

FINAL TRANSCRIPT

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ADI - Q1 2008 Analog Devices Inc. Earnings Conference Call

Event Date/Time: Feb. 20. 2008 / 5:00PM ET

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Jerry Fishman

Analog Devices, Inc. - President, CEO

Joe McDonough

Analog Devices, Inc. - CFO

CONFERENCE CALL PARTICIPANTS

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David Wong

Wachovia Securities - Analyst

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PRESENTATION

Operator

Good afternoon. My name is Eva and I will be your conference facilitator. At this time, I would like to welcome everyone to the Analog Devices first-quarter 2008 earnings conference call.

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All lines have been placed on mute to prevent any background noise. After the opening remarks, there will be a question-and-answer period with our analyst participants. (OPERATOR INSTRUCTIONS).

Ms. Tagliaferro, you may begin your conference.

Maria Tagliaferro - Analog Devices, Inc. - Director of Corp. Communications

Hello, everyone. This is Maria Tagliaferro, Director of Corporate Communications for Analog Devices.

If you don't yet have our first-quarter 2008 release, you can access it by visiting our Web site at Analog.com and clicking on the headline on the home page.

This conference call is also being broadcast live on the Internet and from Analog.com. If you select Investor Relations and follow the instructions shown next to the microphone, you can listen via Internet. A recording of the call will be available today within about two hours of the conference call's completion and will remain available via telephone or Internet playback for one week.

Participating in today's call are Jerry Fishman, our President and CEO, and Joe McDonough, our Vice President for Finance and CFO. We have scheduled the call for 60 minutes and will begin in a moment with Mr. Fishman's opening remarks. The remainder of our time will be devoted to answering questions from our analyst participants. (OPERATOR INSTRUCTIONS).

I would like to point out that, under the provisions of the Private Securities Litigation Reform Act of 1995, this conference call will include forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions which are difficult to predict. Risk factors which may affect our future operating results are described in the Company's most recent annual report and Form 10-K filed with the Securities and Exchange Commission.

Also, this conference call will include time-sensitive information that may be accurate only as of the date of this live broadcast, which is February 20, 2008.

With that, let's begin with Jerry's remarks.

Jerry Fishman - Analog Devices, Inc. - President, CEO

Good afternoon. As we previously reported during our first quarter, we completed the divestitures of our wireless handset modem chipset business and our PC voltage regulation and thermal monitoring business for a total after-tax gain of approximately \$247 million. These businesses are being reported, as we have previously mentioned, as discontinued operations. The management team and my comments today are focusing, of course, on the continuing operations of the Company.

Our Q1 2008 sales from continuing operations totaled about \$614 million, which was 4% up from a year ago and down about 1.5% sequentially from last quarter. On an equivalent 13-week basis, since the first quarter of last year was a 14-week period, our sales were up 12% from the same period last year on a 13-week basis.

Overall, our revenues from customers in the industrial end market grew slightly in Q1. Within the industrial market as a whole, products used in broad-based instrumentation, factory automation and defense applications grew sequentially during the quarter. Automotive products declined sequentially, and ATE product revenues declined significantly, albeit on a relatively low base.

The ATE declines were of course in line with negative semiconductor capital equipment trends that have been well reported. We are very pleased that our industrial end market, which in aggregate represents thousands of products, sold ten thousands

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of customers and now, after the divestitures, represent 49% of our sales, continued to grow in what turned out to be a tough seasonal and a tough cyclical period.

Revenues from communications customers grew 6% sequentially. Within the communications market, our strongest growth came from base stations, particularly in Asia, and also from analog products used in wireless terminals, where our newest microphone pre-amps, lens drivers, power management products and screen keypad touch-sensing products all add substantial new functionality to the newest mobile devices. Communications customers represented approximately 23% our revenues last quarter.

Consumer customers represented 22% of our revenues in the first quarter. Revenues from consumer customers declined 12% sequentially after a similar increase the prior quarter, which included much of the Christmas season. This pattern is very typical each year, and we expect to see revenues from the consumer end markets increase in our Q2, based on the recent customers' forecast that we've seen from the largest consumer customers.

Revenues from computer customers also declined in Q1 after good growth in prior quarters building up to the holiday season. Computer customers now represent only approximately 6% our revenues last quarter. On a geographic basis, our revenues grew in China and other parts of Asia and declined sequentially in North America and in Japan, in line with the decline in our consumer business last quarter.

On a product basis, our analog products represented 90% of sales, and DSP products 10% of sales during the quarter.

Converter revenues declined sequentially, in line with our overall product revenues, but increased 15% year-over-year on a normalized 13-week basis. Amplifier revenues were essentially flat sequentially and up 7% year-over-year on a normalized 13-week basis. Together, converters and amplifiers represented more than two-thirds of our total product revenues during the quarter.

Power management, Radio Frequency products and MEMs products each grew sequentially and year-over-year. General-purpose DSP products were down slightly sequentially and up year-over-year on a 13-week basis.

Very interestingly, our sell-through to our broad base of customers that are serviced through distribution was very linear during the quarter with the exception of the two weeks over the holiday period, which were lower. Our sell-through in January remained strong and was consistent with November and early December rates.

The gross margin for continuing operations in the first quarter was 61.2%, which was up from 60% the prior quarter. This sequential improvement was mostly the result of a favorable mix of revenue from products used in industrial and communications infrastructure applications, which generally have higher gross margins than products used in consumer and computer applications. Excluding the \$25 million restructuring charges that we recorded in the prior quarter, operating expenses were relatively flat sequentially. As a result, operating margins from continuing operations increased sequentially to 23.8%. That, of course, now includes the expenses of stock options.

Diluted earnings per share from continuing operations was \$0.40. The leverage in our business model is demonstrated by the fact that our earnings grew faster than our sales. Our earnings on a continuing basis grew 5% sequentially, relative to a slight decline in our sales for the quarter on a sequential basis. On a year-to-year basis, earnings grew 9% on a 4% increase in sales.

Our results from continuing operations reflect a now richer mix of fast-growing, high-margin products. Our focus is on serving a very diverse range of applications where ADI can deliver innovative solutions that give our customers a competitive advantage. We continue to invest heavily in the engineering challenge at ADI that fuels these innovations. At the same time, we're continuously optimizing our manufacturing infrastructure to maximize our return on assets.

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Our cash balance and cash flow remained very strong during the quarter. Operating cash flow was \$177 million or approximately 29% of our sales. Capital expenditures were about \$40 million.

In Q1, we repurchased approximately 12 million shares or 4% of shares outstanding for \$359 million. We have repurchased a cumulative total of 28% of the outstanding shares from the start of the program through the end of the just recently completed first quarter. We have approximately \$306 million remaining of the total \$4 billion that have been previously authorized by the Board of Directors.

Cash dividends paid to shareholders in Q1 totaled \$54 million, which represented 44% of income from continuing operations, 31% of cash from operations and a yield of about 2.6%. This yield is above the average of our peer group and also the average of the S&P 500.

Overall, order rates were strong during Q1 and were higher in Q1 than in Q4. Looking at end customer ordering patterns, which means the total of orders that we received directly from customers, plus the orders placed by end customers on our distributors, total end customer orders also increased sequentially. Our end customer book-to-bill ratio was slightly above 1 in Q1 compared to slightly below 1 the previous quarter.

Our opening backlog entering Q2 was higher than the start of Q1 and represented about two-thirds of our second-quarter sales plan.

We're planning for our diverse product market and geographical mix of businesses to provide ADI with good stability during all of these economically uncertain times for four predicted reasons. Number one, our orders and revenues in the industrial end markets have held up well through the January period and are poised for seasonal growth, as we would typically expect, in our Q2. Even though we're planning for more muted growth in the US in Q2, our industrial business is strong in most other regions of the world.

Secondly, we expect a lift in Q2 above Q1 levels from our consumer customers for advanced TVs, cameras and home entertainment products, which was entering a stronger seasonal period in Q1 -- in Q2 compared to Q1. We're very well-positioned in many of the newest, exciting and popular consumer applications that we've talked about a great length in previous conversations.

Number three, we now have relatively minor exposure to PCs and to low-end handsets, which are both currently the most volatile markets and are being negatively impacted by seasonal, economic and a much more competitive landscape, which impacts unit volumes and pricing.

Lastly, as I mentioned earlier, our opening backlog is up from last quarter and so far in Q2, the weekly order rate remained consistent with Q1.

As we integrate all of these variables and balance these against the uncertain economic conditions we're all facing, we're planning for revenues in Q2 to be in the range of \$615 million to \$640 million, which is flat to up 4% sequentially. We're planning for gross margins to remain approximately flat at about 61% with a higher mix of revenue from consumer applications, balanced by continuing growth in industrial and communications revenues. We're planning for some small expense growth in Q2, mostly as a result of annual salary increases, which became effective at the beginning of this quarter, of Q2. Other than that, we're keeping very tight control of all discretionary expenses until we get a much clearer picture of the second half of the year.

So, with these assumptions, the GAAP earnings from continuing operations are planned to be in the range of \$0.39 to \$0.42 in Q2.

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Maria Tagliaferro - Analog Devices, Inc. - Director of Corp. Communications

Thank you, Jerry. During today's Q&A period, please limit yourself to one question and no more than one follow-on question, and we will give everyone an opportunity to ask an additional question if we have time remaining. Operator, we are now ready for questions from our analyst participants.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Christopher Danely, JP Morgan.

Svenk Nathanami - JPMorgan Chase & Co. - Analyst

Good afternoon. This is [Svenk Nathanami] in for Christopher Danely. Thanks for taking my question. You had talked about your gross margin trends and operating margin trends for Q2. Can you give us some additional color on what you expect the gross margin and operating margin trends to be beyond fiscal Q2?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, I think, on the gross margin side, we've talked about, in the past, that a lot of that depends on the mix of products we have and the higher the mix towards industrial and some of the high-speed communications products, the higher the gross margins. The more we get on the consumer side, that impacts gross margins negatively, even though the return on assets for those products tends to be very good because we don't manufacture a lot of those products ourselves and we don't carry any assets and we carry low inventory. So I think it really is mostly dependent on what the mix is of the business.

On the expense side, though we're trying to get an operating leverage on the expenses by letting expenses grow more slowly than the sales, and that's still our plan for the balance of the year, after we absorb the salary increases that we're going to absorb in the second quarter. Beyond that, we expect to be able to grow the revenues at a rate faster than the expenses and get some leverage on that in the second half of the year.

Svenk Nathanami - JPMorgan Chase & Co. - Analyst

Right, so the follow-up -- do you expect a higher mix of your higher-margin industrial and communications products for the rest of the year?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, it varies a lot quarter-to-quarter, and I think, in this uncertain world, it is very hard to make that prediction. Certainly, in the second quarter, we understand what is most likely to happen. We're likely to get a run-up in both the industrial products as well as consumer products. But every quarter is a little bit different, so it's very hard to be precise about that far out.

Operator

David Wong, Wachovia.

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David Wong - Wachovia Securities - Analyst

Within your guidance, can you give us some feel whether you're expecting better than seasonal or less than seasonal growth from any of your end market segments in the April quarter?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, I think the way to think about our guidance for next quarter is that we haven't really seen a lot that makes us very negative at all about the outlook. We've listened very carefully to what many people have said about this quarter. Our trends in the industrial business have been good, which is half our business.

So I think part of the conservatism a little on the outlook for the quarter is we just don't know what's going to happen going forward. The fact that the industrial business has held up is a good sign. The fact that our large consumer customers are forecasting a good quarter this quarter is a good sign. The fact that we're not in some of the most volatile markets that are causing many of our competitors to be very guarded in their outlook, I think that's a good sign for us. But I think, at the end of the day, we'll just have to wait and see what happens.

We don't see any very negative trends in those major end markets that comprise the largest bulk of our sales. So I'd say, for a first approximation, at least our planning process and our product lines and our sales force expect roughly a seasonal quarter for us. The reason we're a little more hesitant on the guidance is we just don't know what the world is going to throw at us, given all the uncertainties out there. So we're a little bit cautious on that.

Operator

David Wu, Global Crown Capital.

David Wu - Global Crown Capital - Analyst

Can you talk a little bit about -- typically, in a normal year, your second quarter is your strongest quarter of the year because of industrial exposure.

Jerry Fishman - Analog Devices, Inc. - President, CEO

Right.

David Wu - Global Crown Capital - Analyst

This year, you are basically expecting revenue for the second half to lead expense growth. If I go by historic standards, the next two quarters, the second half tend to be, on a revenue basis, very flat with your Q2. Does that mean that your expenses are going to be flat on a sequential basis also in the second half?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, first of all, I think our product mix is a little bit different than it used to be, where it was really dominated by the industrial business. But typically, we see a little bit growth in the third and fourth quarter in our industrial business. We see more growth in the end of the year in the consumer business. That's a larger portion of our sales. So our historical ratio -- the historical growth quarter-to-quarter is a little bit different than it used to be.

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But I'd say that the only real expenses that we're going to let add right now are the expenses for the raises until we're certain or a lot more certain what the revenue pattern is going to be in the second half of the year. So we are going to keep that under a very, very tight foot on the expenses until we really understand the revenue growth that we can get in Q3 and Q4.

David Wu - *Global Crown Capital - Analyst*

When does MEMS come in from TSMC to help your consumer business?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

I think that will happen in the second half of the year pretty much is the way we've been describing. We've seen samples of that, and everything about it looks okay so far. So I'd say we will start to see it in Q3 and we'll see more of it in Q4, and that has been our plan.

Operator

John Dryden, Charter Equity Research.

John Dryden - *Charter Equity Research - Analyst*

First, for power management up Q-to-Q, can you discuss the progress toward share gains in this area, the increased attachment to either your core products or improved application-specific sales or the final shift to more portable products?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

I would say, in aggregate, we have very good traction at some good accounts for our power products. The sales growth in that -- it takes a little bit longer after the designs are done. But we ought to begin to see that in the second half of the year, and the quality of the design-ins that we have we're very pleased with. So this has been a long haul for us, but based on the early indications in that business, I'd expect we would see some contribution from that business in the second half of the year in a way that we've been planning for.

John Dryden - *Charter Equity Research - Analyst*

A question for Joe, a follow-up on gross margin -- for the rest of the year, any update on improved utilization despite the increased inventory days this quarter for the remainder of the year? Is there any benefit from the ASP lift?

Joe McDonough - *Analog Devices, Inc. - CFO*

Well, there is some benefit from the ASP actions that we've taken. Certainly, the factory utilization can improve in the out quarters once we reduce the inventory a bit. But I think the other side of it is there's the mix of the business, which is always a heavy part of the gross margin. So some of the growth that will likely be experienced will be in some of the parts of the business where the gross margins on that business might be a bit lower. So I think, as a first approximation, 61% gross margin is a pretty good gross margin for the business we're in. That's what we like to run the business, in a way that we can maintain that.

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Jerry Fishman - Analog Devices, Inc. - President, CEO

I think most of the answer of how that turns out will be very dependent on the mix.

Operator

Steve Smigie, Raymond James.

Steve Smigie - Raymond James & Assoc. - Analyst

I was hoping you could talk a little about what was responsible for the very nice year-over-year growth in the communications on a 13-week basis. It looks like up 27%. Were you expecting those trends to continue this year?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, I think the largest part of it -- it's a very diverse business in communications. There is some business that's in some of the large end markets like phones and particularly phone infrastructure, networking products and the like. There some that's just general purpose communications applications in just a wide variety of applications, some of which we service through the broad base of distribution that we have.

But I'd say specifically in the larger markets, the base station business for us remains very strong. As I mentioned earlier during the quarter, a lot of that strength was in Asia as compared to the US. But nevertheless, that's a very strong business for us, and our competitive position is very strong there with the largest people that make base stations. In fact, virtually almost anyone who makes a base station uses our products in those on the analog side.

Interestingly, we saw a good growth in the handset market ex -- that's not the digital base band in radio part, which is the most competitive part. But in analog products that sell to those kind of customers, for those types of products, our customer base is much, much richer than the customer base we had on the digital base pad, which was always one of our problems, which caused us to divest that business.

So we had some new functionality in the analog side, a couple of areas I mentioned earlier that really do increase the functionality of the phones in a very important way as well as some other products in the power business that really do give our customers a competitive advantage over what they had been buying. So it's really a combination of base stations, handsets, networking products, any kind of high-speed communications or infrastructure. It's really a very varied group of different end markets, all of which are doing very well for us.

Steve Smigie - Raymond James & Assoc. - Analyst

Just as a follow-up, assuming that the macroenvironment doesn't completely roll over, is it reasonable to assume you could get a similar magnitude of growth this year, continue to penetrate, continue to offer good products, et cetera, or is that a little more [suspect]?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, it's very early to make that protection. There are some businesses there that tend to bounce up and down a little bit, so I think we will have a better sense for the year after the end of the second quarter.

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Operator

Ross Seymore, Deutsche Bank Securities.

Ross Seymore - *Deutsche Bank Securities - Analyst*

A couple of quarters in a row, you had given the exact breakout by the product types, converters, amplifiers, et cetera. This time, you talked about that more in your prepared monologue. Is it something we're going to get a breakout on, or are you going to go back to kind of just talking to it?

Joe McDonough - *Analog Devices, Inc. - CFO*

This is Joe McDonough. The breakout of the product groups over time gets a little tougher because of some of the integration that goes on in some of the product development efforts. So it seems more appropriate to talk about it during the quarterly comments rather than to provide the details on an ongoing basis. We started that practice when we had our DSP business and the analog business, and it was kind of hard to understand the handset baseband business. It was hard to understand Analog Devices without that breakout. Now, we have a company that, for the most part, is an analog product-based company. The product discussion, I think, is best left to the narrative.

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

You know, I think one good example of that is that we have been selling recently, into the medical market, a new scanner product that has many, many dozens of A-to-D converters integrated on it, which now fall into the category of other analog because it not only includes converters but a whole bunch of other signal processing. So the demarcation between other analog and both amplifiers and converters each quarter gets very complicated.

On a quarter-to-quarter basis, you don't really get a lot of information out of that. So the way that we came to that conclusion, or what Joe just said, is we started to getting into a lot of internal conversations about which category does that go in. As soon as you get into those kind of discussions, you realize that it's not a good measure to put out each and every quarter because there's not a lot of information in there. So that's the primary reason for doing it. We will make relatively specific comments about it in the commentary, but there's not a lot of specific data in there because of the integration of many of these components. It's a more complex systems-level products.

Ross Seymore - *Deutsche Bank Securities - Analyst*

Switching over to the end market breakdown that you give that's very helpful as well, you talked a lot about the end market mix impacting the gross margin, consumer of course being less gross margin and the industrial being more. Give us an idea of just the deviation around the average, just so we can get an idea of how big the mix can be, should the good side grow faster or the bad side grow slower, et cetera.

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

The thing that makes that hard to really be very quantitative about it -- even within each of those product segments, there's wide variations in gross margins. In the industrial business, we put in products like automotive markets, and we put in products like process control products. Just the deviation between those products can be quite a bitch on the gross margin line. The same is true with consumer products.

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So I don't think we're real comfortable in being very quantitative about that beyond just generally saying that the gross margins are a little bit lower on those products. There are certainly gross margins in many of those products that most semiconductor companies would be very happy to have at the average. So, these are not really low, crappy gross margin products that have no value. They are just -- when you're comparing them to the industrial products, which have extraordinary gross margins, somewhat lower. But I don't think we're comfortable going into a lot more detail than that about that.

Joe McDonough - *Analog Devices, Inc. - CFO*

I think the other part that's important is the return on assets calculations. We have -- the gross margins that would be lower than the Company average typically are on products that are manufactured externally at foundries, where the foundry has the asset base and is achieving a return on its assets. We're getting a return on the design that we've added there.

The other businesses (multiple speakers) manufacturing and we are getting the return on those assets.

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

The other way to look at this thing is with a much richer mix of consumer products. Even last quarter, we were putting up 61% gross margins, which is a pretty good number.

Ross Seymore - *Deutsche Bank Securities - Analyst*

I'm not questioning the margins at all; they are very, very good. I just wonder if mix is the reason why things get better or worse and deviate, I'm just trying to get an idea of how to calculate that going forward and forecast it.

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

Well, what we're trying to do, I think, as Joe alluded to, is we have a complex mix of businesses. We think the kind of gross margins that we're putting up are sustainable going forward. We've looked at the mix; we've looked at the cost structure. Certainly, that's what the goals of the Company are. Whatever the mix is to get there, I think that's where we're putting the money to invest.

So we're trying to keep -- we don't like a gross margin in aggregate that vacillates heavily quarter to quarter although I think everybody would allow for the fact that, from quarter to quarter, it could go up or down a little bit. We don't expect to see large variations in gross margin relative to the mix of business in a particular quarter.

Operator

Tristan Gerra, Robert Baird.

Tristan Gerra - *Robert W. Baird & Assoc. - Analyst*

What is your inventory target for this quarter? What is the impact of any potential inventory reduction in the quarter on the gross margin guidance?

Joe McDonough - *Analog Devices, Inc. - CFO*

Is the question, what is the expectations for inventory for the second quarter?

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Tristan Gerra - Robert W. Baird & Assoc. - Analyst

Correct. Also, what would be your gross margin guidance, excluding [for any change] in inventories and, as such, any change in utilization rates?

Joe McDonough - Analog Devices, Inc. - CFO

Our operating plan for the quarter is for inventory levels that, in dollars, are approximately equal to where they ended up at the end of the first quarter and for the days in inventory to decline somewhat during the second quarter. The gross margin, we don't really think of it that way, as inventory as an effect on gross margin. We think of inventory as available to service the demand of our customers. So it's not a gross margin issue.

Tristan Gerra - Robert W. Baird & Assoc. - Analyst

As a follow-up, are you planning -- what direction (inaudible) should we expect in terms of utilization rates this quarter, and what were utilization rates in the January quarter?

Joe McDonough - Analog Devices, Inc. - CFO

The utilization rates during the quarter that just ended were approximately the same as they were during the prior quarter.

Tristan Gerra - Robert W. Baird & Assoc. - Analyst

And for this quarter?

Joe McDonough - Analog Devices, Inc. - CFO

More or less the same.

Operator

Craig Ellis, Citigroup.

Craig Ellis - Citigroup - Analyst

First, just a clarification -- looking at the increase in inventory days in the reported quarter and then just the mix dynamics, was there anything that happened in consumer that might have caused consumer to be a little bit lighter than what you expected going into the quarter?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, I don't think there was anything in particular, other than consumer demand was a little weaker than we thought during the quarter, but not by a lot and certainly not anything that's really impacted our customers' forecasts for this quarter. Typically, we see a decline after the October month, which is where we stopped really shipping for Christmas. Typically, in the quarter, we see that going down a little bit. It went down a little bit more than we thought, I think, as the consumer customers probably

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got a little more cautious during the quarter. But if their forecasts are right for next quarter, we ought to see that go back up, but I don't think there is anything newsworthy there that we saw.

Craig Ellis - Citigroup - Analyst

Okay, thanks, Jerry. Then a separate question and more of a bigger picture question for you. As you look at the portfolio now, given the number of divestitures that you've had, and a lot of that is really -- looks like getting the portfolio back to its high-performance analog routes -- are you happy with where the portfolio is now positioned, or do you see either other areas of potential divestiture or areas where you think the portfolio is deficient, where you would need or want to beef it up?

Jerry Fishman - Analog Devices, Inc. - President, CEO

I think that the largest concerns we had were in the base band business because of the competitive dynamics there. The same was true for some of the power stuff that we sold. So I'd say that we have, certainly, a better mix of business that we had before. I don't think that's never a static thing. We are always reviewing our portfolio to see what we like and what we don't like. But I think the most important part of the portfolio that we wanted to get better resulted in those two transactions. But we always look at it every year. We look at it more frequently in certain businesses to make sure that's the case. But right now, those two divestitures were very important ingredients in getting our mix better, as you can tell by the gross margins and other characteristics of the business.

Craig Ellis - Citigroup - Analyst

As a follow-up to that, do you think you can grow the power management business to the scale that you'd like to have organically, or is there potentially our role for acquisitions there?

Jerry Fishman - Analog Devices, Inc. - President, CEO

I think there's our role for both potentially under the right circumstances.

Operator

John Pitzer, Credit Suisse.

Deepak Sitaraman - Credit Suisse - Analyst

This is Deepak Sitaraman for John. Jerry, you commented about strong orders in Q1 that have continued into the current quarter as well. Can you give us any additional granularity on this trend, whether it's largely broad-based or whether you're seeing particular strength from either [testes] or OEMs or EMS and so on?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, I think, to a first approximation, we had a very broad-based, solid order book in Q1. The distribution business, both in terms of its sell-through and the order rates that came in, were good. The interesting part in distribution was that the orders that our distributors place on us, which as we said previously we don't pay a lot of attention to, were stronger even than the orders that the customers placed on the distributors, which means that the distributors, at least for our products, believe that the next couple of months, at least they are thinking, are going to be okay. So the areas of weakness last quarter I mentioned, and the only one that looks like it's sort of sustaining weakness -- although we'll have to see how that goes -- is the ATE business,

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which is in a cyclical depression here for us. But our products are good, and the competitive situation hasn't changed very much. But it's just the large ATE customers have in place a lot of orders. We've gotten anecdotal evidence from them that their business is getting a little bit better, but we'll have to wait and see how that comes out. So there's nothing anyplace in the mix, with all of the diversity we have, that says anything is -- other than the ATE stuff, is really weak or really stronger.

When we look at the sell-through in distribution during the quarter, I think I mentioned a little of this in the opening comments. Every week for the 11 real weeks we had in the quarter, other than the Christmas weeks, was remarkably consistent. That was true in November; it was true the first half of December; it was true in January and it was true in early February, which, given that there's so many customers and so many products in that, at least makes us feel like the world isn't coming apart and that there's no reason to be panicked about that. But we'll have to wait and see. If you listen to all of the commentary out there, it makes you very cautious. But certainly, we haven't seen that in the order rates from the broadest base of customers.

Deepak Sitaraman - *Credit Suisse - Analyst*

Okay, great. That's helpful. Just as a follow-up, would you care to comment on inventories in the channel and how you feel about sort of (inaudible) levels?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

The inventories in the channel are normal. They are relatively flat to last quarter. The turns are normal. The demand that we're seeing from the distributors with orders on us for replenishing their inventories are actually strengthening, which would indicate that they believe they need more inventory.

Operator

Uche Orji, UBS Warburg.

Uche Orji - *UBS Warburg - Analyst*

Just let me ask you, Jerry, in terms of the earlier question you were answering about inventory and the consistency in the orders you're received, presumably there were some changes within regions. Can you talk about what you may have seen regionally? I know Asia, you alluded to Asia on the infrastructure side being strong. But we've had comments about Europe being weak from various players. Can you just give us any insights you might have by the regions, Europe versus Asia versus the United States?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

I'd say, from a high-end view, North America was a little weaker than typically you'd expect. But Europe actually was good for us last quarter and in early weeks of this quarter looks fine. So I don't see much of a change there. Again, in Europe, we have a very diverse business and one that is heavily industrial. So our mix of business in Europe is probably a little bit different than some of our competitors', but the only other place geographically we saw any weakness was in Japan, in the consumer space, and that's a very seasonal phenomenon. So that's what we seen so far. That's about as much detail as I can give you.

Uche Orji - *UBS Warburg - Analyst*

Just in terms of the -- you talk about your operating backlog being two-thirds of your target sales. What is your expectation for turns orders within this quarter? How will you characterize that within historical level of turns you'd expect at this point?

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Jerry Fishman - Analog Devices, Inc. - President, CEO

The turns orders that we saw in the first quarter were a bit higher than they were in the fourth quarter. Our expectation is that we'll need fewer turns in the second quarter in order to have the sales within the range of the guidance.

Joe McDonough - Analog Devices, Inc. - CFO

That's because the opening backlog (multiple speakers)

Jerry Fishman The backlog is a bit higher.

Uche Orji - UBS Warburg - Analyst

Right, right, okay. Just one last question, Jerry -- if we look at your cash level now, your \$1.3 billion of cash, that's about \$0.16 of your current market cap. What would be your intention for the use of this cash? You've talked about opposition as a possibility. Where does that rank in terms of how you use your cash (inaudible) share buyback?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, we have, I think, as we mentioned earlier, we have about \$300 million left on the authorization. We have certainly been heavy buyers of our stock over the last couple of years. You know, we bought back almost 30% of the Company during that period. I think now we are looking hard at how much cash we have in the US, what about debt, what's the advantage of that? The capital markets are very complicated right now to take on debt. We have a large part of our cash balance outside the United States. So we're constantly evaluating. That is the best we can say, and we'll see how that goes and we'll tell you, but right now, those are all of the considerations.

Operator

Sumit Dhanda, Banc of America Securities.

Sumit Dhanda - Banc of America Securities - Analyst

Jerry, I wanted to follow up on your comment about the order rates from [distribution] being stronger than what the end customers placed on the distributors. If you had to disaggregate order rates from distribution versus OEM, how would you characterize the direct order rates from the OEMs (inaudible)?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Joe, do you have all of that?

Joe McDonough - Analog Devices, Inc. - CFO

I guess, as the first approximation, the strength of the business from the distribution channel and the OEM channel is similar. We've seen the same growth rates, same trends in ordering.

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Jerry Fishman - Analog Devices, Inc. - President, CEO

There's not a marked difference in the two channels. The reason that we don't pay a lot of attention to the orders from distribution or, in fact, we don't pay much attention to the sales into distribution is because that bounces around a lot. That's purely based on their inventory levels. So we mostly pay attention to the order rates from the customers on the distributors and certainly the order rates from the large customers on analog. We only pay attention to the sales out from the distributors because that's the only thing that really matters.

So there's a lot of noise in that system of the order rates from distribution up and down. In many ways, there's more noise in that than signal. So we don't pay a lot of attention to it, nor would we recommend anybody else does.

Sumit Dhanda - Banc of America Securities - Analyst

The other question I had was your industrial business -- relatively strong. Can you give us a sense of what your non-US industrial business (technical difficulty) the composition of the industrial business? Then are there any significant differences in terms of the margins associated with the portfolio of products you are selling in non-US geographies versus your US sales?

Jerry Fishman - Analog Devices, Inc. - President, CEO

I don't have the specific numbers on that, but we have a very large industrial base of customers in Europe. We have an increasing industrial business in Asia, particularly in China, where there's many, many industrial companies that are building their businesses in China. I don't really have any data on how those margins compare to the US, but I'd say, to a first approximation, in the industrial business, they are not very different.

Sumit Dhanda - Banc of America Securities - Analyst

Would you say the first approximation, your non-US industrial business (inaudible) revenues is half of the business, more or less, ballpark that at all?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Could you repeat that? I thought I missed the first half of the question.

Sumit Dhanda - Banc of America Securities - Analyst

Yes, sorry. So my question was -- your first approximation, could you ballpark what your non-US industrial revenues are? Is it 50%? 60%, less than that?

Jerry Fishman - Analog Devices, Inc. - President, CEO

I'd say I don't know the answer to that. We don't have the data here in front from us. But I'd say, from thinking about the business, we probably have the largest percentage of our industrial business in the United States and Europe. Probably in Japan, we have some. In China, we have some, but certainly the largest part of our industrial business is in the United States and Europe.

Now, that might change in the future with China growing so fast for us but right now, I'd say that the percentage is higher in those two geographies in the industrial business.

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Sumit Dhanda - Banc of America Securities - Analyst

One last question for either you, Jerry, or Joe -- you indicated the backlog was up sequentially. You need lower turns to register sequential growth, which would be the midpoint of your guidance. Is it fair to assume the backlog is up mid single digits? Is it more or less than that? Can you give us some flavor?

Joe McDonough - Analog Devices, Inc. - CFO

I think it's fair to assume that it's up to mid to low single digits, consistent with the guidance that we're giving. I think the right way to look at the guidance is we're talking about flat to up 4%. If it wasn't for the economic overhang that exists in the world economies today, that 4% would be consistent with our expectation for next quarter. We're tempering that as a result of just the economic uncertainty that exists in the world today.

Jerry Fishman - Analog Devices, Inc. - President, CEO

Now, on the industrial business, just so that we characterize that correctly, we've mentioned that the industrial categorization is about 49% of our revenues. But within that, about half of it is classic industrial. The rest of it is in medical and automotive and military and security and a whole array of end markets that are not classical industrial markets.

Operator

Doug Freedman, AmTech Research.

Doug Freedman - AmTech Research - Analyst

Thanks for taking my question. A lot of them have been asked and answered, so I'm getting somewhat trivial here. Can you give us the share count exiting the quarter, so we (technical difficulty) an idea where it will be next?

Jerry Fishman - Analog Devices, Inc. - President, CEO

The share count exiting -- the shares that went into the EPS calculation were 304 million for the first quarter on a diluted basis.

Doug Freedman - AmTech Research - Analyst

That's your average. So what I guess I'm getting at is what number should we use for the April quarter?

Joe McDonough - Analog Devices, Inc. - CFO

Probably something in the 297 million or so. We don't know that number yet.

Doug Freedman - AmTech Research - Analyst

Just stepping back -- and probably just from a high-level standpoint, talk a little bit about what you have seen. Clearly, customers are cautious out there about the economy. From a competitive standpoint, have you seen any sort of irrational behavior on the pricing front or any sort of things happening on the competitive front that has you saying other -- your competitors are seeing it worse or less or doing things as far as protecting marketshare? Any commentary you can have on the competitive landscape that you're seeing would be helpful.

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Jerry Fishman - *Analog Devices, Inc. - President, CEO*

I think, Doug, if we were heavily vested in the baseband modem business and the PC power business, we'd probably be seeing a lot more price pressure than we're seeing. That's a very volatile business. There is a lot of competition out there in those markets, and the prices obviously respond to that.

I think, generically, customers always are putting a lot of price pressure on everybody. The real key is to have products that other people don't have. That's always sort of been what we wanted to do. In a couple market segments, we veered from that strategy for a couple of years, until we changed it. But our sense is that we have a lot of pricing power in the market because our products create a lot of value for the customers. There's not seven competitors that can go out there and easily cut your price and replace your functionality.

Now, having said that, there is a lot of price pressure out there. Customers are bringing armies of people around to try to separate value from price. We respond to that from time to time, and so the burden is on us to keep reducing our cost structure so that the margins stay strong.

I don't think Analog is immune from the general price pressure that's out there in the market, but we're certainly immune from the most difficult price pressure, where people sell products that three different people have and the last vendor standing gets the order and doesn't make any money on it. I think we have a much lower percentage of our mix in those kinds of products than we have over the last couple years. Is that helpful?

Doug Freedman - *AmTech Research - Analyst*

Yes, it is. If you were to look at it from the other standpoint, when the market gets really tighten and difficult for your customers, are you seeing any shift on their part moving towards, hey, we need to get the costs out of our systems; we're having a hard time selling our things? Or are they still really focused on pushing you for the highest-performance products you guys can deliver?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

Well, I think you see a little of both. We try to keep them focused on, you know, if you want lower prices, buy a product that's a lot more efficient, which is what our goal has been -- continuing to innovate, get -- like we mentioned earlier, if we have a problem with a medical customer that he's now buying ten A-to-D converters and he's complaining about the price because the hospitals are beating him up, then we try to sell him one with 10 to 12 A-to-D converters on a single chip that really gets the performance that he needs but yet provides very good margins for us.

So the only way to really, long-term, win in this business is you've got keep the innovation level high because if the products they are buying are just what they have been buying over time, in any volume that's -- any application that's high-volume, there's always pressure on customers to bring the price down because they're under pressure from their customers.

But I would say that the fact that we are -- we've cracked the 60 barrier here in the gross margins is a good sign for us. It says that we're continuing to get paid for the products despite the customers beating on us, as they always do. So, (inaudible) rather the difference between the price and the cost is still favorable for us. And that's our job.

Operator

Uche Orji, UBS Warburg.

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Uche Orji - UBS Warburg - Analyst

Just one question again, Jerry -- on the MEMS, on TSMC outsourcing, we have talked about it now for a few quarters. Now, you are saying it's second half of '08.

Jerry Fishman - Analog Devices, Inc. - President, CEO

It's always been second half of '08, by the way.

Uche Orji - UBS Warburg - Analyst

Right. Let me just as you, though, Jerry. Is there any reason why, from what you have seen so far, the quality you are getting out of TSMC -- how does that compare with what you have at the present? Then how does your gross margin change when this outsourcing finally happens? When the product finally starts to get shipped, how much of this will go from your factory to TSMC, just for us to get a sense of what impact it will have on your gross margins?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Well, I think, in general, the products that will be shifting to Taiwan are mostly consumer products, not the automotive products, at least at the beginning. Those are the products. We've changed around some of the designs in order to accommodate the process that's available to TSMC.

But I think, at the end of the day, the products are going to be lower-cost and therefore, on those group of products, the margins should be -- the gross margins should be more positive. Certainly, we're not going to be deploying a lot of assets we have here on producing those products. So both of those trends would result in higher returns on those products. But you have to remember, of course, that the MEMS products are 7% or 8% of our sales.

Maria Tagliaferro - Analog Devices, Inc. - Director of Corp. Communications

And consumer as well.

Jerry Fishman - Analog Devices, Inc. - President, CEO

Consumer is a fraction of that. So it doesn't move the gross margin needle a lot although, over time, as the volumes of those parts continue to build, it should have a positive impact on the markets.

Joe McDonough - Analog Devices, Inc. - CFO

It also opens up market opportunities that are otherwise closed.

Jerry Fishman - Analog Devices, Inc. - President, CEO

Oh, that's right. There's a part of the market that, [at the] cost structure of what we're producing here in Massachusetts, we probably wouldn't go into those markets. At the cost structure we get at it with using our partners at TSMC, we can address markets that we heretofore have not thought were attractive.

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Uche Orji - UBS Warburg - Analyst

Just one last question on marketshares -- I mean, I think we've seen Texas Instruments become very aggressive in terms of taking share from within the analog segments. What is your sense as to your ability to defend your fairly high market share in converters at the moment, because that just seems like an area where most people will want to take a shot at you?

Jerry Fishman - Analog Devices, Inc. - President, CEO

Our sense is we have some of the -- a majority of the best converter developers in the industry. We sell our converter products to tens of thousands of customers. Our technology is extremely good and valued by the largest converter customers as well as the army of thousands of customers in the general marketplace.

So, based on all the statistics that we see, we're doing a pretty good job of defending that position. Our goal is to continue to do that. This is not a market where you can come out with one product or two products and scoop a lot of market share. It's just not like that. Our largest converter products, only a few percentage of our sales, and we don't have many that are a few percentage of our sales. So it's a very challenging market to change share quickly. At least from everything I've seen and listened to all our people on, I think we're doing pretty well in defending that position.

Operator

David Wu, Global Crown Capital.

David Wu - Global Crown Capital - Analyst

One for you and one for -- anyway, Jerry, given the amount of uncertainty right now, when do you think you would have a pretty good idea of how the year looks because, theoretically, the maximum period of uncertainty is really right now through the end of calendar Q2? So if things don't fall apart by then, I assume that you would be able to bet on a rising second half of the fiscal year in terms of revenue. Am I reading it correct?

Jerry Fishman - Analog Devices, Inc. - President, CEO

(multiple speakers)

David Wu - Global Crown Capital - Analyst

Joe, what kind of tax rate should we be using for the rest of fiscal 2008, assuming who knows when the R&D tax credit will be coming back?

Jerry Fishman - Analog Devices, Inc. - President, CEO

It's very hard to say, Dave. Our [incent] is we will know a lot more as we get into March and April here, the second two months of the quarter. I think everything else right now is really speculative, and it's hard to say but our product portfolio is good. Our competitive position is good. If the market gives us some tailwinds, I think it will be very good. We'll have to just wait and see what happens.

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David Wu - *Global Crown Capital - Analyst*

Joe, any change in tax rate?

Joe McDonough - *Analog Devices, Inc. - CFO*

No. I think the level at which it is right now is probably as good an estimate as we have.

David Wu - *Global Crown Capital - Analyst*

What would happen if the R&D tax credits get reinstated? What rate would that bring the tax rate down to?

Joe McDonough - *Analog Devices, Inc. - CFO*

I do have the answer to that. Obviously, it will help us a bit.

Maria Tagliaferro - *Analog Devices, Inc. - Director of Corp. Communications*

We're just coming up on the end of the hour here. We have two questions left in the queue. Maybe will go ahead and take those and run a little long.

Operator

Allen Zwickler, First Manhattan.

Allen Zwickler - *First Manhattan Advisors - Analyst*

A quick philosophical one -- you've done a great, great job at reducing your share count. You are to be commended for that and helping the shareholders. What I'd like to know is, philosophically, when you look at your compensation structure, which -- and I've known you guys for a long time -- was heavily weighted towards stock options and that kind of compensation, how should we look going forward in terms of, now that you have reduced the shares, there are still options outstanding? I just philosophically would like to understand how you view the number of shares you have and how compensation/paying people with stock versus cash money will look going forward?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

Well, it's a very good question. It's a very challenging thing as we think about it at the management level. On one hand, options are now very expensive because we put them in the P&L, so that causes us a lot of pause on that. Over the last couple of years, of course, the option holders haven't made a lot of money, and all of that stuff is going in the P&L anyhow.

But I think there's a mix out there that, as we think about it, between what we pay people on a base salary -- most of the upside for people on the cash side is based on our operating margins, which we think are ultimately what's going to drive our stock price. We have taken a lot of shares off the market; that's certainly given us some leverage. I think, as we get up to higher earnings levels, the fact that we have 100 million less shares outstanding will really help us on the way up.

So I think, for employees, as we think about compensation, it's probably a mix of stuff they can rely on to pay their pills, bonuses, which are heavily dependent on the performance of the Company, and some form of equity that, as the stock goes up, they

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get to participate in the gains we have. We talk about that a lot at the management level. There's a lot of different ideas on what to do. There's enough opinions on that to literally fill the room.

Allen Zwickler - *First Manhattan Advisors - Analyst*

What I'm asking is, in the current year, how many options do you expect to issue?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

Okay, that question --

Joe McDonough - *Analog Devices, Inc. - CFO*

I think you'll find the answer to that in the 10-Q that we just filed, because we annually give out options. The annual cycle occurs on January 2 I think.

Allen Zwickler - *First Manhattan Advisors - Analyst*

That's what I thought, okay.

Joe McDonough - *Analog Devices, Inc. - CFO*

(multiple speakers) per year that we use, the second trading day of the calendar year, so that we don't get into the question of what date did we choose to give out options.

Allen Zwickler - *First Manhattan Advisors - Analyst*

I appreciate it.

Joe McDonough - *Analog Devices, Inc. - CFO*

So those are reflected in the 10-Q that we filed during this call.

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

So what's the [real] number?

Joe McDonough - *Analog Devices, Inc. - CFO*

The number is 5.5 million shares that were just issued.

Allen Zwickler - *First Manhattan Advisors - Analyst*

So you are issuing 5.5 million? How many options will you have at the end of (multiple speakers)?

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Joe McDonough - Analog Devices, Inc. - CFO

But there are also options that were canceled during the quarter as a result of employees who have left us.

Jerry Fishman - Analog Devices, Inc. - President, CEO

So you'll see that there was very little effect on the dilution as a result of the option transactions during the quarter.

Allen Zwickler - First Manhattan Advisors - Analyst

If you don't mind appeasing me at this late hour, how many options are there outstanding today?

Jerry Fishman - Analog Devices, Inc. - President, CEO

I think you'll have to go through the details in the Q and make your own assessment because we have all the details of what's underwater and what's in the money and you know, I think the best way is to make your own assessment.

Joe McDonough - Analog Devices, Inc. - CFO

Yes, we've given a pretty detailed breakout of the number of shares at each price point.

Allen Zwickler - First Manhattan Advisors - Analyst

Okay, I'm sorry. I'll be happy to look at that. It was more of the philosophical question, as you can understand, because --

Jerry Fishman - Analog Devices, Inc. - President, CEO

It's to try to keep the dilution down well under 2% on a net basis.

Operator

Phil Marriott, ASB Advisors.

Phil Marriott - ASB Advisors - Analyst

My question, actually, is a nice follow-on from that question on the options. I noticed that the expense came down from the prior quarter. I'm wondering whether -- you guys have put out of goal, I think, of, I think, 30% operating margins. But my recollection was that excluded options. What are your thoughts sort of longer-term on margin goals these days?

Joe McDonough - Analog Devices, Inc. - CFO

Well, the way to think of it is, as you have stated, that this quarter I think the option expense was 2% or 2.2% of sales. Our operating margin was 23.8% of sales. So the 30% was including the option expense, so there's another 4% or so of leverage that primarily will be driven by operating expense management. We continue to think in terms of operating expenses growing

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at less than half the rate of sales, so we'll take growth of the Company in order to increase the operating margins, but that's part of the leverage.

The other part of the leverage occurs as a result of the shares that we have bought back, and so there are 30% fewer shares outstanding than would otherwise be outstanding. That leverage will come as the earnings grow.

Phil Marriott - *ASB Advisors - Analyst*

My second and last question is just following up on your power management goals, given that there has also been a fair amount of pruning, so my guess is you're at sort of a \$100 million run rate these days in power management? Is that about right?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

It's in that range.

Phil Marriott - *ASB Advisors - Analyst*

My recollection was that the goal over the next three or four years was to get up to scale, being \$400 million or \$500 million. Is that still a longer-term goal for the Company?

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

Well, the original goal that we had set out didn't assume that we're going to get out of the PC power stuff. But the way to think about that is, if we didn't think we could make that into a large business, we wouldn't be investing what we're investing. That's really going to be a combination of some pretty good-sized hits with some very large companies and also a business that's more coincident with the sort of general analog business of a lot of customers, a lot of products.

But if we didn't think we could get it out to some reasonable scale, the investment levels that we're currently putting in are way too high. So that's certainly our assumption.

Phil Marriott - *ASB Advisors - Analyst*

And you guys are committed to keeping us updated on that progress, right? Because (multiple speakers)

Jerry Fishman - *Analog Devices, Inc. - President, CEO*

Well, I think you're going to make us.

Phil Marriott - *ASB Advisors - Analyst*

That's why I'm asking the question.

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Jerry Fishman - Analog Devices, Inc. - President, CEO

No, I understand. We believe that's a very important strategy for us. We're spending a lot of money. We have a really first-class team of people that have been working on this thing. We have some good early indications that customers like the products they are doing. But we will certainly keep you updated on that.

Joe McDonough - Analog Devices, Inc. - CFO

It's about 5% of the revenues, in order to size it today.

Maria Tagliaferro - Analog Devices, Inc. - Director of Corp. Communications

Okay, great. Well, that was our last question, so I want to thank everyone for participating in today's call. We'd encourage you to take a look through all of the detail provided in our press release and also in the 10-Q which was filed today with the release. Thank you.

Operator

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

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