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ADI - Q4 2014 Analog Devices Inc Earnings Call

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OVERVIEW:

Co. reported 4Q14 sales of $814m and diluted EPS (excluding special items) of $0.69. Expects 1Q15 revenues to be $745-775m and non-GAAP diluted EPS (excluding special items) to be $0.58-0.64.

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PRESENTATION

Operator

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

(Operator Instructions)

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

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

Thanks, Jennifer, and good afternoon, everyone. Thanks for joining our fourth quarter and FY14 earnings conference call.

We have posted a press release and relating financial schedules on our IR website at investor.analog.com. I would encourage everyone to follow along as we go through our results today. Our agenda for this afternoon's call will be as follows.

First, I will provide a brief overview of our fourth quarter results, then Dave Zinsner, our Chief Financial Officer, will review our financial performance for the fourth quarter and FY14, which will be detailed further in our 10-K which we expect to file next week as we finalize the purchase accounting relating to the Hittite transaction. Dave will also discuss our outlook for the first quarter FY15. And then Vincent Roche, our President and CEO, will provide closing remarks.

And after these comments, we'll open it up for questions. Since we'll be discussing both our fourth quarter and our fiscal year results today, our prepared remarks will run for about 20 minutes which will still leave ample time for Q&A. Today's call will include non-GAAP financial measures that have been adjusted to exclude special items in order to provide investors with useful information regarding our historical results and our outlook. Reconciliations of these non-GAAP financial measures to their most directly comparable GAAP measures are included in today's earnings release which is posted on our IR website.

The information we're about to discuss, including our objectives and our first quarter outlook, includes forward-looking statements. These forward-looking statements include risks and uncertainties including but not limited to those described in our most recent 10-Q. Our actual results could differ materially from the forward-looking statements made on today's call.

Subsequent events and developments may cause our outlook to change and as required by law, we do not undertake any obligation to update the forward-looking statements made by us today to reflect the subsequent events or circumstances. Therefore, this conference call will include time-sensitive information and may be accurate only as of the date of today's live broadcast, and so now let's start the call.

As you know, we completed the acquisition of Hittite Microwave in late July so our fourth quarter was the first full quarter of contribution from Hittite. Our combined performance was very strong with results that were well above the mid-point of guidance.

Revenue in the fourth quarter totaled $814 million, increasing 12% sequentially and 20% year-over-year. On an organic basis, revenue increased 2% sequentially and 8% year-over-year. Communications infrastructure applications outperformed our revenue plan while the industrial, automotive, and consumer end markets were about in line with our expectations for the quarter.

Revenue from communications infrastructure customers represented 27% of total sales and increased 31% sequentially in the fourth quarter with both our organic and acquisition related revenue growing faster than expected. On an organic basis, fourth quarter communications revenue grew 5% sequentially and 23% year-over-year. And for the fiscal year, communications infrastructure revenues totaled $681 million. Industrial customers represented 45% of total revenue in the quarter, increasing 6% sequentially and 19% year-over-year.

On an organic basis industrial performed as expected, declining 4% sequentially primarily in the core industrial applications areas of automation and instrumentation while energy, healthcare, and defense and security in the aggregate were approximately flat sequentially. For the fiscal year, industrial application revenue totaled $1.3 billion. Our automotive business grew in line with expectations, increasing 3% sequentially and 2% year-over-year, and this market represented 17% of our total revenue in the fourth quarter.

In FY14, our automotive business grew 9% or about two times the rate of vehicle unit growth. Automotive is now a $500 plus million a year business, having grown at a 20 plus% CAGR over the last five years and consequently more than doubling revenues since FY09.

Consumer revenue increased 14% sequentially, declined 3% year-over-year, and represented 11% of sales in the fourth quarter. Approximately half of our consumer business is within prosumer audio video applications where life cycles and profitability levels are akin to our industrial business.

The balance of our consumer revenue, or only about 6% of total sales, is for more typical consumer applications such as smartphones, tablets, wearables, and DSLR cameras, where our technology provides a real strategic benefit to our customers. In total, we ended the year with revenue up approximately 9% to $2.9 billion of which 89% was from the industrial, automotive, and communications infrastructure markets.

So now I would like to turn the call over to Dave for details of our financial performance in the quarter and for the full year as well as for our business outlook for the first quarter. With the exception of revenue, Dave's comments on our fourth quarter 2014 P&L line items will exclude special items which in the aggregate totaled $126 million. When comparing our fourth quarter performance to our historical performance, special items are also excluded from the sequential and year-over-year results.

Reconciliations of these non-GAAP measures to their comparable GAAP measures are included on Schedule E of today's earnings release. Dave, it's all yours.

Dave Zinsner - *Analog Devices, Inc. - CFO*

Thanks, Ali. Good afternoon, everyone, and thank you for joining us today.

The fourth quarter was an excellent quarter across multiple dimensions. Revenue growth and profitability were strong and the strength of our balance sheet enabled us to meaningfully increase stock buyback activity in response to stock price volatility, which reduced our share count by approximately 2 million shares.

Sales in the fourth quarter increased to a record $814 million, well above the midpoint of guidance and diluted earnings per share, excluding special items, grew to $0.69 near the high end of the range. Gross margin at 66.4% of sales was better than our guidance on a better mix of business. Compared to the year-ago period, gross margins increased 80 basis points on higher utilization and a better mix.

Excluding acquisition related inventory, days of inventory in the fourth quarter decreased by 2 days to 115 days, and on a dollar basis, inventory increased $3 million compared to the prior quarter. We expect to bring utilization rates in our fabs down by approximately 10 percentage points to the low 60%s in the first quarter, which on an expected lower sales, should keep dollars of inventory approximately flat to fourth-quarter levels.

Weeks of inventory and distribution were approximately 7.5 weeks, consistent with the prior quarter. Total end customer orders decreased in the fourth quarter as compared to the third, in line with seasonal patterns and our book-to-bill was below 1, which is quite typical in advance of a seasonally slower first quarter. Lead times during the quarter were stable with virtually all shipments occurring within our stated lead times of four weeks to six weeks.

We continue to align our investments to critical strategic priorities and during the quarter, we streamlined our management structure and took other actions to redirect investments while maintaining operating expense control. As a result, during the quarter we recorded a $35 million restructuring charge.

Operating expenses in the fourth quarter increased 10% sequentially, primarily from the inclusion of a full quarter's activity with Hittite. On an organic basis, expenses were approximately flat to the prior quarter.

As a percent of sales, operating expenses in the fourth quarter declined 90 basis points sequentially and declined 70 basis points year-over-year. Operating profit before tax increased to $271 million or 33.2% of sales, which is 70 basis points higher compared to the prior quarter and 140 basis points higher than the same quarter in the prior year.

Other expense, which is primarily our net interest expense, was $6.4 million in the fourth quarter. We're expecting net interest expense to be approximately $5 million per quarter in FY15.

Our tax rate in the fourth quarter was higher than planned as we adjusted our annual tax rate from 14.2% to 14.5% on higher than planned US income.

Excluding special items, diluted earnings per share in the fourth quarter was $0.69, near the high end of guidance and up 11% over the prior year. Cash flow in the fourth quarter continued to be very strong. We generated $262 million, or 32% of sales and operating cash flow, and CapEx was $43 million resulting in free cash flow of $219 million or 27% of revenue.

Our FY15 plan is for capital spending to be between $150 million and $165 million, of which approximately $20 million relates to new facilities and upgrades to existing facilities with the rest relating to our ongoing capital equipment spend. The return of cash to our shareholders has been a top financial priority. During the quarter, we returned $304 million to shareholders in the form of dividends and share repurchases, which included stepped up buyback activity of $187 million.

On November 25, our Board of Directors declared a cash dividend of $0.37 per outstanding share of common stock. This will be paid on December 16 to all shareholders of record at the close of business on December 5. At the current stock price, this dividend represents an annual yield of approximately 2.9%.

During the fourth quarter, our cash and short-term investment balance decreased by $2 billion to $2.9 billion, as we repaid the short-term debt associated with the Hittite transaction. At the end of the fourth quarter, we had approximately $900 million in debt outstanding resulting in a net cash position of $2 billion with approximately $900 million available domestically.

As this is our first full quarter of contribution from Hittite, I would like to give our investors some additional context around this great business. During the quarter, Hittite revenue increased to a record $81 million, which was up 15% year-over-year and delivered strong EPS accretion of 8% excluding special items.

The transaction closed a little over three months ago, and the integration efforts are going extremely well. We have already opened up the Hittite products to our OEM customers, and all customers are now covered across direct and indirect channels. Our distribution channel has begun stocking the Hittite parts and within a few weeks, customers can place orders for Hittite products with ADI's global distributor network, and all order processing systems will be integrated.

Now let me take a moment to talk about our performance in FY14. Revenues of $2.9 billion increased 9% over the prior year. On an organic basis, ADI grew 6% year-over-year with our core business of industrial, communications infrastructure, and automotive combining for 10% revenue growth both for the fiscal year and on a five-year CAGR basis.

Compared to the prior year, non-GAAP gross margins of 66% and operating margins of 32% increased 170 basis points and 180 basis points respectively, which was a good result in a period when factory utilization rates averaged only in the low 70%s. While these are solid results, we are operating at the lower end of our financial leverage model range. As business conditions improve and our strategic investments continue to take hold, we expect that higher factory utilization rates coupled with careful expense management should drive better operating leverage.

For the year, we generated operating cash flow of $872 million or 30% of sales, and free cash flow of $694 million or 24% of sales. In addition during the year, we increased our dividend by 9% which represented the 11th dividend increase in the last 10 years.

During the year, we repurchased $356 million of our stock. In total, we returned $811 million or 117% of free cash flow to shareholders in the form of dividends and share repurchases.

So in summary, ADI's fourth quarter and FY14 delivered solid results. We believe the portfolio and productivity actions we have taken set us up for better operating leverage as sales increase, factory utilization improves from current levels, and we continue to tightly control operating expenses.

So now to our outlook for the first quarter, which with the exception of revenue expectations are on a non-GAAP basis and exclude special items that are outlined in today's call and release. After a strong fourth quarter, we are planning for normal seasonality in all our end markets in the first quarter, which includes the holiday period and typical calendar year-end inventory rebalancing at customers. As a result, we are planning for fiscal quarter revenues to be in the range of $745 million to $775 million. At the midpoint of this range, revenue would increase 21% year-over-year.

Based on lower expected sequential revenue, we plan to reduce production levels in the first quarter to the low 60%s from the current low 70%s level. As a result, we expect gross margins in the first quarter to be approximately 65%. We expect operating expenses in the first quarter to decline sequentially to approximately $263 million, or down approximately $7 million.

We're planning for our tax rate to be approximately 14.5% in the first quarter, which is our planned non-GAAP tax rate for all of FY15. In total, we expect diluted earnings per share to be between $0.58 and $0.64 excluding special items.

We intend to keep our expenses under tight control in FY15, holding OpEx flat to fourth quarter run rates. For the year, we plan to invest the savings of approximately $40 million relating to this quarter's restructuring charge by redirecting investments to strategic growth areas, and to a lesser extent, regular inflationary items.

By fiscal quarter, we expect operating expenses in the first quarter decline and to increase in subsequent quarters but nevertheless, excluding special items, we expect operating expense to decline as a percent of sales in 2015 and for our financial model to deliver better operating leverage. So now I will turn the call over to Vince to wrap it up.

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

Thank you, Dave, and good afternoon to you all. As you can tell from our remarks this afternoon, we had a great fourth quarter, and I'm very pleased with our execution in what was a strong finish to FY14. As we approach our 50th anniversary, I want to spend some time talking to you about where we stand today and where we want to take our Company.

At ADI, we've been dedicated to delivering the highest performance signal processing products and solutions over the past 50 years to our tens of thousands of customers and across hundreds of applications, and we remain true to this mission. Over the past few years, we've been refocusing our strategy and our organization and directing investments to those areas that we believe will drive sustainable and profitable growth for ADI. As a result, we are in a stronger position today in terms of our technologies, our markets, and our customers than we have been at any point in our history.

This transformation, while difficult, has been necessary and now provides us with a strong foundation upon which to continue to build the future of our Company. As we have spoken to you many times before about, many forces are driving the IT industry, such as in the areas of automation and connectivity. From time to time, I'd like to provide investors with a deeper perspective on key aspects of some of these trends and ADI's strategy relative to them.

Now today, I'd like to talk more specifically about connectivity, which is becoming as important as electricity in the modern global economy. From connected devices to connected cars, to connected machines, ubiquitous and secure connectivity is a critical challenge that we believe will help drive growth across our key markets. But what I want to focus on today is specific to our communications infrastructure business.

By the end of the decade, networks will need to support 1,000 times more data capacity, likely on higher frequency bands to support next-generation communication standards. Today, only about 4% of mobile subscriptions are 4G, yet they are responsible for one-third of all mobile data traffic. In addition, the number of 4G subscribers is forecasted to increase more than seven fold to about 30% by the end of the decade.

Now, the expected increase in average spectral efficiency and available spectrum is unlikely to keep pace with consumer demand, leaving a significant gap requiring additional carrier investments in new base stations and transmission equipment. The increases in the number of 4G subscribers, the bandwidth used per subscriber, and the number of base station units deployed is expected to effectively double our served available market in the area of communications infrastructure alone to about $4 billion by the end of 2020.

Carriers are dealing with enormous challenges in keeping up with data demand. They need flexibility, efficiency, and coverage while delivering ever increasing bandwidth levels. The network must always be on, must be reliably available everywhere, and must support new mission critical applications, all under the envelope of decreasing total cost of ownership. In order to respond to these challenges, our customers are turning to new radio and smarter antenna architectures which maximize spectral efficiency and significantly increase the radio channel count.

At ADI, we anticipated these challenges and have invested aggressively to develop the highest performance signal processing products, processes, and solutions over the past several years. In radio applications, like all signal processing applications, the data converter defines the system performance, and ADI is the undisputed converter leader. Over the last several years, we have increased our lead in converters and we have also augmented our technology offerings by developing and acquiring RF and microwave technology, high-speed clocking technology, and critical algorithmic technology.

RF and microwave expertise and the acquisition of Hittite are critical to our strategy to deliver the most advanced radio solutions. ADI now has the ability to convert the entire frequency spectrum all the way from digital to beyond 100 gigahertz, which meaningfully differentiates us relative to our competitors. We have engaged with many of our largest customers and they, too, are very excited about our acquisition Hittite of as we forge ahead together, re-architecting customer technology road maps in previously unimaginable ways.

In fact, in the short period of time since we closed the transaction, we are very, very pleased with the early design activity ramp rate. As expected, we have raised the level of collaboration in our customers' design activities. For example, in key applications in communications infrastructure, aerospace, and industrial instrumentation, not only are we benefiting in the short term by the combination of the ADI and Hittite product portfolios, but our visibility into longer term system design leads is dramatically increasing and opening up additional opportunity for ADI.

So overall, we're extremely pleased with the speed, the quality, and results of our integration efforts which have been facilitated by the strong cultural affinity we share across our organizations from engineering, to customer support, and, of course, to management. As you may have heard, Rick Hess, the former CEO of Hittite, has joined my staff, reporting to me with the responsibility for not only RF and microwave but also communications infrastructure and automotive, the two markets we believe will be most transformed by ADI's connectivity solutions capability.

So to summarize the overall team of my prepared remarks, in our view the combination of greatly expanding demand for connectivity and limited available spectrum will drive growth for ADI in the infrastructure market. That said, this is just one of the exciting growth drivers that our diversified business is capitalizing on. And these are all key ingredients that position us for sustainable earnings growth well into the future.

So with that, I'll turn it over to you for any questions that you might have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Steve Smigie with Raymond James.

Steve Smigie - *Raymond James & Associates, Inc. - Analyst*

Great. Thanks, guys. Congratulations on a nice quarter.

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

Thank you.

Steve Smigie - *Raymond James & Associates, Inc. - Analyst*

I was hoping you guys could talk about what you see happening with gross margin as we move forward into April. Obviously, you're taking down utilization here so you can talk a little bit about why you're doing that and how that looks into April.

Dave Zinsner - *Analog Devices, Inc. - CFO*

It's fairly typical that we kind of reduce production levels in the first quarter, consistent with what most of our customers do, by the way. So we usually take a margin hit in the first quarter.

That -- as you know, the second quarter tends to be a very good quarter for us. Seasonally, a very strong quarter with a lot of production days.

In the second quarter, we start to ramp back up production and so my guess is we will very quickly snap back to gross margins generally in the range that we exited fourth quarter at. And as you know, we constantly are trying to make improvements on the gross margin front through the years. And so our goal is to continually drive those gross margins up over time so we get to the high end of our 65% to 68% gross margin model.

Steve Smigie - *Raymond James & Associates, Inc. - Analyst*

Great. Thanks. Then just on the revenue side.

I guess you talked a lot about the com opportunity. Can you talk a little bit about how that growth looks near term? Is that going to be your biggest driver over the next couple of quarters?

And there are some questions about CapEx spend over the next few quarters. Can you talk about how your dollar content gain may differentiate your growth versus that of the telecom equipment market? Thanks.

Dave Zinsner - *Analog Devices, Inc. - CFO*

That's a mouthful. Okay.

So generally as we've looked at the communications business, obviously we're expecting it to come off a little bit this quarter, which is fairly typical for the communications infrastructure space given many of our customers like to rebalance their inventories. But the end demand actually looks very good.

Certain areas have pockets -- periodic pockets of weakness. The beauty of our products is they go into equipment that ends up in just about every region of the world. So where some areas might be seeing weakness, others are seeing strength.

So we generally think that communication is going to do quite well over the course of the year. And most of that is, I think either Ali or Vince said in the prepared remarks, there is an overwhelming need for more bandwidth, and we don't think that's going to abate anytime soon. So our expectation is that the business will do quite well.

Our dollar content in 4G is at least 20% to 30% better than 3G. And I think a lot of the carriers have indicated that they are going to migrate to kind of small cell technology in a big way over the course of the next couple of years because that just will drive the radio count up over time. That's going to be very good for us because our dollar content per radio is quite good, and if the number of radios increases on a unit basis, that should drive good tail winds for us in that business.

Steve Smigie - *Raymond James & Associates, Inc. - Analyst*

Great. Thank you, guys.

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

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

Operator

Our next question comes from Ross Seymore with Deutsche Bank.

Ross Seymore - *Deutsche Bank - Analyst*

Hi, guys. Congrats on the solid results, first and foremost.

Question on the orders and how the quarter unfolded. I know you said in your press release that the orders were stable in the quarter but there seemed to be some significant volatility amongst many of your peers. Can you just talk about how the quarter trended for you, if you saw that volatility and what the cause was?

Dave Zinsner - *Analog Devices, Inc. - CFO*

Yes, we -- obviously the first month of the quarter was a little bit weaker -- August. It was -- it came back a little bit in September and October finished off strong. I'd say it was relatively stable, though. Per week, it might have been a couple million dollars difference really on a per week basis.

So we did not see any perturbation through the quarter. Other suppliers into the space are sometimes targeting different markets and those marks may have behaved differently than the markets that we're focused in. But I think in general things were very stable through the entire quarter and really continue to be stable in the month of November.

Ross Seymore - *Deutsche Bank - Analyst*

Great. I guess as my one follow-up, you mentioned in an answer to the prior question that you expected comps to be down. Any sort of color on the down roughly 7% sequentially than your guidance? How that will split between the four end markets that you serve?

And then maybe in 2015, which would be the fastest or slowest growing of those? Then I'll go away. Thanks.

Dave Zinsner - *Analog Devices, Inc. - CFO*

My gut would say that communications probably will be down a little bit more than the other three end markets, which is definitely seasonal versus what's happened in history. Industrial and automotive will also be down. My guess is that the consumer business, although down, will probably do a little bit better than the other three markets simply because we have some decent product cycles that appear to be hitting in the first quarter to some extent. And so it might be a little bit insulated from what is typically seasonally down for the first quarter.

For the year, we're pretty optimistic about every end market, I have to say. I think that all four end markets are going to do quite well in the 2015 time frame.

We think in each case there is some good kind of macro tail winds going on and we've made a lot of investments, particularly in what we call the B2B space, which is the communications, industrial and automotive markets over the last four or five years. And my guess is that that will start to really generate revenue on a go forward basis.

Ross Seymore - *Deutsche Bank - Analyst*

Thank you.

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

Thanks, Ross. I just look to remind everyone to try and keep it to the one question here as we try to get to all callers here tonight. Operator, we'll get to the next question, please.

Operator

And our next question is from Tore Svanberg with Stifel.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Thank you. Congratulations on the results.

Vincent, you talked about your connectivity business. Thanks for that. I was also hoping you could update us on your MEMS business and if there is any new initiatives there that we should be aware of.

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

You know, MEMS, of course, is very much ADI centered in the automotive space. It's where we got our traction in that technology. We continue to invest heavily to make sure that we are over the long term a major, major player in the MEMS business. It's instrumental in our safety strategy, of course, in general within the automotive sector.

We have, as well, been developing some very, very low power technologies that are being used in new applications in the industrial space, for example, and also in the healthcare area. So it's a growing strategy for the Company. It's an important strategy for the Company. It's part of our sensor initiative which we talked in some depth at the analyst day. So it is still very, very automotive-centric but diversifying into particularly industrial and healthcare applications.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Very good. I'll be courteous to others and leave it at that.

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

Thank you.

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

Thanks, Tore. We'll move on to our next caller.

Operator

Our next question comes from Vivek Arya with Bank of America.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Thank you for taking my question. I'll ask a two-parter.

First, just a very broad question for Vince. How you are thinking very broadly about 2015 because there seems to be a recovery but it varies quite a bit by region, US versus other regions. I was wondering what you are hearing from your customers?

Then my more detailed question for Dave is that when I look at your January quarter guidance on gross margins, you are guiding sales down 7% but gross margins down 140 basis points. And when I look at the same period last year, Dave, your sales declined by a similar amount but gross margins only came down by 50 bps, and this year you have the benefit of the better mix from Hittite.

So I'm just curious why you're guiding gross margins down a bit more than they were last year despite having the benefit of mix from Hittite. Thank you.

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

Okay. I'll go first.

So on your first question about FY15, as Dave has said, we're feeling pretty good about 2015 overall. I think for ADI, it's really a question of how the macro economy behaves.

Our customers, generally speaking, I think, and I speak with a lot of our customers each quarter, I would say in all segments, industrial, communications infrastructure, automotive, our customers are feeling pretty good about the world. And as I said, as long as the macro economy holds in play, I think, you know, we will have a very, very decent 2015 across all the market sectors.

As Dave said, we have -- we've got a couple of product cycles in the consumer space that should add additional revenue. And I think as well, we've gotten the worst of the headwinds on the consumer business behind us. So I think as long as the markets hold up, we'll do fine.

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

Vivek, I think we're getting something on the line there. Do you have your line on mute?

Vivek Arya - *BofA Merrill Lynch - Analyst*

No. I will mute it, just to make sure.

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

I'll last Dave answer the gross margin question.

Dave Zinsner - *Analog Devices, Inc. - CFO*

Okay, so really when you look at, rather than look at it kind of on a sequential basis, I'd look at it kind of on a year-over-year basis. Gross margins in the first quarter 2014 were about 65%. That is around the guidance that we're giving this quarter.

And we are getting the benefit of Hittite. Now, Hittite is only one-tenth of the size of ADI.

So the margin accretion from that is a little bit but not significant at this point. Although I would point out that we do expect the gross margins to improve for the Hittite business as we start to capture the synergies on the cost of manufacturing towards the end of 2015 and then into 2016.

So really what utilization is going to be at fairly similar levels this quarter versus last year at this time. So net-net, those two are neutral.

The difference really comes from the mix. The mix is going to be a little bit more negative this time around versus last year. Most of that, quite honestly, is the consumer business.

The consumer business as a percent of revenue is going to end up being a little bit higher this quarter versus last year, and that's going drive it. So in any event, that's basically the answer to that question.

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

Thanks, Vivek. We appreciate you muting the line and we'll move on to our next question.

Operator

Our next question is from Craig Ellis with B. Riley.

Craig Ellis - *B. Riley & Co. - Analyst*

Thanks for taking the question. I'll just keep it at one question.

Dave, you and Vince indicated that you're happy with the way the Hittite integration is going, and it sounds like a lot of the work has been done to get the channels to a point where you can start driving sales. You have talked about the potential for revenue synergies in the past. Can you quantify what you might be able to realize as you look out over the coming fiscal year from a revenue synergy standpoint as you put the Hittite product into your channel and vice versa?

Dave Zinsner - *Analog Devices, Inc. - CFO*

Well, I can't at this point give you a specific figure on what we have in terms of synergies. It's a little bit early to tell at this point. But I would say that the early traction we have gotten at a customer level has been very significant. Of course, you know, it takes a couple of years before that translates into revenue for us because as those other markets we operate in.

But there have been several cases where we actually were not going to win the next generation of a product or we were going to get a very piecemeal portion of that product where the entire dialogue between us and the customer changed radically when we had the Hittite products to offer. So we were really starting to go from just talking about some sub segment of the circuit design to a whole solution that we can provide, given our ability to do the microwave portion of the spectrum.

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

So I think, Craig, in terms of timing, just to add a little bit more color to what Dave has said, given the design cycles, I think when we announced the acquisition of Hittite, we had said that we thought we should start to see some up tick in revenue, additional revenue beyond the Hittite specific pipeline with the combination of the two pieces in the FY16 kind of area. So that's my sense. We'll begin to see the revenue growth benefits through the OEM and distribution channels somewhere in the -- I think the early part of 2016, late 2015, early part of 2016.

Craig Ellis - *B. Riley & Co. - Analyst*

Thanks for that color, guys.

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

Thanks, Craig. We'll get to our next caller, please.

Operator

And our next question is from Ambrish Srivastava with BMO Capital Markets.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Thank you. Just one from me.

What specific areas are you targeting for the joint products between Hittite which help the core analog? Thank you.

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

Yes, so the great strength of the franchise we've got now is that we've combined the ADI strengths in mixed signal and the very, very high performance analog signal processing products that Hittite has got. And one of the great attractions to us, of course, is that it directly lines up with the markets that we really care about.

So areas like industrial infrastructure, for example, in the instrumentation area, specifically. Areas like aerospace, Hittite has a strong position in the military area, and I think we'll see additional growth there. Of course, communications infrastructure, the back haul, and the emerging 5G networks that require much, much higher frequency coverage will benefit from the capabilities that we can bring jointly. As you know, there are in the area of automotive applications for radar technology, the frequency levels there get ever higher.

It's very diverse, and the good news is that from our customers' standpoint, we can cover the application from end-to-end, and that's exactly what we are setting out to do. We've made, as Dave said, very good progress in engaging with our OEM customers. And are now really beginning in earnest the movement of our products through the distribution channel to give us the long tail effect, so to speak.

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

All right. Thanks, Ambrish. We have a very disciplined bunch here tonight and we'll get to our next caller, please.

Operator

Our next question is from John Pitzer with Credit Suisse.

John Pitzer - *Credit Suisse - Analyst*

Good afternoon, guys. Thanks for letting me ask the question. Vince, Dave, congratulations on the good results. I guess I'll ask my question on the auto business, Vince.

It's been a great business for you guys. As you mentioned in your prepared comments, a 20% plus CAGR over the last years. That growth rate, though, has been decelerating a bit this year. I think it was up 9% for the full fiscal year but just 2% year over year in the fiscal fourth quarter.

I'm just curious how much of that do you think is some of the macro uncertainties out there hitting SARS versus timing of kind of content growth? When you look out to FY15, how do you think about content versus unit growth for you guys and what could be sort of the applications we should be thinking about for content growth going forward?

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

It's a great question. I think from our perspective, we've obviously been way outgrowing the unit volumes of cars being sold over the past five years. My sense is on a steady state basis over the longer term, if we could grow our revenues at 2x kind of the unit volume of cars, that would be a good result. I'll give you a little more color.

I think we've seen a little deceleration of the business of late. Our infotainment business is very strong and growing. We've announced some very exciting new products there, as well, just recently in that area. I think the area where our growth has been a little slower of late is safety and specifically in the active and passive safety area where some of the older products have just lingered a little bit longer.

But again, we have a great pipeline of products that go across the entire safety spectrum, active, passive, as well as predictive. So my sense is we'll be through 2015 in better shape in terms of growth, assuming again that the macro economy holds up. But as I said, I think if we could grow this business at 2x the rate of car growth, that would be a very, very good result over the long term.

John Pitzer - *Credit Suisse - Analyst*

Perfect. Thanks. That's helpful.

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

Thanks John. We'll get to our next question, operator.

Operator

Our next question is from Ian Ing with MKM Partners.

Ian Ing - *MKM Partners - Analyst*

Thanks. I've got a CapEx question here. So what are the milestones to eventually end source the Hittite Microwave revenues? It look like you're not really elevating your CapEx spend right now.

Also, TI talks about being opportunistic to eventually look at low-cost manufacturing assets to meet the incremental long-term demand. Is that something you're looking at, too?

Dave Zinsner - *Analog Devices, Inc. - CFO*

On the Hittite production, we at this point plan to continue to do the front end wafers through outside foundries. They actually were doing their own test. The real cost savings is we're going to move that high-volume test activity to our captive facility in the Philippines.

So it's really -- not really moving it inside. I guess it's moving it from one location to another internally that drives the benefit in terms of gross margin.

What was the second question, Ian? I missed that.

Ian Ing - *MKM Partners - Analyst*

I guess manufacturing assets are on a fire sale. TI talks about being opportunistic in certain situations. Is that something you're looking at, too?

Dave Zinsner - *Analog Devices, Inc. - CFO*

We exited the fourth quarter operating at 70%, low 70%s utilization. We're going to come back down to the low 60%s in the first quarter. My expectation is we get back up into the low to mid 70%s in the second quarter. So we have quit a bit of headroom before we have to worry about adding capacity, and quite honestly, we actually have a lot of the clean room space already.

So it's maybe a few pieces of equipment here or there that would actually expand that capacity quite significantly. We do buy equipment in the aftermarket in general for the front end. But I don't think that we're going to have any meaningful change in our CapEx approach over the foreseeable future given that we have so much headroom in terms of our capacity.

Ian Ing - *MKM Partners - Analyst*

Understand. Thanks, Dave.

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

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

Operator

Our next question is from Craig Hettenbach with Morgan Stanley.

Craig Hettenbach - *Morgan Stanley - Analyst*

In prior calls, you have given some context on the industrial market in terms of customers and their view. With the fair amount of their ability by region today with Europe weakening a bit, the US still very strong. We'd love to get your take on what industrial customers are thinking going into next year and any particular sub segments that stand out to you from a growth perspective?

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

Yes, I think regionally, it's been fairly even. I think I mentioned before on a couple of calls that we've been particularly pleased with the growth rate of our business in Asia, in the industrial area.

And I think overall, we've seen again, good growth in Asia over the recent times. Japan included. Just less production days in Europe during the fourth quarter, we saw a little bit of a downturn there. But overall, I think it's the strength is quite evenly distributed, and from a segment standpoint, energy has been strong, particularly the transmission and distribution part of that.

Automation has been strong, and the instrumentation side of things took a little bit of breather in the fourth quarter as expected, particularly on the ATE side. But as I mentioned a little bit earlier, our industrial customers in general are feeling good about the world, generally speaking, looking into 2015. And if the macro economy holds up, I believe that the CapEx will be spent and we'll benefit from that.

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

Craig, I would just add that inventory in the channel is about 7.5 weeks this quarter. It's pretty consistent with the prior quarter, and deferred gross income was about flat as well to the prior quarter. So from an inventory standpoint, I think things seem to be in pretty good shape there, as well. Appreciate the question, and we'll move on to the next question, operator.

Operator

Our next question is from Steve Chin with UBS.

Steve Chin - *UBS - Analyst*

Hi. Thanks for taking my question.

I just had a question on the automotive segment, if I could. Just looking at that time guidance for Q1, another down seasonal quarter and that's consistent with the last two years where it was down sequentially in Q1. For the two years prior to that, the automotive business was up.

Just wondering if it's a function of just existing product technology wins that you have currently with where the business there is fairly normalized and I'm imagining, fairly concentrated in the more developed markets, or automotive manufacturers. But is there any potential for some of these new technologies like the active safety features and possibly more infotainment design wins that may go into mass market vehicles? Does that potential for change the seasonality in the business where we see like three up quarters and typical one down quarter?

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

I'm not sure we'll change seasonality, but to give you an example, our advanced driver assistance business, the predictive safety business, has been up actually about almost 20% year-over-year. So that part of the business is growing well. It's still a small part of the safety strategy for ADI but it's growing fast and as it penetrates -- as that modality penetrates more and more car offerings and future will benefit greatly from that.

So I think the powertrain business, which is around oil quality sensing, fuel sensing, around battery management, that's going well. We've tremendous penetration, particularly on the battery side of things. But we've also got some new product waves coming, aside from the advanced driver assistance area. We have a new bus structure for processing audio and sound in a car, which is gaining a lot of traction particularly in the mid and high end of the car market.

So I think as I said overall, it's still going to be, I think, a very good growth space for the IC industry, the many, many cars now have got many thousands of semiconductors per. There's more and more sensing going to take place across many, many facets of the car. So I think for the long term, it's going to be a great business.

As I said a little bit earlier as well, we've seen just some of our safety programs, some of the product cycles there lasting a bit longer than we expected. But the design activity is very, very strong, and our business as well, we've put a lot of focus on trying to make sure our automotive business really reaches into the Asia region as well. So I think during 2015, we will see some good up tick there with a couple of new customers that are quite significant. So I think overall, it'll be a great story for many, many years to come.

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

All right. Thanks, Steven. We'll get to our next question.

Operator

Our next question is from Stacy Rasgon with Sanford Bernstein.

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

Thanks for taking my question. If you don't mind, I'd like to spend it on restructuring and OpEx.

So can you talk about the restructuring you did? What did you cut, where are you repurposing? Is this Hittite related or does it go beyond that?

And given the guidance is sort of flattish OpEx for 2015, how are you thinking about your variable compensation in that context? Are you already incorporating it into that guidance or will there be variability depending on the business level?

Dave Zinsner - *Analog Devices, Inc. - CFO*

Okay, so this did not really include much in the way of Hittite restructuring. We think we took that charge in advance of this.

But most of it was, as you might imagine, we are heavily focused in the B2B space. So we have kind of refined the resources necessary to operate successful in consumer in the areas we want to operate in consumer. That was a meaningful part of the adjustments.

And then there were some various product areas, and quite honestly, we also took a little bit of a more holistic view of the management structure and attempted to more streamline that to enable better decision making and more align it with the strategic direction of ADI on a go forward basis. So some of the areas impacted were in the management ranks, quite honestly.

I'm sorry, Stacy, what was the other part of your question?

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

I'm sorry, how are you, I guess, conceptualizing variable compensation next year?

Dave Zinsner - *Analog Devices, Inc. - CFO*

On the variable comp side, that guidance of being flat to kind of fourth quarter run rate contemplated that we would hopefully see variable compensation increasing next year. And so we contemplated that in our guidance for this kind of flattish related to the fourth quarter in terms of operating expenses. So that really won't be a -- that really won't be a headwind on the OpEx side.

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

Got it. So you're taking that elsewhere?

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

Just a little more color, Stacy, in what Dave had said. So we have reorganized the Company, and we have set up two large business units with tighter alignment between strategy and execution, I would say. And as Dave said, what we're trying to do is just get more speed in general.

We're trying to make ADI faster everywhere. And also get our engineers even closer to our customers. So I think with the restructuring, there's been some natural efficiency gain, and that's had a large impact on the restructuring of the Company.

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

Got it. Thank you, guys.

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

Thanks, Stacy. We'll get to our next question, operator.

Operator

Our next question comes from Blaine Curtis with Barclays.

Blayne Curtis - *Barclays Capital - Analyst*

Hello, guys. Thanks for taking my question.

I was wondering if you could provide a little bit more color on the softness or seasonality you're seeing in com. I think we've seen either by product or geography would be helpful.

I think we've seen some weakness in wired. I think wireless has been less negative into Q4 from others. Just curious your thoughts.

Dave Zinsner - *Analog Devices, Inc. - CFO*

This is really standard seasonal. I wouldn't call it weakness. I'd call it just kind of the standard seasonality we see given the fact that we have kind of their year ends that our OEM customers, their year ends impacting our business as they kind of calibrate inventory levels. But in general, we've seen that business be very, very stable and disciplined.

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

As you know, our business has really two components to it. It's got the wireless infrastructure part, which is the dominant part of the revenue stream and infrastructure, but also the wired portion has behaved very, very well over the last couple of quarters. So we've seen evenness in terms of performance in both areas, but as Dave said, what we're seeing now is just a seasonal breather.

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

Great. Thanks, Blaine. We'll get to our next question, operator.

Operator

And our next question comes from William Stein with SunTrust.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Thank you for taking my question. I'm hoping to just get a clarification on the operating leverage comments.

I thought I heard -- well, certainly you guided OpEx for the coming quarter, and I thought I heard a comment about $40 million of savings in that category and I also heard about better leverage through the year. Can you maybe quantify it a little bit as we go through the year, what kind of leverage we can expect to see come in on the OpEx line?

Dave Zinsner - *Analog Devices, Inc. - CFO*

Well, I guess, it's tough for me to predict what the top line is going to do, which is what the major part of the numbers to calculate the operating leverage. But I think what I can tell you is that we think OpEx will be down about $7 million in the first quarter. We will get about $40 million of savings from the restructuring.

Obviously, there are things that are going to be headwinds next year, one of which is, as I already pointed out, the variable compensation is expected to increase next year versus this year. Also, we will have kind of the normal salary increases and so forth that come into the P&L through the year. But I think the expectation is that on average, over the four quarters, it should average about $270 million per quarter, which is basically what we had in OpEx in the fourth quarter.

The first quarter is obviously going to be $263 million or so, or whatever the number is, somewhere in that range. So the third, fourth, and fifth -- sorry, the second, third, and fourth quarter -- I'm adding a quarter -- the second, third, and fourth quarter will probably be a step function higher than that $270 million to get the average to be somewhere in that range. I think it's going to be relatively flattish through the rest of the year though.

It might be -- incrementally add $1 million or $2 million per quarter or something in that range. But I think in general it's not going to be terribly different from quarter-to-quarter through the year. Is that helpful?

William Stein - *SunTrust Robinson Humphrey - Analyst*

Yes. It's helpful. Thank you.

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

Thanks, Will. We'll get to our next question.

Operator

Our next question comes from Doug Freedman with RBC.

Doug Freedman - *RBC Capital Markets - Analyst*

Hi, guys. Thanks for taking my question. If I could move our focus over to pricing and what you are seeing in the marketplace.

I know you've had some programs in the past that focused on your ASPs. Can you comment on what you are seeing in terms of year-on-year ASP changes in your portfolio or whether you have seen any like-for-like ASP changes in the products that you sell via annual contracts?

Dave Zinsner - *Analog Devices, Inc. - CFO*

It's been relatively stable. We're obviously in a competitive market. Certain OEMs are tough on us, as they are with all their suppliers.

And so we see some erosion in some of the major customers that we see from year-to-year, but I think in general the margins, or rather the ASPs, have been relative stable. We have obviously taken steps to kind of manage the business so that we are extracting the right value on the ASP side for the value we're providing to the customers, not surprisingly.

So in certain instances that's enabled us to adjust prices in the opposite direction, which has kind of helped I think on stabilizing the ASPs. And quite honestly, that's been a real focus of mine, quite honestly, as I think it's a key lever to seeing our gross margins expand to be focused in on that, that particular metric.

Doug Freedman - *RBC Capital Markets - Analyst*

Great. Thank you.

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

Thanks. We'll get to our last caller of the night here.

Operator

And our final question comes from Tristan Gerra with R.W. Baird.

Tristan Gerra - *Robert W. Baird & Company, Inc. - Analyst*

Good afternoon. You mentioned opportunities in small cell in the next two years. What's the catalyst given the ramp of this product class being pushed out? And if could you talk about what the competitive landscape is going to look like in small cell relative to what you're seeing in base station today and how you feel your position in this market?

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

As to the first part of the question about what's driving, it's really the densification of the network. As you know, carriers have been spending the last few years trying to build out a basic footprint. But with the massive demand increase for bandwidth, carriers are now desperately trying to catch up with consumer demand by laying in more capacity to deal with the bandwidth need. So there's a tremendous amount of performance.

All the same kind of performance needs exist in the small cell as the macro cell in terms of spectral efficiency, number of channels, number of radios and frequencies that can be managed flexibly, albeit in a smaller kind of footprint. So we've focused heavily as a Company. As I've said, we've been trying to get ahead by anticipating the needs.

So we've got a transceiver portfolio that is best in class that has got us into a huge number of sockets across the globe in Asia, in America, in Europe. So I think what it will do, it will add a lot more available markets. And that will be I think a large growth portion of the story as we move towards the $4 billion SAM over the next six years or seven years.

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Dave Zinsner - *Analog Devices, Inc. - CFO*

And on the competitive landscape, I think in general it's the same dynamics as in the larger bases. This is really hard stuff to do, very high-speed radio capability, now integrated. And so this won't have, I think, an opportunity for a new entrance, at least from our standpoint, because this is just getting really, really cutting edge, quite honestly.

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

Tristan, what I would only add to that is, you know, you've seen some of the headlines in the US about $34 billion-odd of spectrum being auctioned. It that sort of mid level type spectrum is really centered in some of the more dense urban areas in the US. And so I think that's a very good sign that 2015 could be a good year for small cells as well.

So I appreciate the question. And I'll have Vince come back and provide his closing remarks before we sign off for the night.

Tristan Gerra - *Robert W. Baird & Company, Inc. - Analyst*

Thank you very much.

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

Thank you. Thanks, Ali.

So as we approach, we're in our FY15 now. I just want to let you know that we remain true to our core principles as a Company. Basically that superior innovation drives superior returns.

We've important work ahead of us. We've a tremendous vain of opportunity available for us to convert into revenue and ultimately deliver very high quality earnings to you and returns in general. So at ADI, we will continue to innovate, to execute to a high level, and deliver for our customers, our employees, and also for our shareholders.

So with that, I'd like to thank you all for joining us this afternoon, and I wish you all a very, very happy and safe Thanksgiving.

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

Thanks, operator.

Operator

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