FINAL TRANSCRIPT

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ADI - Q2 2010 Analog Devices Inc. Earnings Conference Call

Event Date/Time: May. 18. 2010 / 9:00PM GMT

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PRESENTATION

Operator

Good afternoon. My name is Shanelle and I will be your conference facilitator. At this time, I would like to welcome everyone to the Analog Devices' fiscal second quarter 2010 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, Shanelle, and good afternoon, everyone. This is Mindy Kohl, Director of Investor Relations. We appreciate you joining us for today's call. If you haven't yet seen our second quarter fiscal 2010 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's 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 is Jerry Fishman, President and CEO, and Dave Zinsner, Vice President of Finance and CFO. During the first part of the call, Jerry and Dave will present our second quarter 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 will refer to several 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.

We have also updated the schedules on our IR website, which include the historical quarterly and annual summary of P&Ls for continuing operations, as well as historical quarterly and annual information (technical difficulty) revenue from continuing operations by end market and product type.

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

The forward-looking information that is provided by the Company in this call represents the Company's outlook as of today, and we do not undertake any obligation to update the forward-looking statements made by us. Subsequent events and developments may cause the Company's outlook to change. Therefore, this conference call will include time-sensitive information that may be accurate only as of the date of the live broadcast, which is May 18, 2010.

With that, let's begin with opening remarks from our CEO, Jerry Fishman.

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

Well, good afternoon, and thanks for joining us today on today's second quarter earnings call.

As you can tell from the press release we put out earlier, the second quarter was just a great quarter for ADI. Our revenues grew about 11% sequentially, 41% year-over-year to $668 million, which is above our recent peak that we achieved in 2008. Our earnings per share grew at a rate more than three times the rate of revenue growth for a record $0.55 per share for the quarter.

As we described to many of our investors at the beginning of last year, we had set a goal to fundamentally improve ADI's operating model, and obviously, we've made significant progress towards achieving that goal.

In the second quarter, our gross margins reached record levels, increasing 390 basis points sequentially to 65%, and our operating margins went up to 32%, which is over 700 basis points higher than our recent peak. Because of our strong financial performance and our very strong cash flow, our Board has approved a 10% increase to our quarterly dividend to now $0.22 per share.

Our industrial revenues were particularly strong, and increased by over 20% sequentially, as industrial activity picked up worldwide. Automotive revenues also increased substantially. Consumer and communications revenues were approximately flat sequentially. Revenues increased overall in the United States, in Europe, and Asia, and declined slightly in Japan.

I will elaborate a little bit more on the end markets and some of the trends in each of the markets after Dave discusses the financial results, in a bit more detail.

I think very importantly, we continue to be recognized in the industry as the premier analog supplier. In January, Huawei, one of China's top telecom companies and one of our largest customers, awarded ADI their Golden Core Supplier award to ADI for delivering superior performance in technology, quality, responsiveness and delivery. And in March, one of the industrial automation leaders, Rockwell, named ADI as its Electronic Supplier of the Year for 2009. It's very noteworthy that ADI was the only semiconductor company to be recognized with this reward from Rockwell.

These are just two examples of the recognition we're receiving across our customer base for our innovative signal processing solutions that give our customers a very significant competitive advantage, coupled with our superior customer service and responsiveness to our customers' needs.

So now I'm going to turn the call over to Dave Zinsner, who will provide a little more details about our financial results.

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

Thanks, Jerry. As Jerry mentioned, revenues in the second quarter grew 11% sequentially and 41% from the same quarter last year to $668 million. We responded to the significant increases in demand over the past few quarters while keeping our lead-times short.

During the second quarter, we shipped nearly 100% of our orders from direct customers within four to eight weeks, and nearly 90% of our orders from distributors within four to eight weeks. This is similar to our lead-times during the first quarter for OEM customers, and only slightly longer for distributors, where our ordering patterns tend to be more volatile.

In our view, our ability to deliver quickly and reliably has three significant benefits. First, we believe that in the current environment, our lead-times are winning us cross-over business from competitors. Second, we believe that over the long-term, ADI will continue to gain share since customers are confident in ADI's ability to meet its commitments to them in a volatile environment.

And lastly, we believe that ADI's short and steady lead-times should reduce the likelihood of double ordering that typically results from extended lead-times, providing us a somewhat more accurate picture of end demand.

Gross margins for the second quarter increased to 65%, up 390 basis points sequentially and also up 390 basis points from the last time our revenues were in the $660 million range, which was during the fourth quarter of 2008. This margin increase is primarily the result of lower manufacturing costs derived from the manufacturing consolidations we completed last year; higher manufacturing utilization; and, to a lesser degree, our richer mix of higher margin products used in industrial applications.

Our inventory levels remained within our stated range of 90 to 100 days at 97 days cost of sales, up only $4 million sequentially. Our distributors days of inventory declined slightly; at approximately eight weeks, it continues to be healthy and at historically low levels. Our deferred income on shipment to distributors is up approximately 17% sequentially, reflecting much higher sales and distribution combined with significantly higher gross margins, which further increased our deferred income.

Internal fab utilization rose about 10 percentage points to approximately at a low 70's of production-ready capacity. In line with better-than-expected revenue growth, we have raised our capital spending plan slightly to approximately $95 million for the year. Longer-term, we can add substantial capacity to existing clean rooms, if needed, with a relatively low level of additional capital equipment.

Operating expenses were $220 million, with the most significant increases in variable compensation driven by significantly higher operating margins and also higher sales commissions. Operating expenses as a percentage of sales have declined from 36.3% at the end of fiscal 2008 to 33% of sales in the second quarter, as we are now operating the business with 7% less non-manufacturing personnel. In addition, our strategy has been to increase the percentage of our operating expenses that are variable, so that we can more effectively modulate these expenses in response to future business cycles.

Operating margins increased to 32% of revenues. The last time our revenues were at current levels, operating margins were less than 25% of sales -- 720 basis points lower than in our recently-completed quarter. This quarter's substantially higher operating margins are partly due to an improving business environment; but equally important, our results reflect the actions we have taken over the past few years to better focus our investments, and improve our execution and our cost structure.

Our tax rate was 21.9%, which was up from 20.3% last quarter, as we now estimate our annual tax rate to be 21.3%, excluding the effect of restructuring expenses. We have also carefully managed our working capital. In addition to keeping our inventory within our stated range, days sales outstanding has remained in check at 45 days despite a tighter credit environment worldwide.

Cash flow from operations totaled $278 million or 42% of revenues, and free cash flow was $261 million or 39% of revenues. Our cash balance now totals approximately $2.4 billion or $2 billion net of debt, which is more than $200 million higher than the previous quarter and more than $700 million higher than the previous year.

In summary, by every financial and business metrics, this was a very successful quarter for ADI. So I'll now turn the call back over to Jerry, who will discuss the results from each of the end markets.

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

For the third consecutive quarter now, we've seen strong sequential growth from the industrial market. In this quarter, industrial revenues grew about 20% sequentially to about $316 million, which is a very positive sign for recovery in this broad and diversified industry group.

The growth in second quarter was primarily driven by growth in the industrial automation and instrumentation markets, but every application area within the industrial category also showed sequential improvement. All regions had good growth in industrial products, with particular strength in industrial products in Europe and in North America.

Our revenues from our remote customers were approximately $84 million for the quarter, which was up 14% quarter-over-quarter. Although certainly, the growth of the automotive industry has been held to some degree by the stimulus programs, feedback from many of our automotive customers indicate their belief that improving overall demand has also been a result of a gradual and steady improvement in consumer confidence.

Further, ADI technology is most relevant to higher-end cars, which have not been the primary beneficiary of most government stimulus programs. And finally, we continue to see very favorable macro trends for ADI within the automotive space, including safety, fuel efficiency and convenience, all of which drive higher dollar content for ADI.

Our communications revenues at about $133 million for the quarter were down very slightly from Q1. Networking applications, optical, microwave, and satellite increases were offset by a decline in wireless revenues, primarily as a result of delays in base station programs in China. For Q3, based on the current ordering patterns and the backlog we have in place, we expect growth from our Chinese base station customers. European and US base station sales increased during the second quarter.

The wireline market had its fourth consecutive quarter of sequential improvement, delivering good return on various significant investments that we've made over the past few years in applications such as optical communications and also cable. This quarter, our revenues from wire communications applications were up approximately 20% sequentially.

Revenues from the consumer market were about $120 million, which was up a couple of percent from the previous quarter; went up about 45% from last year. We saw a particular strength for the digital camera and the portable media markets, and our customers today are indicating that consumers are once again buying these types of products. The computing sector, our revenues increased 15% sequentially, which still represents only a modest 2% of our total revenues.

The new orders for the quarter were again very strong in the second quarter as a result of backlog for shipment in the third quarter, increase from both OEM customers and distribution end customers, and the book-to-bill ratio for the quarter was well above one.

Looking ahead to the third quarter, given our higher backlog, we're expecting continued revenue growth. We're currently planning for our revenues to be in the range of $695 million to $715 million for the third quarter. We expect this growth to be fairly broad-based and that's based on our customers' forecasts and the opening backlog that we had starting this quarter.

We're planning for our gross margins to be in a range of 65% to 66%. We're expecting operating expenses to grow as a result of higher variable comp; and as the operating margins continue to expand, the quarter-to-quarter OpEx growth is planned to be well below our anticipated revenue growth in the third quarter, giving us additional leverage in the third quarter. As a result, we anticipate that our operating margins will expand to the 33% to 34% range and earnings per share should be in the range of $0.59 to $0.61.

Obviously, we're very pleased with our operating performance, both in terms of our growth and our profitability in the second quarter. We had fundamentally and significantly improved our operating margin structure at ADI without sacrificing sales growth opportunities, which has been our goal for the past two years as we sharpened our strategic focus and we reduced costs company-wide.

We believe we still have additional leverage ahead of us, as we fully recognize the benefits of lower unit costs. We continue to experience good price stability in most of our products, and we limit expense growth to a fraction of sales growth, and continued to develop very innovative products that help our customers gain share in the markets they serve and command good margins.

While the external world, of course, still remains uncertain, we are today a fundamentally better and a fundamentally stronger company than a few years ago. We believe that as we continue to demonstrate world-class financial returns and above-market growth, our shareholders will be the beneficiary, ultimately, of this success.

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-on question. We'll give you another opportunity to ask additional questions if we have time remaining.

Operator, we are now ready for questions from our analyst participants.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Doug Freedman.

Doug Freedman - *Broadpoint AmTech - Analyst*

Congratulations on the very strong result. And as much as I hate to ask the hypothetical question, Dave, you mentioned in your commentary that the Company has increased its flexibility to the spending that the Company does in regards to the cycles. With these stocks not really able to get moving here, it's clear people recognize business is strong. But my question really is, hypothetically, if you were to see revenues decline by 10%, what impact would that have to the earnings potential for the Company?

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

Well, I don't think I want to go, Doug, right into the measuring because it depends on mix and things like that. But I would tell you that what we've done is fundamentally changed the balance of the OpEx between what is variable and what is fixed. And so, as revenues, if they were to decline, we have an ability to maintain a lot more of the profits to the P&L and, hopefully, keep the margins relatively balanced.

Doug Freedman - *Broadpoint AmTech - Analyst*

Great. And I guess, if I could, my follow-up -- if you could focus us on sort of one segment that you think you're seeing much better-than-expected demand from and not really customers trying to do an inventory refill, where is it that the demand is surprising you guys to the upside?

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

Well, I'd say probably the places that have been the strongest [ever], the industrial and the automotive side, at least for this part of the seasonal lift. I mean, typically, our second quarter is a strong industrial quarter, but I think the industrial part of the business has recovered quicker than we would have expected. It's above where it was at the peak of the last cycle but not by that much. And it's spread out amongst so many customers in that space, we -- you know, [10-plus-thousand] customers.

So I don't think there's a broad inventory accumulation cycle going on. That business was down very substantially last year, well over 30%. So I think what's happened is when we talk to the large customers, the Rockwells, US and their counterparts in Europe and China, you know, I think they're seeing the fact that their factories are running hotter than they did and their inventory levels have been very low.

But I think they're predicting that this is not really a bubble. You never know, as you well know, about what our customers are really doing, but we don't get a lot of sense from the large customers that they're stockpiling inventory. It would be very surprising in a customer base as broad as this, both by products, by customer, by geography, that all these customers would be acting in unison to build inventories.

So I think they are recovering some of the inventory that they depressed, but I think they're ordering commensurate with what they think their outlook is at least for the next six months. I mean, as we look at the third quarter, we're predicting that industrial revenues will grow again. We've looked at this from the large customers, the small customers, distributors, and at least the sense we get fairly broadly across the board is -- that business has recovered quicker than we would have thought, but not to the levels that we wouldn't have predicted they'd recover to.

So the automotive stuff is the part that there's obviously some of that stimulus stuff which has put more people buying cars, but I don't think, at least what we hear from our guys that run that business, that a huge amount of the increases we've seen are due to that. I mean, we have -- most of our products that I mentioned in the opening comments, the higher end cars, that's not benefiting so much from the stimulus stuff. But also, our content for each car, the safety stuff and the sensors, and all the products that we've been working on for a couple of years, is just much higher than it was a couple of years ago.

So we don't have a sense that automotive companies are stockpiling inventory either. First of all, they don't want to. And secondly, I don't think they have the cash to. So I mean, those are the two segments probably that have surprised us most on the upside.

Doug Freedman - *Broadpoint AmTech - Analyst*

Great. Thanks so much and, again, congratulations on the superb improvement in operating margins.

Operator

Steve Smigie.

Steve Smigie - *Raymond James & Associates - Analyst*

Thanks and I'll add my congratulations on the great numbers. I was hoping you could talk a little bit about the com business in more detail. If I look back over the past number of years, it seems sort of flattish dollar-wise. And maybe some classification changes there or something. But you obviously said there was some -- maybe 20% growth there in the wireline business, but overall, it's still sort of flattish.

Can you talk how that might roll out over the coming year? Do you think we can see better growth going forward out of that?

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

This is in the communications?

Steve Smigie - *Raymond James & Associates - Analyst*

Yes, just overall communications.

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

Yes, I think -- you know, that business is obviously a very large customer business. And when one customer does well, often you see that customer flatten it out for awhile. Clearly, the part that we were a little disappointed in this quarter was that a few of our large customers in China, we actually saw a decline this quarter, which was anomalous for that business. Mainly because there was some well-publicized push-outs in China capital spending in the communications business.

I think as we go forward, we've looked at the order book pretty carefully, particularly over the last month or so, and based on the orders that we have on the books from our customers in China now, we expect that we're going to get -- have third quarter be a good growth quarter in that business in China.

Even during all the ups and downs in the wireless market over the last couple of quarters, the not-China business has continued to grow. So, I mean, we have a very solid position with the largest market shareholders in Asia and in Europe, and the United States. If anything, our -- I think our share is better than it was two or three years ago. So I think as that business ebbs and flows with capital spending and inventory cycles with those customers, I think the wireless communications part of business is going to continue to be a big growth driver for us in the coming years.

It tends to be a little lumpy, for sure; but what I tend to pay attention to the most is the feedback we're getting from the customers about our position, about how we're doing. The award we got from Huawei was a great substantiation of the fact that we have an enormously strong position and one of the strongest players in the base station business in the world.

So -- we also have very strong positions in other very significant players or (inaudible). So I think we have a very good balance and we have a very strong position, which is going to continue to have that business be a good business for us for a long time in the future if we keep executing.

Steve Smigie - *Raymond James & Associates - Analyst*

Great. And then just for my follow-up question, you guys took the dividend up, obviously feeling a lot better about cash flow. I think you had raised some debt to maybe insure that back when things were pretty ugly. And I'm just curious, now that cash flow is obviously better and you're taking up the dividend, will you also choose to pay down the debt or do you keep that on that for awhile? If you could talk to that. And again, thanks -- or congratulations on the really good numbers. Thanks.

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

Yes, well, we have a few years yet before we have to decide on the debt. So at this point, we have plenty of cash in the US and we have plenty of cash worldwide. So we're certainly not in need of any cash.

The focus of the dividend was really to represent what we think is a very strong cash flow model for the Company today and going forward. And we seek to provide some of that back to the shareholders in the form of the dividend.

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

I think also, the debt is very low cost. We swapped it to floating rates, which turned out to be, at least for now, a good thing to do. So the net cost to us of that debt is extremely low. So, I mean we haven't decided but it's not a high priority for us right now.

Operator

Shawn Webster.

Shawn Webster - *JPMorgan - Analyst*

Yes, thank you, and I'll add my congratulations to the pile. On the gross margins in terms of Q2, do you expect you utilization rates to increase as well?

And then just in terms of the long-term operating model you highlighted at your analyst day, it looks going into the Q2, you'll be above the high end of the range. Is there any change in your mind in terms of a longer-term operating model? Or how should we think about that evolving over the next year or so?

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

Well, I think as far as utilization, the utilization will bump up slightly for the quarter. As far as long-term model, let's get to where we said we're going to get to first, and then we'll talk about that some more. We're obviously fairly optimistic about our prospects going forward, but I'd like to see another quarter before we get into that conversation.

Shawn Webster - *JPMorgan - Analyst*

Okay. Well, then maybe my follow-up is -- in the supply chain inventory, it sounds like things are still a little bit on the lean side. Are there any end markets or areas where you're seeing that inventory is at a normal level?

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

Is it at a normal or abnormal?

Shawn Webster - *JPMorgan - Analyst*

Just at a normal level, just because it seems like a lot of areas are a little bit on the lean side.

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

I really don't know that enough to be definitive in a comment on that. I mean, most of the comments we get about inventories from our customers are anecdotal. The inventories that we really understand the best are what's in distribution. But beyond distribution, we don't know where it's going. So it's very hard to answer that question accurately and definitively.

Operator

[Chris Stanley].

Chris Stanley - *JPMorgan - Analyst*

Thanks, guys. Nice quarter. Maybe a different way to ask that question, can you just give us a sense of what utilization rates are and maybe what the incremental gross margin is as the utilization rates go higher?

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

The current utilization for the second quarter was in the low 70s. I think I even mentioned that. And it likely will be going into the mid-70s. So not a significant increase in utilization. But that's going to be a benefit to our gross margin. Really the bigger driver for gross margins I think in the next quarter is going to be additional cost reductions associated with the fab consolidations.

Chris Stanley - *JPMorgan - Analyst*

Got it. And then in terms of the strength in the industrial and auto in particular, what do you ascribe would be the major factors in the strength? Is it -- do you think that there's still some inventory replenishment out there? Is it share gains? Is it increasing content? Is it a mix of all three? Is there something else in there? Maybe highlight one or two of the biggest factors you guys think is driving that.

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

Well, I think it's all of those things probably, in some ratio that we don't really know definitively. But one of the interesting things -- and we talked about this a little at the analyst meeting we had a couple of months ago -- is that there are some new segments in the industrial area that are growing pretty rapidly that we're very well-penetrated in.

I think I also mentioned that -- or the guy mentioned, who runs our industrial business -- that his goal is that he really believes that the industrial market could provide as much or more growth than any other market segment we're in, given the growth rates in some of these segments. So, I think the old story that the industrial market was a sleepy old market; it's going to grow 2% a year. The real excitement is in cell phones and consumer products was the place it was going to grow.

I mean, I think it's going to turn out to be fallacious. I think there is significant opportunities in the industrial business. And I think also, the automotive business where just the electronics are changing and just more and more signal processing content in automotive products and industrial products. And there's great opportunities for growth there, just like there are in every other market segment.

And I think when history is written, at least for ADI, we're making our investments in the industrial or automotive business -- I'm not speaking broadly for all semiconductor companies, just for ADI -- I think it will turn out that the industrial business does hold its own relative to anything else we're doing on the growth side.

Operator

Ross Seymore.

Ross Seymore - *Deutsche Bank - Analyst*

I'll give my congrats as well, especially on the gross margin side. Dave, you mentioned that some of the lower costs from the fab closures was in the quarter. Can you just talk a little bit about how much that added in the April quarter? And then how much is left as we go forward?

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

It was meaningful. It's been meaningful now for the last few quarters. It's a combination of the consolidation of the six-inch Lion Limerick into eight-inch, which we completed midway through last year. And at the end of the year, we closed down Cambridge and we're already starting to see some benefit. We saw some benefit in the second quarter. We'll see more benefit in the third quarter. And those are the things that are really the big drivers of our gross margin leverage right now.

Ross Seymore - *Deutsche Bank - Analyst*

I believe in the past, you talked about the Cambridge side was, what, about $40 million in savings? Do you have any kind of rough ballpark how much of that you've already seen and how much is left to be benefited from?

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

Rough order of magnitude, I think we've got probably about one-third of it and there's probably two-thirds left.

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Ross Seymore - *Deutsche Bank - Analyst*

Great. And then the follow-up question on the revenue side of the equation -- everybody is clearly nervous about too much inventory and things have been good for awhile to come. Can you talk about the turns you did in the April quarter and any sort of turns assumption that you have, if it's increasing or decreasing in conservativism for your July quarter guidance?

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

Well, one thing you've got to remember is when we're looking at backlog, we're looking at backlog placed on us. So the distributor of backlog tends not to be a great measure. So we have to kind of -- we do a lot of different analysis to come up with a number that we predict for revenue. We hardly ever look at this number, I would tell you. But it was -- it ran about 40% in the -- I'm sorry, a little less than 40% in the second quarter. And it's probably going to be a little bit even lower than that. We are getting a fair amount of visibility, obviously, from our distributors.

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

The [only] backlog is up quite a bit, so -- but I think, as Dave said, backlog distributors [place] (inaudible) are not indicative of anything. So we don't really look at that very carefully. We look at what distributors are actually selling through. And we look at what the large OEM customers are telling us. And that's how we come up with the guidance.

Operator

Terence Whalen.

Terence Whalen - *Citigroup - Analyst*

Thanks for taking the question. The first question is on the device revenue performance. It seems like you had very strong performances from amplifiers and RF, as well ask from power management and from the other analog signal processing circuits. It seems like data converters grew a little bit less, grew about 5% sequentially.

I was wondering what contributed to that? Was it end market mix? And do you have any observations in general about the data converter market competition in it?

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

One thing you might not want to misread just one quarter's performance in data converters. I mean, data converters have been up every quarter since the second quarter of last year sequentially. So where some of these other product areas have kind of been up and down a little bit through the year, data converters had very, very steady improvement since Q2 of last year.

So I think on a peak to trough analysis or a peak to peak analysis or what have you, you'll see that data converters is actually doing really well.

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

Yes, on the question of the competition, I think there's a lot of competition out there. It's a great market. We have 40-plus percent of it and everybody wants it. And there's a lot of people that have invested a lot in the converter market and so on.

But I think when you look at all these statistics and you listen to the customers, which are the ultimate statistic, I think -- that's a great business. It's probably one of the best market segments in the analog space. It's one of the very few that the share is as concentrated as it is in the converter market. There is every bit of evidence that our share over the last couple of years has gone up, in spite of all the competitive noise out there.

And certainly the highest priority we have is to keep that high or even increase it each quarter. And I think based on what I've seen we're doing in that business, I think we have a good chance of doing that.

Terence Whalen - *Citigroup - Analyst*

Okay, great. And then as my follow-up, I had a question regarding Dave, your commentary about distributor inventory. I think the past three quarters you've said it's about eight weeks. You said it went down actually, so it must've been down fractionally but not enough to be a half-week or so. Can you kind of help me understand that comment in light of the deferred income to distribution growing 17%?

I know if I normalize for gross margin, that comes out to only about a 10% growth. So am I to understand that distributor revenues grew over 10% sequentially to drive distributor days down? Thanks.

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

Yes, distributor revenues were higher than the corporate average and OEM was lower than the corporate average. So you're correct, that is what drove it.

Terence Whalen - *Citigroup - Analyst*

And I guess, just in general, the level of distribution inventory, do you expect that to have to go up at some point or is this the new normal? Thanks.

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

Well, I think they're trying to keep it within that kind of eight-week range. It's slipped a little bit and that's based on just the fact that they've been ramping. And so there's a little bit of a lag to keep pace with that.

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

I think we're also trying to keep it at that rate. We have an interest in not putting too much inventory in the channel. So when we get orders placed on us, which we're not -- things that we look at very closely, we have a lot of dialogue with our distributors about what's the sell-through, why do you want it, and so on. So I think we have a very significant stake in keeping our inventories at reasonable levels. We don't get any revenue credits if we confuse everybody if we don't do that.

And by the way, capacity is more scarce than (inaudible). So the main thing we want to do is use capacity to just put inventory on distributor shelves beyond what their sell-through is. So we just don't do that.

Terence Whalen - *Citigroup - Analyst*

Understood. Thanks for the color and great job.

Operator

Jim Covello.

Jim Covello - *Goldman Sachs - Analyst*

Great. Guys, thanks so much for taking the question and congratulations. I just want to drill down even a bit further on the gross margin thing that I know has been probed on a little bit. I know, Dave, you talked about utilization. And then you made the comments on where it is and where it's going. And then you said about one-third of the last fab closure is kind of baked into the numbers and two-thirds is still too come.

Can you give us a sense of how much maybe on a basis point impact that two-thirds left is having on the margins?

And then I think Jerry mentioned pricing is the other margin leverage in his closing comments. Do you need prices to go up to have margin leverage? Or are your costs coming down enough so that if prices stay flat or only go down a little bit, there's incremental margin leverage there as well? Thanks.

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

There's still about 100 basis points of benefits still coming from fab closures.

Jim Covello - *Goldman Sachs - Analyst*

And is that all coming in the next quarter? Or is that to be spread out over the next couple of quarters?

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

Spread out probably over a couple of quarters.

Jim Covello - *Goldman Sachs - Analyst*

Okay. And then the pricing leverage?

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

Well, I think it's -- I mean, we always watch pricing. We have very high, value-added products and we're always in the mode of making sure that we can pay some products commensurate with the value they create. But we're not anticipating wholesale price increases to maintain or improve our margins across the board.

I mean, we always have opportunities on older products and so on to think about that, because we're one of the very few, if only, companies that support semiconductor products for 20 years or more after we introduced them, which is a great value to our customers. And so -- but I think the direct answer to your question is, we're not anticipating any significant price increases to either maintain or raise our margins here.

Jim Covello - *Goldman Sachs - Analyst*

Okay. And then if I could just ask one follow-up. Relative to the power management business, that's something that got discussed quite a bit maybe nine or 12 months ago. Obviously, with the business being so robust now, maybe there's not as much urgency for new growth opportunities, but where's your head on that potential avenue for growth looking forward?

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

Well, I think it's still good. I mean, the whole challenge for ADI in the power business has been to focus in on areas where we really have unique stuff. We've gone through a metamorphosis in that business about a year or two ago to better focus it to where it's -- particularly applications where we already have a very significant control over the bill of materials.

And I think the group out there has responded well to that. And I think we've begun already to see the benefits of better focus in that business. Pretty significantly last quarter -- I mean, one quarter doesn't make a business, one way or the other, but I think there are a lot of indicators there that if we focus -- I mean, we're not taking on the (inaudible) power business, trying to compete, of course, a $7 billion market with entrenched competitors.

We're looking for opportunities where we can do something unique and where we have a large control of the bill of materials. And I think if we do that and we stay true to that strategy, I think we'll do very well in that business.

Operator

[John Fitzer].

Unidentified Participant

Good afternoon, guys, and congratulations. I guess I'm going to go back to a comment I think, Jerry, you made in the opening comments about your short lead-times allowing you to gain some market share. I was hoping you can quantify that a little bit. Is that the main driver why some of the other businesses outside of converters grew more quickly sequentially? And are those share gains, you think, sustainable? And then I have a follow-up.

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

Well, I'd say quarter-to-quarter, it's very hard to make that judgment. I think the cross-over business is not significant relative to our total sales but it's significant I think relative to our reputation.

So I think the more important victory here, if there is one, is that customers come to us and we can supply the stuff. And certainly, the conversations we've had with our sales force is we wouldn't expect to be losing that business when other competitors start to deliver again. I mean, there's no reason for that.

So I think a lot of that business is going to stick. And I think it's going to increase in future quarters. So it's not meaningful relative to $650 million, $700 million of sales, but it's really relevant to the perception of analog as a supplier. I think that's the more important takeaway from this.

Unidentified Participant

Got it. And then just for my follow-up, Dave, going back to the deferred shipment line, understanding you need to adjust that sequential growth number for gross margins, but even when I do that, you're still kind of back to peak revenue levels but deferred shipments are above that level.

Just help me understand why I shouldn't be worried that that's some sort of yellow flag, that there might be some inventory building. Is there a change in the business where you're just going to be running with higher deferred shipments going forward? And how would you expect that to trend over the next few quarters?

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

Well, I mean, one thing you've got to remember is that the cost of the inventory being held at distribution is not necessarily the same. Or in other words, the gross margins aren't exactly the same change for the total company as they are for that. So the gross margin has actually improved a bit more at the disty level than they did for the total company over -- from the peak to peak period of time. So that's driving a lot of it.

I think you'll find, and I'm pretty sure when I did the analysis, that the days of inventory are actually lower than they were by a good 10 days or so from the Q4 '08 period. And we have pretty good accurate assessments of that.

Unidentified Participant

So it's all being driven by just better profitability on your guys' part?

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

Yes, that; plus I think disty is now back to levels where they're shipping at a fairly decent rate.

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

It turns out that companies like analog, the distribution margins are usually higher because the volumes we ship out and the customer -- it's much lower and the customer base is much more flattened. So that is a more profitable part of our business. It's also the part that services the industrial market mostly. So all those things add up to the fact that that business tends to be higher margin than anything else we do.

Operator

Craig Ellis.

Craig Ellis - *Caris & Company - Analyst*

Thanks and congratulations. It looks like record quarterly profitability, guys.

Just -- Dave, cycling back to gross margins, nice tailwinds and utilization and in factory shutdown and consolidation activity. Are there any headwinds at play? For example, last year, consumer grew at a well above average rate in the second half of the year. Anything like that going on?

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

Well, our anticipation is that mix will impact the third quarter by a little bit. But mix in either direction quarter to quarter tends to be well below a point. And we have enough things going the other direction in terms of utilization and cost reduction that are able to offset those and more.

Craig Ellis - *Caris & Company - Analyst*

Okay and then (multiple speakers) --

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

So we're not very concerned about gross margins and our ability to leverage.

Craig Ellis - *Caris & Company - Analyst*

A utilization-related question. I think we would typically expect analog companies to run the utilization levels in the low to mid 80s in the companies moving back towards the mid-70s. But how do you look at utilization here? Do you view it as something that can move up and be run in the mid-80s percent range? Or is there a reason why we should expect ADI's utilization level to really hover more in the mid-70s range?

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

Well, I think it has an opportunity -- this is Jerry -- to move up a little bit. And as Dave said, we've increased capital spending slightly to make sure we're right about this.

And I think the important takeaway on that is that for relatively small amounts of incremental capital, we can add capacity both cheaply and quickly. So the capacity additions that we're putting on are really incremental in nature. You know, our goal is to keep our lead-times low and that's what we're going to do; in the absence of something cataclysmic happening on the top line on the upside, I mean, that's where we're going to be.

Craig Ellis - *Caris & Company - Analyst*

And is the incremental spending on the capital side the uptick in guidance for the year on the front end or the backend or both, Jerry?

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

It's both. We're incrementally making more investments to get more internal wafers out. And we're also making investments in back end equipment to make sure that we'll get the wafers out; we can test them and so on. So it's really across the board.

But again, for a company that's running $2.7 billion, $2.8 billion, we're still -- our capital plan is below $100 million this year. So I think we've become a lot less capital-intensive and we can make, given the footprint we have in our fabs, we can make very incremental investments and get a lot more unit growth out there.

Operator

David Wong.

David Wong - *Wells Fargo Securities - Analyst*

I know that you don't want to give explicit guidance beyond the June quarter, but can you help us understand the seasonality in the September quarter? If we look back several years, in some years, September is a decline sequentially; and other years, it grows. Specifically, could you give us a feel for what proportion of your revenues today come from end markets that seasonally decline in the September quarter?

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

I think your comment earlier is probably one I'll spit back to you. It's very challenging to figure out precise seasonality when the markets are so volatile. So I don't think we have any better read on seasonally what happens in Q4 compared to the rest of the year. So we just don't know enough. I mean, some years, as you say, have noted go up; for some reasons, go down -- and some years, they go down. We just -- six months out, just don't have a good sense of what's going to drive that.

I mean, the only thing that we typically know is that our second quarter is usually the seasonally strongest quarter because it's more days in distribution than our first quarter, which has holidays. But beyond that, it bounces around year-to-year based on mix, based on the seasonality, based on inventory levels, based on -- so many things, it's just very, very hard to predict. And I think that's why we don't predict them.

David Wong - *Wells Fargo Securities - Analyst*

Okay, great. Well, just to try another quicker question with the elephant in the room, any signs of any weakening in demand from European end markets at this point?

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

No.

David Wong - *Wells Fargo Securities - Analyst*

Great. Thanks so much.

Operator

Stacy Rasgon.

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

Thanks for taking my question. One quick one on OpEx. Now that you're into basically back or exceeding previous peak revenue levels, would it be fair to say at this point that all of the temporary OpEx cuts that you were discussing before have now returned, and then all of the permanent cuts at this point have actually been completed? Are you basically at the right operating -- right OpEx model that you've been targeting? Are there any more, I guess, further -- is there any more further fat, I guess, to take out?

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

Well, we're at the model that we put out, about 33% of sales. And we are, as I think we -- Dave or I mentioned, in the coming quarters, we're planning to grow OpEx a lot less than our records, assuming the revenues come through that we expect.

So I think we'll get some more OpEx leverage in future quarters. I think the thing to note that is noteworthy on the OpEx line is that we've long had a plan in analog that incented all our employees to get our operating margins up quite a bit. And what you're seeing as the rise in OpEx over the last couple of quarters is primarily the result of that success.

It's not a trivial exercise to put on 700 points of operating leverage from last time with these kind of levels. So I think the pressure continues to keep moving the margins up in the Company. The payback for our employees for doing that has been quite high. Of course, the margins have been on a very steep incline. Even though we expect the margins to improve in future quarters, we don't expect -- or at least we're not anticipating to add another 700 basis points on the margins in the short-term.

So I think certainly the rate of acceleration of that is going to be down quite a bit. And we are going to try to control the OpEx to a fraction of the revenue growth rate. So the answer to your question is we still think we have some more OpEx leverage coming up in the future.

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

Got it. That's great. Thank you. A quick follow-up on, I guess, the RF business. So, I know the amplifier and RF business looks like it was up quite considerably, about 16% quarter-over-quarter. My understanding was a fair amount of the RF piece of this was actually the communication infrastructure that looks like it was down a little bit. But I know that this was a big kind of key strategic focus of yours that you talked about at the analysts day.

Could you just give us a little bit of color on what you're seeing in the RF business and, in particular, I guess, in the light of where it was this quarter and also maybe outlook for the year?

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

Well, I think it's a great business for us. I mean, if you came to the analyst meeting, you heard more of the detail of the applications. But it turns out that it's a fair amount of RF in the wireline side of the business as well as the wireless side of the business, and in other segments as well.

So I think we have a very broad product base in RF. We have great technology. The feedback we're getting from the customers in terms of growth and road maps to the future is very strong, so I think that's going to be a very important business for us and we're doing extremely well with it right now.

Operator

Doug Freedman.

Doug Freedman - *Broadpoint AmTech - Analyst*

If you look at the R&D tax credit getting extended, what impact would that have on the tax rate going forward?

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

You mean if it was approved?

Doug Freedman - *Broadpoint AmTech - Analyst*

Yes.

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

It's a percentage or two.

Doug Freedman - *Broadpoint AmTech - Analyst*

Okay, thank you.

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

That concludes our Q&A session. Thank you all for your participation, and we look forward to talking with you again during our third quarter 2010 conference call, which is scheduled for August 17, 2010, beginning at 5 p.m. Eastern. Thanks very much.

Operator

This concludes today's analog devices conference call. You may now disconnect.
