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TXN - Q2 2015 Texas Instruments Inc Earnings Call

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OVERVIEW:

TXN reported 2Q15 net income of $696m or $0.65 per share. Expects 3Q15 revenue to be $3.15-3.41b and EPS to be $0.62-0.72.

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PRESENTATION

Operator

Good day, everyone, and welcome to the Texas Instruments second-quarter 2015 earnings release conference call. At this time I would like to turn the conference over to Mr. Dave Pahl. Please go ahead.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Good afternoon and thank you for joining our second-quarter 2015 earnings conference call. As usual, Kevin March, TI's Chief Financial Officer, is with me today.

For any of you who missed the release, you can find it and relevant non-GAAP reconciliations on our website at ti.com/ir. This call is being broadcast live over the web and can be accessed through TI's website. A replay will be available through the web.

This call will include forward-looking statements that involve risks and uncertainties that could cause TI's results to differ materially from management's current expectations. We encourage you to review the notice regarding forward-looking statements contained in the earnings release published today, as well as TI's most recent SEC filings, for a more complete description.

I will start with a quick summary. Revenue declined 2% from year ago inclusive of notably weak demand in communications equipment and continued strong demand in automotive. In the quarter, we also had about a $45 million negative impact year-over-year from currency exchange rates, as expected.

Even in this environment our core businesses of Analog and Embedded Processing together grew slightly year-over-year and comprised 85% of second-quarter revenue. Analog delivered its eighth consecutive quarter of year-over-year growth.

Earnings per share were $0.65, up $0.03 from a year ago. With that backdrop, Kevin and I will move on to details of our performance which we believe continues to be representative of the ongoing strength of TI's business model.

In the second quarter our cash flow from operations was $820 million. We believe that free cash flow growth, especially on a per-share basis, is most important to maximizing shareholder value in the long term. Free cash flow for the trailing 12-month period was $3.6 billion, up 13% from a year ago.

Free cash flow margin was 27% of revenue, consistent with our targeted range of 20% to 30%. This is a two percentage point improvement from a year-ago period and we believe reflects our improved product portfolio and the efficiencies of our manufacturing strategy, the latter of which includes our growing 300-millimeter analog output and the opportunistic purchases of assets ahead of demand.

We also believe that free cash flow will only be valued if it is returned to shareholders or productively invested in the business. For the trailing 12-month period we returned $4.1 billion of cash to investors through a combination of stock repurchases and dividends.

Analog revenue grew 3% from a year ago due to High Volume Analog & Logic. Power Management also grew. Silicon Valley Analog was even and High Performance Analog declined. As mentioned earlier, this is the eighth consecutive quarter of year-over-year growth for Analog.

Embedded Processing revenue declined 2% from a year ago after 10 consecutive quarters of year-on-year growth. This decline was due to the weakness in wireless infrastructure equipment for the processor product line. In contrast, the connectivity and microcontroller product lines grew.

In our Other segment revenue declined 17% from year ago due to custom ASIC products, which are highly concentrated in wireless infrastructure equipment. DLP products also declined while calculators grew.

In distribution resales increased 8% from a year ago. Weeks of inventory decreased by 1 week to just above 3.5 weeks, which is a historically low level. We believe this inventory level reflects an environment of good product availability due to healthy TI inventories and stable lead times, which together drives high customer service metrics. It is also important to note that inventory in our distribution channel has decreased over the past few years because we've structurally changed how inventory is managed with our consignment program.

Now I'll provide some insight into our revenue performance by end markets versus a year ago, which in total resulted in the revenue in the bottom half of our range due to more significant softness in communications equipment and incremental softness in industrial. Specifically by end market, automotive had strong growth with almost all sectors inside this market growing at double-digit rates.

Industrial revenue was about flat in contrast to last quarter's year-over-year growth and was incrementally weaker than we expected. More specifically, there was growth in about half the sectors inside of industrial, but these were offset by declines in others.

Personal electronics grew in total due to one large customer. Outside of this customer, almost every sector inside of personal electronics declined, including PCs as we expected.

Communications equipment declined primarily due to the wireless infrastructure sector which was down about 50% from a year ago, even weaker than we had expected going into the quarter. And enterprise systems declined due to DLP projectors as we had expected.

In general, as we look to the third quarter, the strength in demand varies by end markets, but our market in total is expected to be weaker year-over-year and our outlook for TI revenue and earnings is consistent with this environment.

While we don't control the near-term environment of our markets, we do control the focus on making TI stronger through our approach to manufacturing and technology, the breadth of our product portfolio, the reach of our market channels and our diverse and long-lived positions. These four attributes taken together are at the core of what makes TI unique and capable of long-term free cash flow growth.

Kevin will now review profitability, capital management and our outlook.

Kevin March - *Texas Instruments Inc. - CFO*

Thanks, Dave, and good afternoon, everyone.

Gross profit in the quarter was $1.88 billion or 58.2% of revenue. Gross profit was even from the year-ago quarter despite lower revenue, as we benefited from lower manufacturing costs. Gross margin was up 110 basis points.

Moving to operating expenses, combined R&D and SG&A expenses of $790 million were down $31 million from a year ago. The decline reflects the targeted reductions in Embedded Processing and Japan, which have been completed. Acquisition charges were $82 million, almost all of which were the ongoing amortization of intangibles which is a non-cash expense.

Operating profit was $1.01 billion, up 3% from the year-ago quarter. Operating profit margin was 31.3% of revenue, up 150 basis points from a year ago. Operating profit margin for Analog was 35.5%. Operating profit margin for Embedded Processing was 19.6%, almost 5 percentage points higher from a year ago as we focused our investments for growth and now see the benefit from our plan to better align resources with the opportunities that we are pursuing. Net income in the second quarter was $696 million, or $0.65 per share.

Let me now comment on our capital management results, starting with our cash generation. Cash flow from operations was $820 million in the quarter. Inventory days were 126, as we had expected.

As our business model has evolved, we continue to evaluate our inventory model. Capital expenditures were $125 million in the quarter.

As a reminder, in April we retired $250 million of debt. In addition, we issued $500 million of five-year debt at a coupon rate of 1.75%. Including the $750 million of debt due in August of this year, we will have retired $1 billion, while having issued $500 million in debt this year. This is consistent with our practice over the past few years. This will leave total debt of $4.125 billion with a weighted-average coupon rate of 2.3%.

On a trailing 12-month basis cash flow from operations was $4.1 billion, up 14% from the same period a year ago. Trailing 12-month capital expenditures were $476 million, or 4% of revenue. As a reminder, our long-term expectation is for capital expenditures to be about 4% of revenue, which includes the 300 millimeter Analog plan discussed in our February capital management call.

Free cash flow for the past 12 months was $3.61 billion, or 27% of revenue. Free cash flow was 13% higher than a year ago.

As we've said, we believe free cash flow growth, especially on a per-share basis, is most important to maximizing shareholder value in the long term and will be valued only if it is returned to shareholders or productively invested in the businesses. And as we've noted, our intention is to return 100% of our free cash flow, plus any proceeds we receive from the exercise of equity compensation, minus net debt retirement.

In the second quarter we paid $354 million in dividends and repurchased $654 million of our stock, for a total return of $1.01 billion. Total cash returned in the past 12 months was $4.08 billion. Outstanding share count was reduced by 3.1% over the past 12 months and by 40% since the beginning of 2005. These returns demonstrate our confidence in TI's business model and our commitment to return excess cash to our shareholders.

Fundamental to our commitment to return cash are our cash management and tax practices. We ended the second quarter with $3.31 billion of cash and short-term investments. TI's U.S. entities own 82% of our cash. Because our cash is largely onshore, it is readily available for a variety of uses, including paying dividends and repurchasing our stock.

TI's orders in the quarter were $3.26 billion, down 2% from a year ago. Turning to our outlook, we expect TI revenue in the range of $3.15 billion to $3.41 billion in the third quarter.

As we've said, while strength in demand varies by end markets, our market in total is expected to be weaker year-over-year in the third quarter than it was in a second. This includes a negative impact of about $40 million due to changes in currency exchange rates.

We expect third-quarter earnings per share to be in the range of $0.62 to $0.72. Acquisition charges, which are a non-cash amortization charge, will remain even and hold at about $80 million per quarter until the third quarter of 2019. It will then decline to about $50 per quarter for two additional years.

Our expectation for our annual effective tax rate in 2015 remains about 30%. This is the tax rate you should use for the third quarter and for the year.

In summary, even in a weaker market environment such as we saw in the second quarter and expect in the third, our business model, which is built upon the four attributes that Dave mentioned earlier, delivers strong free cash flow. As a reminder, these attributes are our approach to manufacturing technology, the breadth of our product portfolio, the reach of our market channels and our diverse and long-lived positions. We believe these attributes in combination are unique to TI and they are sustainable, giving us the ability to provide continuing returns to our shareholders.

With that, let me turn it back to Dave.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Thanks, Kevin. Operator, we can now open up the lines for questions.

In order to provide as many as you as possible an opportunity to ask a question, please limit yourself to a single question. After our response we'll provide you an opportunity for an additional follow-up. Keith?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Chris Danely, Citigroup.

Chris Danely - *JPMorgan - Analyst*

Thanks, guys. A little bit of a longer-term question. Could you give us your sense, having the benefit of six, seven months of hindsight on why the semi market is sucking wind right now?

And then I think the last time things were like this was 2011 and 2012, so if you could, give us a sense of comparison on how things are right now versus 2011 and 2012? Is it better, is it worse is? Is it the same, do we not know?

Kevin March - *Texas Instruments Inc. - CFO*

Chris, I'll go ahead and take a stab at that, I guess. I think that what we are seeing right now is basically customers adjusting their expectations as to the growth rates for the remainder of the year, and toning down a little bit on where they are at.

We actually believe that what we're seeing is more a symptom of like a macro-based kind of events. The market is getting a bit more cautious, especially with all the news flow in the financial markets, things you hear from Europe, things you hear from China.

But the fact is, the signs that we're seeing suggest to us that we are in a traditional market, macro-driven, not necessarily on a semi-cycle per se. We continue to see lead times are quite short, cancellations remain low, distributor inventories at historically low levels, as Dave mentioned. So all things put together, I think what we're just seeing is a growth rate on a macro level that's probably slower going into the second half than what people thought coming into the first half.

As to comparisons to 2011, 2012, there were too many things going on back then. We had earthquake events in Japan that I can recall. We had flooding in Thailand. I don't think these are really comparable events that we can talk about on that front, Chris.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Do you have a follow-on?

Chris Danely - *JPMorgan - Analyst*

Yes, just to dig in a little more, can you give us a little color on linearity? And then in terms of the end markets, you talked about softness in communication and the new softness in industrial. May be go down your end markets as far as which is stable, which is getting better, which is getting worse.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Okay, I'll make a comment on both revenue and order linearity in the quarter. In both cases revenue and orders increased each month during the quarter. I think as you look at the end market detail, as I just had walked through, in general we saw automotive was strong with all the sectors inside of that growing, or all but one, growing at double-digit rates. Industrial revenue was flat, just contrasting that to last quarter's year-over-year growth. We didn't see growth there and it was incrementally weaker than we had expected. As we had talked about inside of there, we really saw about half of the sectors increase. That, of course, was offset by declines in the other sectors.

Personal electronics, as we talked about, grew in total due to specifically one large customer. And outside of that customer, actually saw almost every sector decline, including PCs as we were expecting.

Comms infrastructure, as we mentioned, was impacted by -- or comms equipment was impacted by wireless infrastructure, and that was down 50% from a year ago. That actually was weaker than what we had expected when we started the quarter. Then the last, enterprise systems declined due to DLP projectors, as we had expected. So that's kind of a summary of what we saw by end markets. Thanks, Chris, and we will move to the next caller.

Operator

Harlan Sur, JPMorgan.

Harlan Sur - *JPMorgan - Analyst*

Great, thank you, good afternoon. Thanks for taking my question. On the Q2 results you talked about incrementally weaker trends in industrial. This has been a particular focus by the market.

Can you talk about the geographical trends within your industrial business? There's a lot of concern around demand trends in industrial in Europe and China. Love to get some color from you guys.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Sure, Harlan. Let me tell you what happened with revenues in the quarter. Year-over-year revenue was down, as we mentioned before, 2%. Europe was down the most and Japan was also down. Asia was flat, while the U.S. was up. From a sequential standpoint, revenue was up, led by the U.S. Asia and Europe were both about even sequentially, while Japan was down.

We are always cautious, we'll give you that information and walk through it. But we're always cautious because that's reflective of where we ship products versus where it is actually consumed. It is really hard for us to see regional weakness unless it is extremely pronounced in a market like industrial, just because of the tens of thousands of customers that make up that market. Do you have a follow-on, Harlan?

Harlan Sur - *JPMorgan - Analyst*

Sure. I think last quarter you said the team said that they were going to bring down utilizations. Did you in fact bring them down? And directionally, where do you expect them to head into the third quarter?

Dollar inventories stayed relatively flat. Does the team expect this to come down in Q3, just given the weaker demand profile?

Kevin March - *Texas Instruments Inc. - CFO*

Harlan, in fact we did reduce utilization in the factories in the second quarter. Inventory actually came in right about where we expected it at, 126 days. Given the outlook that we have just described to you, we do intend to further reduce factory utilization in the third quarter. And we expect the result of that is that our inventories will probably come down somewhat in the third quarter as result of the reductions that we're planning for 3Q as well as the 2Q. It just takes a while for that to flow through the system.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Great, thank you, Harlan. Next caller please.

Operator

James Covello, Goldman Sachs.

James Covello - *Goldman Sachs - Analyst*

Good afternoon, thanks so much for taking the question. First question is on consolidation. You guys have been very clear in your articulation of what you look for and what the parameters are over time. But I have a couple specific questions about consolidation in the current environment. Does the current environment where revenues for the industry are in some pretty sharp declines, does that change the view on near-term consolidation potential, in the sense that you worry about paying a multiple for a cash flow stream that's going to wind up being much lower over the next 12, 18, 24 months than what it currently is? Or does that create more of an incremental opportunity. I'd love your perspective on that.

Kevin March - *Texas Instruments Inc. - CFO*

Jim, the timing doesn't enter into our thinking, so with some of the points you just brought up, although they'd make for an interesting discussion, they don't actually alter the way we tend to think about M&A.

As we've discussed in the past, the first and most important thing is that any potential M&A consideration has to be consistent with our strategy. In our mind that's going to be something that's going to be focused on helping drive our success in the analog space.

Then beyond that, as you alluded to in your comments there, we have been and expect to continue to be quite disciplined on making sure that we can get a return on what we spend. Clearly, at some of the prices today that you might see at certain companies out there and you factor in a premium, I'm looking at what I've seen in some other companies, getting a 3% return, 4% return doesn't seem like a good long-term strategy for maximizing shareholder value. So our inclination is to make sure returns can see there way past our cost of capital in a reasonable time frame. We'll stay disciplined on that front.

James Covello - *Goldman Sachs - Analyst*

That's very helpful, thank you. For the follow-up, how do you think about what the company's long-term growth rate is in this environment? It was good last year. We're in a tougher environment now, we're down on a year-over-year basis for revenues in this quarter, and maybe flattish for the year if we look at normal seasonality for the back half.

This might be overly negative to take this snapshot in time for long-term growth; maybe last year was overly positive. Do you think something in between what you'll achieve this year and what you achieved last year is a reasonable view on what long-term normalized revenue growth could be?

Kevin March - *Texas Instruments Inc. - CFO*

I think you are probably thinking about right, Jim. You should look at it over periods of time like that, not start from the wrong quarter. At a high-level we take a look and we make the assumption that semiconductor market will continue to grow, call it 2x global GDP. That's on increased content into industrial and automotive that will continue to drive demand.

It's been a question of what do you think the GDP is going to do over the long-term, the global GDP. And clearly it does appear that, and certainly in the last three or four years and probably the next few years, it has been slower than what we saw in the prior decade or decade before that. The overall industry is, again in our view, will probably grow at about 2x the global GDP. And the global GDP is the real wild card here. I was trying to figure out how fast that will grow. We're preparing ourselves for the fact that it probably doesn't see any real robust growth to help us, therefore we have to focus on execution and making ourselves stronger internally.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

I'd add to that that our business model is robust even in a weak environment like this. It throws off lots of cash. We've got the capacity to support much stronger rates of growth if that were to show up.

It will be a lot more fun if we get into an environment where GDP growth is stronger. One can argue what the multiplier on semiconductor growth rates overall are, but we can still operate and produce lots of cash even in these weaker markets. We'll look forward to having more fun when it's stronger. Thanks, Jim.

James Covello - *Goldman Sachs - Analyst*

Sounds good, thank you.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Go to our next caller please.

Operator

John Pitzer, Credit Suisse.

John Pitzer - *Credit Suisse - Analyst*

Good afternoon, guys. Thanks for letting me ask a question. Kevin, the first question is you took some utilization action in the June quarter, but gross margins were actually up sequentially and very healthy. Is the right way to think about this is the June quarter utilization actions impact September, September impacts December? And specifically, can you help me think about how I should be thinking about the gross margin range in the September quarter around some of utilization actions you're taking?

Kevin March - *Texas Instruments Inc. - CFO*

Yes, John, we've got a couple things going on there. Clearly, as we see more of our revenue coming from industrial and automotive, that has an attractive profit mix. You saw some of that second quarter. You heard Dave's prepared remarks, talking about strength in automotive that we saw in the quarter. That's clearly having a benefit to our gross margins.

Even in the light of lightening up on our utilization a little bit, you are correct in that utilization changes don't have an immediate impact. It takes a few months for it to roll through the system, so some of that was in second quarter. More of it will be in third quarter.

We also have lower overall manufacturing costs, as we begin to see depreciation starting to slowly trickle off. We're becoming much more efficient in our factories. We're getting more and more of our revenue off a much lower cost 300 millimeter.

So you've got a number of things combined that are keeping those margins in a pretty healthy state. As we look into next quarter, I wouldn't expect a significant any kind of material change in that particular metric in third quarter

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John Pitzer - *Credit Suisse - Analyst*

That's helpful. And then as my follow-up, you guys are constantly kind of pruning the portfolio. One of the things that's been talked about is whether or not you're going to plan to do power on the new Skylake platform. I'm curious as to how the PC business and your desire to want to participate there is impacting either the June quarter results or more importantly, the guide in September.

Is there a hit coming because you are not going to participate there? Again, if there is, can you help us quantify the size of the PC business today and where it goes over time?

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Yes, John, what you are seeing in our results has nothing to do with the investments on a V-Core product line. I'll just say that we continually look at our investments and we want to obviously invest in places where we think that will lead to sustainable revenue, a differentiated position and solid returns. There's portions within V-Core that are more attractive and less commoditized than others. We are continuing to make those investments. We know that there have been rumors out there that we are exiting the space in total, and that is not true.

Again, these are fairly small tweaks to where we direct our R&D resources. Those teams are off investing in other areas and producing products that we believe will give us longer-term better results. I'll contrast that to a market where we may have exited, like wireless, where we're actually reducing and exiting a market. And we're not doing that here. I hope that helps. Go to our next caller please.

Operator

Ross Seymore, Deutsche Bank.

Ross Seymore - *Deutsche Bank - Analyst*

Hi, guys, a product mix question first. Within your Analog space you guys have obviously done a great job over time. I'm a little curious as to an explanation why the HVAL side is growing so much faster year over year over the last couple quarters versus HPA specifically. I recall asking questions about HPA investments in the past and that seemed to be an area of extreme focus, given its high profitability. But the growth doesn't seem to be keeping up with HVAL. So any color on that will be helpful.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Sure, Ross. I think when you look at both SVA and as well as HPA, those businesses have different exposures to various end markets. Actually both of those businesses have a higher exposure to both industrial as well as communications equipment. You'll see a business like HVAL that will have a higher exposure to personal electronics.

Kevin March - *Texas Instruments Inc. - CFO*

And automotive.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

And automotive. Yes, good point. That's really what you're seeing in those results. Do you have a follow-up?

Ross Seymore - *Deutsche Bank - Analyst*

Yes, switching gears quickly, but kind of a follow-on to John's earlier question, any sort of color you can provide on the OpEx side. It's helpful to have gross margin relatively flattish, but how do you adjust the OpEx given that the revenues have been a little challenged looking forward?

Kevin March - *Texas Instruments Inc. - CFO*

John, we've already taken action on the OpEx side. We had announced, I think a year and a half ago now, actions that we were taking in Embedded Processing and Japan. Those are pretty much complete now. You're seeing those benefit OpEx in the results that we turned in the last couple quarters.

These short-term fluctuations in revenue, we don't let those lead us to rash decisions that could have a negative impact on us. We make longer-term decisions based upon strategy. As we look into third quarter -- if you look at the last couple of years, 2Q to 3Q, OpEx has been flat to roughly down. I don't expect anything different than recent history as we go into third quarter of this year.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Okay, thank you, Ross. We'll go to our next caller please.

Operator

Vivek Arya, Bank of America Merrill Lynch.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Thank you for taking my question. For the first question, you mentioned this 50% decline in wireless infrastructure. If you could help us quantify what proportion of your sales that is now versus last year.

And the thing that I'm really curious about is that -- and it is not just a Texas instrument question, we are seeing that from Xilinx and others - is that there is really no slowdown in mobile data consumption. There is no slowdown in LTE users. So why are you seeing such a large decline in wireless infrastructure build-out? Is it just an excess inventory of base stations? Is it a move away from your products? Is it a share issue? If you could help me understand that, that would be very helpful.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Sure, so Vivek, our communications equipment market is, at the end of last year, was about 17%. The largest sector inside of that was wireless infrastructure at about 10%. So we've given you the color on half the size. We haven't gone through all the end equipment percentages, but that will get you into the zip code of the impact to our business.

It's interesting that you bring it up, it continues to actually be a very good market for us. It's one that we're continuing to make investments. We had dialed back some of the investments a year or so ago inside of Embedded Processing, but that's really a view that that market over time, that carrier CapEx isn't going to go up, that it probably will decline slightly as we look over the next 5 and 10 years and perhaps longer.

But carrier CapEx isn't going to zero and that revenue will return. It has been notoriously just a choppy market, and it's just the dynamics of the market, the way that the tenders go out, the way that the OEMs have to prepare to deliver that product. Oftentimes it's in a 30- or 60-day window, so this isn't new to us. We're used to it.

We can still make a lot of money and generate a lot of cash from this market, so we will continue to do that. But it is just choppy, that's just a characteristic. And I think as you talk to other semiconductor suppliers that supply into that market, that's pretty consistent, I think, with what all of us see. You have a follow-up, Vivek?

Vivek Arya - *BofA Merrill Lynch - Analyst*

Yes, thanks, Dave. On my follow-up, I'm wondering if 75% is still that right incremental gross margin number to think of, because you are guiding sales to the midpoint to go up somewhat, but you are saying gross margins will be flattish. And as part of that, does this slowdown in sales have any impact on how soon you move your capacity over to 450 millimeter? Thank you.

Kevin March - *Texas Instruments Inc. - CFO*

Vivek, the 75% fall-through is still probably a pretty good one to use, but keep in mind that it's noisy from quarter to quarter. It's something you should look over a multi-quarter period as you move through time.

Clearly, you will get good product margin fall-through as we go into next quarter. But as I mentioned, we're also dialing back some of the factory starts, you have moving parts inside there. But when you look over a longer period of time than just a quarter, that's when start seeing that 75%.

As to migrating product to, I think you said 450 millimeter?

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

He meant 300.

Kevin March - *Texas Instruments Inc. - CFO*

We don't have that one on the radar.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

He's thinking well ahead. (laughter)

Kevin March - *Texas Instruments Inc. - CFO*

300 millimeter, we will continue to do what we have been doing in the past and that is many of our new products that are released are being released on 300-millimeter. That becomes even more valuable to the company as we move forward. Keep in mind what we talked back in February capital call, that in addition to our Richardson fab, which is capable of about $5 billion of total 300-millimeter Analog revenue, we have also begun the conversion of our DMOS6 factory, which will provide an additional $3 billion of Analog revenue capability.

So with that kind of conversion underway, clearly new products that we're releasing are being biased towards 300 millimeter versus 200. Active products on 200, for the most part, will continue where they're at.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

I will add to that, as we had indicated before, the qualification, as Kevin said, of DMOS6, that conversion is underway. And we expect a qualification to be completed by the end of the year. We're still on track for that. Thank you, Vivek, and we can go to the next caller, please.

Operator

Christopher Caso, Susquehanna Financial Group.

Christopher Caso - *Susquehanna Financial Group / SIG - Analyst*

Yes, thank you. I wanted to dig into the industrial market a little more deeply, yet talk about that being a bit weaker than expected in the quarter. Then recognize that you're going into one of the seasonally weaker quarters for industrial. I'm sure you heard the commentary from one of your competitors earlier today.

Can you help us to get some perspective on what your customers are telling you in that market? I know you don't like to give commentary going forward on what's baked into your guidance, but help ground us in how you are thinking about that particular market at this point.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Yes, Chris, not a lot to add. It was, again, use the word incrementally weaker. We gave you the color that we saw growth in half the sectors and that was offset, so even inside of that there's a bit of choppiness.

I think as we look forward and obviously, as we get the demand signals both in orders as well as from what we can see from consignment through our distributors, there's signals that we look at there. As Kevin mentioned earlier, I think people are just taking a more cautious outlook into third quarter. Besides that, probably don't have too much to add. Kevin, I don't know if you --

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Kevin March - *Texas Instruments Inc. - CFO*

The only thing I'd remind you of is that industrial was about 31% of our revenue in 2014. My recollection is no single sector in that market was bigger than 4%. We're talking about a lot of really small customers. So there's not really any one customer that can give us a signal of what's going on. It seems to be a broad-based reconsideration on the part of participants in that space as to their outlook for growth for the second half.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Good point. Chris, do you have a follow-on?

Christopher Caso - *Susquehanna Financial Group / SIG - Analyst*

Sure. As following onto that, perhaps you could talk about what you think customers are doing with inventory now. I know you had talked about your distributors taking some inventory out of the channel, again, as they likely reconsider what's going on in the second half.

Do you expect that the end customers are doing similar? On top of that, what do you expect the distributors to do with inventory as they go forward? Do you think the inventory levels can get leaner than where they are right now?

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

In general we believe that customer inventories are lean, as we worked our way through the reports and some of the anecdotal from last quarter's reports, as well as the anecdotal information that we get from our sales teams. Of course there's always the exceptions, like within wireless infrastructure, as that market goes through its adjustments.

So with inventory in our distributors at 3.5 weeks, that is a historically low period in my tenure as well as Kevin's. We really think that's reflective, Chris, of confidence from distributors that they believe that they can get the product that they need from us. Obviously, it's driven overall because of the consignment programs that allow them operationally to run at those levels.

I think there is a believe that confidence and stable lead times and availability of product is probably working its way out into the customer base as well. Harder for us to actually have that direct visibility. As Kevin talked about, we're talking 100,000 customers, so it's hard to have that collectively. Thanks, Chris, and I will go to the next caller, please.

Operator

Ian Ing, MKM Partners.

Ian Ing - *MKM Partners - Analyst*

Yes, thank you. Kevin, you talked about orders increasing every month in the quarter. Do you have any order commentary quarter to date? I'm assuming we're entering Q3 with a relatively strong backlog. How much more conservative are turns order assumptions to meet guidance?

THOMSON REUTERS

Kevin March - *Texas Instruments Inc. - CFO*

Ian, as we did mention earlier on, orders increased each month in the second quarter. And I will just say as to orders for this quarter, they're consistent with the guidance range that we gave early in the call.

We did have a book-to-bill in second quarter of 1.01, so we did build a little bit of backlog. But I wouldn't call it a dramatic amount. It's consistent, though, I think with the outlook that we have offered for third quarter.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Yes, and I will remind you, Ian, I'm sure you probably know that we've got 60% of our revenues that go through distribution. 60% of that is supported by consignment and about 55% of TI's revenues overall is by consignment.

Just be careful with the book-to-bill. Part of the reason why we don't highlight it is because it just applies to a smaller portion of our actual revenues. And that backlog isn't necessarily reflective completely of the demand that we actually see. So you have a follow-on?

Ian Ing - *MKM Partners - Analyst*

Yes, I think you've done a really good job of highlighting your competitive advantages, broad portfolio, growing into your manufacturing assets. What's the response, though, to scenarios where there could be some demand in end markets on a permanent secular decline? If you look at comms infrastructure, PC, some of the consumer markets, how do you address the potential for some permanent declines in some of these end markets?

Kevin March - *Texas Instruments Inc. - CFO*

I've been in this for quite a long time, Ian. There's always some market that's in decline and other markets that are actually in the growth phase. The examples you just offered, if in fact they turned out to be in a secular decline, the offsetting markets for that, the most obvious one is automotive, where we're seeing significant content growth, not just us but many in the industry, seeing significant content growth. And we're still in the very early stages of that content penetrating automobiles.

So that's probably a secular growth market that I would suggest would probably add for a decade or more. That's a great opportunity for the industry in general and for us in particular, because we've been focused on there for a number of years now.

Then there's the broader industrial market, where we are seeing an increasing usage of semiconductors in equipment in those markets that simply were never used before. As people are using semiconductors in those spaces, they're finding new applications and needs for more semiconductors.

So while there may be some markets or sectors that could be in secular decline, there are others that are in secular growth. And in general that leads us to the belief that I commented on earlier in the call, that we think the industry overall will grow at about 2x the global GDP because you have got these kind of underlying changes going in how semiconductors are being used across our economy.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Yes, and I could add too that even if you look at a market like PCs, that probably over the next 10 and 20 years, will be on a decline like that, we can take two actions. One is we'll spend differently today than we would have spent 10 and 15 years ago inside of that market.

But we can still find opportunities for products that will actually live through one product cycle to the next and still have long-lived positions, even inside of a market like that. And certainly PCs aren't going away anytime soon, so there's still quite a bit of money that can be made in those markets. Thank you, Ian, and we can go to the next caller, please.

Operator

Ambrish Srivastava, BMO.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Hi, thank you. Dave and Kevin, we're trying to understand the difference in the commentary on the order patterns that you guys are seeing versus Linear. The same kind of diversified businesses, in fact they have very similar -- they don't have consumer as you do, but then you also have infrastructure which is down very hard. Can you help us understand what's going on there? And then I had a very quick follow-up.

Kevin March - *Texas Instruments Inc. - CFO*

Ambrish, I can not offer you any insight into Linear's order patterns. They clearly are the most qualified to do that. I can simply tell you what we saw, and that is our orders increased each of the three months as we came through -- two of the three months. In other words, May was up over April and June was up over May as we came through 2Q. We certainly are in different markets and that could possibly be an explanation. But I just don't know enough about how their order book works to be able to help you with the contrast between the two companies.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Okay, that's fair, Kevin. My follow-up is on the factory loadings. Is the right way to also think about when you are bringing utilization down, that's mostly on the 200 millimeter? And 300 millimeter continues to creep up?

Kevin March - *Texas Instruments Inc. - CFO*

That's actually not a bad way to think about it, Ambrish, because in fact the way we are operating the 300-millimeter fab today, RFAB, is near full equipped utilization. In other words, we don't have it equipped to full capacity, but to the extent that we have it equipped, we try to keep it quite highly loaded. The adjustments that we take on loadings generally impact the 200. There may be some impact on 300 as well, but it generally impacts the 200-millimeter factories.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

And I'll just add that any product that runs any measurable volume will often source in multiple factories. So it could actually be sourced in a 200-millimeter fab as well as a 300-millimeter fab. As you know, the economics of getting 40% lower cost per chip on a 300-millimeter, obviously will tilt us into starting that 300-millimeter wafer. Thank you, Ambrish. We can go to the next caller, please.

Operator

C.J. Muse, Evercore ISI.

C.J. Muse - *Evercore ISI - Analyst*

Yes, good afternoon. Thank you for taking the question. First question, not to beat a dead horse, but another one on the industrial side. Curious what kind of exposure you have to the energy patch and your vision for whether that business has troughed and/or there's further declines ahead?

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Yes, CJ, as Kevin pointed out last year, 31% of our revenue is industrial. The largest sector inside of industrial is factory automation, and that was 4%. So you are probably down, getting into the very low single-digit percentages, by the time you are down onto that. So it's very, very diverse from that standpoint. Do you have a follow-up?

C.J. Muse - *Evercore ISI - Analyst*

Yes, I do. Given your perspective in terms of your leverage to personal electronics, calculators, DLP, would love to hear your thoughts on the global consumer and the health of the consumer and your willingness to step up and spend during this macro malaise, or pause, or whatever you want to call it.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

If you look at our personal electronics market, it was actually up. It was up because of our exposure in our customer base. So to the extent that there's compelling products out there that people want, that will drive demand. You see that stepping up.

You take that one customer out, of course, we saw declines in almost every sector inside of personal electronics. You have the good with the bad, somewhat of a mix on that front.

Kevin March - *Texas Instruments Inc. - CFO*

I might just add it is probably not so much consumer willingness to consume those things, it's more is there something interesting they can spend their money on. And certain customers are much more successful at that than others.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Okay, thank you. C.J., did you have a follow-up?

C.J. Muse - *Evercore ISI - Analyst*

No.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Okay, one last caller please.

Operator

We can go next to Timothy Arcuri, Cowen and Company.

Timothy Arcuri - *Cowen and Company - Analyst*

Thank you so much. Actually I had two. First of all, if you look at 2015 as the whole year, usually you're targeting to grow roughly 2x GDP. We don't know what GDP is going to be, but if you assume a seasonal fourth calendar quarter, it implies that revenue this year is down like 250 basis points. So it definitely seems to be under-growing whatever GDP comes out to be this year.

My question is do you think that any of this is share, will you end up to have lost any market share this year? I know you usually target up about 40 bps per year. And then I had a follow-up, thanks.

Kevin March - *Texas Instruments Inc. - CFO*

Yes, Tim, what we're talking about, again, long-term growth rate was how the question was asked earlier. And long-term growth rate we believe will be about 2x global GDP. Just like you see noise in the quarters, you're probably going to see noise in the years.

For example, last year the industry arguably grew considerably faster than 2x global GDP. This year it's apt to grow less than global GDP. So I think you're going to have that kind of noise to deal with. I don't think it can be mechanically imposed into a formula with precision.

As we look out for the reasons that we talked about, increasing penetration in certain markets, especially auto and industrial, that will continue to require semiconductor content. And there'll be growth inside that. From a market share standpoint, we'll be able to answer that at the end of the year, but I'd say we're off to a darn good start so far.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

I would point out that when you look at our market share gains, they've averaged 30 to 40 basis points. We've had years where we've eked out 10 basis points and a knockout year is 100 basis points. So inside of that we've had a range of outcomes. Do you have a follow-on, Tim?

Timothy Arcuri - *Cowen and Company - Analyst*

I do, yes, thanks. The guidance is like 400 basis points below what the five-year seasonal is. Maybe you talked about this and I sort of missed it, but can you try to pinpoint what the primary either geography or end market that can potentially explain that gap is? I guess I'm thinking about China in particular. Can you help us cover that gap? Thanks.

Kevin March - *Texas Instruments Inc. - CFO*

Tim, we don't believe there is something called a seasonal average in our space. When you go and take a look at any of those quarters, the variation is so wide that there's not really anything meaningful in there. I think you look at those 2Q to 3Q growth rates and you see zeros to high single digits and I don't think you can divine too much out of that.

I think we have to look at it in the context of the current global environment. Certainly a lot of negative news flow coming out of Europe and some out of China and so on. We had a slow start to the year in the Americas because of weather and the port issues on the West Coast. So I think what we're seeing is what we talked about early in the call, which is that on a macro level, our customers are looking and adjusting their expectation for growth in the second half and they're tweaking that down a little bit versus what they had anticipated coming into the year.

Dave Pahl - *Texas Instruments Inc. - VP & Head of IR*

Okay, thank you very much, Tim. And with that, thank you all for joining. A replay of this call is available on our website. Good evening.

Operator

This does conclude today's program. Thanks for your participation. You may now disconnect. Have a great day.
