PARTICIPANTS

Corporate Participants

Ron Slaymaker – Vice President-Investor Relations, Texas Instruments, Incorporated.
Dave Pahl – Director-Investor Relations, Texas Instruments Incorporated

Other Participants

Glen S. P. Yeung – Analyst, Citigroup Global Markets Inc. (Broker)
John W. Pitzer – Analyst, Credit Suisse Securities (USA) LLC (Broker)
Chris B. Danely – Analyst, JPMorgan Securities LLC
David M. Wong – Analyst, Wells Fargo Advisors LLC
Romit J. Shah – Analyst, Nomura Securities International, Inc.
Tim M. Arcuri – Analyst, Cowen & Co. LLC
Vivek Arya – Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.
Doug Freedman – Analyst, RBC Capital Markets LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Texas Instruments Second Quarter 2013 Mid-Quarter Update Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference call over to your host, to Ron Slaymaker. Please go ahead, sir.

Ron Slaymaker, Vice President-Investor Relations

Good afternoon and thank you for joining TI's mid-quarter financial update for the second quarter of 2013. Dave Pahl from our Investor Relations team is also joining me today.

In a moment, I will provide a short summary of TI's current expectations for the quarter, updating the revenue and EPS estimate ranges for the company. In general, we will not provide detailed information on revenue trends by segment or end markets, and I will not address details of profit margins. In our earnings release at the end of the quarter, we will provide this information.

As usual with our mid-quarter update, we will not be taking follow-up calls this evening. Considering the limited information available at this point in the quarter and in consideration of everyone's time, we will limit this call to 30 minutes.

For any of you who missed the release, you can find it on our website at ti.com/ir. This call is 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 Safe Harbor statement contained in the news release published today as well as TI's most recent SEC filings for a more complete description.

We have narrowed our expected ranges for TI's revenue and earnings around the middle of our previous ranges. We now expect TI revenue between $2.99 billion and $3.11 billion. We expect earnings per share between $0.39 and $0.43.

Operator, you can now open the lines for questions.

In order to provide as many of you as possible the opportunity to ask a question, please limit yourself to a single question. I will provide you the opportunity to ask a follow-up.

Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And we'll take our first question from Glen Yeung with Citi.

<Q – Glen Yeung – Citigroup Global Markets Inc. (Broker)>: Thanks, Ron. You know, obviously you're guiding in line on revenues and EPS, but I wonder if within the mix of your business there was any deviations from what you thought might occur over the course of the quarter, either product mix or geographic mix?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: I can give you some review of that, Glen. You know, as you noted, I think the quarter is generally tracking consistent with our expectations. Along those lines, strength has broadened across both customers and markets during the quarter, as we had expected when we gave our April guidance.

The strength in the industrial market that we saw in the first quarter has continued into the second quarter. And just as a reminder, the industrial market, you know, it's important to us today, but we expect it will be even more important to our future as we really focus more and more of our investments in that space. We serve that market mostly through catalog product lines, such as Silicon Valley Analog, our High-Performance Analog product line; as well as some of the product lines in Embedded Processing, such as microcontrollers.

Automotive also continues to grow, such as we saw in the first quarter. We serve the automotive market through a range of products, including both catalog and application-specific analog products, OMAP applications processors and also DLP products.

In the communications market, we're seeing some growth in communications infrastructure this quarter on a sequential basis, as well as some growth in handsets, and the handsets really being through a range of catalog product, such as audio amplifiers that we sell into that space.

Revenue from our legacy wireless product lines will decline sequentially as we continue to wind them down and as we had expected and communicated. PCs and notebooks are weak this quarter as we had expected.

And then finally, I would note that consumer is mixed, with areas like gaming consoles weak – well, specifically gaming consoles weak, and other areas in consumer mostly tracking sideways this quarter.

Do you have a follow-on, Glen?

<Q – Glen Yeung – Citigroup Global Markets Inc. (Broker)>: Yeah. Ron, you know, as I hear you say things like industrial is going to become a greater proportion of your business and as you think forward as TI's obviously still in sort of the midst of some degree of transition, can you describe what your model is going to look like two or three years from now? I know it's rare to get a long-term question on this kind of call, but just do you feel like you have room for your model to improve from where it stands today? Do you think it's sort of on an upward-facing trajectory?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: You know, Glen, I'm not going to break from the model that we've communicated previously, which is our expectation that we certainly have the capacity and the expectation to generate 20% to 25% of free cash flow from our revenue. That being said, clearly, with the capacity position we have, which is very strong, and an improving product mix, and if you look at, for example, gross margin and the income statement side of things, just a simple thing I'd point out is last year depreciation was 7.5% of revenue and capital spending is, was actually below 4% of revenue, and we expect that it will hold at that level until we're able to cross $18 billion of revenue. So I think, clearly, you would expect that financially we have room for improvement and pretty good runway ahead of us there.

Okay, Glen, I appreciate your questions, and let's move to the next caller please.

Operator: Next caller will be John Pitzer with Credit Suisse.

<Q – John Pitzer – Credit Suisse Securities (USA) LLC (Broker)>: Good evening, Ron. Thanks for letting me ask the question. The first question, Ron, just quickly, as far as the trajectory of this upturn. If you look at your June quarter guidance, it's coming in more along seasonal lines, than kind of above seasonal and I'm just kind of curious if you think that, that's a reflection of just still uncertainty in the macro environment? Because typically, the first quarter off the bottom, you tend to see better than seasonal growth so I'm trying to get a sense of how you guys are kind of viewing the cyclical recovery for the industry?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: John, I think what we're seeing thus far is a very well behaved recovery. And clearly what can cause rapid acceleration would be things like lead times starting to extend and then customers feeling they need to layer in more inventory and that causes a surge in demand that causes lead times to go out further. And frankly, that is a very – that is not a particularly healthy environment.

One where the macro is providing support for growth in the electronics industry, which then puts higher demand on our product, where we're able, as we are right now, both because of our strong capacity position, to maintain lead times that are short. And also with our inventory position, to be able to service customer demand as it comes in, that is a very well behaved and well controlled upturn. And frankly, versus the former case, we would much rather have a well-behaved upturn.

So, you know, again this is mid-quarter. We still have to get through this quarter and we'll see what's ahead, but what we're seeing right now is very encouraging in terms of growth, the broadening of growth, as I said earlier, across customers in various end markets. And especially our ability to service that demand in an environment, frankly, where when we look across various competitors, we're already seeing some things that make us believe that competitors, for example, are taking actions to try to get customers to give more extended visibility to avoid lead time extensions.

We've seen upside demand from particular customers and what I'll call an unfair share of demand coming TI's way where customers are citing competitors that are not able to respond to their increased demand in a near-term type of environment. So, again, we find the current environment very encouraging right now.

Do you have a follow-on, John?

<Q – John Pitzer – Credit Suisse Securities (USA) LLC (Broker)>: Maybe just to follow on from that, can you quantify kind of what the share gains might be for you guys in this environment? Because clearly some of the rationale of being – of having as much capacity as you do was the ability to gain share, so when you look at the June guidance, what do you think is industry growth versus perhaps TI gaining share?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: That's really impossible for us to know or for us to even guess at at this point, John, and I'm not trying to imply that you're going to see some big step function in terms of share gains for TI. That's not the case.

Frankly, even though I do believe, I agree with what you're saying that the capacity position that we are in, can be and is starting to become, a competitive advantage for TI even, even here and now today. That really was not the rationalization. The rationalization was we got really good prices on that capacity and we're going to be able to generate really good returns on that capacity over a 20 to 25-year period.

So certainly certain periods like we're starting to enter, it can be a near-term competitive advantage, but we really look at those capacity investments more from the standpoint of some really attractive returns we're going to be able to generate on those investments going forward.

Okay, John, thank you for your questions, and we'll move to the next caller, please.

Operator: Next question, with JPMorgan, Christopher Danely.

<Q – Chris Danely – JPMorgan Securities LLC>: Hey. Thanks, Ron. Last quarter on the update you talked about how your book-to-bill was trending. Can you just talk about how bookings and backlog are trending? And remind us what a typical Q3 sequential growth looks like?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Okay, Chris, and I'm going to, I'll answer your question on backlog, on backlog and bookings, and, Dave, I'll let you answer the question about typical Q3. So I would say, in general, I would describe orders this quarter as strong. We've seen turns levels that we expected would be high, because of our short lead times and just the nature of the customer, right now, to try to stay hand-to-mouth. They have been high this quarter, as – but again, that really ties to our ability to deliver strongly in terms of service levels and on-time delivery with those short lead times.

That being said, I'll also note, that we are building backlog again this quarter, so to your question on book-to-bill, it is expanding; it's greater than one again this quarter. And I would say that customers are beginning to provide a little more extended visibility for TI with their backlog, in this case, giving us some visibility out into third quarter even.

Dave, do you want talk about typical third quarter rates?

<A – Dave Pahl – Texas Instruments Incorporated>: Yeah. I'll – Chris, I'll give you our average sequential growth in third quarter, and this is just our numbers. All in, we have seen a 5% on average increase over second quarter in the third quarter. And I'll just remind you, on those five data points, obviously, very noisy and the range on those five data points range from flat to up 17%. So you can tell it's pretty noisy from that standpoint.

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Do you have a follow-on, Chris?

<Q – Chris Danely – JPMorgan Securities LLC>: Yeah. So I think in response to John's question, you mentioned that you've been able to gain share because some of your competitors weren't able to make deliveries. Can you maybe expand on that? Do you see your competitors' lead times stretching out? Or are they just leaving the customers lying down? Maybe talk about that a little bit and how you're able to react to that?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Chris, and again, that was a pretty narrow example I gave. It's a, you know it's one of those things you would expect to see early in a recovery. I don't want to try to translate it into some big broad trend in the industry. But what I would say is we have seen where customers' demand for their products is starting to pick up. They are coming in with relatively near-term requests, in terms of wanting product.

I don't know that it's so much that the competitor in this particular case was extending lead times or anything like that. It was just probably an inside lead time request from the customer. The competitor couldn't deliver to it, and we could. And so we got our unfair share of – or I shouldn't say unfair share of that business. We got our due share of that business, but it shifted somewhat from a competitor more directly to TI.

Okay, Chris. Thanks for your questions. We'll move to the next caller.

Operator: David Wong with Wells Fargo has our next question.

<Q – David Wong – Wells Fargo Advisors LLC>: Thanks very much. Just to push a bit further on Chris' question. The bookings, did you actually see the momentum – have you been seeing it grow through the quarter? Has it -each week you see a higher level of bookings? Or are you saying that it's staying on a high plateau that it began with?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Oh, David, that kind of order linearity question always – it – I guess what I would say is, we've felt in general throughout the quarter that orders have been strong. It hasn't been every day by day or week by week getting stronger. It's, as any quarter, noisy. But in general, I would describe the order trends this quarter as having been strong.

Do you have a follow-on, David?

<Q – David Wong – Wells Fargo Advisors LLC>: Yes. Can you give us any sort of feel for what your sequential growth of your core business is? If we sort of back out – I mean your guidance – what that implies for your core business? Because you have got some businesses that you're exiting that are coming down and you have the seasonality of your calculator business, right? I mean, is it still about 5% to 6% sequential growth for your core semiconductor business?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Okay, David. I think a couple of things there. The calculator growth typically adds about three points of growth to our third quarter and as you pointed out, the decline in legacy wireless this quarter will have about that same impact or an offsetting impact, meaning that – just that the legacy wireless revenue will lower our sequential growth by about three points alone. So those, the legacy wireless and the calculator trends, for the most part are offsetting, and so that would give you an indication of where Analog and Embedded are. And they may not – again, we see differences within those areas, so like I said, HPA or high-performance analog, and the Silicon Valley Analog, both with their very good exposure into the industrial and automotive markets will probably run a little bit above that, and some other areas will be running a little bit below that. But kind of a normal mix up there.

Thank you for your questions, David. We'll move to the next caller.

Operator: Romit Shah with Nomura Sec will have our next question.

<Q – Romit Shah – Nomura Securities International, Inc.>: Thanks a lot. Hey guys, you know a couple of the other diversified semi companies, Avago and Microchip, have raised guidance recently or talked about accelerating trends in the industrial space. How do you guys reconcile that versus your comment that business is good but from your comments it doesn't sound like it's better than what you thought when you gave guidance back in April? Thanks.

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Okay, well I will take a stab at that. I think in the case of Microchip, their recent guidance raise took their midpoint to 5.5% which was slightly below the midpoint of growth for which – for the revenue range that we initially described in April and are reaffirming today. I know Analog Devices came out not too long ago with their guidance for – they're off, I believe, by a month versus our quarter, but the midpoint of their guidance is 2%. So – and to be honest I didn't follow the details of Avago, but I think when I look at the peer guidance and what we're seeing, I think we're seeing very similar and describing very similar things in our markets.

Do you have a follow on Romit?

<Q – Romit Shah – Nomura Securities International, Inc.>: Yeah. Just any visibility you could give us on the comm infrastructure space? And you mentioned that it was a growth area this quarter, but how are you thinking about China LTE going into the back half of the year?

<A – Dave Pahl – Texas Instruments Incorporated>: I'll take that one, Romit, and let me make the comment in the context of Embedded Processing. So we do expect that we will have growth in Embedded Processing, both driven from industrial as well as automotive markets and in addition to communications infrastructure so – and we're seeing that strength in comms infrastructure, primarily driven by spending by North American operators and I'd say with some signs of increased activity inside of China. So we're beginning to see that benefit flow through the business.

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Okay, Romit, thank you for your questions. Let's move to the next caller.

Operator: Timothy Arcuri with Cowen has our next question.

<Q – Tim Arcuri – Cowen & Co. LLC>: Can I just ask a little bit about distributor inventory? If you look at some of the companies that recognize revenue on sell-in, they had some of the best guidance for the June quarter, you know, relative to normal seasonal. So I'm wondering, does that imply that the channel is building some inventory in June? Can you talk a little bit about that?

<A – Dave Pahl – Texas Instruments Incorporated>: Yeah, Tim, I'll take that question. I would say overall, our expectation for re-sales through distribution will be that it will grow a few points sequentially. And if you look at the inventory that they own, we think that that should hold about the same level as what we exited last quarter at, and that's around 5.5 weeks. So definitely lean by any measure that we'd have.

I'd also remind you that about half of our distribution inventory is supported by our consignment programs, so the fact that we do recognize everything technically by a ship-in method, that inventory and those sales behave exactly as if it were sell-though.

So do you have a follow-on...

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: So some of those swings that you might normally see for sell-in type of players with inventory building and depleting will be dampened as we move more revenue toward consignment.

Do you have a – Tim, do you have a follow-on question?

<Q – Tim Arcuri – Cowen & Co. LLC>: I do, Ron, yeah. This might be mincing hairs, but when you guided June, you said that TV was going to be a bit weak and now you're saying that within the consumer sector that only gaming is weak. So does that imply that TV was a little bit better than you thought?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Tim, I might be wrong and you have, you may have your notes directly in front of you from that last quarter call, but I believed when I talked about what we were seeing in television in April, that was really referencing first quarter more so than our expectations for second quarter. We normally try not to get into a lot of end-market specific expectations for our guidance.

So to my knowledge, TV has not weakened versus our expectations. My understanding is that what we're seeing in the television market currently is some growth in the very large screen segment of the market and really not much growth in the kind of mid-size and smaller screen market. But I am not aware that there has been a change in trend, other than what, at least from our expectations.

Okay, Tim, thanks for your questions, and, operator, we'll move to the next caller.

Operator: Certainly. The next one will come from Vivek Arya with Bank of America Merrill Lynch.

<Q – Vivek Arya – Merrill Lynch, Pierce, Fenner & Smith, Inc.>: Thanks for taking my question. Can you talk about the factory utilization, Ron? Any changes versus what you were planning back in April?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Dave?

<A – Dave Pahl – Texas Instruments Incorporated>: Yeah. Vivek, we're expecting utilization to be up this quarter, basically just supporting the higher level of demand that we see coming in.

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Vivek, we don't really have comments on whether it's changed versus our expectations in April for you, though.

Do you have a follow-on, Vivek?

<Q – Vivek Arya – Merrill Lynch, Pierce, Fenner & Smith, Inc.>: Yeah. This is probably a slightly unrelated question to what you generally comment on the call but is there a way to tactically use your excess capacity as a foundry for other customers that don't compete with you?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: I guess theoretically we could, but we have no, no intention to do that. In fact, if you fill that capacity up with, I don't care whether it's low-margin – I mean whether it's foundry or just low-margin business in general, then when you need it, you have the capacity utilized, and that's not what our strategy is. We do not believe that we have too much capacity today. As we explained in our call back in February on our capital management strategy, our strategy for capacity is to purchase it opportunistically and therefore, get good prices for it, and then to position that capacity ahead of, or well ahead of demand.

So our view is as growth returns, and it is already, our capacity is quickly becoming a competitive advantage for TI as I said before. I know there's a lot of – a lot of discussions it seems like amongst analysts and investors about pressure on gross margins. What I would say is just keep in mind, only about half of the underutilization expense that's associated with our capacity is cash-based. The other half is non-cash based. So it has really a pretty minimal impact on our cash flow.

So I think more importantly having our – the strong capacity that we do have and having it acquired at the kind of very attractive prices that we did by buying it when, frankly, there wasn't a lot of demand for that capacity in our industry from other competitors, means that our free cash flow is going to be strongly benefited not only today but also in the future.

And I know that I mentioned before, but I'll just reiterate, our capital expenditures are already at historic lows and we're going to be able to sustain those low levels for years ahead. So getting those assets for pennies on the dollar are going to provide years of benefit to our free cash flow, and as you've heard us say before, that higher free cash flow is what allows us then to commit to higher returns to our shareholders, both dividends and repurchases. So while some may be sitting on the sidelines waiting for gross margins to start to lift, our free cash flow is already lifting, and in fact, you've seen the benefit in the form of higher dividends and repurchases.

Okay, thank you for your questions, Vivek. And, operator, I think we have time for one more caller.

Operator: Certainly, sir, and that will come from Doug Freedman with RBC Capital Markets.

<Q – Doug Freedman – RBC Capital Markets LLC>: Great. Thanks for taking my question, guys. Ron, can I focus in a little bit on the CapEx? How are you running quarter-to-date there? And is there any, should we be thinking that your capital spend this year could have some lumpiness? I believe I saw an announcement of some investment in assembly and test assets?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: Doug, I think – I don't have a mid-quarter update on our capital expenditures. What I can say is that we are confident in the kind of guidance that we've provided, which I believe was $500 million of capital expenditures for the year. Those can always be somewhat lumpy from quarter to quarter, but the $500 million is our plan and I think there's no reason for us to believe otherwise. And just by the way, I should compare our guidance on depreciation is $900 million, so you know what's going to happen to that as we hold capital spending at lower levels.

I think what you might be referring to is, in terms of the assembly/test site, is last week we announced that we had selected the location of Chengdu in China, where we already have an existing wafer fab, as the site for our next assembly/test facility, but there will be, that will not create any lumpiness in terms of capital expenditures. And what I mean by that is, we will continue to spend, that will not impact our $500 million forecast for this year. It will not impact our guidance that we will be able to maintain CapEx at 4% of revenue until we achieve or exceed $18 billion of revenue, and then, from then we'll be tracking probably 4% to 7% of revenue. The Chengdu announcement, we also talked about that our future investments in that location could total up to $1.69 billion, but keep in mind, that's over the next 15 years.

So when you're making these kinds of long-range site type planning for our manufacturing operations, they genuinely are long-range. You have to get sites selected well in advance of actually spending money, and that's really what that announcement was all about.

Do you have a follow-on question, Doug?

<Q – Doug Freedman – RBC Capital Markets LLC>: I do, and thank you for that clarification; that was exactly what I was looking for. The follow-on question, though, is a little bit of a clarification to the way you answered a few questions earlier this afternoon. One it was in regards to Q3 seasonal patterns, and then the other – I felt like you were possibly answering the seasonal impact of Q2. So I just want to make sure I understand the 5% average guidance – growth for Q3, and what that would look like excluding the impact of the business change mix that we're expected to experience?

<A – Ron Slaymaker – Texas Instruments, Incorporated.>: And there you speak – you're talking specifically about the legacy Wireless business? So what Dave provided was just that Q3, on average over the last five years, has grown 5% sequentially. I think he said it had a 0% to 17% range. And so, you can decide whether that 5% average number is particularly useful. So that's what we've done over the last five years. This quarter, if you say – I think in April we indicated that our wireless revenue, the legacy wireless revenue, would decline about $60 million from the Q1 level which was $210 million. So that would put it roughly in the range of $150 million in the current quarter.

I don't have a specific update for you here at the mid-quarter on that number, but our expectation is that $150 million or so of legacy wireless revenue in second quarter will continue to decline until it's essentially zero going into the – by the first quarter of 2014. So that would be a consideration, just as it is a consideration this quarter. So Dave nor I were trying to specifically endorse that average growth rate for Q3 for this particular, we were just communicating what that average growth rate has been historically.

Ron Slaymaker, Vice President-Investor Relations

Okay, Doug. Thank you for your questions, and before we end the call, let me remind you that the replay is available on our website. Thank you and good evening.

Operator: And ladies and gentlemen, that does conclude today's conference. We thank you for your participation. Have a great day.