FINAL TRANSCRIPT

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ADI - Q3 2010 Analog Devices Inc. Earnings Conference Call

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PRESENTATION

Operator

Good afternoon. My name is Courtney and I will be your conference facilitator. At this time, I would like to welcome everyone to the Analog Devices' fiscal third-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, Courtney, 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 third-quarter fiscal 2010 release, you can access it by visiting our website at www.analog.com and clicking on the headline on the homepage.

This conference call is also being webcast live on 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 are Jerry Fishman, President and CEO; Dave Zinsner, Vice President of Finance and CFO; Robbie McAdam, Vice President of Core Products and Technologies; and Vincent Roche, Vice President of Strategic Market Segments and Worldwide Sales. We've invited Robbie and Vince, who happen to be in the Boston area today to join the call to answer any questions you might have on specific areas of focus.

During the first part of today's call, Jerry and Dave will present our third-quarter results as well as our short-term outlooks. The remainder of the time will be devoted to answering questions from our analyst participants. We have updated the schedules on our IR website, which includes a historical, quarterly and annual summary P&L's for continuing operations, as well as historical quarterly and annual information for product revenue from continuing operations by end market and product types.

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

The forward-looking information that is provided in 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 new developments may cause our outlook to change. Therefore, this conference call will include time-sensitive information that may be accurate only as of the date of the live broadcast, which is August 17, 2010.

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

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

Well, thanks, Mindy, and thanks to everybody for joining us today on the third-quarter results call.

Business conditions at ADI continued to strengthen during the third quarter. Revenues for the third quarter grew 8% sequentially and 46% year-over-year, approximately $720 million, as we experienced strong demand across virtually every market we serve and also every geography.

Gross margins and operating margins were both at record levels and were well above the levels that we planned for the quarter, primarily as a result of strong growth, favorable product mix, lower manufacturing costs, and continuing very tight operating expense controls.

Overall, we're making very good progress on continuing to focus ADI and in fundamentally improving our business model. Given the strength of current demand, we're planning for Q4 to be another quarter of growth, of increasing profits, and a very strong cash flow. Clearly, we continue to closely monitor and closely analyze our customers' demand patterns to better understand the current order rates.

Overall, our sense is that some product shortages from some of our competitors are causing some customers to boost their orders on ADI to some degree, but for the most part, our customers are reporting that their inventories are being well-controlled relative to the demand they're experiencing from their end customers.

In addition, there are very important macro trends in the industrial market, the communications market, the automotive market, the healthcare market, that are generating very strong growth opportunities for ADI, which are currently boosting our revenue. I'll comment a little bit in more detail about some of these trends right after Dave reviews the financials for the quarter.

In the short-term, we're planning to build what our customers are telling us they need. We're planning to keep our lead-time short. We're planning to keep tight control of our costs and to carefully monitor order rates for any inflection point in the future.

It's important to note, as we look at it, that our current revenue levels are right on the curve of our long-term growth rates, if you eliminate the volatility of 2009 and 2010. We've also significantly increased the percentage of our operating expenses that are variable with sales and profits, which affords us considerable downside protection if the market does turn negative.

So now let me turn the call over to Dave Zinsner, who will provide a little bit more details about our financial results.

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

Thanks, Jerry. As Jerry mentioned, third-quarter revenues were $720 million, growing 8% sequentially and 46% from last year. Gross margins for the third quarter were 66.7% and that's a 170 basis point improvement from the prior quarter. The increase was driven by slightly better utilization on higher sales, a slightly better mix, and lower spending resulting from the closure of our Cambridge manufacturing facility.

Operating expenses for the third quarter were $229 million, a $9 million or 4% increase from the prior quarter, well below our sales rate. Most of the increase was related to variable compensation expense due to increased sales and improving operating margins. We're now approaching maximum variable compensation levels, which, under our current plan, max out at current profit margins.

Operating profits for the third quarter were $251 million or 34.9% of sales, up 290 basis points from 32% of sales in the prior quarter. This was the fifth consecutive quarter that we expanded operating margins, which are now more than 1,000 basis points above the prior peak, clearly demonstrating that we are, in fact, continuing to focus ADI and fundamentally improving our business model. Other income was approximately $200,000.

Our tax rate was 20.6% as we adjusted our annual rate from 21.3% to 21%, excluding the effect of restructuring expenses, and so our fourth quarter tax rate should be approximately 21%. Weighted average share count was flat at 306 million shares.

So, as a result, earnings were $0.65 per diluted share, which is an 18% sequential increase from the prior quarter and an almost three-fold increase from the prior year. As you know, our goal is to grow earnings at a faster rate than revenue, and this is the sixth consecutive quarter we were able to achieve that goal. Cash flow from operations was $225 million or 31% of sales, and we closed the quarter with $2.5 billion in cash or $2.1 billion in cash, net of debt.

Our accounts receivable balance increased approximately 8%, which was in line with sales, and our days sales outstanding remained flat at about 45 days. Inventories increased by 7%, which was slightly below our revenue growth this quarter and in line with our expectations for continuing growth in the fourth quarter. Our days of inventory increased slightly to just over 100 days.

Although we feel that it is prudent to run at a slightly higher level of inventory to meet any upside in demand and keep our lead-time short, our plan is for inventory to be below 100 days at the end of the fourth quarter, when you assume the midpoint of the revenue expectations. This is in line with our model of 90 to 100 days.

In dollar terms, inventory at distributors increased in line with increasing revenues, but days of inventory remained flat. Distributors had approximately 50 days -- 57 days of inventory in the third quarter and that's flat with the prior quarter. Our manufacturing team pays close attention to the inventory at distributors and works hard to keep the inventory at a healthy level, which we target to be approximately eight weeks.

Likewise, the manufacturing team pays close attention to lead-times for our direct OEM customers. This quarter, our lead-times increased very slightly, but again, remained in good control with 96% of our shipments to OEMs occurring within six weeks and 98% within eight weeks. By all accounts, we once again executed well, [as] a result, we are running the business at a significantly higher profitability level versus prior peaks.

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

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

Okay. Well, with regard to our market performance in each of the market segments in the third quarter, first, I'll just give you some comments on the industrial market.

For the fourth consecutive quarter, we've seen strong sequential growth from the broad and diversified industrial market. In the third quarter, industrial revenues grew 8% sequentially with $341 million, which followed some very strong industrial quarters in the preceding two or three quarters. Our strong results were primarily driven by growth in the industrial automation and instrumentation market, but virtually every application area within the industrial category showed sequential improvement.

In aggregate, industrial revenues represented 47% of our revenues during Q3. Activity in the industrial market continues to accelerate, as manufacturers increase their capital spending, rather than their labor costs, to increase productivity, reduce costs, and meet demand. In addition, the drive towards energy efficiency across a broad range of industrial applications requires increased use of high-performance signal processing technology from ADI.

Interestingly, in the past few weeks, we've heard commentary from our industrial customers that gives us confidence that they're ordering products from ADI in line with the demand that they're seeing from their customers. For example, ABB's CEO, Joe Hogan, said recently in his Quarterly Report -- and I quote this -- "After a severe industrial recession of the last two years, customers have started again to invest in technology for energy efficiency and productivity." And Emerson Electric, another one of our large customers, said in their most recent filing -- "Order growth for industrial automation remains very high across all business, with particular strength in the power generating alternator, electrical drive, power transmission and fluid automation." These are all areas where ADI's technology is highly relevant.

ADI supplies these and thousands of small customers, developing all kinds of measurement tests and data acquisition products. Other of ADI's large industrial customers, such as Rockwell, Agilent, National Instruments, and Danaher, just to mention a few, have also offered very similar commentary about the trends they are seeing in their business.

In ADI, specifically, we're benefiting from increased industrial sales in Asia, including China, as we replicate our very strong industrial position that we enjoy in the United States and Europe in what now is the fastest-growing economies of the world.

In the automotive business, revenues were approximately $84 million, which is similar or consistent with the prior quarter after a few quarters of heightened growth of automotive sales. Our sales automotive customers represented 12% of our total sales in the quarter. Again, here, our feedback from many of our automotive customers indicates that they believe that unit volumes have stabilized and that demand remains strong for high-end vehicles, which is where ADI's technology is the most relevant.

In addition, the macro trends within the automotive space, including safety, fuel-efficiency, and convenience, are all continuing to drive higher electronics contents, and consequently much higher dollar content available for ADI. In summary, automotive has become a very attractive market for ADI, where we have the momentum from both increasing the available market per vehicle and increasing market share at ADI.

In the communications market, our revenues were about $154 million in the third quarter and were up 14% sequentially versus the second-quarter level. In aggregate, sales to our communications customers accounted for 21% of our sales during the quarter.

The major focus for mobile operators remains servicing the mobile data demand and improving operating efficiency. So there's a mix of new deployments and upgrades to address the mobile data needs, along with the refurbishment of the millions of existing sites with modern, multi-standard equipment to gain operational efficiency for the operators.

Just recently, one of our key customers, Ericsson, describes mobile subscriber growth as a key driver for infrastructure capital spending, but also the ever-increasing need for higher bandwidth to support the dramatic increases in video demand pushes this need even further. ADI's position in this market continues to strengthen, as we hold major market share for our converters, our amplifiers and our RF or Radio Frequency products, on the radio cards of the largest and most successful infrastructure equipment company in the United States, in Europe, and also in China.

We're equally optimistic about wireline communications, which had its fifth consecutive quarter of sequential improvement, delivering very good returns on the very significant investments we've made over the past few years, and new applications for ADI such as optical and cable. Here, again, the need to drive voice, data, and video through the same network drives more sophisticated analog content within these applications. In the wired infrastructure communications business, we are very well-positioned with products that deliver the performance required to advance network applications.

Finally, in communications, our revenues from handset customers also increased in the third quarter. Although handsets represent a relatively small percentage of ADI's total revenue, we focus on new products on solving the most difficult multimedia and human interface challenges within smartphones, which creates a richer user experience. Given the relative success these applications are having, versus the broader handset market, we believe this segment has solid growth potential in the future for ADI.

Revenues from the consumer end markets were about $129 million, a 7% increase from the prior quarter. Our sales to consumer customers accounted for a total of about 18% of our sales, and were driven by strength in portable media devices, digital cameras, as well as several other consumer entertainment products. In aggregate, for most consumer products, demand has been tepid, as consumers endure a very tough external environment. However, in the electronics segment of the consumer market, growth has been reasonably strong. As a result, we've seen this market continue to recover as we enter what is usually a strong seasonal quarter for our consumer business in our fourth fiscal quarter.

And finally, in the computing area, our computer revenues were approximately flat sequentially but represent only 2% of our revenue. As we mentioned in prior calls, and I think you're aware, that the computing market is not a space where ADI is applying any significant R&D resources.

So, our new orders in aggregate were very strong in the third quarter. Our book-to-bill ratio for the third quarter, as measured by end customer bookings, which we think is a more important measurement, was above 1, and our fourth quarter opening backlog was up from last quarter. So, given these factors, we expect our revenues will grow to somewhere's in the range of $740 million to $770 million in the fourth quarter. And once again, we expect that growth will be broad-based across virtually all the end markets and all the geographies.

In Q4, we're planning for gross margins to again be in the range of 66% to 67% of sales. We expect that operating expenses will grow; but consistent with our model and our prior recent history, we expect the operating expenses to grow well below our revenue growth. As a result, we anticipate that our operating margin will improve to 35% to 36% of sales and earnings will grow to a range between $0.68 and $0.72.

Obviously, there continues to be a lot of uncertainty in the economies around the world and we will continue to closely manage our operating expenses corporate-wide. Notably, today, approximately 17% of our operating expenses are variable, up from 9% when the cycle began, providing us the flexibility to rapidly modulate spending in response to changing market dynamics. Nevertheless, as I mentioned earlier, we are planning to build what our customers have asked, but we'll continue to monitor order activity for any changes in demand patterns.

Today, we continue to be one of the industry's most reliable suppliers, and that gives us important competitive advantages, not only in the short-term, but I think, more importantly, in the long-term, as our customers decide who their long-term vendors are going to be.

So, in summary, we run our business according to a consistent set of priorities regardless of whether we're operating in an up-cycle or a down-cycle. We believe that our actions to strategically invest in innovative products that give our customers a competitive advantage, make fundamental improvements to our cost structure, and deliver superior quality and superior reliability, to continue to provide very sustainable benefits for ADI going forward.

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

Thank you, Jerry. During today's Q&A period, please limit yourself to one primary question and no more than one follow-up question. We'll give you another opportunity to ask additional questions if we have time remaining.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jim Covello, Goldman Sachs.

Jim Covello - *Goldman Sachs - Analyst*

Great. Thank you, guys, so much for taking my question. I appreciate it. Congratulations on the good results.

A couple questions. If we look at the communications segment, do you perceive any significant difference in wireline versus wireless, as we go through the rest of the year in terms of strength of opportunity there?

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

I think it -- you know, the market -- obviously, markets move in different directions quarter-to-quarter, but I think that our penetration in the wireless infrastructure market has always been very, very strong. And our content has been increasing, which gives us a good opportunity there. And in the wired stuff, most of what we're seeing is increases in share in that business, with new product offerings and some new product categories for us.

So I think the -- each of them, or at least ADI, has very different drivers. In the -- just reiterating, in the wireless side, it's mostly more content in every base station. On the wireline side, it's just brand-new functionality that we're offering into those markets that we never offered before. So I think it has more to do with our penetration of those markets than what -- how many routers some of the guys sell or how many pieces of equipment they sell. Ours is, in that regard, is mostly about new functions penetrating new applications for us in the wireline side.

Jim Covello - *Goldman Sachs - Analyst*

When you mention that, because that was going to be my next question relative to automotive, I mean, how much of the strength in automotive for ADI is the market versus content per box growth of ADI, within the automotive segment now?

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

I'll make some introductory comments and then I'll ask Vince, who runs the automotive segment for us, to talk a bit about it. But generally, it's mostly about penetration. It's new functions that are required on cars. And some of those are in safety. I mean, we've been supplying accelerometers and air bags for many, many years but we're now supplying gyroscopes that go into stability controls.

We're now doing a lot of sensors that manage engines characteristics and many other things. We're doing a lot of new functions that go into the entertainment systems. So, just in aggregate, I think for ADI, it's mostly about your new functions that are penetrating new applications, not so much about the unit growth of the automotive market. But it's (multiple speakers) --

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

Well, I think that's well-stated, Jerry. We clearly see an increasing sum for the spaces that we provide technology. And I think not only is the dollar content per car growing for us in terms of opportunity, but also we're increasing our market share, particularly in the safety area. And as Jerry pointed out, the gyroscope, which is a critical component that requires tremendous precision, is a technology that's being adopted in the active safety area. And we're very, very well positioned there on the mid- to high-end.

Jim Covello - *Goldman Sachs - Analyst*

Is it possible to (multiple speakers) --

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

It's always, Jim, somewhat dependent on the unit growth [actually] internally. (multiple speakers) I think a larger part of our -- the reason that automotive is now 12% of our sales -- it used to be 6% or something -- is mostly because penetration of new functions in cars that our technology is very well-suited for.

Jim Covello - *Goldman Sachs - Analyst*

Could we quantify the [SAM] today versus what it was a couple years ago?

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

The SAM that's available to Analog?

Jim Covello - *Goldman Sachs - Analyst*

Yes.

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

I think it's hard to do that. We certainly don't have those numbers here. But it's quite a bit larger based on the new technology that we're bringing into cars. But I couldn't quantify it, sorry.

Jim Covello - *Goldman Sachs - Analyst*

Okay. Thank you so much.

Operator

Craig Ellis, Caris & Company.

Craig Ellis - *Caris & Company - Analyst*

Thanks for taking the questions and very nice job on the revenues and margins, guys. Jerry, you mentioned that you expected broad-based strength in the outlook. Does that mean you expect about equal growth from each of the end markets? Or do you expect particular end markets to be noticeably stronger than others?

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

Well, I mean, we don't -- I mean, we have our backlog and we look at that very carefully. But backlogs are not usually very representative of what you ship the next quarter because they're so volatile. But I think, conceptually, we generally see a stronger consumer quarter in the fourth quarter. That's in line with historical trends.

So I think the only real anomalous thing in the fourth quarter is going to be, we'll probably get more than historical -- previous historical quarterly increases in the consumer business, which is very typical for our fourth quarter. I think other than that, we expect the automotive market to be up somewhat, the industrial market to be up somewhat, and the communications market to be up somewhat too.

Craig Ellis - *Caris & Company - Analyst*

Okay. That's helpful. And then the follow-up is for Dave. Dave, you've done a very good job really moving above both your target gross and operating margins. When does it make sense to revisit the target model? And then you set forth an 8% to 12% revenue growth target for the Company longer-term at the Analyst Day. Has there been anything that you've seen, either internally to ADI or externally, that causes you to think any differently about long-term revenue growth potential of the Company?

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

The second one first. No, there's no changes to our outlook in terms of what we think we can execute to on a long-term basis. As for the model, there's no update to the model at the moment. We're actually in the process of going through our 2011 plan. I suspect in the next few months we'll have a lot more granularity as to what we can expect.

But as we kind of look through the P&L, as good as everything was, we saw opportunities to improve in several different areas. So I think the expectation is that we can continue to do better over time.

Craig Ellis - *Caris & Company - Analyst*

Thanks very much, guys.

Operator

Ross Seymore, Deutsche Bank.

Ross Seymore - *Deutsche Bank - Analyst*

Congrats from me as well. Dave, just a couple questions on gross margin. Within the July quarter, how much did the fab closure help? And last quarter, you talked about one-third of the cost savings already being felt and two-thirds remaining. How should we think about the gross margin benefit going forward from those cost savings?

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

Well, as I said, we had a 170 basis point sequential improvement in gross margins. And a fair amount of that came from the Cambridge -- the lower cost of manufacturing we got from the closure of Cambridge. I think most of that's behind us. There may be a little bit more to go in the next quarter, which will obviously drive the gross margins up.

And then, offsetting that, as Jerry talked about, the mix of consumer, although it's been dramatically improving over the last few quarters, and is actually getting closer and closer to our Company average -- still provides a little bit of headwind. And so, you know, I think offsetting that is what we would kind of expect -- I mean, that's kind of why we're expecting flat gross margins for next quarter.

Well, anything else? I missed the rest of your question, Ross.

Ross Seymore - *Deutsche Bank - Analyst*

No, that was pretty much it on the gross margin one. And then, I guess, the one follow-up -- Jerry, you mentioned a stat about the percentage of your OpEx that's variable. I just wanted to make sure I had the timing right. Right now you say at 17%. The 9% of costs that was variable, was that at the beginning of this cycle --?

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

[It began] and it's about 17% now.

Ross Seymore - *Deutsche Bank - Analyst*

What was it two years ago, like, at the prior peak?

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

(multiple speakers) -- about two years ago, yes.

Ross Seymore - *Deutsche Bank - Analyst*

(multiple speakers) The 9%?

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

(multiple speakers) That was -- it was about 9%; now it's about 17%.

Ross Seymore - *Deutsche Bank - Analyst*

Okay. Great. That was it. Thank you.

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

Yes, one follow-up to what Dave said that I just thought -- I think it's important to emphasize is, for many, many years, we got a lot of feedback and concern from our investors about the only growth was going to be in consumer and the consumer margins were going to go down. And therefore, we're either going to have to lower the margins to get growth and all that stuff.

And I think the point that Dave made, which was very, very important is that the consumer growth margins have come up quite a bit. And they've come up quite a bit because -- for two reasons. One is we've got the costs of those products down quite a bit. The other part is we're now working on products that by and large we can get paid for; whereas some of the other products we were working on had quite a bit lower gross margin.

So, the facts or the statement that Dave made, that the consumer gross margins are now approaching the corporate total gross margins, it's still lower but not nearly as much lower as they used to be, I think is a very, very important point to point out there.

Operator

Uche Orji, UBS.

Uche Orji - *UBS - Analyst*

Jerry, first of all, congratulations on the numbers. Let me just ask you very quickly -- utilization rates -- any way you can quantify what the utilization rate is now? And while you're answering that, how much revenue can your current capacity support, as union demand continues to prove to be positive?

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

Oh, utilization was right around 80% this quarter, up from kind of the low 70s last quarter. And we have actually been increasing the denominator, in other words, increasing our capacity over the last few quarters, with very nominal capital spending, I would say. So, as we kind of look through the next year, we're pretty optimistic that, regardless of what the situation looks like for next year in terms of revenue, we think with just a little bit of capital, we can meet that demand.

Uche Orji - *UBS - Analyst*

Alright. Thanks for that. And just another question quickly on -- some other people have reported recently -- all mentioned some area of tightness, be it in the back-end, or be it in the front-end with some wafer capacity from the foundries. Are you noticing any of this at all? I mean, in terms of affecting any of your areas of business, be it either from your foundry partners or from any of your back-end companies that you use?

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

Well, capacity, of course, with these kind of increases that semiconductor companies are reporting is kind of tight; but in these parts of the cycle, it's the relationships that you build with the purveyors of capacity, be it front-end or backend, that really differentiate one company versus another.

Our manufacturing folks and our product folks have done a remarkable job in building relationships with the foundries and the back-end suppliers, that have really allowed us to get through this cycle so far with -- we reported a 46% increase year-over-year. And we've kept our lead-times short, which really goes to the quality of the relationships and, also, I think, the quality of the people who decide how to build our products within the Company.

So -- you know, because foundries are -- they make very careful selections when they're out of capacity of who to service. And we've been very fortunate that we've had these relationships externally that have really helped us through that period. So, we could have probably shipped a little more [this] quarter if we had a little bit more capacity. But I'd say by and large, the most important thing is, we've had enough capacity that we've been able to garner to keep our lead-times short and to keep our customers believing that we're differentiating ourselves from any of our competitors.

So, I think we're in pretty good shape. We have been and I expect, unless something changes, we'll continue to be.

Uche Orji - *UBS - Analyst*

Okay. And just one last question. Communications was the best performance segment, I think, sequential growth in revenues in the July quarter. As we look into your guidance, $720 million to $770 million, what will be the areas of focus in terms of what could drive it towards the higher end of that? And I know this is the typical range you tend to guide, but by segment, if I can get a sense of where the focus areas could be or where?

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

If I knew that, I would know a lot more than I really know. But no, I think based on the backlogs we have, which is all we can really look for, we expect we're going to get growth into the segments, and probably the highest growth, at least if history is a good indicator of the future, it's going to be in the consumer markets in the fourth quarter.

But we just don't know yet. I mean, one of the real challenges in diverse companies like ADI is sort of trying to pick where these -- what's going to grow in the short-term more than others and what product to build, and where to put on the capacity and where to take it off. So that's a very challenging thing for us to predict long-term in advance.

But if there's any cyclical part of this thing, or secular part of this thing, the fourth quarter is that probably the consumer business will grow faster than the others. But I wouldn't bet a lot of money on the accuracy of that prediction -- because we just don't know.

Uche Orji - *UBS - Analyst*

Okay. Thanks, Jerry.

Operator

Terence Whalen, Citi.

Terence Whalen - *Citigroup - Analyst*

Great. Thanks for taking my question. This one's for Dave. Dave, I think your net cash is about $2.1 billion; have a significant potential to buy back stock, ex-cash your stock is at about 7.5 times your four- and 12-month earnings. Can you talk a little bit about how you evaluate the opportunity for buyback? Also remind us how much of your gross cash domestically versus internationally patriated. Thank you.

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

About $750 million or so is domestic and the remainder is international.

As far as use of cash flow, at this point, given the uncertainty, it's good to actually have some cash on the balance sheet. It was only 18 months ago when the world felt like it was coming to an end. So I think we're just trying to be cautious and prudent.

I would say that we are doing a buyback right now. We have bought back some stock. We're also -- want to make sure that we maintain the dividend, and that's very important to us and, I think, to our shareholders. But we'll continue to evaluate further buybacks as time goes on and we'll update you when we that -- when we make a change.

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

I think -- I'll just -- I'll add a little color to that, at least from my perspective, that we have a lot of cash, and if we look out and assume the world is not going to come unglued, we have this potential to generate quite a bit of cash over the next couple of years. So I think there's lots of ways to get financial leverage when you're generating a lot of cash, and we're looking at all those. I think that's the best way to describe it.

Terence Whalen - *Citigroup - Analyst*

Okay, great. And then as my follow-up question, this one's on just simple gross margin mechanics. You guys are outperforming your target model right now, sort of at a record level of gross margin.

How are we to think about -- and it seems that a lot of the one-off improvements in gross margin related to manufacturing, footprint, et cetera, have been realized -- how should we think about gross margin, say, if you have a January quarter that's a seasonal quarter, down several percent? Will we expect gross margin to decline half a point or a point? Can you give us some understanding of how we should think about that in out quarters under a normal seasonal situation? Thank you.

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

I think it'd be difficult for us to tell. I mean, it's somewhat dependent on what the mix might look like, consumer -- if things were to fall off, consumer might fall off more and mix would be beneficial. So, tough to call, particularly two quarters out. Probably the best I could say is we can give you an update next quarter when we're closer to the first quarter.

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

I think the take-away comment probably is that our stated goal and what we've been able to do so far is when these cycles get higher highs and higher lows. And I think we're pretty confident that we can do that, given the margin structure of the Company.

Terence Whalen - *Citigroup - Analyst*

Great and congratulations.

Operator

Steve Smigie, Raymond James.

Steve Smigie - *Raymond James & Associates - Analyst*

Great, thanks, and I'll add my congratulations on the great numbers. I was hoping you could talk a little bit about turns in the quarter and turns in the guidance?

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

Yes, this one -- as you know, as we looked at these numbers, we decided they were almost irrelevant, if not completely irrelevant. The backlog that gets placed on us from the disty's is almost an irrelevant number, given the fact that we recognize all our revenue once the disty's ship out. So it's relatively low, because the disty's -- turns requirement, that is, is relatively low, given that disty's are placing a fair amount of backlog on us. But I think it would be almost worthless to give you any kind of number.

Steve Smigie - *Raymond James & Associates - Analyst*

Okay. This is a separate question. I was hoping you could clarify -- you made a comment earlier on your prepared remarks about you had maxed out the compensation or something like that. It's just -- hoping you could discuss a little bit more. Does that mean you get more operating leverage going forward or less? And just so if you could just give a general discussion of what R&D and SG&A look like, given what you said?

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

That's a good question, Steve. You know, as we've kind of ramped our operating margins, one of the -- what you might call headwinds to the operating margin leverage has been the fact that variable comp has increased as operating margins have been increasing. There's a cap to that and we're really approaching that cap. And so once we get beyond, I think, 36% or so of operating profit as a percentage of sales, really there isn't any incremental variable comps -- or not very much, at least -- variable comps, that increases as operating margins and sales go up beyond that.

So, the leverage going beyond this, if revenue were to ramp or continue to ramp is actually -- will start to accelerate.

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

I think as Dave has said on previous quarters, the largest ingredient in OpEx includes the -- that we've had over the last couple of quarters, is variable comps. So our goal in Analog has always been, in the last couple of years, to get more and more of these expenses being variable, given the volatility out there in the industry.

So in some ways, we've got a very aggressive plan in Analog to get our operating margins up. And we've accomplished many of those goals. And as a result of variable [comps have] moved up very quickly as the operating margins moved up by, as Dave mentioned earlier, 10 points. And we always believe that was a very valuable way to actually run the business -- it was valuable to investors and it gave us more variability in the fixed costs of the Company.

So -- but like most plans, there's a cap on it, and when you get up to a certain level, it doesn't go down from there but it doesn't go up from there, like it's been going up at a pretty good rates. When you're putting up two or three points of operating margin improvement a quarter, that variable comp formula is very reactive.

So I think what Dave is basically saying is that it's going to sort of peak out around here a little bit higher, and any improvements above that are not going to raise the OpEx at the rates it's been raising it over the last couple of quarters as we went from [25] to [35] to kind of operate.

Steve Smigie - *Raymond James & Associates - Analyst*

Great. Thanks a lot, guys.

Operator

Shawn Webster, Macquarie.

Shawn Webster - *Macquarie Research - Analyst*

Maybe circling back up to the utilization rate question, it sounds like you expect it to tick up a little bit. I guess I was wondering, historically, Jerry, in the past, what has been the highest utilization rate you've observed in the past for your business?

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

Well, we've had periods where utilization was 110%. Of course, we didn't get much out and the lead-time stretched out. We can easily run our fabs up to 90% without any real problems. When you get above 90%, you start to -- you've got to be right on the mix, which is always hard to do.

But I think the important point is that -- and we've said this, I think, in previous calls, that the way the internal capacity is right now, we could incrementally add capacity with very low risk, very quickly with very low capital. So I think what we're doing right now is we're making sure, with relatively small incremental capital investments, that we can have whatever capacity in place that the customers need for us.

We have a very strong fixation around Analog about keeping the lead-time short, because when the lead-time starts extending, you get very confused about what real demand it. So, for us, the independent variable is the lead-time and everything else is dependent on keeping those lead-times short. So as you can see in the capital spendings report, we raised capital spending a little last quarter. And I think that's mostly to make sure that whatever the customers tell us they want, we can ship to them pretty responsibly.

Shawn Webster - *Macquarie Research - Analyst*

And do you expect your lead-times to take out a little bit more during this quarter before they stabilize?

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

(multiple speakers) -- our plan. Like I said, the independent variable for us is lead-time. Everything else comes from that determination. Our goal for lead-times is keeping them about where they are, going forward, because we really think both in the short and long-term, it gives us a great competitive advantage.

Shawn Webster - *Macquarie Research - Analyst*

And on that thread, how much would you say of your business in terms of percent of revenue, or however you think about it, is business which is second sourced, where near-term, you have a chance to gain share from competitors who may have tighter supply conditions than you have?

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

I think it's relatively small. As we think about the lead-time question, it's much more important in the long-term than it is in the short-term with how much you can pick up a few more percent short-term revenue, which I think we probably picked up. But the most important thing about lead-times now is -- the large customers just get absolutely infuriated when, because semiconductor vendors can't ship product for whatever reason, they can't ship their products and it costs them market share.

So I think all the feedback we're getting from our large customers right now is that we've distinguished ourselves on the lead-time question. And that's going to really influence their long-term decisions where they have a couple of choices, as they always do, of who are going to be the critical, strategic vendors for these customers.

So I think the affect of lead-times is much more long-term in nature than the short-term advantage you get on a relatively few parts that is using second sources for, that we get orders for if one of our competitors can't deliver. I think it's much, much more important in the long-term than it is in the short-term.

Shawn Webster - *Macquarie Research - Analyst*

Okay. Thanks a lot.

Operator

David Wong, Wells Fargo.

David Wong - *Wells Fargo Securities - Analyst*

The percentage of your revenues that come from products made at foundries, is this -- roughly, what is this and has this percentage been rising or falling in recent quarters? Do you expect it to go up or fall in coming quarters?

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

It's been relatively flat over the last few quarters. We're roughly running about 50/50. And I don't see any reason why it would change; although we're really not trying to manage that number, it's really a function of mix, based on where the products we have designed -- where they're manufactured and how well they do.

David Wong - *Wells Fargo Securities - Analyst*

Right. And the current levels of utilization at your blended gross margin from products made at foundries are above or below the products made internally?

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

Usually with products manufactured internally carry a better margin.

David Wong - *Wells Fargo Securities - Analyst*

Great. Thanks.

Operator

Chris Danely, JPMorgan.

Chris Danely - *JPMorgan - Analyst*

First of all, congrats on some outstanding margin expansion getting above the previous peak.

My question was -- first question is on the end markets. Now that things seem to be settling down a little bit, is it your impression that we're going to get back into a more normalized revenue growth/end market scenario from here on out?

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

Well, that's certainly the hope. I mean, you know, there's a lot of different scenarios that could play out here. One is that the whole increase, of what everyone has seen in the last 12 months is just an anomalous bubble, and the whole world is going to collapse and go back to where it was in 2009 again.

But if you -- I mean, that's why the comments I was making earlier about, when we look at -- if you draw the lines between where the world was before the disaster and the recovery this year, you know, that growth-laid line is pretty consistent with where we are now, which would at least lead to some credence to the fact that what we'll see is a return to more normal long-term growth rates in these markets. And there won't be a huge correction from these kinds of numbers that we're seeing right now.

But there's a lot of different people that have a lot of different opinions about that. And we don't know much more than they do about that. But certainly, there's quantitative rationale for that belief, that things will get back to more normal patterns and it won't be a huge collapse.

Of course, there's like I said, there's different opinions on that. And at these kinds of valuations, I think there's a lot of people that believe the world is going to come unglued. And that happens to be their opinion. We don't know more than you do about that, so it's hard to predict.

Chris Danely - *JPMorgan - Analyst*

Yes, I know less than nothing. But most importantly, you're not seeing any concern on your end customers, though, right?

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

No.

Chris Danely - *JPMorgan - Analyst*

Great. And then on the second question, in terms of the going-forward gross and operating margin drivers from here, could you just maybe comment on those? And are there any further step functions in improvement we could see in either?

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

You don't relax on the margins, do you? Yes, I mean, we're constantly looking to get the mix better. We're constantly looking for ways to improve our costs. We still have some product areas that aren't earning the right returns that we're trying to make better. So there's always opportunities for continued improvement. And we've been very aggressive reaching into those and I think we're going to continue to be aggressive on them.

Chris Danely - *JPMorgan - Analyst*

Great. Thanks.

Operator

Stacy Rasgon, Sanford Bernstein.

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

Thanks for taking my question. I was wondering if we could drill a little bit into the industrial business? So, right now, you've had four quarters or so of very good growth in the business. I was just wondering if you could go maybe a little bit more granular into the drivers of what's been driving that business well above previous peaks?

And maybe if you could give a little bit of comparison to the prior peaks, say, in 2008 and versus, say, the trough that we saw in 2009? Any color on new markets that you're in that you weren't in back then? Any color on market recoveries? Any color on share gains?

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

Let me make one introduction comment and then I'll turn it over to Vince. I think if you really look at the industrial revenues, we're not running significantly higher on a running rate basis than we were in 2008. So, it's a little bit higher, but in general, if you just project normal growth from 2008 to 2010 where we are, and you see about where the industrial revenues are, which at least gives some credence to the fact that maybe we're just going to start growing at more normal rates going forward -- and not just as a clip.

I mean, you know, it's important to remember that 2009, our industrial revenues [were about] 25%, which is a staggering number in a market that's relatively stable. So I think you've really got to draw the long-term line rather than looking at any quarterly peak or valley to try to see where we are. When you draw that line in the industrial market, you can clearly get -- if the world hadn't had the peaks and valleys, these are about the rates that we'd be at if things had been normal over the last two years.

But with that, in terms of some of the segments, I'll turn it over to Vince.

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

Thanks, Jerry. Yes, the industrial sector for ADI is really dominated by the industrial automation and the instrumentation sectors. Both of those have been tremendously strong over the last four or five quarters. And I would say in terms of getting boost from a new growth area, I'd say the energy sector is beginning to emerge as a significant piece of the industrial business now as well.

I would also say from a geographic perspective that what's very encouraging to ADI is that our business in Asia, particularly in China and the Asia-Pacific region, showed the highest growth -- very, very high growth in the last couple of quarters when compared to the more developed markets, which means we're, I think, gaining share and getting good traction with the emerging customers with the broad base of products that ADI has got.

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

You know, historically, [we always] have been extremely strong in the industrial market in the US and Europe. And what we've been working hard on for the last four or five years is developing the same relative strength in China and the rest of Asia, as we have in the US and Europe. And that's been a real slow process. It takes forever to get at a lot of those small accounts and all over weird geographies and so on. But we're getting some real traction on that. And that is really helping us in the industrial product area.

I don't know if there are many of you who went through -- attended our analyst meeting six months ago or so in Boston, you might remember that Mike Richfield, who runs our industrial business, got up and said that his goal is not only to be the most profitable business in Analog, which it is today, but also be amongst the highest growth, if not the highest growth, business in Analog.

And he went into a fair amount of detail of each of these subsegments, some of which Vince mentioned, some of which he didn't, of why he believes that the industrial business can grow at or above the average [rate now at] Analog. And I think in the summary comments I said, Mike is a serious guy. And I wouldn't bet a lot of money against Mike who's expert and who's been around these industrial customers for years and scoping out these opportunities. And I think we're seeing some of the benefits.

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

Got it. Thank you. And for my follow-up, just one quick question -- you said that you are doing a buyback. I noticed you bought back a little bit this last quarter, about $4 million. Does that imply that that's the beginning of a buyback that is continuing into Q4?

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

Well, we have -- I think it's somewhere in the range of $90 million of approved buybacks. And so at the moment, we're just -- we've been buying back kind of the dilution associated with the options. So, assuming that there's dilution next quarter, that program would be set up to do that. And we're evaluating the broader buyback and trying to balance that with the other uses of cash that we might have.

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

I think, conceptually, we've just been nibbling at it a little bit. We haven't been serious buyers recently and we're evaluating exactly what we want to do about the financial structure of the Company going forward.

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

Got it. Thank you, guys. Congratulations.

Operator

Mark Lipacis, Morgan Stanley.

Mark Lipacis - *Morgan Stanley - Analyst*

Thanks for taking my question. You talked about the variable comp maxing out at 36%. Does that reset -- do you guys reset that next year? Thanks.

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

Yes, we -- next year, we're -- we haven't yet determined the bonus plans, the variable comp plans, but I expect when we do, we're going to have both a margin component and a sales growth component. Of course, for the last couple of years, it's been mostly about getting the margins up. For the next couple of years, sales growth is equally important to margin growth.

So I expect that when we look at that, we're going to reset the targets and decide the various -- at what level we want to pay what bonus. But I think it's probably fair to say no matter how well we do next year, it's unlikely that the variable comp payments are going to be higher than they were this year.

Mark Lipacis - *Morgan Stanley - Analyst*

Okay. That's helpful. The other question -- Dave, you mentioned pretty good visibility into distributor inventories. For the products that you ship directly, could you just qualify or provide color, like how do you think about inventories at customers you're shipping direct to? What do you think about the kind of visibility you have there and how they're tracking and behaving? Thanks.

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

Well, we utilize their bookings; most of them provide some level of forecast. And then Vince and his team have a fair amount of dialogue with them directly to understand what their needs are. We're not obviously getting automated reports from them every week on their inventory levels like we get at the disty, but we get a lot of, I guess, what you'd call more qualitative understanding. And I would say it probably affords us almost as much visibility as the disty's really at the end of the day.

Mark Lipacis - *Morgan Stanley - Analyst*

Thank you.

THOMSON REUTERS

Operator

Your last question comes from the line of Steve Smigie with Raymond James.

Steve Smigie - *Raymond James & Associates - Analyst*

Great. Sorry to squeeze in a last one. Just on the auto business, I noticed it was flat sequentially. Obviously, you've had some great quarters in a row and huge year-over-year growth. Now that we've sort of come up from some pretty low levels, how should we think about that progressing over coming quarters? Is that going to be sort of a sequential grower, given the dollar content gains, new features, et cetera? So just sort of maybe a secular type sequential pattern, if you could.

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

Well, quarter-to-quarter, it's very hard to predict any of these sectors and segments of what's going to happen. But I'd say if we assume a relatively stable economy out there, I'd say that the auto business will grow sequentially year-to-year. And that's about all we can predict right now. I mean, it's very challenging to predict any quarter of what any of these segments will grow.

I mean, Vince said earlier that his expectations for Q4 were that, based on the backlog and what we've seen, we ought to get some more growth in the automotive business. That's our plan right now. We'll see how that turns out.

Steve Smigie - *Raymond James & Associates - Analyst*

Okay. And just on the converter business, can you talk a little bit about how you're thinking about that and how you're managing that? Are you managing that business at this point for share gain? Are you managing it just for overall general growth? And if you could talk a little bit just generally about -- I mean, for product introductions, I'm just trying to understand how you're thinking about the growth opportunity in the next year, roughly?

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

Yes, okay. But no, the converter business, first of all, the converter businesses that we have thousands of customers across all the segments and thousands of products. So it's a very fragmented business. And I don't think -- it's not a business where you tweak a price and you change your growth curve.

It's been -- we look at this as long-term. We have a market share of 46% in converters, which is unique in the industry to have that kind of a share leadership. And you know it's obviously job one for this company to maintain our share, both in terms of technology, in terms of markets in this space. So -- and I tended -- we look at each segment differently. Jerry and Vince mentioned where we're trying to increase our industrial business.

And so I think that -- it's not that we don't look at it as a trade-off between growth and share necessarily, we say, how do we maximize and maintain our leadership positions across all dimensions of this converter business over a long period of time, as we have done over the last 20 -- or 40 years, in fact, and consistently to the last, say, 10 years.

So I think it's more -- it's a great franchise. We have a fabulous position with that market share. And maintaining our position, our leadership position, is how we look at it without being too numerical about it.

Steve Smigie - *Raymond James & Associates - Analyst*

Okay. But is it a certain number of product introductions you're trying to have recorded to maintain that leadership position? Or is that just the wrong way to think about it?

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

Yes -- no, I mean, again, it's a fragmented market. We went through a range of products for industrial and for consumer and products for automotive. So it's very application-specific. And so we have a strategy for each market and submarket segment. And we have core technologies that we -- certain products are introduced to push the core technology further, even before there's an anticipated demand. So we're investing a lot of our R&D, unusual amount of R&D in the converter space, more than anybody else. And that's something that we've been investing the right amount to really maintain leadership in that space.

Steve Smigie - *Raymond James & Associates - Analyst*

Great. Thanks a lot.

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

Okay. That concludes our Q&A session for today. We appreciate your participation and look forward to talking with all of you again during our fourth-quarter 2010 conference call scheduled for November 22, 2010, beginning at 5 p.m. Eastern. Thanks very much.

Operator

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