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ADI - Q2 2017 Analog Devices Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 stand-alone revenues of $1b and non-GAAP diluted EPS of $1.03. Expects 3Q17 revenues to be $1.37-1.45b and non-GAAP diluted EPS (based on these estimates and excluding any special items) to be $1.07-1.21.

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PRESENTATION

Operator

Good morning, and welcome to the Analog Devices Second Quarter Fiscal Year 2017 Earnings Conference Call, which is being audio webcast via telephone and over the web. I'd like to now introduce your host for today's call, Mr. Ali Husain, Treasurer and Head of Investor Relations. Sir, the floor is yours.

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

All right, good morning, and thanks, Jennifer. Good morning, everybody. Thank you for joining the Analog Devices Second Quarter 2017 Earnings Conference Call.

So let's get through our disclosures. Note the information we're about to discuss, including our objectives and outlook, includes forward-looking statements. Actual results may differ materially from these forward-looking statements as a result of various factors, including those discussed in our earnings release and our most recent 10-Q.

These forward-looking statements reflect our opinion as of the date of this call, and we undertake no obligation to update these forward-looking statements in light of new information or future events.

Our commentary about ADI's second quarter financial results are adjusted for special items. When comparing our second quarter results to our historical performance, special items are also adjusted in the prior quarter and year-over-year results.

Available reconciliations of these non-GAAP measures to their most directly comparable GAAP measures and additional information about our non-GAAP measures are included in today's earnings release and on our web schedules, which we've posted under the quarterly results section at investor.analog.com.

As many of you know, we've completed the Linear Tech acquisition about halfway through our fiscal second quarter. And so we've included reconciliations in our Investor page that provide a greater level of detail into our stand-alone and combined results for the quarter. But at a high level, I'll say that Linear contributed $208 million to our non-GAAP second quarter revenue. This number includes $60 million of purchase accounting adjustments that were made for U.S. GAAP purposes and relate to Linear Tech inventory that was in the distribution channel in North America and Japan when we closed the acquisition.

At the end of the second quarter, there remains an additional $30 million of Linear inventory in the distribution channel, which we expect will be sold in its entirety in the third quarter. We've included this adjustment in our non-GAAP revenue expectations for the third quarter and no such adjustments are anticipated starting in the fourth quarter. And then the last point I'll make, and it's information you should be mindful of, is that the first quarter of our fiscal 2018 will be a 14-week quarter.

Okay. So with all that behind us, about to get the show on the road. I'll turn it over to ADI CEO Vincent Roche. Vince's comments on the second quarter are for stand-alone ADI unless he specifies otherwise. And our business outlook for the third fiscal quarter relates to the combined company.

Okay. Vince, all yours.

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

Thank you very much, Ali. Good morning, everyone.

Well, it's been a very busy period for ADI, and I'm pleased to share our results with you. Not only were our second quarter financial results stellar, but we completed the acquisition of Linear Tech in March, and our integration work is going very well.

So let's start with our financial results for the second quarter. ADI's stand-alone revenue came in at $1 billion, a 2% sequential increase and a 28% increase over the prior year. These results were above our revised guidance on broad-based strength, and we continue to see signs of a good business environment, particularly in the industrial market.

Gross margins expanded to 67.6%, which was above the high end of our guidance and the combination of higher sales, higher gross margins and tight control over operating expenses helped expand operating margins to a robust 36% of sales.

In addition free cash flow margins, as a combined company, were also strong at 39% of revenue in the second quarter. As Ali mentioned, Linear Tech was part of ADI for about half the quarter and contributed $208 million in sales on a non-GAAP basis. And we are looking forward to a full quarter's contribution in our third quarter.

Now let me give you some details of our performance by end market during the quarter. Note that my remarks relate only to stand-alone ADI. The industrial market at 46% of sales grew 15% sequentially in the seasonally strong second quarter and continued its year-over-year growth trajectory, increasing 20% over the prior year. Sequential revenue growth was broad-based across all industrial sectors and indeed regions.

While business conditions are certainly more positive than they were at this point last year, our success is also the result of smart R&D investments across diverse industrial applications within factory automation, instrumentation, aerospace and defense, and health care.

Over several decades, ADI has carved out a leadership position in high performance signal processing, serving our tens of thousands of industrial customers where applications demand the highest levels of performance both in terms of signal chain and in terms of power optimization.

In the near term, our industrial customers are excited to gain access to the highly complementary portfolios of ADI and Linear Tech and are even more excited at the future value-creation opportunities made possible by our combination. The automotive market represented 15% of our sales in the second quarter and grew 8% sequentially and 9% over the prior year. Both sequential and year-over-year growth was broad-based across all automotive application areas and was strongest in safety and ADAS applications, while powertrain revenue increased but at a slower pace. We supply thousands of products into dozens of automotive subapplications and are gaining more dollar content as we further automate and electrify.

The combination with LT dramatically strengthens our technology offerings in this market and expands additional dollar content opportunities across our very complementary customer base.

The communications infrastructure market, at 18% of sales, grew 5% sequentially and 4% over the prior year. Sequential revenue growth in this market was led by wireless infrastructure applications where we're making very good progress with our RF and microwave and high-speed signal processing and integrated transceiver solutions.

While we are, of course, only in the very early stages of 5G cellular infrastructure deployment, we believe that our optimized radio signal processing and power management solutions will be a very key driver of growth as channel counts increase and customers move to phased array antennas to make the most efficient use of available spectrum with the highest reliability and performance.

Of course, the wireless infrastructure market is one where Linear largely didn't play, and thus, this market represents an opportunity to drive revenue synergies in the medium term.

On a year-over-year basis, communications infrastructure growth was led by the wireline sector where ADI's customers are benefiting from our precision clocking, timing and control technologies in 100 gig and beyond optical networking applications.

And finally, consumer market revenues at 21% of sales decreased 24% sequentially as prosumer applications revenue increased and portable applications revenue came in better than planned. Compared to the prior year, both prosumer and portable applications revenue increased.

So while our combined financial results were excellent, our near and long-term outlooks are equally bright. During the quarter, we completed the acquisition of Linear Tech, creating the high-performance analog market leader.

As we said from the beginning, we're taking a best-of-both approach, combining the best from ADI and LTC to come up with a new operating system to drive long-term profitable growth for our combined company, and I'm very pleased with the progress we've already made. We're optimizing processes across our selling, new product development, manufacturing and operations activities.

On the sales side, the integration of our 2 sales forces has brought with it a tremendous degree of excitement, and we've already identified many sales synergy opportunities. On the engineering side, our teams have come together at remarkable speed and have begun identifying product road map combinations that we expect, over the long term, will accelerate our growth. On the manufacturing side, our teams have been focused on ensuring that we meet the upside demand and continue to deliver the highest quality products to our customers.

Overall our $150 million cost synergy target within 18 months of the acquisition is firmly on track. To give you some background, during the integration planning phase, the vast majority of actions needed to realize the synergy target were identified. And while many of the related actions have already been taken, we're only in the early stages of seeing the benefits of those synergies in our P&L.

In addition, we expect non-GAAP EPS accretion in our first full quarter as a combined company to be 15%, and we expect earnings accretion to accelerate into fiscal 2018 as we begin to more fully realize the synergies from the transaction.

So with that, I'd like to turn the call over to Ali for details of our financial performance in the second quarter.

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

Great. Thanks, Vince. Good morning, everybody.

Since the acquisition of Linear Tech occurred about halfway through our second quarter, Linear Tech's contributions to ADI's results were limited to approximately 7 weeks, and my prepared remarks will exclude Linear's results and other special items unless I specify otherwise. Note that a schedule reconciling our stand-alone and combined performance can be found on our Investor page at investor.analog.com and a reconciliation of our combined GAAP performance to our combined non-GAAP performance can be found in schedules E and F of today's earnings release.

So revenue in the second quarter increased to $1 billion, growing 2% sequentially and 28% over the prior year and was above our revised guidance. Sequential revenue growth was led by our B2B markets of industrial, automotive and communications infrastructure, which, in the aggregate, grew 11% sequentially and, importantly, 14% over the prior year. Gross margins in the second quarter were 67.6%, up 150 basis points from the 66.1% we achieved in the prior quarter, primarily the result of higher utilization rates.

Days of inventory increased 3 days to 104 days and dollars of inventory increased $12 million sequentially as we increased production to match strong demand. Deferred revenue for shipments into distribution increased 6% sequentially and weeks of inventory in distribution were at 7 weeks, which was consistent with the prior quarter.

Operating expense of $318 million increased 4% sequentially due to the natural lift from higher activity in the second quarter as compared to the first and higher variable compensation in the second quarter as our bonus program responded to better year-over-year revenue growth and operating profit in the quarter. As a result, operating margins of 36% of sales expanded 500 basis points compared to the prior year on strong revenue growth, higher gross margins and prudent expense management by the team.

So now for P&L line items below the operating margin line, I'll talk to results on a combined company basis, excluding special items, outlined in today's release. Other expense in the second quarter was $59 million, the result of a partial quarter with the financing related to the Linear Tech acquisition in place. We expect our net interest expense to be approximately $70 million in the third quarter and approximately $60 million per quarter thereafter.

Our second quarter non-GAAP tax rate was approximately 10%, and that's the rate we expect for the remaining 2 quarters of the year. We are also planning for a non-GAAP tax rate in 2018 to be approximately 15%, so note that'll be higher than the 10% rate this year.

Our diluted share count increased in the quarter due to the equity consideration related to the acquisition. Since this is a weighted average calculation, the diluted share count in 2Q increased to 346 million shares, and we expect diluted share count in the third quarter, which will be our first full quarter as a combined company, to be approximately 375 million shares. Excluding special items, diluted earnings per share in the second quarter of 2017 was $1.03.

The second quarter was also a very strong free cash flow quarter. As a combined company, we generated $475 million in free cash flow in the second quarter. And for the reported trailing 12 months, the combined company has generated $1.9 billion of free cash flow, which translates to free cash flow margins of 37%.

Now this level of free cash flow generation is noteworthy for several reasons. First, it reflects the strength of our business model and our brand. Second, it means that our EBITDA generation was also very strong. And this means that we're better positioned from a leverage ratio standpoint at the current time than we had communicated to you earlier. So as a result, our net debt-to-EBITDA ratio based on reported combined company results is, in fact, approximately 3x, which is significantly lower than the 3.8x net debt to EBITDA number that we'd estimated when we announced the deal.

So moving to capital additions, which in the second quarter were $47 million for the combined company and are planned to be in the range of $200 million to $220 million for the year here in 2017. During the quarter, we also paid $139 million in dividends, and earlier this week, our Board of Directors declared a quarterly cash dividend of $0.45 per outstanding share of common stock payable on June 20 to shareholders of record at the close of business on June 9. And that represents an annual dividend payment to shareholders of $1.80 per share.

Okay. So with that, I'll turn it back over to Vince for our outlook for the third quarter of 2017, which again is on a combined company basis and excludes special items outlined in today's release.

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

Thanks, Ali. After a strong second quarter performance, we're planning for a continued sequential and year-over-year revenue growth in the third quarter and for revenue to be in the range of $1.37 billion to $1.45 billion. By end market, we're planning for continued sequential revenue growth in industrial and for the communications end market to remain stable to the prior quarter.

In automotive, we anticipate that seasonal trends will prevail, which would suggest a mid-single digit sequential decline in the third quarter. In the consumer market, we're planning for modest sequential revenue growth in the third quarter.

We expect gross margins to be between 69% and 70% as we keep utilization levels stable to their second quarter rates and benefit from higher industrial revenue mix. We estimate that operating expenses will be between $430 million and $440 million. Notably this translates into an operating margin range of 38% to 40% in the third quarter. Based on these estimates and excluding special items, diluted earnings per share are planned to be in the range of $1.07 to $1.21.

While we continue to see good business conditions, we're always pragmatic and cautious in how we manage our business and in how we convert our precious resources into free cash flow. On this point, with the combination complete, ADI's free cash flow margin now ranks within the top 5% of the S&P 500.

At our Investor Day on June 20, we'll outline our plan to drive the long-term profitable growth for ADI, leveraging the customer value-creation capabilities of our innovation and business diversity and our focus on best-in-class operational efficiencies to continue to drive our free cash flow to even higher levels.

So with that, we're ready now to take your questions.

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

All right. Thanks, Vince. So before we get to the Q&A session, just a couple of quick housekeeping items for me. So note that we'll be hosting an Investor Day on June 20. It's accessible via live webcast. I invite you all to tune in on June 20 to hear more about our long-term strategy and the new financial model for the company.

And so let's get to the Q&A session. (Operator Instructions). So operator, can we have our first question, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Ambrish Srivastava with BMO.

Ambrish Srivastava - *BMO Capital Markets Equity Research - MD of Semiconductor Research and Senior Research Analyst*

I had a medium-term question, Ali, and maybe you could answer that. And then I had a longer-term follow-up for Vince. So for the medium term, could you please help us frame the consumer business, how -- and when I say medium term, I'm thinking how should we be thinking about this over the next 6 to 18 months? And then I had a follow-up for Vince.

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

Okay. Sure, thanks, Ambrish. Look, I guess, what I would tell you is our strategy in consumer is no different than our strategy in any of our markets. We focus on very tough problems that our customers have. We work to solve those for them. We try and create as much value as possible for our customers. And in turn, that tends to generate a lot of free cash flow for ADI. I'd say the only difference in consumer, relative to our other markets, is that the product life cycles tend to be a little bit shorter. But apart from that, I'd say the strategy at ADI is very, very consistent across all of our markets. Now you've seen that strategy play out over the last couple years. We've grown our consumer business nicely. It's generated a lot of free cash flow for the company. We've diversified our position in consumer both at our large customer. We've diversified our position across many other customers and into new vectors of growth that we think will drive consumer free cash flow and revenue growth over the long term. All that being said, you know as well as I do that the consumer market tends to have shorter life cycles. And so as a result, you can have periods of time where you've got some older designs that are rolling off and there's a bit of a pause between that happening and newer designs rolling on. My sense is that we're likely in one of those periods at the current time. I expect as a result, our mix of B2B markets to expand as a percentage of our revenue as we get into the back half of 2017. And I'd expect that to continue into 2018 as well. I guess the only other point I would make is, just to provide a little bit more context, Ambrish, is the -- each -- we manage a very complex mix of portfolios and businesses at ADI. Each one of them have different life cycles. Each one of them have different revenue growth profiles. Each one of them have different profitability profiles. But what I would tell you is as long as ADI is focusing on very tough problems to solve for customers, and we can drive a lot of free cash flow and, frankly, if we're meeting our hurdle rates, and we can drive really good long-term profitable growth and free cash flow, we'll play. Because ultimately that's the measure. Vince mentioned it in the prepared remarks, we're now a top 5% S&P 500 free cash flow generator. And our goal is to drive that even higher from here.

Operator

Our next question comes from C.J. Muse with Evercore.

Christopher James Muse - *Evercore ISI, Research Division - Senior MD, Senior Equity Research Analyst and Fundamental Research Analyst*

First clarification, in terms of the revenue guide, was that combined or did that exclude old Linear? And then, I guess, as my main question, just a follow-up on Ambrish's question around consumer. Is that a business looking into calendar '17 and '18 that can grow given that you have brought on diversification increase to customer? Or is that something that we should be thinking about declining over the next 1, 2 years?

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

Okay. So I think that was your first question and a follow-up. So I think on the revenue side, we provided combined company guidance for both companies. And the range is $1.37 billion to $1.45 billion. That would imply a midpoint of $1.41 billion. And I guess, if you were just to think about how that flows by end markets, C.J., we expect -- the industrial market again had a very good second quarter. We expect that strength to continue into the third quarter. As a result, we're expecting industrial to grow somewhere in the low to mid-single digits sequentially in the third quarter, which again would be better than seasonal. Automotive, we're expecting a pretty seasonal quarter. So as a result, that would decline kind of in the mid-single digits sequentially. Communications is implied to be relatively stable. And on the consumer side, we are expecting modest sequential growth relative to the second quarter. And Vince, did you want to take the question about consumer implied growth in 2017 and 2018?

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

Yes, I think, as Ali said, we experienced fundamentally shorter life cycles in the consumer market. And we've been working very, very hard over the last couple of years to diversify our product base and our customer base and the application base within consumer, and we're making good progress at that. I think as we look into the third quarter, as Ali said, we're seeing modest sequential revenue growth but nonetheless below what we would consider to be seasonal norms. So we're probably in a slower growth environment in the consumer business for the near term here.

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

And I'd say, C.J., if I could just add 2 points. One is we do expect as a result, our B2B markets to expand as a percentage of total revenue. And I think as you look into 2018, the accretion from the Linear Tech deal is very strong here in the third quarter, about 15%. And given some of the synergies that we've talked about, we expect that EPS accretion to accelerate into 2018, and I think that would be a very strong result.

Operator

Our next question is from Harlan Sur with JPMorgan.

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

Given the stronger industrial demand pull and outlook for continued growth, just wondering if you guys are seeing any component tightness or lead time stretching out? I know a few of your peers have highlighted some tightness. I'm just -- it sounds like you guys still have more room to grow on utilizations but wanted to get your views on the supply side situation.

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

Yes, on the supply side -- no, thanks. Good question, Harlan, one that we obviously think about a lot as well. But I would tell you, our -- we're delivering the vast majority of our products within our stated lead times of 4 to 6 weeks. That frankly hasn't changed all that much over the last several quarters. I guess, what I would tell you is, at ADI, we're very focused on providing the highest levels of customer service and support, and part of that service and support model is to deliver products when we tell our customers that we're going to deliver them. And so we tend to keep our lead times pretty short, 4 to 6 weeks delivering the vast majority of our products within those stated lead times. And I guess I would also tell you that we are carrying 3.5 months worth of inventory in our balance sheet, which I think is a fair amount of inventory to help supply our customers with the products. The only one other point I perhaps make on this front is that if you recall back in 2016, we did bring our utilization rates down pretty hard. And the reason we did that is we wanted to manage our DSI, or days of inventory, down. And we managed the impact on gross margins by making permanent improvements in our cost structure. And I think as you now look out to 2017 and 2018, I think what investors should expect from ADI is a nice benefit on the drop-throughs. Because as we're building the inventory, the drop-throughs are certainly better. But I guess, just coming back to your earlier point on the lead times, vast majority delivered within 4 to 6 weeks, and we're keeping up high levels of service to our customers. Did you have a follow-up?

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

No, I'm good.

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

Okay.

Operator

Our next question is from Craig Hettenbach with Morgan Stanley.

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

Question for Vince. I just want to follow up on your comments around automotive with Linear Tech. And more specifically, can you talk about how expansive your opportunity set is? If there's any examples of things that you think they will help you expand the content within automotive?

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

Yes. So automotive for us is a story of continuing content gain here for both LTC and for ADI. So we see it as a key growth market for the combined companies. So I think we've talked before about ADI having great strength in emerging applications like, for example, 77 gigahertz radar -- LIDAR, infotainment with our A2B technology, for example, bringing new technologies into the powertrain, such as the rotational and linear sensing magnetic devices and, as the powertrain electrifies, being able to get our battery management technologies in there as well. So I think both LTC and ADI have a lot of complementary capability, for example, to the ADI signal chains that I've just talked about here, we're adding LTC power management capability. And the outcome of that is we can architect an optimized solution for each of the subapplications here for the automotive customers. And the -- there's great complementarity between the signal chain and the power chain. So I think that's looking very, very good. And also, there's a lot of new power management things that we're looking at independent of signal chains that LT will be instrumental in helping us nail down over the coming few years. So as I said, there's a tremendous amount of benefit in coupling power management with the signal chain. And every single application in which we play within the transportation automotive sector requires both signal chain and power management. So -- and what I'm seeing so far is a tremendous level of collaboration between the applications teams, the design teams in really grabbing the opportunities here with both hands.

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

Great. Thanks, Craig, did you have a follow-up?

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

Yes, I guess, just a brief one, just on the integration. Good to hear that it's on track and kind of good start out of the gate. Just any comments in terms of culture, key people and any kind of milestones we should be aware of?

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

Well, we've known that LT is a very, very high-quality company. And I've been obviously hands-on involved in the integration of the 2 companies. I'm very, very impressed by the quality of the people throughout LT, and I'm also very impressed with just how fast both companies are coming together to create something better than the sum of the parts. So right now, we're laser-focused on leveraging the combined strengths of both companies to generate this long-term profitable growth possibility that we know is there. And we are taking our time to really figure out -- and we're being been very, very patient at figuring out how to combine the leadership -- we've combined the leadership teams, but we're being very patient in trying to figure out what the best of both really means here. So I think to answer your question very directly here, Craig, we're culturally I think in good shape. Our values, as I've talked about many times before, the values around technology and business and customer are very, very similar. And in creating this best of both, we're actually leveraging the differences in the way the operating routines of both companies -- to draw from, to create something greater than the sum of the parts. So we're focused, as I said, on delighting our customers, ensuring that we're capturing the upside demand here. And I think overall, the -- once the values are compatible, as I said, I'm using the cultural differences to create something greater than the sum of the parts. And the LT leadership is playing a key role. I've got 2 members of the senior LTC staff on my staff. And the LT leaders are contributing to this new company multiple levels down at this point in time.

Operator

And our next question is from Ambrish Srivastava with BMO.

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

You're back. Good.

Ambrish Srivastava - *BMO Capital Markets Equity Research - MD of Semiconductor Research and Senior Research Analyst*

I had my follow-up keyed up. For some reason, I got dropped off. I wanted to get back to the capital allocation and the free cash flow. It seems like the free cash flow generating ability might be higher than at least what our models were suggesting. So could you please remind us just in terms of capital allocation and the timing for the paydown? Obviously, the leverage ratio was lower than what you had communicated and what it was at the deal close. So any light on that would be very helpful.

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

Okay, fair enough. I'll leave the key takeaway for next month when we present to you at the Analyst Day because I think we want to save a little bit of dry powder for that. But what I would tell you is, since we announced the acquisition, there's a couple of things. One is, we set out this target of 3.8x net debt to EBITDA. And in typical ADI fashion, we put out targets, and we execute extremely aggressively against those targets. And part of just coming out at a lower leverage ratio is just a function of the mindset at ADIs. We execute extremely aggressively against the targets that we lay out. Part of it is, look, business conditions have been better, and as a result, we've generated more cash flow. And part of it frankly is just having a laser focus on operational efficiencies. And so that's driven a lot of good cash flow as well. The good news, I guess, from a leverage perspective as we've talked about is we're certainly well ahead of schedule in terms of the deleveraging plan. The bogey we're shooting for is 2x net debt-to-EBITDA, and I'd say we're probably ahead of schedule in trying to hit that number. Once we get to that number, I think we've been pretty public in terms of saying, look, we're going to turn the share buyback program back on. In the meanwhile, the dividend remains a cornerstone of our capital allocation strategy. And then the only other last point I'd make is -- and again this kind of supports the notion that we're ahead of schedule is, after the quarter ended, we did pay $200 million down on the $5 billion term loan balance. So I think we're certainly ahead of schedule and in very good shape on that front.

Operator

Your next question is from Tore Svanberg with Stifel.

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

So the industrial market is growing very strongly. I believe you mentioned 20% year-over-year. How much of that is the market coming back versus perhaps more electronic content or even some share gains?

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

Yes, thanks, Tore. I think it's true to say that, first off, we're recovering from a relatively weak environment in the prior year. So the compare is kind of easy from that perspective. From everything that we can tell right now, the growth is broad-based across all the industrial sectors and, in fact, across all the geographies as well. And I think that's just a function of the better business environment versus last year overall. And if you -- just paying attention to our own customers as well, they're all guiding for low to high single-digit growth in 2017. As a company, several years ago, we made a strategic pivot in terms of where we placed our R&D, putting more into B2B applications. And industrial has been a great beneficiary of that. So I think just given the cycles in the industrial sector, in general, we're beginning to see some of those products really contribute in a meaningful way across factory and process automation, aerospace and defense, the instrumentation ATE business. And so I think the business environment is overall better, but we're also doing better in terms of grabbing share through the effects of our new product investments over the last several years.

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

Did you have a follow-up?

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

Yes. Vince, you also mentioned earlier that you plan to leverage Linear Technology into the wireless infrastructure market. I was just hoping you could elaborate just a little bit more on that because, certainly, that's a market that's been weaker the last few years. But assume with 5G coming on, your plan is to leverage both entities to participate in that market.

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

Yes. Thanks, Tore. Well, we're-- as ADI organic, we've been doing better and better in terms of building solutions for our customers from antenna right down to bits, leveraging the strength of ADI and Hittite combined. And we know that as customers put greater and greater pressure on for more integration, to be able to solve the noise problems more effectively in these radio systems, that power management is going to be a great help to us. And already, I think in the shorter term, we're being actively engaged in discussions to use existing products with ADI solutions, for example, in the transceiver space, in 5G systems, leveraging LT's power technology. And that's only the beginning because, over the coming generations, when we can start to architect the radio solutions now with the new advances in power management technology that LT has been making, I think we can have several generations here of success in both the wired and the wireless business in the years ahead. And there's no doubt there's tremendous symbiosis between the signal chain technologies that ADI has been so strong in over the years with the power technologies that LT now brings to the table. So the conversations with our customers are very active and -- with existing products, and we're now plotting the next new architectures based on the combination of the 2 companies.

Operator

Your next question is from William Stein with SunTrust.

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

I'm hoping you can expand on something you touched on earlier, the cultural differences, however, maybe they're not as great as some people perceive. But I think one of them is that Linear was known for having an intense focus on gross profit margin and perhaps that limited that business' revenue growth, and I think ADI has a more growthy sort of outlook. So I'm wondering if you can sort of highlight any initial opportunities to expand the growth rate on the Linear business.

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

Yes, it's a good question. It's true that both companies have had very, very strong focus on gross margin. I think it's a great kind of proxy for the quality of the innovation that you're developing, the price you can command and, ultimately, the gross margins that you can get. So what I will say is that ADI has probably just -- given our buying power and our operational focus, we have combined now with LT, we've got more buying power. So we can be more flexible in terms of taking some market share with products already available without sacrificing the margins, just given the signings of the so-called bill of materials that we're now sourcing across both companies. So we don't intend to drop our standards, but we do intend to be aggressive in terms of leveraging all the available products and technologies that we have to grow our business profitably. I think that's the way to think about it.

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

And did you have a follow-up, Will?

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

I did. One of the issues with the integration that's always important in any of these transactions is ERP, and by the disclosure around end markets that sort of lumps the Linear Tech revenue in its own category, maybe a sign that perhaps that's going to take a bit of time to reflect their revenue across your end markets. Any guidance or commentary as to when we should see that disclosed sort of on a combined basis? And just, in general, the update on that aspect of the integration?

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

Yes, fair enough. I can take part of that. Look, from an ERP's perspective, and frankly from an integration perspective, we're generally keeping Linear Tech on a stand-alone basis for the first year. And then we'll converge. With regards specifically to the end market question, we actually have the data. I just didn't feel like it was that meaningful for a stub quarter, and I can certainly talk to it right now on the call. But you should expect from ADI next quarter that we have all of the disclosures by end market mapped out, and that's absolutely no issue to do. What I would tell you in the quarter, had Linear been part of ADI for a full quarter, they would have seen their industrial business grow, and they would have seen their automotive business decrease sequentially given their exposure to the powertrain market, specifically in transportation in China, which has been a weaker market. But the good news there, I'd say well is that, that market is actually pretty stable right now and that gives us a fair amount of confidence guiding into the third quarter that automotive will be pretty seasonal.

Operator

Your next question comes from Chris Danely with Citigroup.

Christopher Brett Danely - *Citigroup Inc, Research Division - MD*

Now that Linear is kind of lumped into the mix, how -- if you could, frame the October quarter for the combined company just in terms of where combined OpEx could go? Could it go down again? And then also what should we expect for seasonality for revenue for the combined company for the October quarter?

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

Yes, okay, so let me try and parse that out a little bit, and maybe Vince can help me as well. But look, from a -- Chris, we have absolutely no visibility into the fourth quarter, the October quarter at this stage. So in the absence of any orders, all I can rely on is what seasonal trends tend to do, and seasonally speaking, industrial tends to be a little weaker in the fourth quarter. Automotive generally increases. Communications is always a wildcard, just frankly, depending on how the builds and the deployments are going. And then consumer generally has a pretty good growth quarter sequentially because you start to see more of the builds taking place. So that's all I can tell you today with absolutely 0 visibility into the fourth quarter. What I would tell you on the OpEx side, and actually, it's a fair point, is on a stand-alone basis this quarter, ADI had OpEx of $318 million. Linear Tech contributed $62 million in the quarter. I guess, I'd caution you on that number. One is, obviously it's a stub period, and so it's a partial quarter. And number two, there were public company costs that did come out of that number, which we've always talked about public company costs being somewhere in the range of $15 million to $20 million annually. And so the quarterly run rate that we've guided to for operating expenses in the third quarter of $430 million to $440 million already includes those synergies embedded. Now to your other point, there are more synergies on the come. We'll start to see some of them. It'll be very back-end loaded, though, Chris, in the third quarter, but you'll start to see more of them play out in the fourth quarter. And I'd expect them to be then pretty linear back into the fourth quarter of 2018. If you recall, we've always talked about $100 million of OpEx synergies and achieving that run rate by the fourth quarter of 2018. I guess, what I'm saying is $20 million of that is now baked into the third quarter run rate number, and there's still another $80 million to come, again on an annualized number, as we go into the fourth quarter of 2018.

Christopher Brett Danely - *Citigroup Inc, Research Division - MD*

Great. Do I get a follow-up?

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

Of course.

Christopher Brett Danely - *Citigroup Inc, Research Division - MD*

Any update on the CFO -- new CFO?

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

Well, let me tell you, Chris, we've -- obviously, we've retained the search firm. And what I can tell you is that we're making excellent progress right now. My expectation is that we'll have a replacement named by the end of the fiscal year at the latest. But I'm quite optimistic that we'll be able to announce something quite well before then. So in the interim, I'm taking a very hands-on approach with the integration of LT. And I'm also relying -- we've a terrific bench of people at ADI across all the facets of the management of the finance function of ADI. So we can -- we're very, very well positioned to ensure that we hit our targets in terms of the ongoing operation as well as the synergies. So synergies are on track, and we'll update you on where we are at the Investor Day in the latter part of June here.

Operator

Your next question is from Amit Daryanani with RBC Capital Markets.

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

I guess, just a question on the Linear side. You've had this under your belt for a few months now. So I'm curious when it comes to revenue synergies, where are you guys more focused on to drive revenue synergies because I would imagine consumer might be the easiest place to get it or the quickest place to get it but perhaps not the most ideal one for you. So how do you think about the end markets and revenue synergies as you go forward?

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

Yes, well, I think as we've talked about earlier on, the various markets all have different cycles in terms of uptake, design cycles and adoption cycles. But I think obviously every sector in which we play, including consumer, has an opportunity for ADI to draw Linear Technology power management for additional revenue opportunity and growth. I would say in the -- it's the medium term to see the effect anyway of leveraging existing products and getting any meaningful revenue growth from those products, it's probably a 2- to 3-year proposition as we've experienced as well with Hittite. But I think the areas that we will see meaningful growth in the medium term here will be automotive, for sure. I think the communications sector will see a good uptick in the medium term. Very judiciously, as well, we're looking at some consumer opportunities. So obviously, those hit probably sooner than any other sector of the portfolio we manage. And I think industrial is 3 years plus from here. So I think that's the way to think about the adoption of existing products and new sockets and the effect that we should see on revenue growth here.

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

Did you have a follow-up?

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

Got it. I do, sir. I guess your consumer guide for July, modest sequential growth. I think last couple years, it's been triple digit-ish kind of number in the July quarter. The delta, do you think it's due later product launch in that segment or a change in the content that you guys have or maybe the OEMs will have more comfort around your ability to ram these products, so they're asking you to do it a little bit later? But it seems to be a fairly big delta versus what you've seen the last [2] years at least. Perhaps help explain what's driving that?

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

So I guess, I'll take that. I think we answered the question earlier in the call. I think this is definitely something that is, I'd say, more related to ADI. And we just have our content in various products are very much SKU dependent, and we just think we'll have a different kind of a mix this year relative to previous years. But I'd say as we progress into 2018, my expectation is that our B2B mix -- our B2B markets expand as a percentage of total revenue as a result.

Operator

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

Craig Andrew Ellis - *B. Riley & Co., LLC, Research Division - Senior MD and Director of Research*

Congratulations on your execution as you get started in the new era with Linear Tech. My question is regarding the synergies for the combined company. It's clear, Vincent, that the company's quite happy with the way the early combined work is going. The question is, does the progress on synergies thus far cause you to think differently about the linearity with which you expect to realize the $150 million in cost gains from the 2 companies?

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

No. I think when we've talked about synergies, we've been very clear that we've acquired LT for all its capabilities in terms of technology and customer management, channel management, operations and so on, to drive revenue synergy over the long term. But -- no, I think as I said in the prepared remarks, I'm very pleased with the progress that we're making. We've -- we had actually executed a lot of the decisions on the $150 million of synergies in advance of combining the companies. And the synergies are well identified and the actions are in place to get the synergies executed. So my sense is it'll take us, during the coming year, to really see the effects of the synergies in our P&L from a cost perspective. And a little bit longer than that, I think, as I've just been talking about to get the synergies from the cross-selling opportunities.

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

Great, Craig. Another follow-up?

Craig Andrew Ellis - *B. Riley & Co., LLC, Research Division - Senior MD and Director of Research*

Yes, thanks for that, Ali. And I'll follow-up on end market communications. Vincent, I think you've mentioned 5G a couple times. And it seems like relative to 4G, the bigger picture is that, that seems to be more on track or maybe pulling in a little bit earlier versus what we had seen with some of the prior interface changes. But with regard to that opportunity, when would ADI expect 5G-related infrastructure revenues to start to become a material part of its communications segment?

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

Yes, I think your point is well taken. I think originally, when we began talking about 5G, we were talking about it being a facet of our business in kind of 2020-plus. It now seems that we're obviously in trials right now with 5G, all the major application areas, all the major customers globally. So my own sense is that we'll begin to see, I think, a meaningful ramp in revenue in the 2019 kind of area. Maybe it's a little sooner. Maybe it's a little later, but that's my sense at this point in time that there's an aggressive pull-in at the carrier level as well as the OEMs to make faster progress in deploying 5G.

Operator

Your next question is from Tristan Gerra with Baird.

Tristan Gerra - *Robert W. Baird & Co. Incorporated, Research Division - MD and Senior Research Analyst*

You had mentioned that you recently that you've seen the small cell business finally picking up. What's your market share in that business, which I'm assuming has been fairly small, and what type of growth are we looking? And what type of revenue contribution could we get, let's say, in the next 12 to 18 months?

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

Tristan, let me try and take a crack at that. I'm sure Vince would be much more eloquent than I could ever be. But in any event, I'd say on the small cell side, it's been a relatively small contributor to our growth. I guess, what we're particularly proud of are our integrated transceiver solutions that are picking up content both on macro base stations and in small cell base stations. So to be perfectly candid with you, we are pretty agnostic as to where these platforms end up. What is really important for ADI is the channel count. And so as long as you got more and more things that are connecting up, we tend to do extremely well when that happens. And so that could be a small cell. That could be a macro base station. But we're doing extremely well in the marketplace. We had another record quarter on top of a record quarter in the prior quarter in our integrated transceiver solutions that are just sucking up a lot of bill of materials and allowing us to gain share in this market. So interestingly, you saw our results this quarter. And again, it speaks to the diversity of our communications infrastructure market and our business. But our sequential revenue growth was led by wireless infrastructure, and our year-over-year growth was led by wireline infrastructure. So you can see the diversity there. The other point I'd make is with the addition of Linear Tech, our communications infrastructure business is more diversified than ever. In the past, about 2/3 of our calls business was wireless. At the current time, it's more like 50-50. So I think we have the full suite of technology, and we're pretty agnostic as to form factor. We've got the products, and I think really it's a question of, as the market percolates, we're going to do extremely well.

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

Yes, I think just to add a little bit of color to what Ali has said, small cell is still a small activity from a market perspective. We're very, very well positioned. And I think it will start to accelerate somewhat during the course of the next 12 to 18 months and become a more meaningful part of the overall wireless story in communications infrastructure.

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

See you answered it better than I would. Tristan, do you have a follow-up?

Tristan Gerra - *Robert W. Baird & Co. Incorporated, Research Division - MD and Senior Research Analyst*

Yes, if I could. And thanks for the very useful answer. It looks like your Hittite business has grown fairly significantly since the close. Could you provide some color on what's been driving that growth? Has it been share gain, new products or just distribution synergies? And the question really relates to how should we look at Linear Tech in terms of the experience that you've gained with Hittite and the revenue growth achievement that you've done with Hittite?

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

Okay. Let me try and unpack. There were a couple of key questions there. I think, with Hittite, we knew that the technology was very, very strong. And ADI -- one of the big synergies we got from acquiring Hittite was just the channel reach -- the customer reach and the channel reach that ADI had that Hittite didn't have, so we've been able to leverage that to tremendous effect. We knew that the portfolio of products was very, very strong, so that's been a huge help to us. Obviously, we've been able to architect. We've been together now almost 3 years, and we've been able to architect some really new creative solutions in areas like aerospace and defense, phased array antenna, for example, these days, these new radar systems that are being deployed as radar systems digitize across the globe. Even in instrumentation, where a lot of the high-frequency systems require the combination of mix signal and microwave technology. Obviously, in the automotive sector where all these microwave technologies are being deployed, having the combination of ADI and Hittite there has been really, really powerful. So I think it's -- it was a case of a lot of products that needed a new channel and a lot of re-architecting of customer systems based upon ADI's signal processing mix signal strength and Hittite's Microwave strength. So what was the second part of that question?

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

How would you leverage that to Linear?

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

So, leverage to Linear. I think the approach we have on the best of both was also true with Hittite. We tried to figure out how to be patient, understand the world-class capabilities that Hittite had in terms of people and technology. And we've taken the very same approach with LTC. LTC is obviously a world-class company as well. So just being patient, listening to create something greater than the sum of the parts, build a whole new operating system across the company for speed and simplification. That's what we did with Hittite, and that's what we're doing with LTC times 5.

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

Thanks for the question. And we're zooming into the 11:00 hour here, so we're going to do our best to get to everybody. In case we can't, feel free to call our Investor Relations phone at (781) 461-3282. So we'll continue until 11.

Operator

Your next question comes from Stacy Rasgon with Bernstein Research.

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

You talked a bit about the trajectory of synergies on OpEx. But what about on the $50 million in COGS? Can you give us a feeling for how much of that, if any, is embedded in the Q3 guidance? Where might we see that by the end of the year? And should we expect a different trajectory of capturing those gross margin synergies versus what you're suggesting we should think about for the OpEx side?

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

Yes, I'd say on the gross margin side, we're very early in the process. I'd say those are all very much on the come. I wouldn't expect to see those in Q3 or Q4 this year. Did you have a follow-up?

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

I did. On the OpEx or just on the cost synergies, in general, so it doesn't sound like you're quite ready to take the target up. But can you give us a feeling given how far you are in the planning phase and which areas have proved may be easier than you might have thought initially as well as more difficult? And if we were looking for potential upside, where do you think it might be easiest to squeeze more in?

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

Well, clearly we've been able to reduce the public company cost of the combined company. That's one of the things that's been executed pretty much straightaway. I think we had talked before as well about an early retirement program that we had put in place at ADI, and we begin to see the benefits of that fettering in over the next couple of quarters. But the -- and obviously distribution channel optimization as well that we had talked about before, that will start to show benefits to us I think towards the back end of this year and the early part of the coming year. So they're just 3 or 4 examples of the things that we've already got in play that we'll start to see the benefit of. And all the other synergies are identified. And we've got the actions in place, and we're now just ready to realize them.

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

And Stacy, I would just add, we've talked about it before, but the EPS accretion in the third quarter is expected to be 15%. And I think if you start baking in some of these synergies into 2018, I think you get a number well north of that. So we look forward to updating you on the model and any potential updates on the synergy target next month at the analyst meeting. All right, I think we just hit the 11:00 hour. So listen, thank you, everybody, for joining us this morning. A copy of this transcript will be available on our website and all available reconciliations and additional information can also be found on the quarterly results section of our Investor Relations site at investor.analog.com. So thank you again for joining us this morning. We look forward to talking to you -- many of you next month. Take care.

Operator

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