

FINAL TRANSCRIPT

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ADI - Q2 2011 Analog Devices Inc Earnings Conference Call

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Chris Danely

JPMorgan Chase & Co. - Analyst

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Raymond James & Associates - Analyst

PRESENTATION

Operator

Good afternoon. My name is Michelle I will be your conference facilitator.

At this time I would like to welcome everyone to the Analog Devices second-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). Ms. Kohl, you may begin your conference.

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

Thank you. This is Mindy Kohl. I just want to apologize that I have a bad case of laryngitis today, so I'm going to turn it over to Dave for the opening remarks.

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

Thanks, Mindy, and good afternoon, everyone. This is Dave Zinsner, Vice President and CFO.

We appreciate you joining us for today's call. If you have not yet seen our second-quarter fiscal 2011 release, you can access it by visiting our website at analog.com and clicking on the headline on the homepage.

This conference call is also being webcast live from analog.com. Select investor relations and follow the instructions shown next to the microphone icon.



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The 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 with me are Jerry Fishman, President and CEO; Vincent Roche, Vice President of Strategic Markets and Segments and Worldwide Sales; and Robbie McAdam, Vice President of Core Products and Technologies. This is an opportunity for you to get more color on the markets and product segments since we have Vince and Robbie joining us today.

During the first part of today's call, Jerry and I will present our second-quarter fiscal 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've updated the schedules on our IR website which include 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 product type.

Next, I would ask you to please note that the information we're about to discuss includes forward-looking statements which include risks and uncertainties. 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 which may be accurate only as of the date of the live broadcast which is May 17, 2011. With that, let's begin with opening remarks from our CEO Jerry Fishman.

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

Well good afternoon and thanks for joining us on today's ADI call. Our second quarter was a great quarter for ADI across virtually every dimension of our business with results that were way ahead of the earlier guidance that we provided last quarter.

Revenues were \$791 million which were up almost 9% sequentially and 18% year over year. Our growth was driven by strength in industrial, automotive, and communications infrastructure products which increased sequentially by 14%, 12% and 7% respectively. Sales of consumer products declined by 7% sequentially in Q2.

Order rates were very strong in Q2 and our book to bill ratio was above 1. Over the course of the quarter, orders were generally strong in February.

They spiked in March in reaction to industrywide uncertainty caused by the events in Japan and leveled off to more normal rates in April which were in line with what we would normally expect on a seasonal basis.

In managing ADI going forward, it's very critical that we carefully understand the upside that we experienced in Q2 and properly plan with that upside for the balance of 2011. Our best sense after analyzing all the data is that there are three principal factors that came into play in the second quarter.



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First, clearly the earthquake and tsunami in Japan resulted in less business for ADI in that region in Q2 as many factories were shut down and consumer demand dropped following these disastrous events in Japan. Secondly, the events in Japan likely caused an industrywide acceleration of buying by customers to build some safety stock.

Despite the fact that ADI's leadtimes remain short and we have had very few product shortages, we believe that customers, some customers anyhow, added some buffer inventory of ADI products during the quarter. While we don't believe that this was material to the results in Q2, it was nevertheless a factor.

The net of those two opposing forces, in one sense, Japan being weaker and in the other sense, some acceleration of orders in the second quarter, we estimate probably increased our second-quarter revenue by approximately \$20 million. However, it's important to note that even with this upside, caused by these events, revenues would have been above the high end of the range that we communicated at the beginning of the quarter, indicating that the fundamental demand for our products is very strong.

Lastly, our results were led by continuing strength in the industrial, automotive and communications infrastructure products; all markets which are growing and robust in most geographies and markets in which ADI is extremely well-positioned. In addition, we have very little exposure to the computer market and to the low-end cell phone market where competitive price pressures and uncertain demand patterns are certainly at the current time limiting market growth.

Our outlook for Q3 which I will comment on a little bit later in the call will take into account all of these factors. So now I'll turn the call back to Dave who will provide a few more details about our second-quarter financial results.

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

Thanks, Jerry. As Jerry mentioned, second-quarter revenues were \$791 million, increasing 9% sequentially and 18% from last year.

Gross margins were above guidance at 67.6% in the second quarter, a 140 basis point improvement from the prior quarter and a record for the Company. The increase in gross margins was driven by better utilization on higher sales and favorable product mix.

Operating expenses for the second quarter were \$236 million, a \$13 million or 5.8% increase from the prior quarter. The increase was a result of a planned salary adjustment, the first in three years, which took effect at the beginning of the second quarter and other related costs along with some modest strategic hiring.

As a percentage of revenue, operating expenses declined to 29.8% in Q2 compared to 30.6% of revenue in the prior quarter and 33% a year earlier. Operating profits for the second quarter were \$299 million or 37.8% of sales, up 220 basis points from 35.6% of sales in the prior quarter.

Here again, operating margins are at record levels for the Company. The increase in operating margins was the result of tge higher sales, continued strength in gross margins and tightly controlled operating expenses.

For the second quarter, operating profit increased sequentially by \$39 million or 15% on a \$62 million or 9% revenue increase. This represented a 63% drop through of incremental revenue to operating profits.

Other expense was approximately \$1.7 million compared to \$600,000 in the prior quarter. The increase was related to interest expense which increased as a result of the \$375 million 3% coupon bond that we issued on April 4.

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Our non-GAAP tax rate was just over 22% this quarter, in line with expectations. We expect the tax rate to remain at approximately 22% next quarter.

Diluted earnings per share from continuing operations was \$0.78 and non-GAAP diluted EPS from continuing operations was \$0.75 excluding a one-time tax benefit. This compares to diluted EPS from continuing operations of \$0.70 and non-GAAP diluted EPS of \$0.66 in the prior quarter.

Our cash generation continues to be strong as we generated 25% of our revenues or \$197 million in operating cash flow. Our cash balance now totals proximately \$3.4 billion of which approximately \$1.2 billion is in the US. Our Q2 cash balance includes the \$375 million 3% bond I mentioned earlier.

Net cash at the end of Q2 was approximately \$2.5 billion. Capital expenditures were \$34 million which resulted in free cash flow of \$163 million or 21% of revenue for the quarter.

In addition, we repurchased approximately 1.7 million shares or \$68 million worth of ADI stock in the second quarter. As a result of our strong financial performance and cash flow and our commitment to returning cash to shareholders, our Board of Directors approved a 14% increase to ADI's quarterly dividend to \$0.25 per outstanding share of common stock. This increased dividend will be paid on June 15 to all shareholders of record at the close of business on May 27.

Our accounts receivable balance increased sequentially by approximately 8% in line with our revenue growth and our day sales outstanding remained flat to the prior quarter at 48 days. All of our customers are current to their terms.

Inventory at the end of the second quarter increased by 4% sequentially and our days of inventory were 104 days compared to 105 days in the prior quarter. Our distributor inventory expressed in terms of days of inventory was up slightly in line with distributors' more positive outlook on business conditions and remains at target levels of approximately eight weeks.

Leadtimes for our direct OEM customers remain similar to last quarter and are in excellent control with 99% of our shipments to OEMs occurring within six weeks. Overall, from a supply chain perspective, we've not experienced any material impact from the Japan earthquake and tsunami.

We have no manufacturing facilities in Japan, have not experienced any shortages of raw silicon or processing and packaging materials and as our leadtimes show, we did an excellent job supplying to upside demand from our customers in the second quarter. In summary, by every financial and business metric, this was a very successful quarter for ADI. 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, CEO

Well with regard to our market performance in the second quarter, in the second quarter, our revenues from the broad and diversified industrial market which includes industrial automation, instrumentation, energy defense and healthcare grew 14% sequentially, reaching a record level of \$384 million.

Our strong results were primarily driven by growth in the process control and instrumentation markets with most other application areas within the industrial category showing sequential improvement as well. In addition, we saw strong sales both in our large OEM industrial accounts as well as in within our broad base of smaller industrial accounts.

In aggregate, industrial revenues represented 49% of our total revenues in Q2. Overall we continue to believe that the industrial market offers significant long-term growth opportunities in line with ADI's overall corporate growth rate, driven by our customers need for energy efficiency and higher performance in industrial automation and advanced instrumentation equipment, as well as an increasing trend to substitute capital for labor in modern factory buildouts around the world.

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For the balance of 2011, we expect industrial sales to remain Strong, a prediction that is supported by leading industrial customers who have reported that they believe underlying conditions in this market are very solid. For example, Siemens and ABD which are two of ADI's major industrial customers in their most recent earnings announcements reported double-digit increases in new orders, underscoring the strength in their respective businesses.

We believe that ADI is very well-positioned to benefit from the momentum that these and other many other industrial customers continue to see. Revenues from our automotive customers were \$106 million in the quarter, an increase of 12% sequentially from the first quarter. That was yet another record for our automotive business which in Q2 represented approximately 13% of our total revenues.

Leveraging our strength along the single chain sensors and signal conditioning and data converters and the [DFPs], ADI has developed a very compelling portfolio of solutions in the area of safety, entertainment, and also powertrain electronics. This portfolio along with a more robust market in automotive worldwide continues to drive our success.

During Q2, safety systems represented a large portion of our business in automotive with particularly strong sales in the area of stability control which is a new large market opportunity for ADI technology. In addition, infotainment remains strong in the areas of head units and audio amplifiers.

And in powertrain products, we experienced continuing success with our battery management products, achieving record revenue levels in Q2 with sales of key products such as our intelligent battery management solution which is used in low-emission vehicles. Looking ahead, we expect automotive to continue to be an important growth driver for ADI and we believe that we will continue to benefit from favorable macro trends within the automotive space in the areas of active and passive safety, entertainment, and fuel efficiency, all of which together should continue to drive higher dollar content for ADI.

Communications revenues at \$176 million for the quarter were up 7% versus Q1 levels. Sales to communications customers accounted for about 22% of our total sales in the quarter.

During the second quarter, escalating adoption of smartphones and the accompanying data growth continued to drive cellular market expansion in Europe, in North America and also in China. For ADI, wireless infrastructure sales surged in Q2 driven by strong base station demand as computing operators remain focused on aggressively expanding their capacity and their footprint.

We believe ADI will continue to benefit from this expansion as a result of the need for broadband high-performance mixed-signal radios in base stations and in point-to-point system. Less than 10% of our communications infrastructure revenues in Q2 were derived from TD-SCDMA equipment in China which given the large sequential communications revenue increase we saw in Q2 really clearly demonstrates the underlying strength and most importantly the breadth of ADI's position in the wireless infrastructure market worldwide.

Our current estimates are that TD-SCDMA revenues will begin to increase in the second half of the year as TD-SCDMA deployments we hope resume in China. Wired communications although down slightly quarter over quarter were up year over year in Q2 and continue to trend upward on an annual basis.

Though moderated to some degree by constraints on capital spending in the short term, we expect that the fundamental demand for higher wire traffic will continue to drive growth in this business for ADI over the longer term. Going forward, we expect that communications infrastructure will remain a key area of opportunity for ADI driven by the explosion in mobile broadband data usage and continued mobile subscriber growth pushing infrastructure capital spending to new high levels.

In the second quarter, our consumer revenues were down 7% sequentially primarily due to events in Japan as well as weaker consumer spending environments worldwide. Our Q2 revenues from consumer customers were \$111 million and accounting for 14% of ADI's revenues.



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During the second quarter, increased revenues from portable consumer products partially offset weaker revenues in digital camera products while home entertainment revenues were essentially flat sequentially. And finally, our computer revenues were flat sequentially but represented now just 2% of ADI's total revenue.

As most of you are aware, the computing market is not a space where ADI is applying almost any R&D resource. So let me now turn to the outlook for Q3.

Overall, business was very strong for ADI in Q2. As I mentioned earlier during the second quarter, industrywide uncertainty about supply related to the Japan disaster likely accelerated some demand which is not expected to repeat in the third quarter.

At the same time, our order trends were strong throughout Q2. Now we're entering Q3 with a book to bill ratio of above 1 and higher OEM opening backlog which together indicate continuing growth in the demand for ADI's products. In addition, our customer forecasts indicate continuing strong demand for industrial, automotive and communication infrastructure products and also some recovery in consumer products particularly in Japan.

In aggregate as a result of strength in our end-markets coupled with our continuing ability to supply upside demand, we're now more optimistic about what we can achieve in 2011 than we were when the year began. As such, we're planning for our third-quarter revenues to be in the range of \$765 million to \$795 million with a midpoint of about \$780 million which is above our original plan for Q3.

We expect continuing strong gross margins in the range of 67 to 68% and we expect operating expenses to be flat to down slightly sequentially. We believe that this should result in earnings from continuing operations in the range of \$0.70 to \$0.75 which was also above our original plan for the third quarter.

In summary, I am very pleased with where ADI is today and also where we are headed. Our heightened focus coupled with secular strength in the markets that are strategic for ADI is producing above market growth rates and makes us more optimistic about achieving the long-term growth rates that we projected.

Clearly the benefits of strategically focusing our R&D on higher margin and sustainable markets is beginning to pay off for ADI. And our fundamentally lower and more variable cost structure is resulting in one of the most profitable business models in the semiconductor industry today with upside opportunity and some downside protection.

Most importantly, our employees understand and support where we are headed and are enthusiastic about ADI's future and the role that they continue to play in our success. In a recently completed survey of our 8500 employees around the world, we noted very significant improvements in virtually every category of employee understanding and employee satisfaction which together are generally a very good leading indicator of our future success.

By design we're in the right places at the right times with a highly capable and energized workforce and our growth in financial returns which we believe will continue to drive superior returns for our shareholders are indicative of the strength of this position.

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

Thank you, Jerry. During today's Q&A period, please limit yourself to one primary question and no more than one follow-up question.

We'll give you another opportunity to ask additional questions if we have time remaining. Operator, we're now ready for questions from our analyst participants.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Chris Danely, JPMorgan.

Chris Danely - JPMorgan Chase & Co. - Analyst

Congratulations on a great quarter. First question, a little longer term, can you just talk about the gross margin drivers for the rest of this year? And then maybe throw in what the utilization rates are right now?

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

Sure, let me start with the utilization. Utilization was about 80% this quarter and it was about 75% last quarter. That's likely to come down a little bit next quarter. We'll While modulate our inventory build a little bit and we do have a shutdown planned over the July 4 holiday for the Wilmington site.

Long term, I think obviously at these gross margin levels we're pretty pleased but certainly exceeded our original expectations that we provided to you in the analyst day back in early 2010. I think most of the driver going forward has a lot to do with revenue both in terms of the absolute dollars of revenue driving margin expansion as well as the utilization creeps up beyond the 80% levels we are at today.

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

I think the other part of it has to do with the fundamentally better product mix that we've had over the last year or two. We have really increased our focus in the B2B space and certainly those markets provide much higher gross margin opportunities than some of the other higher volume and much more competitive segments.

So I think that the combination of the utilization -- we have the factories properly sized that we can get the upside that we need -- even though we had 30 million or \$40 million more revenues than we thought we were going to have, but yet we have extremely low costs in those factories. So I think it's really a combination of certainly if utilization creeps up, the gross margin should respond well to that, and certainly as the product mix continues to evolve more towards the B2B space or the business-to-business space, I think that could have some positive drivers as well.

So as Dave said, we were wondering about a year ago if we could sort of get past the 63, 64% area on gross margins. I think now we are comfortably above that and we're looking around for continuing opportunities to move that. So we'll have to see how that goes but those are the primary drivers.

Chris Danely - JPMorgan Chase & Co. - Analyst

Thanks. And for my follow-up, just a little more color on Japan. If you guys could, could you estimate how much of the weakness is due to demand versus is anything on the supply constrained side? And then how did you guys arrive at that \$20 million number?

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

Well first of all, there was a word in front of the 20 that said approximately. So this is not a scientific calculation about that.

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What we did is we looked at some of our logistics group and the people who were servicing the customers, looked at customers that they know pulled some orders in and we made some estimates on others, and we came up with that number based on the best guess we have from looking at our large customers and our small customers. By definition it's a very complicated number because we serve 60,000 customers around the world in all these different countries who are all going through different cycles.

But I thought it was important to come up with an estimate of that to properly set the stage for Q3 and Q4. Because there were some one-time things in Q2 and we wanted to try to at least put boundaries on that to help everybody understand what were the one-time benefits that we got or what the sustaining part of the growth curve that we're operating on is.

So we don't have any -- we don't have a spreadsheet that adds up to plus or minus \$10 on this thing. We just have some guesses from the large and the small customers about what happened.

The best guess we have is that the events in Japan and the Japanese market probably cost us \$5 million to \$10 million in revenues in Japan and the rest of it was upside that we got from other customers. So that's -- if we had to make a guess, that would be the guess for the balance that we saw.

Chris Danely - JPMorgan Chase & Co. - Analyst

Great, that's very helpful. Thanks a lot.

Operator

Terence Whalen, Citigroup.

Terence Whalen - Citigroup - Analyst

Congratulations on the strong results. This first question is a little bit higher level question regarding buyback. It seems like secularly, ADI is doing very well in end-markets, having very good uptake of its product across a number of applications.

And it appears based on the margins and the returns that you're generating that your stock looks cheap at these levels. I was wondering given that you have a fairly large authorization, why weren't you more aggressive in the buyback this quarter?

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

Well, a bunch of reasons. First of all, for a large part of this quarter, the world was a very uncertain place. There were people that were projecting the world was going to come unglued; they couldn't get substrates, they couldn't get plastic, they couldn't get wafers.

We were concerned about that as well early in the quarter, so we were a little bit more hesitant. The other part is we just raised the cash balance in the US.

So we did a financing in early April to get a larger cash balance in the US, give us more flexibility in the future to do that. Right now based on the results, we decided to raise the dividend substantially as one indication of that. But I think that opportunistically as we said and we've proven in the past, we've had to be aggressive buyers of our stock when we think it's appropriate.



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Terence Whalen - Citigroup - Analyst

Okay, thank you. And then as my follow-up, I was hoping that maybe Vincent or Rob, you could chime in on what are maybe one or two key takeaways from progress on the reorganization of the sales and products groups a year and a half ago? I was hoping to get their view on maybe one or two of the most positive benefits of that and also perhaps one setback that they've encountered as well. Thanks.

Robbie McAdam - Analog Devices, Inc. - VP, Core Products and Technologies Group

Maybe I will chime in on that one. I think there are two very, very tangible benefits we're seeing at this point.

I think one, the strategic planning process in terms of how we allocate the vital resources in terms of R&D, our fuel resources and so on, we have gotten a lot more strategic clarity around where it is we want to play and how it is that we create the win for the Company. I think as well we're just in terms of being able to engage with our critical customers, the key customers in terms of really getting a granular understanding of our needs and being able to define products in a way that address those needs in the most aggressive and innovative way, those are two clear benefits I see at this point in time.

Robbie McAdam - Analog Devices, Inc. - VP, Core Products and Technologies Group

Yes I mean -- it's Robbie here -- I think about having much more clarity and certainty about our long-term strategies, knowing that we've got winning strategies and knowing where we don't in fact, changing it.

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

I'll throw an answer in on the hardest part, the second half year question. The hardest part I think in this thing is we have radically turned ADI upside down in the last couple of years.

I mean the numbers and the results we're getting are not just normal things that happen. So, we have changed the strategic balance in the company Tremendously where we're putting money and where we are not.

We've gotten out of business, we've increased investment in other businesses. We have virtually the top 30 people in the Company in different jobs primarily than they had including Vince and Robbie, I would say, than they had 18 months ago.

And when you take an organization that is as large and complex as ADI and you're trying to transform it in ways we have both on the strategy side, on the operational efficiency side, on the cost side, we've changed direction on many, many things we were doing to get to where we've gotten, and it just takes time in the organization to get everybody around to that point of view. One of the reasons we did the survey that I mentioned earlier in my comments -- and we really didn't exactly know what the results of that survey were going to be when we did it.

So one of the reasons we did is we really wanted to see if there was some really significant fundamental movement in the way people were thinking about what was going on in the Company and what they saw the issues are. I think the largest issue that people have seen as result of that inside the Company is that there are different jobs and they're adjusting to them, and it takes a while.

Their perspectives are different. They don't get to make some of the decisions that they used to make on their own without regard to what customers wanted and so on.



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So I think those are just things that we're pushing our way through. I was very pleased by the results we got in the survey. When we look at some of the numbers, people really believe things have changed here and they're generally very enthusiastic about the change. I just wish like always it would happen faster.

Terence Whalen - Citigroup - Analyst

Thanks, very helpful color, Jerry. Thanks, Robbie.

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

Unlike you guys who give us long periods of time to see results.

Terence Whalen - Citigroup - Analyst

That's right, thank you.

Operator

Uche Orji, UBS.

Unidentified Participant

This is (inaudible) for Uche. Just a question on the your results and outlook.

Even if we adjust the impact from Japan, [the pull in] for demand, you're a lot better than many of your peers. So just wondering is there any other dynamics at play like you're seeing any acceleration in (inaudible) of design wins or any share gains that you are seeing better revenues than your peers?

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

I think the third part of the mix for the quarter that I mentioned in the opening comments was we are doing extremely well in the B2B business right now. For markets like industrial where many people believe there was sort of a slow growth stodgy market and at last year's analyst meeting, we had the guy that runs our industrial business stand up and say that his goal is to grow that business as fast or faster than any of our other businesses, and everyone sort of rolled their eyes and said that was not really possible.

I think I mentioned in one of the last couple of quarter calls that I really believe the guy and we're seeing that, that there's a huge re-industrialization going on in many countries of the world. There's a tremendous substitute of capital, industrial capital for labor going on every place in the world.

And the industrial business with the push on efficiency and so on is really creating great opportunities for our technology. So I think when you look at that market and the infrastructure market, I mean if there is a reason that generically we are doing better, it's because the market segments that we are strategically committing to, market segments where we have added resource at the expense of other market segments where we retracted resource, I think those tend to be markets that are doing extremely well right now and that's one of the reasons that our performance is differentiated right now.

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I think secondarily we have created a great model with our operations and logistics people where we are able to respond very rapidly to upside and downside demand and take care of our customers. And that helps us a little in these -- in the short term we get a few more orders and we get to fill a few more sales.

But I think long term, we've created an environment where customers really believe they can rely on us. And I think that is a big competitive advantage in the longer term. So I think it's those reasons that really as we have analyzed everything are contributing to some of the upside.

Unidentified Participant

Just to follow up on the industrial market, you indicated that you expect to see continuing demand momentum going forward. But if you look at the macro data that's coming out, that seems to indicate some slowdown on the industrial market. Just wondering how do you reconcile the two data points and also (multiple speakers)

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

Well you also have to have a point of view and try to manage this business, and we tend to listen a lot more to what our customers are saying than to what economic sages are saying right now. So we've always had a philosophy over the last couple years that we're going to build what our customers say they need.

And we are going to keep the leadtimes short and we are going to deliver to them when they need the product. And if it turns out that the customers are wrong, then we'll have a little bit too much inventory which generally is not a problem for us because a lot of it last forever given the product cycles we have.

But the one thing we can't afford to do and we won't do is try to second-guess our customers of what they are telling us over the next few quarters. So we are going to build what the customers say they want and we're going to be prepared to respond to upside if it's a little bit better and we're going to be able to throttle it pretty quickly if it looks like they're not meeting their forecasts.

That's all we can do in running the Company. Because if you read all the summaries and you try to track all the economic analysis, it just gets very confusing and I think you make very large mistakes by doing that. So we have a very simple model. The customers tell us they want it, we build it.

Operator

Steve Smigie, Raymond James.

Steve Smigie - *Raymond James & Associates - Analyst*

Congratulations on the great numbers here. My first question is just you break out -- one of your categories is amplifiers in RF. On the RF side, was hoping you could talk about where you see you guys now product-wise and what that roadmap might look like for your products in that category over the next couple of years.

Robbie McAdam - *Analog Devices, Inc. - VP, Core Products and Technologies Group*

Well, the RF business has various aspects and the largest portion of it is in communications infrastructure. As we've said over the years, we had a very strong position in data converters in communications, so that's basically base stations is the main part.

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And over the last seven years, we've been investing in components in the RF and we've been building our share aggressively over that.

The second part of the RF business is in the industrial space (inaudible) smart metering, a lot of industrial communications and remote sensing and our narrowband RF (inaudible) so we just see RF as the final frontier in terms of performance frequency and we have to say, this just has been growing very heavy for us over the last while. We haven't -- we will continue to increase our share in the base station area as (inaudible) that has got to be one of the driving factors over the last year and a half.

Steve Smigie - *Raymond James & Associates - Analyst*

Okay, and I had just one quick follow-up on gross margin. I apologize if you touched on it. But in the past, you'd indicated a couple drivers for margin were going to be pricing the products a little bit better. And then the other thing is you had certain products you thought you could design for manufacturability in a better way.

I apologize if you touched on that, but if you haven't, could you just give us an update how far are you in terms of those two issues? Or is there still room left to get some more margin yet out of that? Thank you.

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

Certainly those are all factors that led to -- if you look over the last year or two, gross margins were up 12 points or something, 13 points. So those were all factors that contributed to that.

I would say that that is a never-ending mission at Analog. We're continuing to bang on the products where the margins aren't what we want them to be.

We're continuing to look for opportunities to keep the price levels up and particularly for the older products where customers really value the fact that we will supply them for 20 years. I think a lot of those things are areas that we just continuously focus on and if we're successful, that ought to help.

But it hasn't ended with where we are today. But no, we're not going to predict the future on that until we get there. But overall that is a continuing program at ADI is the best I can say.

Steve Smigie - *Raymond James & Associates - Analyst*

Great, thanks a lot and congratulations.

Operator

Shawn Webster, Macquarie.

Unidentified Participant

This is (inaudible) for Shawn. Thanks for taking the question.

I had a question about your communications business. It looks like it's reaccelerated during the quarter despite the weak China spend. Can you talk about the dynamics in that market? Is there some kind of dollar content story that's taken off your LTE or what else do you think is going on here?

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Vincent Roche - Analog Devices, Inc. - VP, Strategic Markets and Segments and Worldwide Sales

Yes, our business is strong across the 3G and now we're seeing an emergence of 4G technologies being deployed in areas like America for example. So, typically three or five years ago, our business was heavily 2G and 2.5G based.

The content we are getting per system in 3G and 4G systems is higher. With each progression from across the generations, we are getting typically higher value content per system.

And I expect that to continue in the future as well. So that is a big, big part.

So I think part of the story is that there's just more deployments across the board in general as operator scramble to meet the capacity needs, to be able to meet the consumers' need for mobile video data (inaudible) increases. So I think in general, what we're seeing is a mixture of macro trends and ADI getting more share per customer and more content per system and I expect that to continue in the years ahead.

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

I think one of the takeaways that I commented on in the opening comments was our business grew pretty significantly despite that TD-SCDMA has been sort of much slower over the last six to nine months. That just goes to the breath of the deployments that are going on and our position with customers who are supplying to a much wider market than just China.

So I think we look at that as a good leading indicator to the future because eventually the TD-SCDMA deployments will pick up and we will get that on top of what we're already getting in the broader market.

So, with the large infrastructure customers, the top five or six ones that add up to 90% of the market, we have extremely strong position and that's really helping us. You know, there were a lot of -- there used to be a lot of comments of fears that most of the business was China and that if CDMA slowed down, that business would disappear. But I think the fact that we're doing this without any real growth there is a very good sign for us.

Unidentified Participant

Yes, it's very helpful. Thank you.

Also about the public sector, there's been some commentary especially at Cisco this week about a weakening public sector. People talk -- obviously Washington has had a lot of issues with budgets. Are you seeing any weakness in the defense sector or any kind of other public business that you had?

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

Go ahead.

Robbie McAdam - Analog Devices, Inc. - VP, Core Products and Technologies Group

We've seen a little growth. We lump aerospace and defense into the same cluster. And we're seeing I would say very, very moderate growth there there. But I don't see any particular discernible trends on public spending effect on our business.

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Unidentified Participant

You don't see any weakness going forward or anything to cause concern?

Vincent Roche - *Analog Devices, Inc. - VP, Strategic Markets and Segments and Worldwide Sales*

That's a relatively small portion of our business (multiple speakers)

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

That's a small part of that industrial category. We thought from time to time we ought to grow that more because our products are very suitable in many of those applications.

But we just haven't had a huge focus on that. And maybe that is some opportunity for the future but it's not a very large portion of our sales to date.

Operator

Sumit Dhanda, Citadel Securities LLC.

Unidentified Participant

This is Ian in for Sumit. Just a question, could you comment a little bit on orders quarter to date and how that may relate to the level you saw in February sort of pre-earthquake spike?

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

I think what I can tell you is the order level that we had for the first couple weeks was pretty indicative of what our guidance is.

Unidentified Participant

Okay, so maybe just asked differently, if you kept the current rate, would you expect a positive book to bill in the quarter?

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

We really just don't know. So I mean we -- the quarter is only two weeks old. We try to take a look at it to see if our universe changed in the two weeks since we ended the quarter.

I think what Dave said is it hasn't and I think that's all we can really say or try to project based on two weeks of data.

Unidentified Participant

Fair enough. Just on automotive, Jerry, I think you touched on this a little. But could you parse the automotive business between the sort of core traditional safety business and maybe some of these newer infotainment and powertrain applications? Are those new apps half the business today or more or --?

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Robbie McAdam - *Analog Devices, Inc. - VP, Core Products and Technologies Group*

On the safety business, it's not air bags anymore. It's stability control. So we're seeing a lot of growth in the actual MEMS-based part of our business which is really around stability control, antiskid systems using our gyroscopes.

And the remaining growth is coming from as we mentioned earlier battery monitoring, engine sensing, just all of the additional signal processing that goes around making cars more efficient as well as their -- those are mainly (inaudible) cars today and that's where most of the business is coming from.

But the traditional core as you call it MEMS business has transformed from being an airbag business really to being a stability control business and that's we're (multiple speakers) as well as, not the only growth.

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

We've mentioned in the past the gyroscope products that were in an enormous invention. In fact, just last quarter, we promoted the guy who sort of invented a lot of that in Analog to be a fellow at Analog which is our highest technical achievement.

And it's really got a lot of traction. I mean our gyro is unique in the industry, it offers tremendous advantage and stability control is a huge opportunity going forward because it's legislated many countries now.

And so I think that is one of the areas that we're getting a lot of upside in and I think we will continue. But I don't have the breakout of how much that business is versus the engine control. Down in the ranks we probably do but I don't have it handy here.

Unidentified Participant

Got it. Well, thanks for the color.

Operator

There are no more questions at this time.

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

Okay, that concludes our Q&A session. We appreciate your participation and look forward to talking with all of you again in our third-quarter 2011 call on August 16. Thank you.

Operator

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

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