

FINAL TRANSCRIPT

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ADI - Q3 2008 Analog Devices Inc. Earnings Conference Call

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PRESENTATION

Operator

Good afternoon. I will be your conference facilitator. At this time I would like to welcome everyone to the Analog Devices third quarter 2008 earnings conference call. 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) Thank you. Ms. Kohl, you may begin your conference.

Mindy Kohl - *Analog Devices Inc. - Director, IR*

Thanks, and good afternoon. This is Mindy Kohl, Director of Investor Relations for Analog Devices. If you don't yet have our third quarter 2008 release, you can access it by visiting our website at analog.com and clicking on the headline on the home page. This conference call is also being broadcast live on the Internet. From analog.com select investor relations, and follow the instructions shown next the microphone icon. A recording of this conference call will be available today within about two hours of the call's completion, and will remain available via phone and Internet playback for one week.

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Participating in today's call with Jerry Fishman, President and CEO; Robbie McAdam, Vice President and Head of our Analog business; and Joe McDonough, Vice President of Finance and CFO. We scheduled this call for 160 minutes. Jerry Fishman will present the results of our fiscal third quarter during the first section of the call, and the remainder of the time will be devoted to answering questions from analysts participants. Analysts can press star one on their phones at any time, beginning now, to queue up for questions.

Before Jerry begins, I wanted to let you know that we have updated the schedules on our IR website which include the historical quarterly and annual summary P&L for continuing operations as well as historical quarterly and annual information for product revenue from continuing operations by end market and by product type. Next I would ask you to please note that the information we're about to discuss includes forward-looking statements, which include risks and uncertainties. The Company's actual results could differ materially from those discussed herein. Factors that could contribute such differences include but are not limited to those described in the Company's SEC filings, including our most recent quarterly report on Form 10-Q which was filed earlier today. The forward-looking information that is provided by the Company in this call, represents the Company's outlook as of today, and we do not undertake any obligation to update the forward-looking statements made by us. Subsequent events and developments may cause the Company's outlook to change. Therefore, this conference call will include time-sensitive information that may be accurate only as of the date of the live broadcast which is August 19, 2008. With that I'll turn the call over to Jerry Fishman for opening remarks.

Jerry Fishman - Analog Devices Inc. - President, CEO

Thanks, Mindy. The third quarter 2008 was another very solid quarter for ADI. Our revenues grew \$659 million, which was up about 7% year-over-year, and about 1.5% sequentially, which was right at the midpoint of our plan range that we communicated last quarter. This performance follows a 6% sequential revenue increase during the prior quarter. Once again, the diversity of our products, the end markets we serve, the customers we serve, and the geographies that we operate in, provide a great stability in our results in a very challenging economic environment.

Similar to last quarter, the comments I'm going to make this afternoon will refer to the information that's posted on our investor relations website, which provide analyses of our revenues for our continuing operations for the past five years sorted by both end application and also by product type. The very positive feedback that we got from investors last quarter on this level and the format of the data that we're now providing indicates that many investors find this information useful in monitoring the trends in our results.

Our revenues from our industrial customer base were up about 10% year-over-year, and they were down just slightly less than 1% sequentially. Within the industrial segment, interestingly, most of the industrial segments were up sequentially, while our sales to automatic test equipment customers, which tends to vacillate from quarter-to-quarter, declined significantly. In fact our sales to ATE customers declined about \$6 million sequentially, after a very large increase in sales to automatic test equipment customers in the prior quarter.

Probably most noteworthy in the industrial sector were increases that we received in sales to our automotive customers, primarily those automotive customers outside the United States, which grew 6% sequentially, and grew 26% year-over-year. This very strong sales growth is really the result of a very -- a significant position that we have established with leading automotive manufacturers and safety systems such as air bags, and electronic stability control, high-end entertainment systems in cars, and sensor applications for batteries and also for braking systems. In aggregate, our industrial revenues comprised approximately half of our revenues in Q3.

Overall, industrial revenues have been growing very significantly at ADI for many years. Our five-year compounded annual growth rate has been about 13% per year, and as a result, revenues of industrial products have almost doubled over this five-year period. The industrial market, which is as I mentioned now about half our sales, represents, really, the backbone of ADI. It's our most diverse customer base in many different product subsegments at industrial products. It requires our highest performance

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technology. It supports very long product life cycles, and it earns above average corporate gross margins. Our brand is extremely strong amongst those customers, and we often receive the first call from designers as leading industrial customers to help them design in the new systems.

For those who have followed ADI for many years, you know that most of our industrial growth in prior years has come from the US and Europe, but we're now rapidly penetrating new industrial applications all through southeast Asia in China, and those are experiencing high growth.

Revenues from our communications customers were up 11% year-over-year and up about 1% quarter-over-quarter. We enjoyed strong sequential revenue growth in optical and networking applications, and also from analog products and handsets, products such as microphone preamps, para management products, lens drivers, and RF detectors. Our sales debate station manufacturers declined sequentially in Q3 after an extraordinarily strong Q2.

Based on our very strong market position, and the current backlog, and the current forecast we have from customers around the world in base stations, we expect base station sales to resume growth in our fourth fiscal quarter, the quarter we're now beginning. In aggregate communications revenues comprised approximately 25% of our revenues during the quarter. Our revenues from consumer customers were down about 1% year-over-year, but were up 5% sequentially, led by continuing strong sales in advanced TVs, and digital cameras, and high-end home audio products. These are all areas where our share is very high amongst the very top brands. We continue to see very good opportunities for ADI to expand our footprint in high-end consumer products, by providing new functionality to enhance the consumer/user experience. In aggregate our consumer revenues comprised about 20% of our revenues in Q3.

Revenues from our computer customers declined 5% year-over-year, but grew 12% sequentially, in line with the generally strong PC market worldwide. Computer revenues comprised the remaining 5% of our revenues in the third quarter. Analog product revenues in Q3 grew 6% year-over-year and grew 1% sequentially, which is solid performance relative to the market and also relative to our peer group of analog companies. Overall, if you look at revenues in the analog space over the past two years, ADI's product revenue growth in the analog space over that two-year period, has well exceeded that of our closest analog competitors.

Our data converter sales grew 8% year-over-year, and 2% sequentially, and represented 46% of our revenues in the third quarter. Converters remain our largest and our most diverse product sample with ADI, and an area where we are continuously innovating to enable our customers to redefine and also to differentiate their products. During Q3, we once again expanded our convert a portfolio, with the launch of many new very important products, including our highest precision, what we call our AD7626, Pulsar AED converter, which is 2.5 times faster than any other FAR AED, 70% smaller, and offers the lowest power consumption in this class of 16 bit converters in the entire industry. We also announced that high-end X-ray imaging device maker, Trixel, which is a joint venture of Talus, Phillips Medical, and Seamus Healthcare, chose this converter for their medical imaging system, and given the fact that those are leaders in the medical field, it bodes very well for that product going forward.

Also during the quarter, we announced a 24-bit 7190, sigma delta A-Z converter, which delivers the industry's best combination of data ray and also noise-free resolution. It is this relentless focus on delivering innovations that give our customers a competitive edge that has been the key to ADI's decades of leadership in converters, and we continue to invest to maintain our leading position in the market. Our converter revenues have grown at a compounded rate of 13% per year for the past five years, well ahead of the market, and as a result, we have continued to grain market share during this five-year period.

The statistics published by Gartner Data Quest which uses a very broad definition of converters, indicates that ADI's market share of converters was approximately 37% last year, over two times that of our closest competitor. Other industry analysts indicate that ADI's market share and converters last year was in the 43 to 47% range. But really by any measure, even though there are significant competitive shifts amongst smaller converter competitors, ADI's position remains significant in what we believe is the most important product category in the analog space.

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Amplifier revenues grew 5% year-over-year, and were approximately flat to the prior-year quarter. Amplifiers represented approximately 23% of our sales during the quarter. Industry analysts now indicate that our share of the overall amplifier market is about 20%, but we estimate that our share of the high-performance segment where performance and prices are typically much higher is approximately 40%. Revenues from other analog products, the category which includes RF products, or radio products, MEMS clocks, and other signal-processing products was similar to last quarter, and represented about 15% of our revenues during the quarter.

Para management revenues grew 20% year-over-year, and 6% sequentially in the third quarter. We are beginning to get traction in this product area after nearly two years of significant investment. We continue to focus our product development in to industrial, communications, and consumer applications, where we can really leverage our position as the world's leading converter and amplifier supplier, at customers who already know and respect ADI's technology. We're planning for continued improvement in 2009 for para management products.

General purpose DSC product revenues grew 14% year-over-year, and 4% sequentially in Q3, and contributed about 9% of our revenues. After the divestitures of our more-commodity based DSP products such as DSL and cellular baseband modems, our DSP product line now more closely resembles our analog business in terms of gross margins and also in terms of end-market diversification.

As I mentioned earlier, revenues grew about 1.5% sequentially after growing 6% the prior quarter. Our results for the first three quarters indicate that we're now on track for a solid year, despite very challenging economic conditions. Our gross margins at 61%, were flat for the prior-year quarter, and up 50 basis points from the same quarter last year. We believe this is a very good result, given the mix of business we experienced during the quarter. The continuing reduction in our inventories, and the higher raw material and energy prices that we have all suffered over the past couple of months.

Our operating expenses grew less than 1% sequentially, which was in line with our plan for the quarter, and also the cores containment goals that we have established corporate wide. Operating margins expanded by 30 basis points sequentially, and 90 basis points year-over-year, to 24.5% of sales. And earnings for our continuing operations were about flat sequentially at \$0.44, but up 16% from the same quarter last year on a 7% year-over-year increase in revenues. Our cash flow remained very strong in Q3. Totaled \$196 million, or 30% of our sales. Capital expenditures were \$39 million or about 6% of sales. Our inventories decreased by just under \$10 million or 3% in Q3, following an \$11 million decline last quarter. As a result, our days in inventory declined by five days to 110 days, which is within our model levels. Accounts receivable decreased 2% from last quarter, and the DSOs are now down to 45 days from 47 days the prior quarter.

During the quarter, we paid out \$58 million in dividends, representing 42% of our net income, and a dividend yield of approximately 2.5% at current stock prices. Our share repurchases during Q3, totaled about \$28 million. As a result, we ended the quarter with \$1.3 billion in cash and no debt. Approximately \$1 billion out of the 1.3 is currently held outside the United States in various foreign subsidiaries. The order rate for ADI remains strong in Q3, including July, and were fairly linear during the quarter. Regionally, we experienced best growth during the quarter in Europe and also in China. Overall, end customer orders in Q3 were up slightly from the prior quarter, and the book-to-bill ratio was slightly above 1. As in previous quarters, we continue to experience very strong turns environment, where many customers are placing orders for delivery during the quarter, which is reflective of our short lead times.

Our operating plan for Q4 is for revenues to grow flat to 3% up sequentially. On a year-over-year bases, if we achieve those numbers, this range represents a revenue increase of 6 to 9% for this Q4 over last year's Q4. In Q4, we expect the industrial market to be in aggregate, relatively flat sequentially on a worldwide basis. We expect seasonal growth in our consumer business, and we also expect to experience a rebound in our communications revenues, primarily in the base station business. We're planning for gross margins to be approximately flat to 61% with, of course, the results depending on the actual mix of business that we achieved. We're planning for operating expenses to be about flat sequentially, in line with our goal of continuing to get operating leverage on increasing revenues. This should produce earnings from continuing operations in the range of 44 to

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46%(Sic -- see press release) for Q4. The earnings we're expecting from our discontinued operations is expected to be approximately \$0.02 a share.

Clearly, from these numbers, ADI produced a solid quarter in a tough environment. A continuing ingredient in our success is the good returns that we're achieving on the significant investments that we have made over the past few years, and also from actions that we have taken to reshape our product and our investment portfolio to focus on higher growth and more profitable segments where customer's value information because the change of the user experience and are willing to pay for that. We believe that we can continue to raise our operating margins by limiting expense-growth rates to rates well below the revenue growth rate, and thereby achieving good leverage on revenues as we go forward. And certainly our continuing very strong cash-generation capability offers the prospect of enhanced shareholder returns in the future.

Mindy Kohl - *Analog Devices Inc. - Director, IR*

Thank you, Jerry. During today's Q&A period, please limit yourself to one primary question and no more than one follow-up question. We'll give another opportunity to ask additional questions if we have time remaining. Operator, we're now ready to open it up for questions from our analyst participants.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) We'll pause for just a moment to compile the Q&A roster. Your first question comes from the line of Doug Freedman.

Doug Freedman - *American Technology Research - Analyst*

Hi, thanks for taking my question. Jerry, if you just look at the business from the big picture here, we're clearly coming up in a tough environment for growth. You have highlighted several product segments that are growing but overall your top line revenue growth year on year looks to be challenging. What segment can you sort of point this to over the next 12 months that you think will propel, sort of your growth?

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

Well, I think it's very hard to predict in the future. I think if you go back to the kind of historical growth we have seen in industrial products, it is certainly been north of 10% annually. We have seen good growth in consumer products, the automotive products are growing quickly in some segments of the communications market the sales are growing. I think if it turns out we post these kind of numbers for 2007 in a pretty tough environment, I mean, I think that bodes well for the kind of things we can achieve when -- just having neutral compliance. There's an awful lot of head winds out there for growth this year, and to some degree everybody is limited by that. But I think we have a lot of good drivers and a lot of different places in the Company, that if we just get an even break from the economy, and the markets that are out there around the world I think the top-line growth should be good, and, one of the interesting parts of ADI has always been we get a little bit of growth from a lot of places, and I think that will continue to be the case going forward. I think putting up numbers like 7 or 8% year-over-year numbers this quarter in an environment, which is very, very challenging out there, is not a bad sign for the future, is the way I would describe it.

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Doug Freedman - *American Technology Research - Analyst*

And then, can you highlight anything underneath the covers on sort of the gross margin line? Are there things going on as far as the cost structure? Or is it really going to be at this point mix related that is going to help move the gross margin numbers? Should we think of gross margins going forward as rather stable at this level?

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

I mean, I think they are relatively stable at this level. I think if the mix goes really badly one way, it could be down a little bit. It doesn't vary, very much because of the lower large numbers. There are so many products in so many markets, no one particular segment loses very much, and the relative part of the business in each of the industry segments, with a lot of quarterly fluctuation, hasn't really changed very much. (Inaudible) and communications has been about a quarter, and consumer has been about 20%, so I don't think that's is going to change very much. We have a lot of cost reduction initiatives that we have been working on hard, where -- we're getting towards the final part there in reducing our two fabs in Ireland to one fab, we're consolidating our 6 and 8 inch fab into an 8 inch fab. I think that's going to help our cost structure, particularly as we get out to the early parts of 2009 in our fiscal year, and a lot of other cost-reduction programs we have also, but I think to a first approximation, we believe most of the earnings leverage in front of us is more on the expense side than the gross margin side, and that -- for a business like ADI, there's nothing wrong with sort of 61% gross margins. But the real leverage will be mostly on the expense side.

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

This is Joe McDonough. I think this quarter demonstrated that some of the actions that we have taken in terms of cost reduction, trying to manage the pricing with the customers, trying to really offset this quarter some of the cost increases that we get in raw materials. We saw the mix of business move in the wrong direction relative to the gross margin, and yet the gross margin held at 61%, so we were pretty pleased with the results this quarter on the gross margin.

Doug Freedman - *American Technology Research - Analyst*

So you did mention that there has been some cost structure increases that you have seen from commodity prices; is that fair to say?

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

Yes, I think's no doubt. I mean they are sort of hard to identify precisely, but there's gold-in our products, there's oil and the transportation of our products, there's just upwards pressure on every raw material. So it's hard to quantify exactly, but I think as Joe said, the ability to hold the margins with that kind of cost pressure, with price pressure from all of the customers continuing, with all of the head winds, and the mix that we have, with automotive being much stronger, industrial being flat, with consumer being up, and the PC products being up, I think 61% with that mix in business in that environment we think is a pretty good result.

Doug Freedman - *American Technology Research - Analyst*

Right. And then my last question for you, have you guys noticed any real change from the competitors in the landscape, any changes in behaviors out there that you have noticed as a result of the toughening environment?

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Jerry Fishman - Analog Devices Inc. - President, CEO

Well, I think, Doug, for the companies that have a commodity product line, the price competition is extremely high. I mean, we -- so much of our product line is proprietary that -- we get price pressure from competitors, but I would say most of the price pressure we get is from customers, who are trying to figure out a way to get the cost of their products down, not necessarily as a result of competitor A or competitor B coming in and dropping our prices. We have some products like that, and we fight them off. But I think the largest pressure we have is from customers who are just trying to be more competitive. But not so much from competitors who are trying to just go in and undercut our price. Because it's very hard to do that without very similar products. So the customers always try to separate price from value. We try to make sure our customers understand the value our products provide.

Doug Freedman - American Technology Research - Analyst

Great. Thanks for answer my questions.

Operator

The next question comes from Steve Smigie.

Steve Smigie - Raymond James - Analyst

Yes, thanks for taking my question. Actually, following-up on the gross margin question. It seems like given all of the head winds that that gross margin if -- in a more normalized environment and a good quarter could almost be a couple hundred basis points higher. It seems like looking back over the past few years you have actually come up quite a bit from in the high 50s up into the 60s. And was hoping you could talk about that? Does that make sense? Could you -- absent all of these head winds could you get to something like a 63? And it is just better mix that has allowed you to improve even over the past years?

Jerry Fishman - Analog Devices Inc. - President, CEO

What's really happened over the past couple years, we right now have a better mix of products than we did without some of the lower-margin products that we divested. I think going forward, it's very much dependant on so many different moving parts of the -- the mix we have, the products we sell, the geographies we sell, what the relationship of the dollar is to the euro, and the dollar to the yen, and the dollar to Chinese currency, it's just too hard to predict, certainly -- so we don't want to get ahead of that is really what I'm saying. I think if you look at 51 for this quarter, that's a good sign, and that's where I think I would leave it.

Steve Smigie - Raymond James - Analyst

Fair enough. And you did a little bit of a share buyback and took out some dividend here. Could you just talk about what dividend and cash buyback policies are going to look like in the next quarter or next couple of quarters?

Jerry Fishman - Analog Devices Inc. - President, CEO

Well, I mean we raised the dividend last quarter, and it's 2.5% we're paying out 45% of our net income. The -- as we mentioned on the call last quarter, most of arguably -- the largest majority of our cash is outside the U.S. We're not anxious to bring that back to -- to buy stock back, we can pay a very significant US tax on that. So buying stock back at very large levels in this environment would require us to borrow money. The -- I think as Joe said last quarter, the environment for doing that is not very favorable right now. So I think the way to think about ADI going forward is that we have earnings that are going up, that's

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a good sign. We have 30% of our sales in cash we're generating on a regularly routine level. Eventually the interest rate environment and the credit markets will stabilize and we certainly have access to a lot more debt than we're carrying now which is about zero. So I think there are a lot of prospects for the future in terms of returning even more to shareholders than we have been returning.

We have bought back approximately 30% of the Company over the last couple of years and taken obviously 30% of the shares off of the market and we've raised our dividend consistently. I think we understand the value of that to investors. We understand the impact of all of that, providing support for the stock price, so it's purely a question of trying to sort out what to do in a very complex finance market right now, and -- and why we're going to keep a very good eye on that. The best thing is we have plenty of capacity to do that. And that fact has not escaped us, and I think we have also demonstrated that in the right environment, we have bought our stock very aggressively.

Steve Smigie - *Raymond James - Analyst*

Okay. Great. Thank you very much.

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

That's the only thing I can say about predicting the future.

Steve Smigie - *Raymond James - Analyst*

Thank you.

Operator

Your next question comes from Chris Danely.

Chris Danely - *JPMorgan - Analyst*

Thanks, Jerry. Just to follow-up on -- I think it was Steve's question. It sounds like about \$1 billion of cash you'll always sort of have around because it's kept offshore.

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

We have capacity -- hopefully that number will grow.

Chris Danely - *JPMorgan - Analyst*

Yes.

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

Because we're generating profits both inside the United States and outside the United States. The cash outside the United States just happens to be trapped, but that's not a bad thing. But I think for a Company our size, carrying a cash balance is a good idea, but we can certainly support debt under the right circumstances. I think that's fair to say.

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Chris Danelly - JPMorgan - Analyst

Sure. And then would you characterize your guidance this quarter as I guess roughly seasonal and can you just talk a little bit about the end markets and what you're seeing out there? Where you see a little bit better and where you're a little more concerned?

Jerry Fishman - Analog Devices Inc. - President, CEO

Yes, I would say that's an accurate description. This is about seasonal guidance. The fourth quarter tends to be -- sort of usually a crappy August a good September and a very good October and that all adds up to flat to a little bit up typically. Just a little bit better than that. And, I think what we're expecting is -- at least the input we're getting with the industrial business is typically roughly flat in this quarter. The consumer business tends to pick up a little bit in anticipation of the back-to-school season and beginning in October it builds up to the holidays, and we're expecting the communications business, particularly the base station business, which grew a lot in Q2, declined in Q3, at least if the forecasts and the backlog that our customers have given us for this quarter holds, that ought to grow next quarter, and that would be a good thing, which would -- depending on how all of those things happen will determine whether we're at the low end, the high end, or in the middle of that guidance.

Chris Danelly - JPMorgan - Analyst

Got it. Thanks, guys.

Operator

Your next question comes from Craig Ellis.

Craig Ellis - Citigroup - Analyst

Thanks for taking the question. Jerry you mentioned in your comments that Southeast Asia is an opportunity of growth in the industrial business. What do you need to do operationally to really make that a meaningful source of revenue? And is it possible that over the next 12 to 24 months, that can have a meaningful impact on the 13% five-year CAGR that you have been achieving in that segment?

Jerry Fishman - Analog Devices Inc. - President, CEO

We're actually fairly enthusiastic about that. We started out if you look back two or three or four years in the region of Southeast Asia primarily selling very high-volume products because that was the market there. And what we have really concluded about two or three years ago is there's 10s of thousands of customers in regions like China, and a lot more customers than we would have predicted in places like Korea, and Taiwan, that are all very active in what we call industrial products, which includes industrial process control, medical, and many other segments that we have been very active in. So what that's really required us to do is to try to duplicate the sort of efforts and infrastructure that we put in the United States and Europe to develop that very broad-base of customers in regions in Asia. And we're really doing that now, and we're beginning to see the benefit of that program.

It would be very disappointing if when we looked at our sales in some of those regions, particularly like in China, if we didn't wind up with 10,000 or 15,000 accounts in China, that heavily in the industrial, medical, and other aligned businesses so that. So I think that, requires better channels, better application support, better marketing, and all of those things are areas that we have been investing in to build the infrastructure in Southeast Asia, because we really think there is an opportunity there for

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significant growth. And the early signs are very, very good in that. I mean, even over the last two years, as the industrial business has grown at pretty good rates part of that reason is because of the growth we have seen in those regions.

Craig Ellis - Citigroup - Analyst

So, Jerry, with -- if you think about getting your organization in Asia/China to a level of maturity, how far along are we on that, so that we can understand those previous comments a little bit more?

Jerry Fishman - Analog Devices Inc. - President, CEO

Well, if you ask our sales guys they say 80%. If you ask me, I would say about 50. In other words that's a work in progress. It takes -- when you are dealing with industrial customers that are 10s of thousands of them in every -- in a very wide, diverse geography, and you are trying to build a brand at the same time in the region, it just takes -- there's a lot of things to do, and it takes a long time, but the good news is, once you get it as it has happened in the US and Europe for ADI -- once you get it, you own it. And you keep it for a very, very long time. So, the easier things we have done, and some of the harder things, but we got a lot of work to do to really get that to where we want it to be, which I still believe is one of the greatest opportunities going forward.

Craig Ellis - Citigroup - Analyst

Okay.

Jerry Fishman - Analog Devices Inc. - President, CEO

And in many ways, I would answer that that when you look at our sales channel in that region, where we were selling base band handset chips, it was very focused on that business, because that's -- they thought that's where all of the money was. But just the divestiture of the base-pad chip business and some of the power products in PCs in that region, has really allowed us to focus our selling-applications efforts on a very, very different customer base, which in my sense I would say was at least a significant if not a predominant motivation for getting out of those businesses. And I think now with the salesforce and the applications force focused on those applications, I think our progress there will even accelerate further than it already has.

Craig Ellis - Citigroup - Analyst

That's helpful, and then switching gears for the second question. You mentioned the encouraging progress you are starting to see in power management. How should we think about what is happening within the portfolio? Are you starting to see design ins about equally across those three end markets that you talked about, or is it much more in consumer, industrial and how can we think about the sequential growth going forward relative to what you just put up?

Jerry Fishman - Analog Devices Inc. - President, CEO

I think first of all it is important to realize that that's still a relatively small portion of our overall sales. So it shouldn't get -- everybody get carried away and have to put on a huge amount of sales very quickly. I think that in the early phases, a lot of -- the designing rate is very high in each of those sectors, but the sales have been higher in sort of the more volume, consumer-oriented products than they have been in the industrial products, but as I commented on about China and Asia, I mean that's going to develop. I mean we're beginning to see the right products come out. The customer feedback on the products is good, and I think if -- over time, we are going to see good growth from each of those three sectors, but certainly right now over the early phases, it's more related to some of the higher-volume stuff than the very fragmented stuff that we are working to develop the infrastructure.

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Craig Ellis - Citigroup - Analyst

Thanks, Jerry.

Operator

Next question comes from John Dryden.

John Dryden - Charter Equity Research - Analyst

Could we step back a little bit in the communications market. Was the uptick there sequentially across the board, or was there a difference between converters and your other products?

Jerry Fishman - Analog Devices Inc. - President, CEO

I would say that what we said in the opening comments is the segments that grew the optical and the networking segments, and the -- also the products that we sell into handsets -- we sell a lot of analog products into handsets, which are very proprietary, and are very useful in handsets and I mentioned a few of those. I don't really have the detail, on whether it was converters or so on, but the only area that we saw a sequential decline was in base stations, mostly because of the tremendous growth we had the quarter before, and we think that's going to come back this quarter. But maybe Robbie is here -- who is the world expert in our converters -- do you care to comment?

Robbie McAdam - Analog Devices Inc. - Group VP, Analog Semiconductor

The converter business (inaudible) last quarter and the bids that Jerry mentioned the base-station business it is slightly lumpy with a very, very strong quarter in Q2. Came back a little bit this quarter, and it's -- it's a mix between -- in quarter two we had the (inaudible) in China which eased up a little bit, and we had very strong, both 3G and GSM deployment. We -- we expect that to come back this quarter, but in -- so it's hard between products, the converter business because there's such a strong share in converters moves up and down directly with the base station business but we've had strong market share. But our new RF business, which is -- that would have been a very strong quarter during the during the quarter. Next quarter we expect the business to be strong because the overall business is taking position back.

Jerry Fishman - Analog Devices Inc. - President, CEO

I think the fact that our overall converter business grew a couple of percent sequentially when the base station business, which is a very large consumer of converter products actually declined is something that we're happy with.

John Dryden - Charter Equity Research - Analyst

And then could you update us on the TSMC relationship for your MEMS products, how that will help in Q4 at the gross margin level?

Jerry Fishman - Analog Devices Inc. - President, CEO

Well, the -- the way to think about that is, the TSMC efforts really apply to about half of our MEMS business, which is the consumer part of that business. I think most of you know, we had our program that is getting towards fruition to transfer a lot of that

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production to TSMC both for scale and for cost reasons. That's where the area is moving along. I wish it was a little further than it is, but I think it's really on course, and I think it's going to contribute exactly what we thought it was going to contribute towards the margins and the consumer, MEMS product and also the scale of that business.

John Dryden - *Charter Equity Research - Analyst*

Thanks for taking my questions.

Operator

Your next question comes from Sumit Dhanda.

Sumit Dhanda - *Banc of America - Analyst*

Jerry, first question, or Joe, if you could tell us what the backlog was as you entered the quarter? Was it up slightly and any difference in terms of how it looked within distribution versus OEM?

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

No, there's really not too much news there. I think as Jerry said, the book to bill ratio was slightly above 1, the backlogs are a little bit up quarter-to-quarter. When we look at different cut of the demand we include the end customers that are distribution channel has, we still see the same thing that the book to bill ratio is a little bit above one. The turns ratio this quarter were a little bit less. I think about 40% of our sales were turns sales this quarter. That's down a little bit from last quarter. With the cancellations we don't see anything unusual in cancellations. They were actually a little bit less than they were last quarter, which is good news. So I think when you look at all of those elements, it looks pretty stable, and is what -- we think is the foundation for the business plan that we have got for next quarter despite a lot of turbulence in a lot of economic markets around the world.

Sumit Dhanda - *Banc of America - Analyst*

Okay. The next question I had for you was on the operating margin, or operating expense front. You saw a little bit of an expansion in operating margins, 30 basis points, ostensibly maybe something of that magnitude in the October quarter. Is that the rate of improvement we should be looking forward to? Assuming that the environment doesn't change significantly from a macro economic perspective? Or is there a more meaningful expansion to get to your non-GAAP target of 30% that we should be looking forward to?

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

Well, I think the right way to look at it right now is that we're at 24.5% of sales in a really tough environment. Everything is challenging right now, and yet the margins are expanding. So -- at whatever point everything eases up in the world, and -- we see things recover in a more meaningful way, I would expect the gross margins to expand pretty significantly at that point. In the meantime--.

Sumit Dhanda - *Banc of America - Analyst*

The operating margins.

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Joe McDonough - Analog Devices Inc. - VP-Fin., CFO

The operating margins. At that point what has to happen -- at this point everything is being constrained by everybody, and our operating expenses are being constrained, and we're going to keep doing that. We'll keep doing it even in the phase of growth of the revenues, so it really is some expansion of the business environment that's more meaningful that will probably get us up toward the 27.5% that we're looking at.

Sumit Dhanda - Banc of America - Analyst

Let me put it differently, assume that the sales trajectory does start to grow -- does start to pick up. Can we expect something better than just OpEx growing at half the rate of sales to deliver more significant margin expansion? I mean--?

Joe McDonough - Analog Devices Inc. - VP-Fin., CFO

Certainly that will be the objective, and each quarter we will give you an idea of what we expect for the next quarter based on the plan that we have got for the following quarter.

Jerry Fishman - Analog Devices Inc. - President, CEO

Yes, I think the way we're managing the business right now, that half the rate is one way to look at it. But right now we're trying to keep the operating expenses as close to flat as we possibly can. That's the direction we have given all the business units, that's the plan for this coming quarter, and that is relatively irrespective of the growth rate in revenues. Until we get to the kind of numbers that I think this business should be producing. So we're make slight progress on that, but I think there's a lot more progress to be made by keeping the expenses relatively flat almost irrespective of the growth rates.

Sumit Dhanda - Banc of America - Analyst

Then just one quick clarification, again, on the cash and the share repurchases. So just so that I understand this correctly, you are at the point now where you don't anticipate any major reductions in share count given that much of your cash is offshore at this point; and so that's how we should be thinking about--?

Jerry Fishman - Analog Devices Inc. - President, CEO

Model the share count -- I think if you model the share count relatively flat, and -- I guess some of the other elements that you are probably interested in. The tax rate is probably around 23% next quarter, and the non-operating income is in the 8 million to \$8.5 million range for income next quarter. Those are the elements below the operating profit as a percentage of sales.

Sumit Dhanda - Banc of America - Analyst

But even as you cash generation continues, we should not anticipate any kind of meaningful reduction in share counts, given where the cash is--?

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Joe McDonough - Analog Devices Inc. - VP-Fin., CFO

Well, a lot of the cash is being generated outside of the United States, and a lot of cash is being used to pay the dividend inside the United States. So it is simply, as Jerry said, just a little more normalization in the debt markets that will allow us to free up the capital structure a bit.

Jerry Fishman - Analog Devices Inc. - President, CEO

I think the way to think about it is with constipation of the debt markets, we're not actively going to go out and borrow a lot of money to buy stock back here. But with the debt markets stabilizing, we have a tremendous -- we have a lot of capacity for debt in the Company, and -- but I think Joe's comments were related to what we're looking at right now in terms of the debt markets. If that changes, certainly our strategy of continuing to buy shares could obviously, potentially accelerate.

Sumit Dhanda - Banc of America - Analyst

Okay. Thank you so much.

Joe McDonough - Analog Devices Inc. - VP-Fin., CFO

We only have to borrow the money that we have outside of the United States.

Jerry Fishman - Analog Devices Inc. - President, CEO

Right.

Joe McDonough - Analog Devices Inc. - VP-Fin., CFO

Without doing it in a way that jeopardizes our tax situation.

Sumit Dhanda - Banc of America - Analyst

Thank you.

Joe McDonough - Analog Devices Inc. - VP-Fin., CFO

It's not that difficult, if the world would just return to a normal situation.

Sumit Dhanda - Banc of America - Analyst

Thank you.

Jerry Fishman - Analog Devices Inc. - President, CEO

Yes.

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Operator

Your next question comes from Uche Orji.

Uche Orji - UBS - Analyst

Can you hear me?

Jerry Fishman - Analog Devices Inc. - President, CEO

Yes.

Uche Orji - UBS - Analyst

Thank you very much. Can I just get one quick clarification. I know you talked about base station and the fact that it's lumpy, and business is coming back. Can you give us any idea by region where you are seeing a rebound in this business? And more specifically, are you starting to see any impact from China on the treaty side?

Jerry Fishman - Analog Devices Inc. - President, CEO

Yes, I think that --.

Robbie McAdam - Analog Devices Inc. - Group VP, Analog Semiconductor

We had a very strong quarter in Q2 in China, in both the local TD-SCDMA thing, and deployment of some of the Chinese company outside. I think it will be this year -- just looking out -- given that we (inaudible) by this stage already, and we -- I would expect it to be in China and Asia on the margin, a change from where we are to date.

Uche Orji - UBS - Analyst

Right. Okay. On the -- just on the comments about consumer, I'm -- you are talking about consumer greens seasonally. In the face of some of the restrictions, we're seeing in terms of consumer spending, how confident are you about this in terms of seasonal growth of consumer, and can you just define what you mean by seasonal growth within consumer? And I understand also with the rebound in base stations that's probably offsetting some of the margin pressure from the growth in consumer, but is there anything specifically happening within consumer to keep any margins higher for example--?

Jerry Fishman - Analog Devices Inc. - President, CEO

Well, first of all as far as the sales in that area, with all of the pressure on the consumer, there -- even this quarter where there was maximum pressure, they bought a lot of TVs and cameras, and audio systems, and, when you look at the growth -- the unit growth rate in that business, it's very, very high. There's always price pressure in that business, so our job, and Robbie and his team there are working very hard to make sure that the costs go down at least as fast as the prices go down. That's the nature of the consumer business, and that's where -- you can't be in that business if you can't accomplish that. So -- I mean, it's always hard to pinpoint that exactly, but typically the third quarter is -- the fourth quarter for us rather, is a seasonally strong consumer quarter, and in the absence of any clear evidence, that's what our customers are telling us, and we are dealing with the larger consumer brands. Robbie, do you got anything else?

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Robbie McAdam - Analog Devices Inc. - Group VP, Analog Semiconductor

Yes, I mean -- we have a lot of history in terms of the preholiday season by -- and -- so, yes, I think in the consumer business that's what we see.

Uche Orji - UBS - Analyst

Right.

Robbie McAdam - Analog Devices Inc. - Group VP, Analog Semiconductor

But it's not as if the margins are that far below the averages, so between that and the other mix with base stations and other things, I guess the margins should be okay.

Uche Orji - UBS - Analyst

Sure. Sure. I got that. Just wanted to be clear if there was any particular change in the mix of your consumer product also that's helping the margins? But I think you -- that does (inaudible). A different question, if I look at some of the commodity price. One of your competitors I think last quarter mentioned the impact coming from gold prices in terms of the back end of the business. Are you facing any pressures from commodity now that it has eased up, is that going to be -- did you face any pressures from commodities in the last quarter, and now that some of them have eased up like gold, is that significant enough to impact your margins right away?

Robbie McAdam - Analog Devices Inc. - Group VP, Analog Semiconductor

Well, I think we certainly face the same commodity price pressures as all of our competitors. The major difference, I think between us and some of our competitors is we were able to keep our prices high, and because of the value that our products bring. So we have more control over the pricing than perhaps some of the other competitors. But certainly, we suffer or face the same head winds on commodity pricing as anybody else would.

Uche Orji - UBS - Analyst

And just finally, please. On inventory, are you now -- are you comfortable with this level of inventory, or are you still wanting to take that down? If you answered this before, I apologize.

Robbie McAdam - Analog Devices Inc. - Group VP, Analog Semiconductor

I think we are in the range of being comfortable. We have always said around 110 days was fine given the mix of business and given the life cycles of the products. When we get up to 130 or 140 we get more concerned. When we get down to 100 or 110 we feel like we're in the right price.

Uche Orji - UBS - Analyst

Thank you very much.

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Mindy Kohl - Analog Devices Inc. - Director, IR

Excuse me, I just want to say that we're approaching the end of our queue, so if any analyst participants would like to ask another question, please press star one on your phone and queue up. Now we'll move on to our next question.

Operator

Next question comes from Craig Hettenbach.

Craig Hettenbach - Goldman Sachs - Analyst

Yes, thank you. Jerry, can you provide any more color on the automotive market given the strength in the quarter and face of the macro conditions? Anything on dollar content you are seeing? And then also just the type of visibility you have within auto would be helpful, thanks.

Jerry Fishman - Analog Devices Inc. - President, CEO

Go ahead, Robbie.

Robbie McAdam - Analog Devices Inc. - Group VP, Analog Semiconductor

Yes. Okay. Our business sale -- it was a good quarter in auto because -- our business is growing in newer applications, mainly in Europe. It is softer in North America, as you would expect. Basically the applications that are (inaudible) are in the safety and sensible air bag sensors and the shaft control centers, and communications in the -- sorry, in car infotainment in the -- our DSPs, and SigmaDSP and audio products and the new infotainment systems, and then some new applications like battery monitoring in cars. So it's basically new applications are driving our growth in the automotive, and we're less exposed to -- other than North America to the overall softening of the automotive market that we see worldwide. And I think we're relatively immune from that until -- at the moment -- but you have to go the next quarter or two, because there are newer applications that are growing.

Jerry Fishman - Analog Devices Inc. - President, CEO

We are mostly riding the wave in cars where the signal processing content is going up at a rate that's probably three or four times the growth rate of the units.

Robbie McAdam - Analog Devices Inc. - Group VP, Analog Semiconductor

Yes. So as long as we continue to put new functions in cars, and new sensors that people who drive cars want, and new types of entertainment that they are interested in, and so on, and new safety features we can offset the unit decline or the unit pressure in car sales. And certainly that's what has been happening over the last couple of quarters. Last quarter was very strong, the quarter before that was very strong for us in automotive. So as long as we can keep providing these new functions and new products that Robbie is talking about, I think the automotive business will continue to do well for us. An example of that is use for converters, RF components and DSP in active radar and (inaudible) systems, a brand new application, very heavy signal processing content.

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Craig Hettenbach - *Goldman Sachs - Analyst*

That's helpful. Then Robbie, if I can just follow-up on the handset power. Can you give us any sense of the breadth of customers or handset models, just for us to shape up the opportunity over the next 12 to 18 months within handset power.

Robbie McAdam - *Analog Devices Inc. - Group VP, Analog Semiconductor*

Yes. As Jerry mentioned the overall power thing, we've got a sign in range across all the -- both the industrial, consumer, communications, but the handset power does by its nature ramp more quickly. So a range of -- like our older handset business, we are dealing with the tier 1 players here, and we have -- several programs at each of the Tier 1 customers that will wrap up a different phase over the next 12, 24 months. 12 months, really.

Craig Hettenbach - *Goldman Sachs - Analyst*

Thank you .

Operator

There are no further questions.

Mindy Kohl - *Analog Devices Inc. - Director, IR*

Okay. Well, with that, I want to thank you for participating in today's call, and we look forward to speaking with you again during our fourth quarter conference call. Thanks very much.

Operator

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

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