FINAL TRANSCRIPT

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ADI - Q1 2011 Analog Devices Inc. Earnings Conference Call

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CORPORATE PARTICIPANTS

Mindy Kohl
Analog Devices Inc. - Director of IR

Jerry Fishman
Analog Devices Inc. - President and CEO

Dave Zinsner
Analog Devices Inc. - VP of Finance and CFO

CONFERENCE CALL PARTICIPANTS

Uche Orji
UBS - Analyst

David Wong
Wells Fargo Securities - Analyst

Chris Danely
JPMorgan - Analyst

Kate Kotlarsky
Goldman Sachs - Analyst

Craig Ellis
Caris & Company - Analyst

Steve Smigie
Raymond James & Associates - Analyst

Doug Freedman
Gleacher and Company - Analyst

Stacy Rasgon
Sanford Bernstein - Analyst

Shawn Webster
Macquarie Research - Analyst

PRESENTATION

Operator

Good afternoon. My name is Michael and I will be your conference facilitator. At this time, I would like to welcome everyone to Analog Devices' first-quarter fiscal 2011 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 of IR*

Thanks, Michael. And good afternoon, everyone. This is Mindy Kohl, Director of Investor Relations. We appreciate you joining us for today's call. If you have haven't yet seen our first-quarter fiscal 2011 release, you can access it by visiting our website at www.analog.com, and clicking on the headline on the home page.

This conference call is also being webcast live from analog.com, select Investor Relations, and follow the instructions shown next to the microphone icon. A recording of this conference call will be available today within about two hours of this call completion, and will remain available via telephone playback for one week. This webcast will also be archived on our IR website.

Participating in today's call are Jerry Fishman, President and CEO, and Dave Zinsner, Vice President of Finance and CFO.

During the first part of today's call, Jerry and Dave will present our first-quarter 2011 results as well as our short-term outlook. The remainder of the time will be devoted to answering questions from our analyst participants.

During today's call, we may refer to non-GAAP financial measures that have been adjusted for certain nonrecurring items, in order to provide investors with useful information regarding our results of operations and business trends. We have included reconciliations of these non-GAAP measures to their most directly comparable GAAP measures in today's earnings release, which is posted on the IR website. In addition, we have updated the schedules on our IR website, which includes the historical quarterly and annual summary P&Ls for continuing operations, as well as historical quarterly and annual information for revenue from continuing operations by end market and by product type.

Next, I'd ask you to please note that the information we're about to discuss includes forward-looking statements, which include risks and uncertainties. Our actual results could differ materially from those we will be discussing. Factors that could contribute to such differences include, but are not limited to, those described in our SEC filings, including our most recent Quarterly Report on Form 10-Q.

The forward-looking information that is provided on this call represents our 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 our 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 February 15, 2011.

With that, I'll turn it over to our CEO, Jerry Fishman.

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

Well, good afternoon, and thanks for joining us on the first-quarter conference call.

The first quarter for ADI was another very good quarter across virtually every dimension. Despite fears of a possible very significant inventory correction and the continued economic uncertainty in many regions of the world, our revenue for the first quarter was at the levels that we had predicted three months ago, and the trends within each end market were mostly also right on target. Specifically, our revenues in the first quarter were $729 million, which were up 21% year-over-year and down about 5% sequentially, which was slightly above the midpoint of the guidance we provided last quarter.

Our order trends during the quarter were very typical of what we experienced in the first fiscal quarter of our fiscal years. We saw some weakness in late November and December, consistent with the holiday-related shutdowns of our customers, and also, of course, some inventory reductions, which was followed by a strong January. For the quarter, our book to bill ratio was approximately 1 and our backlog increased slightly, entering the second quarter. In addition, the order levels from our OEM customers increased from fourth-quarter levels, indicating that business conditions are stabilizing and, in some cases, improving.

Clearly, we did not see the significant inventory correction at ADI that we all feared. We believe this was a direct result of our manufacturing strategy, which kept lead-times short through the entire cycle and kept inventory levels at our distributors within historical norms. Customers were confident in our ability to deliver, and as a result, there was little excess inventory in the supply chain.

In addition, feedback from many of our largest customers indicates that they're optimistic about their business going forward, and their inventories appear to be in good control. Those comments and the recent order trends we've seen provide us some comfort that we can achieve sequential revenue growth in the second fiscal quarter and, hopefully, we can continue to see strength for the balance of the year.

So now I'll turn the call over to Dave, who is going to provide you some more of the details about our financial results.

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

Thanks, Jerry. As Jerry mentioned, first-quarter revenues were $729 million, declining 5% sequentially but increasing 21% from last year. Gross margins were slightly above guidance at 66.2% in the first quarter, compared to 67% in the prior quarter. Gross margins declined modestly as a result of lower levels of production at our internal fabs and a slightly unfavorable product mix.

Operating expenses for the first quarter were $223 million and that was an $8 million or 3.4% sequential decline from the prior quarter. In the first quarter, we benefited from our lower and more variable operating expense structure, and in particular, from lower variable compensation payments versus the fourth quarter.

Our operating margins held up very well despite the sequential revenue decline. Operating profits for the first quarter were $259 million or 35.6% of sales, down only slightly from our record 37.1% of sales in the prior quarter, and a result of continued strength in gross margin's lower operating expenses. Other Expenses was approximately $600,000 and that was compared to $2.3 million of other income in the prior quarter. The decrease was the result of having recorded a one-time gain on the sale of some unused real estate in the fourth quarter.

Our tax rate for continuing operations was 16.7% this quarter versus 21.9% in the prior quarter. The decline was due to a few one-time tax benefit items, including the reinstatement of the R&D tax credit for calendar year 2010. Excluding these tax-related benefit items, our tax rate was 21.7%, and we expect that will continue for the remainder of 2011.

Our weighted average share count was 309 million shares. We repurchased approximately 3.1 million shares or $114 million of ADI stock this quarter. However, the share count increased in the quarter as a result of a higher stock price and our stock option exercise activity being a little bit more robust than usual. Going forward, we anticipate that we will continue to be active buyers of ADI stock.

Earnings per diluted share from continuing operations were $0.70 compared to $0.73 in the prior quarter. Excluding one-time tax benefit items, non-count diluted EPS from continuing operations was $0.66. Diluted EPS from the gain on the sale of discontinued operations was $0.02. At the time of the sale of the cellular handset radio and baseband chipset business to MediaTek, in the first quarter of fiscal 2008, we placed $10 million of the sale proceeds in escrow. These funds were released to ADI in the first quarter of 2011. And as a result, in Q1, we had a gain from discontinued operations net of tax of $6.5 million or $0.02 per share.

Our cash generation continues to be strong, as we generated 30% of our revenue or $217 million in operating cash flow, and our balance sheet is now -- our cash balance, rather, is now approximately $3 billion versus $2.7 billion at the end of the fourth quarter. Net cash at the end of the first quarter was approximately $2.4 billion. Capital expenditures were $26 million and that resulted in free cash flow of $191 million or 26% of revenue for the quarter.

Our Board of Directors declared a cash dividend of $0.22 per outstanding share of common stock. That will be paid on March 23, 2011 to all shareholders of record at the close of business on March 4, 2011. Our accounts receivable balance decreased sequentially by approximately 1%, and our days sales outstanding increased by two days to 48 days in the first quarter. All of our customers are current to their terms.

In anticipation of a stronger second quarter, inventory on our balance sheet at the end of the first quarter increased by 2%, compared to the immediately prior quarter, and our days of inventory were 105 days. Our distributor inventory also increased by 2% in anticipation of a stronger quarter for the second quarter.

Lead-times for our direct OEM customers remain similar to last quarter and are in good control, with 98% of our shipments to OEMs occurring within six weeks and 99% within eight weeks. All in all, the quarter was right on plan across virtually every operating metric.

Now I'll turn the call back over to Jerry, who will discuss the results from each of our end markets and provide our short-term outlook.

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

Well, with regard to our market segment performance in the first quarter, I'll first talk about the industrial market. For the first quarter, our revenues from the very broad and diversified industrial market, which is 46% of our total revenues, declined 3% sequentially to $337 million, which is very much in line with typical seasonal patterns we see in our first quarter.

In the industrial market where we sell literally thousands of products to tens of thousands of customers, and our technology is often the differentiator in our customers' end products, we believe that ADI continues to have an excellent opportunity to be the leading supplier in each of the application areas that we serve in the industrial market. Driven by our customers' needs for increased energy efficiency, industrial automation, and advanced instrumentation, we've seen demand for ADI's high-performance signal processing technology not only in the newer areas, such as energy and building automation, but also in more traditional and INI application areas.

We're also seeing growth opportunities in the Asian markets, as customers build out factory automation infrastructure, social infrastructure, and energy management systems. We expect that this trend will continue to drive our growth in industrial revenues for ADI.

Overall, we believe that the industrial market offers strong growth opportunities for ADI, and we expect it will resume sequential growth in our second fiscal quarter, a prediction that's supported by seasonal patterns as well as by leading industrial customers, who have reported to us that they believe that the underlying conditions in their markets are solid.

Within the industrial category, healthcare presents an extremely strong growth opportunity for ADI. During the first quarter, healthcare revenues actually increased sequentially, as a result of our significant new product portfolio, and competitive strength in imaging and patient monitoring, and our instrumentation applications. In addition, we believe that healthcare sales are benefiting to some degree from the pent-up demand that built up during the credit crisis when capital spending was severely reduced.

We expect continued growth in the healthcare revenues in Q2 and solid expansion through the year, as our strategic customers are optimistic about their growth prospects for 2011. Overall, we expect the number of trends to continue to increase demand for ADI technology in the healthcare market.

Among these are an increasing need for higher speed, and channel count, and medical imaging systems, to improve image resolution throughput while achieving a lower cost per channel; the drive for improved measurement performance to increase diagnostic accuracy; the expansion of telemedicine and the requirements for portability, as well as the inclusion of secure communications capabilities in healthcare applications; and finally, the requirements for patient safety and system reliability.

Revenues from our automotive customers were approximately $95 million in Q1, an increase of approximately 1% from Q4. This was a record for our automotive business. Q1 marks the seventh consecutive quarter in which we've grown our automotive business, and with our annual run rate now approaching $400 million, we're now deriving 13% of our total revenues from the automotive market.

Leveraging our strength along the signal chain and sensors, and signal conditioning, data converters and DSPs, ADI has developed a very compelling product portfolio in the areas of safety, entertainment and power train applications. This portfolio, along with a much more robust automotive market, continues to drive our automotive success.

We expect continued growth in automotive revenues in our second quarter, and believe that we'll continue to benefit from favorable macro trends within the automotive space and the areas of active and passive safety, fuel-efficiency, and convenience, all of which drive higher dollar content for ADI. As an example, our very sophisticated lithium ion battery monitoring products for both hybrid and electric vehicles are achieving expanding market penetration. We expect that these applications will present a particularly attractive opportunity for ADI, due to the very complex nature of the signal processing challenge and the anticipated unit growth of hybrid and electric vehicles.

In summary, the automotive market continues to represent an attractive growth opportunity for ADI, as we have the momentum from both an increasing build of material value per vehicle and also increasing market share for ADI.

Communications revenues at $163 million in the first quarter were down 8% versus our Q4 levels and accounted for 22% of our total sales in Q1. Wireless infrastructure sales declined as expected and were reflective of the completion of the TDS-CDMA Phase 4 rollout in China. This was partially offset by good strength in North America and Europe as a result of significant bandwidth enhancements being deployed in these regions. In addition, in Q1, our sales of wired infrastructure products grew sequentially, as the buildout of fixed networks continue to increase in response to the data communications demand being generated by mobile networks.

In the short-term, we expect our communications revenues to be flat to up slightly in Q2 with continuing strength in North America and Europe, offset by ongoing weakness in China-based deployments. However, by the second half of our fiscal year, we expect the next phase of deployment in China to begin, which should re-accelerate our growth in this segment.

Over the longer-term, we expect the communications infrastructure will remain a key area of opportunity for ADI. Just recently, one of our major customers, who's Ericsson, described mobile subscriber growth as a very key driver for wireless infrastructure capital spending, estimating that the number of global broadband subscriptions will reach 1 billion this year and top 3.8 billion by 2015. In addition, the ever-increasing need for higher bandwidth to support the dramatic increases in video demand pushes this need even further.

Going forward, the need for higher performance radios to support multiple communication standards, higher density of channels to support increased data payloads, new form factors in hard-to-reach places, improved power efficiency, smaller footprints, and lower cost per channel, are all the trends that we anticipate will drive growth for ADI and help us to continue to build on our leadership position in the communications market.

Consumer revenues, while exceeding our very conservative internal plan that we had for Q1, were down approximately 12% sequentially, primarily due to seasonality and overall weak consumer spending. In Q1, revenues from consumer customers were $121 million and accounted for 17% of our total revenues.

We're currently expecting a lift of revenues, consumer revenues, in Q2 above our Q1 levels, basically from applications for cameras and home entertainment products, which are entering a historically stronger seasonal period in Q2 compared to Q1. We also continue to be very well-positioned in a few niche consumer applications in the portable space and in the game area. Overall, we're planning for our consumer revenues to grow in the second quarter.

And finally, our computing revenues were down 4% sequentially, representing just 2% of our total revenues. As I'm sure you're aware, the computing market is not a space where ADI is applying R&D resource. On a regional basis, our revenues declined sequentially in all regions in Q1, in line with our original expectations.

So now let me turn to the outlook for the second quarter of 2011 and make a few comments about the longer-term.

Based on the stabilization in orders that we saw in the first quarter and positive feedback across our customer base, we are planning for revenue growth to resume in the second quarter. Specifically, we're planning for our second-quarter revenue to be in a range of $730 million to $760 million, which is approximately flat to up 4% sequentially, and up 9% to 14% on a year-over-year basis.

We're also planning for our gross margins to increase slightly to approximately 66.5% of sales, based on the current mix assumptions that are built into our plan; and for our operating expenses to grow a few percent sequentially, primarily as a result of annual salary increases, which took effect at the beginning of the second quarter. For the balance of the year, we're planning for our expenses to grow slower than our revenues. On an earnings per share basis, we anticipate that our diluted earnings per share from our continuing operations for the quarter will be in a range of $0.65 to $0.69.

Looking out further than the second quarter, we remain very confident about the long-term prospects for ADI. We've been operating under a new organizational structure, which divides the business into market segment and technology groups now for more than a year. We believe this model has enhanced our understanding of critical applications technology and customer needs, and will continue to make us more effective at developing products that will push the envelope of signal processing technology.

Most recently, we also embarked on a new initiative inside ADI to improve the effectiveness of our new product development spending. We believe that through this process we'll drive more growth out of the R&D dollars that we're currently investing within ADI. As a result of our strong product portfolio and many of these new initiatives to enhance the productivity of our investments, we believe that our objective to grow our revenues long-term in the range of 8% to 12% that we communicated well over a year ago, is both realistic and achievable.

We've also fundamentally adjusted our cost structure to drive more profitability, and we made our model much more variable than historically, which allows our profits to be much more reactive to changes in revenues. We've already seen the benefits of this approach in our first quarter results, where operating margins were above 35% despite a 5% sequential revenue decline. The end results we now believe is a business that achieves very solid growth and very attractive margins, and drives very significant free cash flow, and ultimately very good returns for our stockholders.

Mindy Kohl - *Analog Devices Inc. - Director of 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 you another opportunity to ask additional questions if we have time remaining.

Operator, we're now ready for questions.

QUESTIONS AND ANSWERS

Operator

Uche Orji, UBS.

Uche Orji - *UBS - Analyst*

Jerry, let me just ask you, the year seems to have started very well for ADI, with year-on-year revenue growth now at 20.8%. As you look to the rest of the year within the context of your guidance of 8% to 12%, [in terms] of the longer-term targets, what areas do you think will be the strongest growing for you through the rest of this year? I know a few of these called out like comm equipment and automotive, but if I looked through your business, what area do you think we should be looking at, areas of strength and areas that may worry you a little bit in terms of the outlook?

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

Well, I think overall, the industrial market continues to represent one of the best opportunities for ADI. You know, this is no longer a stodgy, 3% growth business. This is a business that grew strongly last year and the year before, and in fact, over the last three or four years.

There are many, many segments within industrial that are growing very quickly. The fact that even after the very significant growth that we had in industrial products in 2010, that we actually only declined 3% in Q1 -- which is seasonally a very weak quarter because there's less days in distribution and so on -- to us, is a very good sign that it's not that that business is going to grow 35% a year, like -- or whatever, up in the area it grew last year, but that's a solid grower for us. And I expect that if the economies tend to hold at the pace they're being made, I think the industrial business will be a very strong business for us.

We've talked at some length about the automotive business. That business has been one of the higher growth businesses for us, as the portfolio keeps getting richer across applications in cars that tend to be in very high demand right now. So I think that business should be strong through the year.

The communications business has really been a mixed picture with the infrastructure in China being weaker in the first half, but the feedback we get is that's going to strengthen. And certainly, the wired part of our communications business, which is much more dependent on penetration than the end equipment sales right now, should also grow.

Now, probably the remaining largest unknown is what happens in the consumer businesses, and we have strong positions; but ultimately, that will be dependent on what consumers actually do. So that's about the best information we have about the rest of the year, based on what we know right now.

Uche Orji - *UBS - Analyst*

Jerry, any sense of where -- I know you said inventory correction is behind us and you've seen some pickup in OEM orders. Any sense (multiple speakers) --

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

I said I believe it's behind us.

Uche Orji - *UBS - Analyst*

You believe it's behind you, absolutely. In terms of what we've seen with distributors, any comment as to where the level of inventory is now related to historical levels? And in terms of orders stabilization, I believe the comments you made applies to both [these figures] and to OEM for (technical difficulty).

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

So, answering your second question, Uche, that the stabilization of the order pattern happened in both the disty and OEM space. The disty inventory continues to look to be in pretty good shape and their days of inventory are running kind of in the eight weeks that they normally target. It's only up a couple of percent from last quarter, really just gearing up for what we believe will be a stronger second quarter.

Uche Orji - *UBS - Analyst*

Congratulations. Thank you.

Operator

David Wong, Wells Fargo.

David Wong - *Wells Fargo Securities - Analyst*

Roughly what percentage of your revenues come from product made at foundries versus internally? And can you give us some idea as to the difference in gross margin from between foundry and internally-sourced product?

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

Yes, about -- it's roughly 50/50 -- about 50% of our revenue was derived from products manufactured internally; 50% externally.

Gross margins are a little bit higher, obviously, internally, but that has more to do with the mix of products that we produce internally. It tends to be more geared to industrial products. That tends to be our highest gross margin products in the Company.

David Wong - *Wells Fargo Securities - Analyst*

Great.

Operator

Terence Whalen.

Unidentified Participant

Thanks for taking my question. This is [Ben] speaking for Terence. My first question -- I have a quick follow-up on healthcare. And you comment a lot of opportunity in the healthcare. Can you give us some of the [section] -- how much growth you think will happen? And how much percentage healthcare accounts for as a percentage of [your sales]? Thanks.

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

I'm sorry, there's a lot of noise on that -- I couldn't hear the second half of the question.

Unidentified Participant

Second half -- how much is healthcare accounts for the total percentage of sales?

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

Percent of revenue. It's roughly in the mid-single digits as a percent of total. And what was the first part of the question?

Unidentified Participant

So what growth rate do you expect for healthcare for the full year fiscal 2011?

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

Well, I mean, we don't really make predictions by market segment for the year. It's just we don't have enough data to be accurate about it. But I think it's fair to say that when we look at the plans for that business for this year, we expect that to be a pretty good grower for us, both in an absolute sense and relative to many other products.

Unidentified Participant

Okay, thanks. My second question is on CapEx. So CapEx in the first quarter was down from the fourth quarter last year. Do you expect deceleration of CapEx for the full year 2011? Or it could be fairly flat at $25 million or $26 million?

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

It's going to run around this range. We roughly target CapEx to be somewhere in the 3% to 4% of revenue. I expect every quarter will run somewhere in that range.

Unidentified Participant

Okay. Thanks a lot.

Operator

Chris Danely, JPMorgan.

Chris Danely - *JPMorgan - Analyst*

This is actually the alien that's inhabiting Chris Danely's body and upgraded your stock today. Well, that joke fell flat. Anyway (multiple speakers) --

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

Well, I sort of liked it.

Chris Danely - *JPMorgan - Analyst*

(laughter) Can you just talk about what the utilization rates are right now? And where those are going and what your inventory plans are?

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

So utilization for first quarter was about 75%. That was down from about 80% in the prior quarter. We're expecting it, obviously, to tick up because we expect revenues to be up in the second quarter. I'd say it will be up a few percentage points.

On the inventory side, we took inventories up to 105 days also in anticipation of a stronger second quarter. Our goal is really to kind of keep it in the 100-day range. So we're going to try to target bringing the days of inventory back down closer to 100 over the course of this year.

Chris Danely - *JPMorgan - Analyst*

Great. And as my follow-up, can you just talk about the various gross margin drivers going forward?

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

Sure. I mean, I think the primary driver is going to be, obviously, utilization and revenue growth. As we grow sales, we will obviously be increasing production. Also, we have an amount of fixed expense within the cost of sales, that when sales increase, that's beneficial to the gross margins. I think that's the biggest single driver for gross margins going forward. Obviously, through -- from quarter to quarter, mix will certainly impact it; but mix tends to be a fairly minor driver of gross margins.

Chris Danely - *JPMorgan - Analyst*

Okay. Thanks a lot.

Operator

Jim Covello, Goldman Sachs.

Kate Kotlarsky - *Goldman Sachs - Analyst*

This is Kate Kotlarsky for Jim Covello. Thanks so much for taking the question. I wanted to dig a little bit into the automotive part of the business. Clearly, that's doing very well now. And I was hoping you can talk a little bit about what you're expecting for the business throughout the course of the year, and maybe talk about it from a geographic perspective. I know that China is one area that has been doing very well. Maybe you can comment, as we move through the year, what geographies you expect to be contributing more meaningfully to the business.

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

Well, I think it's really a combination in each location. We typically sell to the OEMs that build systems for companies. So if you look at the largest automotive suppliers for the large OEMs, the geography gets a little confusing, because you have OEMs that are in Europe that supply both Europe and America, and other places, even China in some cases.

So the geographic part isn't the most relevant part, given that each of our suppliers has a worldwide business. But I would say that, in aggregate, most of our OEMs that we sell to in the automotive business are enthusiastic about the balance of the year. The volumes they're seeing are good; the desire for more electronics and more safety features. We're selling parts that go into stability control systems, which are becoming part of legislation in many locations.

So we're enthusiastic about that business. I can't quote you a growth rate and what's going to happen in any particular quarter, and particularly those in the far future, but this business has become a good business for us. It's up there at $90 million or $100 million a quarter. It's been growing. We have good customers. And those programs with automotive manufacturers, tend to be ones that take a long time to get, and once you get them, you keep them -- unless, you know, you really screwed up.

We have a very good reputation with automotive customers, not only for the quality of our technology, but also the long-term reliability of our products, which is real important to those guys. So, in automotive, we're continuing to put money into it. We're continuing to build the internal systems in the Company to be a great supplier to the automotive customers.

So it's like anything else in the Analog -- it's not the only thing and I can't even tell you it's the most important thing. But it's one of the drivers that we've been doing well at and that we think we'll continue to do well at.

Kate Kotlarsky - *Goldman Sachs - Analyst*

If we were to think about it from a content perspective and how your content that your customers in the automotive segment have changed over time, where are we today in terms of your content? And do you have an expectation of where we might be a year from now?

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

Well, it's hard to put a dollar number per car on this thing, if that's what you're after.

Kate Kotlarsky - *Goldman Sachs - Analyst*

Yes.

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

But -- no, our penetration of the automotive market, if you go back five, six, seven years ago, was mostly airbag sensors. And we were a very important and high market shareholder -- still are today, in airbag sensors and micromachined accelerometers.

So I think our business in automotive has really expanded in a couple of different dimensions. Firstly, we're continuing to do all the safety stuff. We have a large business supply in automotive accelerometers. We also now are supplying micromachine gyroscopes for stability control applications and many other safety applications in cars. But also, as I mentioned in the opening comments, we're supplying a lot of parts into engine management. We're supplying battery management. We're supplying a lot of our DSPs that go into some of the high-end entertainment systems.

So it's really a combination of sensors that just make the car run better, to things that actually save energy, to things that sound good, to things that, hopefully, save a lot of lives. There's a lot of people now on the stability control application that believe that stability control is more important than crash sensors, because more people die when the car tips over than when it crashes into somebody. So, that's really an emerging market for semiconductor sensors. And I think our gyroscope is a pretty good product in there.

So I think it's in many, many different dimensions, but it's very hard to put a specific dollar content on it. But it's quite a bit -- many multiples of what it used to be.

Kate Kotlarsky - *Goldman Sachs - Analyst*

Okay. Thanks very much.

Operator

Tim Luke, Barclays Capital.

Unidentified Participant

This is [Maricos] calling for Tim Luke. (multiple speakers) I just wanted to get a sense of the comm infrastructure space. Just wanted to get a feel of how is the contribution from China, North America, and Europe, relative to each other? And how do you see India's 3G contributing to this growth going forward?

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

Well, again, you have to be a little careful on where the parts are bought and where the parts are shipped. I think the amount of stuff we -- of sales we have in China is not a huge amount of our sales and infrastructure, despite common belief, that that's the predominant part of our business. It's not today.

But I tell you that a lot of the -- and even within that sector or geography, a lot of products that are built by the Chinese base station manufacturers are shipped outside of China. So the geography is a little confusing on that. I think our business is very well-balanced between China, the US, Europe. And I think that's why, even when the TD-SCDMA application goes a little cold for a couple quarters, our communications business still stays very strong.

Unidentified Participant

Great. Thanks. And maybe a little follow-up on that. In terms of LTE, how is the deployment you're seeing out there? And I wonder how does LTE impact the comm results for you going forward? And does it drive like better ASPs? Better volumes --? (multiple speakers)

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

Well, I mean, each standard as they get better takes higher and more signal processing content. So that business is certainly not a stable business. Each generation when it went from 2G to 3G and 3G to 4G, and to any other standard that comes along, the speeds are higher, the density is higher, and that requires higher performance products. So I think all those trends tend to be very favorable for us.

Unidentified Participant

And ASP difference between 3G and LTE for (multiple speakers) your product?

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

It varies widely by how many radio cards actually are in every system. That's more the driver of that than the particular ASP we get in any particular card, because the configurations are so different. So I can't really give you a firm number on that.

Unidentified Participant

Great. Thank you.

Operator

Craig Ellis, Caris & Company.

Craig Ellis - *Caris & Company - Analyst*

Thanks, guys. Nice job on the margins.

Jerry, as you look at the potential for 8% to 12% growth this year, what are the key swing factors that would bring you in more towards the lower end of that range, versus the higher end of that range?

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

Well, it's all the things everybody fears and hopes for, on either side of that question. There's always concerns that, yes, there's still more inventory out there and what we're seeing isn't real. That's certainly not our belief now, but that could certainly be the case.

And we could see a complete collapse of consumer spending. We could see interest rates going up and people starting to cut back on capital spending. I mean, there's a long list of bogeymen out there that we worry about a lot.

On the other hand, that's certainly not what our customers are telling us. So it depends on whether you want to be enthusiastic or pessimistic about it. But we just look at the trends. We listen carefully to what the customers are telling us. We get very good feedback from the largest customers in each of the segments that we serve.

Amazingly, in Q1, the numbers with all the complicated things that were going on and all the conflicting signals out there, I mean, we came in right down the middle. And not only on the total but within the segment -- so it was pretty close. So, that's all -- I mean, we don't know any more than that. We just know -- we follow the trends; we look very closely at the large customers; and we integrate all that and come up with a number for next quarter, and that's about all we can do.

Craig Ellis - *Caris & Company - Analyst*

Fair enough. And then you had mentioned that the Company is implementing a new approach to looking at and contracting new product efficacy. Can you talk about when you'd expect that new approach to start to yield some payoff that investors would be able to recognize?

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

Well, I mean, what the real challenge for us is that ADI spends about $500 million a year in R&D. If you can get more out for every dollar of input, it's very profitable, and it'd be very appealing to investors.

So, we've been working -- not so much on the creative part of that, which is always something we work on, but there's a lot of systematic parts to getting new products out. And there is, like in every company, we have some that sell and some that don't. And there's always the challenge of figuring out those in advance rather than after the fact.

So I think we're looking at each of the businesses very carefully. We're looking where the productivity of the R&D is the highest. We're trying to emulate the practices of those businesses in the parts where the R&D productivity has not been good. And we try to make changes to reflect the best practices in the Company. But certainly, early on, the best way you can do that is to really understand where it is that the productivity is the highest and where it isn't, and how do you fix the places that aren't and make it look like the places that are?

So, I don't think there's anything magical here. It's just when we look forward, one of the greatest opportunities for sales growth in Analog is getting more productivity out of the R&D we're spending. We're spending plenty money on R&D. And we're getting good results out of it. The payback, obviously, with the margins we're running, is pretty good. But I think it could be better. And we're going to work hard to get that.

Craig Ellis - *Caris & Company - Analyst*

And is that one of the things that gives you confidence that you can keep expense growth growing noticeably slower than revenue growth?

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

Yes, that's certainly the way we're going to get there. I mean, it's easy to quote those statistics and say, well, we're going to grow sales higher than expenses. But we don't like to say that until we get a bead to how we're going to do that -- much the same way as when we said we were going to get the margins of the business up, and everybody asked politely, is that just the usual CEO stuff and CFO stuff? You really got some ideas on how to do it? And we said we wouldn't have said it if we didn't have ideas. And we wouldn't talk about the sales growth rate if we didn't have some ideas on how to get there.

Craig Ellis - *Caris & Company - Analyst*

Thanks, Jerry. Good luck with it.

Operator

Steve Smigie, Raymond James.

Steve Smigie - *Raymond James & Associates - Analyst*

Great. Thank you. First question was just on how we should think about seasonality? You had a pretty decent guide, at least relative to expectations here. Can we still expect to get your sequential growth in the following couple quarters, given the strength in this quarter? To meaning, was this quarter unusual? Or should we expect the usual going forward?

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

Well, I mean, we'll just have to wait and see. I mean, nobody has really phenomenal visibility to what happens six months or nine months or a year from now. So everyone just has guesses. Certainly, that's what we hope would happen and there's reasons to believe it might happen. But we're struggling to get the numbers right for next quarter first. That's our most important thing -- and plan the Company around a set of numbers that we can meet.

So when you look out further than that, it's really just speculation at this point. So I think we'll have to all sit around and hold our breath, and wait and see what happens this quarter, and then we'll give you a sense on what's likely to happen after that.

Steve Smigie - *Raymond James & Associates - Analyst*

Okay. And as my follow-up, Jerry, I was hoping you can you talk a little bit about the design win process on the auto business? Are you finding that when you go in, you're pretty much dominating a particular set of sockets? Where you maybe, for example, maybe have your gyroscope, and you're pretty much always winning 100% of that business? Or is the competitive landscape such that you'll win some but there will be a second source, and then the next platform, you sort of switch with that competitor? Could you just go through that a little bit?

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

Sure. Well, I think it's much more a design-sensitive business with long product lifecycle than, let's say, some of the other applications in consumer products which have that much faster design cycle. So, we approach the automotive business with the mentality that says, if we can do something nobody else can do, and do it better and do it at pretty good margins, then that's a good business for us.

And if we're going to be in the automotive business with me-too products that there's four people and they line them up against the wall, and they pick the lowest price, long-term, that's not going to be a great business for us -- it may be a great business for other companies.

So we're really trying to push the technology window and provide very innovative technology at a reasonable price to customers, and not focus on applications that, every six months or a year, are out for bid. And we've been successful doing that. If we do a good job for the customers, I think they'll stick with us in that business. And if we don't, they'll look for alternatives.

Steve Smigie - *Raymond James & Associates - Analyst*

Right. Thanks a lot, guys.

Operator

Doug Freedman, Gleacher and Company.

Doug Freedman - *Gleacher and Company - Analyst*

Thanks for taking my question. If I could focus a little bit more on the near-term and what you're seeing in terms of booking profiles -- what type of visibility are customers willing to give you? And what are you feeling like your channel partners are willing to say and do, as far as carrying inventory now and going forward for the balance of the year?

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

Well, with our channel partners, as I think we've mentioned in the past, we tend to set their inventory levels more than they do. We listen very respectfully to what they want and then we look at what they're going to sell through, and that's how we provide inventory towards -- that's how we've done it through both the up and the downcycle.

As far as the large customers go, they give us a forecast. Some of our customers, we ship into a warehouse and they pull out from that warehouse. But we get those numbers very frequently and we keep a pretty good balance on that. Generally, the conversion rates that we see from the large OEM customers with -- that pull from hubs or central inventory points, is actually very good. So we usually have a pretty good bead on what our OEM customer is going to take for the quarter.

I don't know if that helps you, but that's the best I can do.

Operator

Stacy Rasgon, Sanford Bernstein.

Stacy Rasgon - *Sanford Bernstein - Analyst*

Thanks for taking my questions. First one just on the OpEx. Will your variable compensation program be the only driver of any OpEx increase through the back half of the year? So, in Q3 and Q4? Or do you anticipate any further investments in OpEx beyond what the variable comp program would drive?

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

Oh, I think as long as revenues keep growing -- which we'll have to wait and see how that goes -- we are making strategic hires in various parts of the business. So I don't think it will be the only driver, but it will be one driver, and the one that reacts the quickest to what happens.

But we keep a very tight fist on hiring new people. But we're in some very exciting growth businesses and we've got to put some more resource into some of the businesses. We tend to balance that out with other businesses that we put less resource in. But I think in aggregate, if business stays strong, then we'll probably do some hiring -- as we did last quarter, in some of the most important businesses we have.

But on the other hand, we've got a pretty good hammer on making sure it doesn't run away with us and it keeps under very tight control, because we are still believing we've got more leverage ahead of us.

Stacy Rasgon - *Sanford Bernstein - Analyst*

Got it, got it. And one question on your gross margin -- specifically, your incremental gross margin. So I think in the maybe 10 years or so before the downturn hit at least, I think your incremental gross margin was about 65%, meaning about $0.65 on average of every incremental dollar of revenue that you earned or lost fell through the gross margin line.

At this point, given the structural improvements that you've made in your gross margin, do you have a feeling for how much higher your incremental gross margin might be now, versus where it was maybe a couple of years ago?

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

I'll turn that over to our erstwhile CFO.

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

(laughter) Well, you know, a part of the -- it's a difficult question to answer, only because half our business comes from products manufactured mostly externally. And so we don't get a lot of incremental lift for increased revenue on those parts of our business. But obviously on the internal side, we do get a fair amount of incremental margin when production -- when revenues increase.

So it's certainly higher than the 66% or thereabouts gross margins we're running on an incremental basis. It could be close to 80% probably on average. Certainly, there are products that are higher than that. And if the mix is higher towards internal, then it would be higher than that. If the mix is more towards the external, then it would obviously be lower than that.

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

(multiple speakers) Obviously, when the industrial business grows the fastest, that's when we get our highest incremental gross margins.

Stacy Rasgon - *Sanford Bernstein - Analyst*

Do you think it's not out of line to think that $0.80 of every $1.00 that you've earned in revenue growth could potentially fall through to your gross margin line?

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

It's rough -- rough order of magnitude; but, obviously, it's mix-dependent.

Stacy Rasgon - *Sanford Bernstein - Analyst*

Got it. Thank you, guys.

Operator

Your final question comes from the line of Shawn Webster with Macquarie.

Shawn Webster - *Macquarie Research - Analyst*

I was wondering if you guys could -- if you have a sense of where you think you're getting the most design traction in winning share, in terms of component categories and markets? And then I had a follow-up.

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

I would say that there's no one area in product or one area in markets that really sticks out. I think we have good design traction in all the market segments that we're investing in. You know, we stopped putting R&D into the computer business, so I wouldn't say we're getting a ton of design ends there. But where we're putting in the R&D, our traction is very good across all the market segments and, certainly, most of the product segments.

Shawn Webster - *Macquarie Research - Analyst*

Okay. And then can you give us a sense of where your turns are versus history for your last quarter and what you're expecting for this quarter?

Dave Zinsner - *Analog Devices Inc. - VP of Finance and CFO*

Yes, again, that's a number that's difficult to quantify, given that half our backlog -- or more than half our backlog is from distys, and we obviously don't recognize revenue when we ship. But if you kind of did a back-of-the-napkin analysis, it's very similar to last quarter, probably, on a rough order of magnitude basis -- and kind of on the lower end of historical norms.

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

I mean, typically, the turns business is in some way inversely proportional to the lead-times. So, if you keep your lead-time short, customers tend to believe they can get product quicker, so there's more turns business and less inventory. If your lead-times go out, just the opposite happens.

So, I think the only way you can ever win in this game is keep the lead-times short -- because or else you really don't have a clue of what's going on.

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

Okay. That concludes our Q&A session. We appreciate your participation and look forward to talking with all of you again during our second quarter of 2011 call scheduled for May 17. Thanks very much.

Operator

Ladies and gentlemen, that does conclude today's conference call. You may now disconnect.