Europe. So we're expecting modest growth in the second quarter.

The headwind for ADI has really been the safety sector where our 24-gigahertz radar technology is declining, probably at a rate a little faster than I had expected. And also in the area of MEMS, more of the kind of the passive safety MEMS where we withdrew investment 3 or 4 years ago. So I think we'll begin to bottom out, I think, on those headwinds, specific to safety. We have a new safety modality in 77 gigahertz, which is, by all accounts, very, very exciting for our customers. We will see bottoming, I think, of the MEMS and the 24-gigahertz radar decline.

So my sense is in the areas we've picked of powertrain, infotainment, we're very, very well positioned to grow those sectors over the next 2, 3, 4 years.

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### Operator

And our next question comes from Ambrish Srivastava from BMO.

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

Prashanth, I had a question on the actual weeks of channel inventory, and I might have missed it, but did you give an actual number? I think you were 8.5 weeks in the prior quarter.

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

We did not give a number, Ambrish. The -- what I mentioned is we took the channel inventory down \$40 million. But if you do the math, we're still going to be above our target range because the revenue -- the numerator has moved, but the denominator has also shrunk.

So on a ratio standpoint, the weeks are still high, but we did take a big chunk out, and we're going to take more out in Q2, as we mentioned.

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

Do you have a follow-up, Ambrish?

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

I did. Vince, maybe for you. In 2 areas, real quick on industrials. What's the right way to think about, given what's going on in China and broader, how to think about return to growth in the industrials business? You guys outperformed last year, but what -- how should we think about year-over-year growth returning?

And then in comms, we always ask you about wireless. I had a slightly different question. How is -- how are you guys positioned in wireline versus if you look back at 2, 3 years ago? And then what gets you excited about the design wins in -- that should be ramping out in wireline?

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

Thanks, Ambrish. Let me try and address the industrial question first. So we are seeing our aerospace and defense business continue to grow at double-digit rates annually. We are seeing, as I said a little earlier on, the factory automation side of things outside of Asia is on a, I'd say, a solid improvement in its demand pattern. I think inventory hangover has largely been taken out of the equation in the industrial sector.





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So I think when you look -- when we look at the impact of the virus in China, we're not expecting really anything in the industrial sector in terms of shipments there for the month of February. But all that said, we're -- we have a very solid book-to-bill in the industrial sector, and we will get, I think, a decent increase in our top line in industrial during the second quarter.

On the wireline side of things, our game there is really 2 pieces. We have a very strong -- we have a strong leadership position in optical control systems for data centers. So all of the FANGs, for example, would use our technology in their data centers for control of the optical signal chain and also the cable market. We have a good position there in infrastructure systems. So wireline business has been growing high single digits now for several years, and I don't see any decline in that. I think that will be a decent growth driver for ADI. It runs into the region of \$400 million annually in terms of sales at the present time. So I view that very much, Ambrish, as a tailwind for the company.

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

Yes. Let me also add on the industrial side, we did take down general inventory meaningfully. A lot of that relates to industrial. And if you look at industrial, you kind of zoom out and you look at it on a trailing 12-month basis, we're only down low single digits, which is a pretty good performance in a tough macro backdrop, and that goes to the diversity of that business.

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**Operator**

Our next question comes from Mitch Steves from RBC Capital Markets.

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**Mitchell Toshiro Steves** - *RBC Capital Markets, Research Division - Analyst*

Great quarter. But I just wanted to clarify a couple of things. I think you guys have done a very good job now kind of talking about your capital allocation, but what I'm having a hard time understanding is kind of the margin mix here. I realize that space and satellite is probably higher margin. I'm guessing like 80%, 90% gross margin. You guys are actually coming down a bit on the gross margin line. Can you maybe talk us through what the gross margin profile should look like in the first half and the second half? And then how that would flow through the operating margin line as well?

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

Sure. Yes. Thanks for the question, Mitch. So I guess, a little bit of background, right? Our model is 70% gross margins sort of long-term model. And in good times, we were operating at 72%. In more challenging times, like now, we're down in the high 60s. So through the cycle, 70%. As we move forward from here, we see 2 things that are going to be impacting margins, both utilization and mix.

So Q1 represented the trough level of our utilization expectations for the year. So a fair amount of under absorption in our internal manufacturing facilities, that gets better from here on, and that will be tailwind to margins. And also as some of the questions that were asked, Vince mentioned the strength in industrial. We expect industrial to continue to be growing as we move forward. And industrial, in general, is one of our highest margin businesses, so that will also provide tailwind.

So we -- I would expect that you could see sequential improvement in gross margins through the balance of this year likely getting back to our model margins in the second half, maybe towards the end of the year.

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**Mitchell Toshiro Steves** - *RBC Capital Markets, Research Division - Analyst*

Okay. That's very helpful. And then I just have one follow-up. Just in terms of the seasonality for the business. I think maybe you should probably be taking a little bit of a more conservative view in April just because it sounds like China is going to open up March 1. But when I look at the July quarter going from April to July, should that be, I guess, above seasonal given that April is depressed from all the macro items that are going on?



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

All right. So the guide for our second quarter included a \$70 million adjustment that we made at the top for the impact of the coronavirus. And the math that we use to arrive at that is we essentially zeroed out February in China for industrial and auto and consumer, and then we also made an adjustment for communications being pushed -- or the deployment of 5G being pushed out a bit just because of the labor challenges that are going on there. We expect that to begin unwinding in the subsequent months and certainly be back to normal in the third quarter.

Could it be above normal? That's certainly a possibility. It depends on the timing of how that \$70 million comes back. It's our current view that, that is purely a timing shift that, that is not lock demand. But as to when that falls back in, it's hard to say, but the order activity certainly suggests that it's not going away.

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**Operator**

Our next question comes from Stacy Rasgon from Bernstein Research.

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

I wanted to zero in first on comm. So it sounds like you're pushing it out. Your prior guidance for comm last year was for it to grow year-over-year, and it feels like you're backing away from that. But the trajectory in the second half on the old guidance was for very strong sequential growth kind of every quarter going forward. How should we be thinking about the trajectory of comm in the second half, I guess, given, I guess, the bump in Q2 versus the profile that was -- that you had in mind 3 months ago when you gave guidance? Do you still expect to see a similar ramp maybe just off a lower base?

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

Yes. So I guess a few things, Stacy. For the first quarter, a little bit lower than we expected, mainly due to the 5G pause that started in the second half of '19. Moving into the second quarter, orders have begun to come back in very much as we expected, and our book-to-bill is above 1. So that's supporting a strong sequential increase in second quarter for both 5G, but also as Vince mentioned, we're seeing some good strength in wireline as has been reported by a number of peers as well.

The sequential increase is below our initial expectations because of the -- a lot of that was related to 5G timing in China. So I think everything is moving a little bit to the right here. So it's hard for us to say at this point whether the timing of that recovery is still going to put us up year-on-year, but I think we'll have to see how quickly this demand recovers and whether the installations happen as -- is it caught up in the year or not? But we feel very good that this is really a dislocation of demand versus actual loss or destruction.

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

Yes. I'll tell you one other comment on that, Stacy. Our optimism about what's happening in America relating to 5G has strengthened over the past quarter as well. So yes, we have the disruption in China. It's really a delay of demand rather than destruction. But my own sense is that we probably see more activity at the back end of the year in the U.S. relating to 5G.

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

So it sounds like also, even though we have the delay because of coronavirus in China, that the order patterns still seem to be very strong. How do we think about the strength of those Chinese orders in relation to potential increases in sanctions that we've been hearing about? Do you feel like

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there's any sort of scramble on the part of Chinese customers to get out in front of those sanctions? I guess what are you seeing in terms of customer behavior in relation to the regulatory?

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

Yes. I think, first off, when you look at the geopolitical machinations, it's actually very hard to figure out what's going on. So -- but I think with our business in general, we have many thousands of customers in China, many thousands of product SKUs, and we see ongoing demand. There are obviously areas where we are restricted, particularly in 5G, but I think the rest of our business right now is in a kind of a normalized market and regulatory situation.

So the demand we're seeing is -- despite the disruption here because of the virus, the demand in China is actually quite strong across the board otherwise.

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

Let me rephrase the question. If, all of a sudden, like the de minimis threshold gets dropped from 25% to 10% and the foreign direct products will get strengthened, and they put more stuff on the controllers, does that impact how you guys view the trajectory in China as we go through the year? Would you have to reevaluate what you can ship and what you can't?

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

Well, yes, we would have to reevaluate. But remember that we have adjusted one large communications customer down from traditional mid-single to low single-digit as a percentage of revenue. So that is kind of -- that's the limit of our exposure depending on what happens to that particular customer.

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

Yes. I think it very much depends on the scope of what happens. And so far, everything we've seen is relating to one specific area of communication. So unknown, Stacy, but we'll see. Time will tell.

**Operator**

And our next question comes from Craig Hettenbach from Morgan Stanley.

**Craig Matthew Hettenbach** - *Morgan Stanley, Research Division - VP*

Just wanted to follow on the comments about the opportunity to double Linear's growth in the coming years. And Prashanth, if you could talk about -- I know there's some gross margin levers as you consolidate manufacturing and just kind of how you're dealing on that in terms of the growth profile versus kind of margins for Linear in the next couple of years.

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

Sure, sure. So I'll take the margin side of it. And then in terms of doubling the growth, I'll let Vince comment. On the margin side of it, we have talked about the focus we've got on shutting down 2 facilities. We've taken -- we've made announcements on those. We've actually been able to accelerate some of the savings for the -- for one of the factory closures, so we're going to start seeing some of that benefit in cost of goods sale at the end of this year. But the balance of that \$100 million, we see feathering in over 2021. And as we've stated in the Q4 earnings call, our intention is to let --



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to kind of let all of that come through the bottom line. So we are not -- we're not looking to redeploy that cost of goods savings. So you should see some lift in our gross margins on an ongoing basis as we exit 2020 and through 2021.

In terms of kind of the progress we're making to double that Linear growth rate, let me hand that off to Vince.

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

Yes. So I think we're making good progress, Craig, in trying to equalize the value of the kind of legacy ADI mixed-signal technology value in a given application with power. So we're looking for equivalents. For every dollar of mixed signal, we expect to get \$1 of power. And that's what the market opportunity available is.

I can tell you that our pipeline for the LTC portfolio, and specifically power, is up about 40% actually year-over-year. And we're moving into production down the automotive sector, the communication wireless sector. Wired, we're in early volume production as well. So we expect to see those areas ramp in terms of meaningful impact on the top line during 2021. And there are many, many, many new sockets in the industrial area that we're working on. So that will just take a little longer given the slower uptake in terms of turning design-ins to revenue.

But I think a lot like Hittite. We feel -- we went through this process with Hittite. We've doubled the size of that company, that franchise over the last 5 years. And I think we're on a very good track right now with LTE to achieving 200, 300 basis points of top line growth based on the strength of the portfolio and the activity at the customer level that we're seeing.

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**Operator**

Our next question comes from Harlan Sur from JPMorgan.

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

Good to see the fundamentals starting to improve here. A&D grew greater than 20% last year. Defense budget was approved beginning of this year. It's strong, up 4% versus last year. It's -- and you guys expect double-digit -- continued double-digit year-over-year growth here this year in A&D. Is most of the strength coming from the defense segment? Or are there also programs in the commercial aerospace SATCOM sector that are starting to fire as well?

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

Yes. As I said in the prepared remarks, obviously, defense budgets are in our favor in terms of buying technology and deploying it. So we're in good shape there. And yes, we're seeing strong double-digit growth in the space area as well. And that's relatively -- we've had a good position there. But the -- if you like, the explosion in the launch of LEO satellites and geo satellites is really increasing demand for the company. And we're looking at, in these in these applications, many thousands of dollars of content per satellite kind of thing. So we're very optimistic about that, but it's a combination of both. Both parts of that business are really growing well.

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

Harlan, I would say, remember, think about defense as when DoD gives the money to the primes and the primes start deploying it, this is going into design decisions that were made many years ago. So we are -- we're enjoying the flow of that larger budget into the primes. And then to us, for decisions that were made some time ago, we still have quite a bit of great design activity that has yet to be funded. So that starts to come.

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On the aerospace side, it's holding as well as can be expected given the environment that's going on there. And then in space, as Vince mentioned, space is really in front of us. That growth is in front of us. So while ADEF has been growing at a nice clip and continues to, we feel even more optimistic about what's in front of us coming both from space and future design win activity that's happened for the defense business.

### Operator

And our last question comes from William Stein from SunTrust.

### William Stein - SunTrust Robinson Humphrey, Inc., Research Division - MD

2 of them, really. First, I'm hoping you can provide some update or commentary as to the competitive situation and maybe the legal competitive situation with an FPGA supplier in high-performance converters, maybe competitive trends as to design win traction relative to that vendor.

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

Well, broadly speaking, in terms of competition, we are -- we've outgrown our closest competitors for the last 3 years. And so we're clearly gaining share across the board in communications and industrial, in particular. So I think competitively, we're in good shape. I think pricing is very, very stable as well. So I think overall, legacy, strong. Our design pipeline is strong. And we're excited about the new R&D programs as well that are coming to fruition for the company.

In relation to the litigation with, as you said, a large FPGA company, we will give you -- as new information emerges, we'll be transparent with you, and we'll communicate with you. But at this point, all I can say is that we're confident that this matter is going through the court and be successfully resolved. And we are defending our IP very aggressively, and we believe we have a very, very strong case. So that's where it is. It's within the courts, but we're very optimistic with how things are going.

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

You said you had a follow-up, Will?

### William Stein - SunTrust Robinson Humphrey, Inc., Research Division - MD

Yes. I appreciate that. Just on the COVID impact. It sounds like what you're saying is that you're assuming certain orders are 0 for February. Given we're February 19th, I assume that's actually what you're seeing in the order book. Is there any anticipation for weakness later in the quarter? And also, any supply disruption that you're noticing at all?

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

Sure. So on the orders, as I mentioned in the prepared remarks, it is very hard to kind of size the activity of what's going on in China. So when we arrived at our \$70 million, we wanted to give the investor and analyst community what assumptions are we using, knowing that these are very dynamic. So for our assumptions, we've taken our China activity to 0 in February and pushed out a little bit of 5G. The -- on the supply chain side, we are not seeing much disruption at this standpoint. We had some of our back-end suppliers early on. We're struggling just with getting some labor in to run their activity, but that's also been resolved as time has settled out here. So from our standpoint, our supply chain -- and we just revalidated this with the guys this morning. Our supply chain, we feel good about.



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

I'll also add, I think it might be helpful, given your question, kind of given our outlook of B2B, what we think each market is going to do because it seems a little bit of confusion out there of how we think the market is going to do. We think each market grows sequentially. We said, in total, B2B will be up mid- to high single digits. Our rank order (inaudible), comms is a little better than that. Industrial does in line with the overall outlook, and auto does a little bit worse. So that kind of helps you think of how the -- sorry, how the corona is impacting our business.

And with that, thank you, everyone, for joining us. A copy of the transcript will be available on our website, and all available reconciliations and information can also be found on the quarterly results section of our website. Thanks again for joining us and the continued interest in Analog Devices.

### Operator

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

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