THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TXN - Q3 2015 Texas Instruments Inc Earnings Call

EVENT DATE/TIME: OCTOBER 21, 2015 / 9:30PM GMT

OVERVIEW:

Co. reported 3Q15 net income of $798m or $0.76 per share. Expects 4Q15 revenue to be $3.07-3.33b and EPS to be $0.64-0.74.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Dave Pahl *Texas Instruments Inc - IR*

Kevin March *Texas Instruments Inc - SVP & CFO*

CONFERENCE CALL PARTICIPANTS

Vivek Arya *BofA Merrill Lynch - Analyst*

John Pitzer *Credit Suisse - Analyst*

Stacy Rasgon *Bernstein - Analyst*

Harlan Sur *JPMorgan - Analyst*

Chris Danely *Citigroup - Analyst*

William Stein *SunTrust - Analyst*

Blayne Curtis *Barclays Capital - Analyst*

Joe Moore *Morgan Stanley - Analyst*

Ross Seymore *Deutsche Bank - Analyst*

Eric Steele *Stifel Nicolaus - Analyst*

David Wong *Wells Fargo Securities - Analyst*

PRESENTATION

Operator

Good day and welcome to the Texas Instruments 3Q 2015 earnings release conference call. At this time I would like to turn the conference over to Dave Paul. Please go ahead Sir.

Dave Pahl - *Texas Instruments Inc - IR*

Good afternoon and thank you for joining our third-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 expectation. 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 a year ago. While our overall demand remained weak, most areas were stronger than we had expected, especially wireless infrastructure and industrial.

In addition, our demand for automotive continued to be strong. I'll elaborate in a few moments.

Even in this environment, each of our core businesses of Analog and Embedded Processing grew year-over-year. Together, they comprised 85% of third-quarter revenue and have delivered nine consecutive quarters of year-over-year growth. Earnings per share were $0.76. With that backdrop, Kevin and I will move on to the details of our performance, which we believe continues to be representative of the ongoing strength of TI's business model.

In the third quarter, our cash flow from operations was $1.4 billion. 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 4% from a year ago.

Free cash flow margin was 28% of revenue, up from 27% a year ago, and consistent with our targeted range of 20% to 30% of revenue. We continue to benefit from our improved product portfolio and the efficiencies of our manufacturing strategy, the latter of which includes our growing 300 mm analog output and the opportunistic purchase of assets ahead of demand.

We also believe that free cash flow will be valued only if it is returned to shareholders or productively invested in the business. For the trailing 12 month period, we returned $4.2 billion of cash to investors through a combination of stock repurchases and dividends.

Analog revenue, which achieved a record level in the quarter, increased 2% from a year ago. The growth was due to High Volume Analog & Logic. Silicon Valley Analog also grew, Power Management was about even, and High Performance Analog declined.

Embedded Processing revenue increased by 2% from a year ago, due to microcontrollers and connectivity.

Processors declined. Our investments in Embedded are translating into tangible results as this quarter's revenue is also a record.

In our Other segment revenue declined 19% from a year ago primarily due to custom ASIC products and DLP products. Compared with a year ago, distribution re-sales increased 6% and inventory decreased by less than one week to just below four weeks.

We believe this inventory level continues to reflect an environment of good product availability due to healthy TI inventories and stable lead times, which together drive high customer service metrics. As a reminder, inventory in our distribution channel has decreased over the past few years because of our consignment program.

Now I'll provide some insight into this quarter's revenue performance by end-market versus a year ago. Automotive remains strong with all sectors growing and three of the five sectors growing double digits.

Industrial revenue was about even, with about half of the 14 sectors growing and about half declining.

Personal electronics was up because of demand from one customer. Excluding that one customer, personal electronics was down.

Communications equipment was down, driven by wireless infrastructure which was down about 30% from a year ago. Although weak, it did growth sequentially.

And finally enterprise systems declined primarily due to DLP projectors.

We continue to focus on making TI stronger through 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 puts TI in a unique class of companies capable of long-term free cash flow growth.

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

Kevin March - *Texas Instruments Inc - SVP & CFO*

Thanks Dave, and good afternoon everyone.

Gross profit in the quarter was $2.00 billion or 58.2% of revenue. Gross profit declined 2% due to lower revenue.

Operating expenses were a total of $750 million, down $45 million from a year ago, primarily in SG&A. The decline reflects continued cost management across the company including the previously announced targeted reductions in Embedded Processing in Japan.

Acquisition charges were $83 million, almost all of which were the ongoing amortization of intangibles, which is a non-cash expense.

Operating profit was $1.16 billion or 33.9% of revenue. Operating profit was down 1% from the year-ago quarter.

Operating margin for Analog was 37.2%. Operating margin for Embedded Processing was 24.0%, eight percentage points higher versus a year ago as we focused our investment on the best growth opportunities.

Net income in the third quarter was $798 million or $0.76 per-share.

Let me now comment on our capital management results, starting with our cash generation. Cash flow from operations was $1.41 billion in the quarter.

Inventory days were 111, down 15 days sequentially. This reduction was the combination of lower factory starts as well as higher-than-expected revenue in the quarter.

As our business model evolves, we continue to evaluate our inventory model. We plan to provide an update on our inventory model to you in our capital management call next February.

Capital expenditures were $139 million in the quarter. As a reminder, in the second quarter, we retired $250 million of debt and issued $500 million of five-year debt at a coupon rate of 1.75%. In August, we retired an additional $750 million of debt.

As a result, we have reduced net debt by $500 million this year, which is consistent with our practice over the past few years. This leaves total debt of $4.125 billion with a weighted average coupon rate of 2.3%.

On a trailing twelve-month basis, cash flow from operations was $4.11 billion, up 8% from the same period a year ago. Trailing twelve-month capital expenditures were $512 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 expansion of our 300 mm analog capacity as discussed in our capital management call earlier this year.

Free cash flow for the past 12 months was $3.60 billion or 28% of revenue. Free cash flow was 4% 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 business. As we've noted, our intention is to return 100% of our free cash flow plus any proceeds we received from exercises of equity compensation minus net debt retirement.

In September, we announced our quarterly dividend increase of $0.04 per-share, a 12% increase. This was the 12th consecutive year in which we've increased the dividend to our shareholders.

We also announced a $7.5 billion increase to our share buyback authorization. In the third quarter, TI paid $348 million in dividends and repurchased $790 million of our stock for a total return of $1.14 billion. Total cash return in the past 12 months was $4.23 billion.

Outstanding share count was reduced by 3.5% over the past 12 months and by 41% since the end of 2004. 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 third quarter with $2.74 billion of cash and short-term investments, with TI's U.S. entities owning 82% of our cash. Because our cash is largely onshore, it is readily available for variety of uses including paying dividends and repurchasing our stock.

TI orders in the quarter were $3.44 billion, up 3% from a year ago.

Turning to our outlook, we expect TI revenue in the range of $3.07 billion to $3.33 billion in the fourth quarter, which includes about a $35 million negative impact from changes in foreign currency exchange rates versus a year ago. We expect fourth-quarter earnings per-share to be in the range of $0.64 to $0.74.

Acquisition charges, which are non-cash amortization charges, will remain about even and hold at about $80 million to $85 million per quarter until the third quarter of 2019. They will then decline to about $50 million per quarter for two additional years. Our expectation for our annual effective tax rate in 2015 remains about 30%, and this is the tax rate that you should use for the fourth quarter and for the year.

In summary, we believe our third-quarter results demonstrate the strength of TI's business model. With that let me turn it back to Dave.

Dave Pahl - *Texas Instruments Inc - IR*

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

In order to provide as many of you as possible an opportunity to ask a question, please limit yourself to a single question.

After our response, we will provide you an opportunity for an additional follow-up. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Vivek Arya, Bank of America. Your line is now open.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Thank you for taking my question. I guess for the first one, I am a little curious when you said demand was weak but the revenue was strong, and then you mentioned that industrial, I think you said it was even year-on-year but was stronger than expected. If you could just give us some more color around the demand environment, because you have such wide exposure, what is better or worse versus two months ago, and what does it really mean that demand is weak but your revenue is strong?

Dave Pahl - *Texas Instruments Inc - IR*

What we're saying, Vivek, is that if you look, our revenue declined 2% from a year ago. Obviously we would describe that as a weak demand. That is actually similar to what we saw last quarter.

But inside of that, certainly it was stronger than what we had expected. There were a couple of areas that were stronger than we had expected. Wireless infrastructure and industrial were both stronger than what we had expected.

So that's really what we're trying to say. We continue to operate in what we would consider to be just a weaker macroeconomic environment, and that's where we came in. Do you have a follow-up?

Vivek Arya - *BofA Merrill Lynch - Analyst*

Yes. Thanks, Dave. On the gross margin, I understand that sequentially they were sort of flattish, because I assume you put some utilization down, but why are they sort of flat to down versus last year? Because I see throughout this year there's been a mixture towards your core analog embedded markets and a mix of I guess towards more 300 mm capacity, so why aren't gross margins up versus last year?

Kevin March - *Texas Instruments Inc - SVP & CFO*

Vivek, the short answer is that the wafer starts were down in the quarter versus last quarter, also versus last year. And so underutilization was a little bit higher than it was a year ago.

Dave Pahl - *Texas Instruments Inc - IR*

Okay. Great. Thank you, Vivek, and we will go to the next caller please.

Operator

John Pitzer, Credit Suisse. Your line is now open.

John Pitzer - *Credit Suisse - Analyst*

Congratulations, just to follow-up on that gross margin comment. So utilization went down in the third quarter. I know you say you're going to update us on your inventory targets, but I think the one that is outstanding right now is about 105 to 115 and you got there pretty quickly sequentially, so I'm kind of curious how do I think about utilization going into the December quarter and what kind of impact should I expect on the gross margin line?

Kevin March - *Texas Instruments Inc - SVP & CFO*

John, as we look into the fourth quarter we're expecting our wafer starts to probably be roughly flat to what they were this quarter, so no significant change in starts there. And keep in mind that the wafers that we start in fourth quarter, other than for the first few weeks of the quarter, are mostly for what we expect in follow-on quarters, so we build quite a bit forward to our expectation of when that inventory actually gets sold.

John Pitzer - *Credit Suisse - Analyst*

That's helpful. My follow-up, you guys are probably one of the first to start the trend of M&A with the acquisition of National several years back. There's been a lot of speculation in the market place about more M&A within the semi-space. I know you've talked about this in the past, but I'd be curious about getting some updated thoughts from your perspective about the advantage from here given your already hefty scale of M&A, and how you guys are sort of thinking about that.

Kevin March - *Texas Instruments Inc - SVP & CFO*

Yes, John, I guess it will take me a second to go through those thoughts there. Of course we acquired National back in the end of 2011, so we probably got ahead of the game versus where people are at today. We've spent the intervening time period really driving hard to accelerate four attributes that we think in combination are pretty unique to TI and differentiate us quite a bit from our competitors, which may in fact be impacting some of their thinking about how they approach their markets.

Those four attributes are our approach to low-cost manufacturing and advanced technology, the sheer breadth of our overall product portfolio, the reach we have to our customers, to our market channels, especially with arguably the largest sales force of anybody out there, and the diversity and long-lived positions that we enjoy in the markets with the products that we have.

But we look at what most companies are doing from the M&A front, it appears that some of them may be changing their focus, and some of them may be trying to build scale. We already have what we believe is significant scale advantage, and we believe we are focused on the two best opportunities that are out there today, being analog and better processing.

Those two reasons aren't motivating us to think differently about M&A. When we do think about M&A, our approach is really to focus on the right strategic fit, one that can generate long-term returns and excess free cash flows, so we really do focus on the numbers that the acquisition might lead us to.

By strategic fit, I'm talking really our biases towards analog. If we were to look at an acquisition, it would probably be a company that is going to be broad in catalog, have a diverse customer base, have a large percentage of its revenue coming from industrial and automotive, probably have a very talented R&D team.

Those would be the sort of attributes we would look at from a strategic standpoint. From a return standpoint we'd look at several metrics, including really making sure that the Return on Investment is accretive to our weighted average cost capital within say four years or so.

We also want to make sure that whatever we acquire can continue to expand our free cash flow. With all that said, and we take a look at what's out there, we have been actually buying our favorite semiconductor company. I know you don't like to hear it that way, but through our own stock buybacks.

Today by buying back those shares we are getting a 7% free cash flow yield on those acquisitions, those shares, and we don't have any integration risk and no banker fees, just a whole lot easier way to run the business and focus on customers.

Dave Pahl - *Texas Instruments Inc - IR*

Thank you, John, we will go to the next caller, please.

Operator

Stacy Rasgon, Bernstein Research. Your line is now open.

Stacy Rasgon - *Bernstein - Analyst*

Hi guys, thanks for taking my questions. For my first question, I'd like to follow-up on the industrial market. You said half of your markets were kind of up year-over-year, half of them were down.

That's pretty similar to the same as last quarter, but you do seem to be seeing upside versus expectations. Within industrial, can you give us some idea of which end-markets you're actually seeing relative strength versus weakness versus those expectations, and talk a little bit about how your end-markets within industrial are concentrated or not?

Dave Pahl - *Texas Instruments Inc - IR*

Yes. So great question, Stacy. We've got 14 different sectors that make up our industrial market, and I'll just go through some of those, because I think some investors if they focus on industrials, we mean something different than that.

So it includes things like factory automation and control, medical and healthcare, building automation, smart grid, energy test and measurement, motor drives, displays, space avionics, appliance power delivery systems, point of sale lighting, industrial transportation. And then a bucket of just other really small stuff.

So last year, as you know, Stacy, industrial was 31% of our revenues, the largest sector inside of there was 4%. So you can see it gets very, very diverse very quickly, and even inside of each of those sectors we have got multiple end-equipments that make each of those up.

So it was very similar to last quarter where we did see about half of the sectors up and the other sectors down, together flat, so there weren't really any huge movements in either that we would call out to say it was unusual.

So that's what it looked like. Do you have a follow-on, Stacy?

Stacy Rasgon - *Bernstein - Analyst*

I do, thank you. Around your OpEx it seems like you came in fairly light in the quarter versus expectations. Why was that, and where do you see OpEx going next quarter?

Kevin March - *Texas Instruments Inc - SVP & CFO*

So Stacy, on OpEx compared to a year-ago quarter, that was really when we just had continued cost management going on across the company, and we also had the benefit on a year-ago comparison to the actions that we have previously announced in Embedded Processing and Japan, and those are now done. So we get that benefit year-over-year. As it relates to sequential, even as you say come in the quarter a little bit better than expected, that's really just cost management continuing.

And also in second quarter there were a few items that didn't recur in third quarter, so that gave us a good benefit second-to-third.

Dave Pahl - *Texas Instruments Inc - IR*

Okay, thank you, Stacy, and we will go to our next caller, please.

Operator

Harlan Sur, JPMorgan. Your line is now open.

Harlan Sur - *JPMorgan - Analyst*

Good afternoon, thanks for taking my question. In Q2, Embedded with up year-over-year for the first time -- actually no, Q2 Embedded was down year-over-year for the first time I think versus the prior ten quarters, it inflected higher in Q3.

I know you guys said MCU and Connectivity drove the growth, but what end-markets helped return this business back to year-over-year growth, and also what drove the 450 basis point improvement in operating margins?

Dave Pahl - *Texas Instruments Inc - IR*

Okay. So I guess two questions there. I'll take the first one. So as you said, Embedded Processing was driven by Microcontrollers and Connectivity, and both of those businesses tend to be very broad market exposures, high exposure to industrial; we've also some exposure inside of Processors to automotive.

And what drove the weakness in second quarter and the reason why Processors declined year-over-year would be exposure to wireless infrastructure is probably the simplest way to say that.

Kevin March - *Texas Instruments Inc - SVP & CFO*

Operating margin, Harlan, the short answer is we had announced at the end of 2012 some restructuring actions inside Embedded Processing that would wind up last year, and in fact they have, so a lot of that cost is out, and so as a result the operating margins are coming through very nicely.

Dave Pahl - *Texas Instruments Inc - IR*

We will let you squeeze in a third question, but we will make an exception for you on this one.

Harlan Sur - *JPMorgan - Analyst*

I appreciate that. You know last quarter you guys indicated you were bringing down utilizations in the third quarter to try and reduce inventories. It looks like you guys executed to that. Should we anticipate gross margins in Q4 down in line with the lower utilizations in Q3?

Kevin March - *Texas Instruments Inc - SVP & CFO*

Harlan, I am not going to try to forecast individual lines of the P&L, but I'll just bring you back to what I mentioned when John asked his question. We expect utilization to decline pardon me, utilization to be about - excuse me starts to be about even in fourth quarter versus third quarter, so we don't expect starts to actually change.

The starts were already down third quarter versus second and third quarter versus a year-ago quarter, and we'll maintain those starts about even going into fourth quarter.

Dave Pahl - *Texas Instruments Inc - IR*

Okay. All right. Thank you. Yes, and certainly the other consideration with fourth quarter is what happens to revenue overall, so we'll have less revenue, so that will impact gross margins.

Okay, thank you, Harlan, and we will go to the next caller, please.

Operator

Chris Danely, Citigroup. Your line is now open.

Chris Danely - *Citigroup - Analyst*

Great, thanks guys. If you look at just some sort of normal or reasonable projections for Q4, for 2015 your revenue is going to be flat but your gross margins will be up, and your OpEx will be down. If we assume this sort of blah environment continues into 2016 and revenue is sort of around the flattish or something like that, is there any way that gross margins could go up and OpEx go down again? Can you just take us through the puts and pulls for next year on those?

Kevin March - *Texas Instruments Inc - SVP & CFO*

I'll go ahead and take you through on those sort of things, Chris. First off, I'm hoping you're wrong in your theory about revenue being flat again next year.

Chris Danely - *Citigroup - Analyst*

Me to. I want to keep my job (laughter).

Kevin March - *Texas Instruments Inc - SVP & CFO*

Under that scenario I doubt that we'd see a whole lot of change in operating expenditures other than just normal annual pay and benefit increases. But on the margins side, on the gross margins side, we will probably continue to see benefit as we see more and more of our production moving to 300 mm, which as you recall gives us about a 40% chip cost reduction from an overall cost of goods standpoint, so that will certainly benefit our gross margin line.

In addition to that, we continue to see an expansion of revenue that's coming out of the industrial and automotive spaces, percent of the total, and those tend to come through with higher gross margins, as well as just overall catalog products versus custom products inside our mix. And then the last item is that, as we talked about for a couple years now, our CapEx has been running under our depreciation by a couple of points, and that is slowly beginning to close. In fact, you can even see that gap closing just in this past 12-month comparison period.

So as we look out into 2016, you'll see that gap close a bit more, so those in combination will give us continued tailwind on the gross margin line. It should follow all the way through to the operating margin.

Dave Pahl - *Texas Instruments Inc - IR*

Yes, and I'd just add, too, that even with this year if the revenue projections come in as you said Chris, free cash flow margin continued to expand, so that's really what we are focused on. Do you have a follow-up, Chris?

Chris Danely - *Citigroup - Analyst*

Yes, so if we look at what revenue did sequentially in Q3 and what you are projecting for Q4, it's pretty even with last year. And it sounds like even though business is still kind of flat, it's getting a little bit better. Would you characterize the environment overall as kind of normal, and if it's not normal then where would be your biggest area of concern or weakness?

Dave Pahl - *Texas Instruments Inc - IR*

Yes, Chris, if you look at the midpoint of our guidance, it would suggest that our revenues would be down 2% from the year ago. That's similar to the number that we just turned in as well as what we saw in second quarter, so you know, we just described the environment really hasn't changed very much.

We just believe that we're operating in a weak macro environment, and we continue to focus on execution, and I think the business is showing the results of that focus in the strength of the business model. But in general that's really what we believe that we're operating in. So okay, thanks Chris, and we will go to the next caller, please.

Operator

William Stein, SunTrust. Your line is now open.

William Stein - *SunTrust - Analyst*

Great, thanks for taking my question. I wonder if you had a 10% customer in the quarter, or if you had any meaningful change in revenue from a single customer that would've affected the overall trend in the business during the quarter?

Dave Pahl - *Texas Instruments Inc - IR*

Yeah, Will, we had -- if we look at last year we had, our largest customer was 8% of revenue. And we don't give customer size by quarter.

But we expect that that customer as they have done well this year that they could come in around 10% of our revenue. And you know I'd say just as we look at that customer, we sell them hundreds of devices across multiple products, and if I contrasted to the last time that we had a customer that was more than 10%, you know most of that revenue was concentrated in just a few parts in a single application, and even more specifically than that, it was really one function that maybe was that different generation. So we really just had one function at that customer.

So even inside of this customer we've quite a bit of diversity. Do you have a follow-on?

William Stein - *SunTrust - Analyst*

Yes, it's related to this. The company exited the wireless apps processor and baseband business a few years ago, and I suppose that the answer is around the concentration at the part number level, but does what looks like a growing exposure to the handset market through at least one but probably multiple customers, does that concern the company the way, you know, in a similar way that caused you to exit some products previously?

Kevin March - *Texas Instruments Inc - SVP & CFO*

I'd say that when you heard Dave's opening remarks that we saw growth in personal electronics, and without that one customer growing personal electronics would have been down, I think that's also telling us that as handsets overall grow, they are really becoming the larger piece of the personal electronics space.

So what's important is to have a lot of different chips that you are selling into, a lot of different customers that sell into that space, and that's exactly what we have. And so from that standpoint, if we're going to participate in personal electronics we're going to be participating in handsets, and there are a lot of very attractive chip opportunities inside handsets.

Unlike what we had a number of years ago, as you remembered with baseband and processors, where those parts were basically standardized and commoditizing, and your ability to differentiate was diminished and therefore your ability to attract profits from selling those parts was diminished. Consequently, I see this as quite a bit different today given the diversity of products that we're talking about here than the example when we were baseband processors 5+ years ago.

Dave Pahl - *Texas Instruments Inc - IR*

And I'd add to that, if you look across personal electronics and you add smartphones and tablets and PCs and TVs and things like that, you're probably if you added all those together, you're probably staring 2.4 or 2.5 billion units. Even though that unit pool probably isn't going to grow much, as Kevin said, there is opportunities to find products that will live through multiple generations that you can sell to multiple customers, and places where we will continue to try to steer our investments overall.

Thank you, Will, and will go to the next caller, please.

Operator

Blayne Curtis, Barclays. Your line is now open.

Blayne Curtis - *Barclays Capital - Analyst*

Thanks for taking my question. Really two related questions. One is a clarification. You said the upside in the quarter came from wireless infrastructure and industrial, it seems like HVAL was up a lot.

Was that part of what you were calling industrial? And then maybe bigger picture from a geographic perspective, there's obviously been some negative data points in the U.S. industrial market, just any change -- over the summer it was China, now you're seeing some U.S. issues, just any perspective from a geographic basis. Thanks.

Dave Pahl - *Texas Instruments Inc - IR*

So let me answer your first question. Which, if you look at HVAL, HVAL will have a high exposure to automotive, which will help drive those revenues. It will also have exposure to personal electronics as well.

It does have some industrial exposure, but I think that those are the areas that will drive that revenue. And you had a follow-up?

Blayne Curtis - *Barclays Capital - Analyst*

The question was just what you're seeing from a geographic perspective, obviously China was the, yes.

Dave Pahl - *Texas Instruments Inc - IR*

Yes, so if I just look at our regional results year-over-year, revenue was down in Asia and Europe and U.S. In Japan, it was up.

If you look at the broader China market, it really wasn't down differently than what the broader Asia was, and that was kind of down consistent with our overall revenues. So really didn't see much different.

The second thing I'll add is that a lot of times we are asked by investors what our exposure to China is or to a particular market, and in our 10-K we give a very precise number of what we ship into China as being 44%, but we always like to point out that if you're looking for what exposure to a particular market is, I think most investors are asking how much of our product is actually consumed there.

And so it's a very different number then 44%. It's much lower than that. Because obviously some of those products that we ship there end up getting shipped into other regions.

I'll also point out that we may ship product into a tier two OEM that gets put into a European automobile in Europe and then shipped into China. So you can't really look at any of our regional results and understand that. So but overall probably a good proxy to begin to start an analysis would be to look at what China is as a percentage of GDP and then kind of start an analysis from there.

Thank you, Blayne, and we will go to the next caller, please.

Operator

Joe Moore, Morgan Stanley. Your line is now open.

Joe Moore - *Morgan Stanley - Analyst*

Great. Thank you. I wonder if you can talk a little bit about your customer inventories. You give us the very helpful disty resale inventory numbers, but just in general you know you had a pretty good year in 2014 a weaker year this year, but my perception is that the customer inventory management lead time, you know, days held, hasn't really changed. Can you just talk about what you see in the inflection there in the last few quarters.

Dave Pahl - *Texas Instruments Inc - IR*

Sure, Joe. I'd say that of course the distribution inventory as you said that we can see very well. You know we've got 55% of our revenues that are on consignment, so for those portions, which will include 60% of our distributor revenue, but we know for that portion of our revenue there is no inventories. It's actually zero, so obviously that's in really good shape.

And if you look overall at the classic kind of book shift tiering inventory type portion of our revenue is really about 20% of our revenue and that's where we'll carry backlog. Customers will have inventory. So we really don't see any signs that customer inventories are significantly out of whack.

I'm sure you can always find pockets here and there. But we believe that they are fairly lean with very few exceptions, you know, such as the wireless infrastructure. So do you have any follow-on, Joe?

Joe Moore - *Morgan Stanley - Analyst*

Yes, I did want to follow-up on wireless infrastructure. You said it was up sequentially recovering from a lower level.

Do you have visibility into whether that sort of China deployments or Western deployments, and what do you see as the share actually for that business going forward?

Dave Pahl - *Texas Instruments Inc - IR*

So Joe, we have I'd say our exposure in wireless infrastructure, if you look at the major OEMs that make up the majority of that market, we'll have a different product exposure but a fairly consistent exposure across them. So if there's demand in any of the regions, we'll typically participate in that.

If you look at by technology -- that's often time another cut that people will look at -- we've got a strong position in 3G, slightly stronger position in 4G, and even in newer areas that we expect growth in the future that we've been investing in, as an example like small cells, we've been investing and believe we'll have a very strong position there as well. So our numbers aren't so much impacted by a specific region. Of course, we won't escape it either if there's weakness in any particular region.

So okay, thank you, Joe. And we'll go to the next caller, please.

Operator

Ross Seymore, Deutsche Bank. Your line is now open.

Ross Seymore - *Deutsche Bank - Analyst*

Hi guys, congrats on the strong results. I know in the past, Dave, you give the year-over-year's -- I think you mentioned that the wireless infrastructure sequentially was up. I was hoping you could give the sequential direction by the other markets, and I think from the map you gave earlier for last year by the end markets, it seemed to imply that the combination of industrial and your comm infrastructure, your wireless infrastructure, must of been up the better part of 15% sequentially. So if you could just comment on the directional color by segment and if those magnitudes are anywhere close, that would be helpful.

Dave Pahl - *Texas Instruments Inc - IR*

Okay. Yes. I've got -- I can share with you some color sequentially. The automotive market grew sequentially, led by our ADAS and infotainment sectors.

Industrial again was about even. And personal electronics was up with growth in most of the sectors that make up that market.

Communications equipment was up, as we talked about earlier due to wireless infrastructure, and enterprise systems was about even. And, you know, as we talked about most of those areas were stronger than we had expected, but specifically wireless infrastructure and industrial.

Kevin March - *Texas Instruments Inc - SVP & CFO*

Just on the year-over-year growth though, I'm not sure, Ross, on the numbers you were reciting there, but industrial overall year-over-year was probably only up about 1%.

Ross Seymore - *Deutsche Bank - Analyst*

Yes. I'm sorry. I was talking sequentially.

Kevin March - *Texas Instruments Inc - SVP & CFO*

Okay. Wireless infrastructure is still down year-over-year. Sequential industrial was actually down about 1% overall. Wireless infrastructure was again up in the single digits, so really not much growth there.

Dave Pahl - *Texas Instruments Inc - IR*

Okay. You have a follow-up, Ross?

Ross Seymore - *Deutsche Bank - Analyst*

Just a quick one, more housekeeping. I know you're not going to give exact guidance on the gross margin you said earlier, as far as OpEx directionally in the fourth quarter and first quarter, I know you guys tend to have some year-end phenomenons that impact that, so Kevin any sort of color on those two quarters would be helpful. Thanks.

Kevin March - *Texas Instruments Inc - SVP & CFO*

It's going to be pretty normal to what you see in the past quarters. Your memory is quite correct on that. 4Q is typically down, you know, low-to-mid-single digits percentage-wise just because of seasonality of holidays around Thanksgiving and Christmas.

And then first quarter is typically up in a reverse direction. Again, because of the absence of holidays and also because of the implementation of our annual pay and benefits increases.

So I think if you look at the past couple of years 3Q to 4Q to 1Q, that's probably the best proxy for you to try to model into your spreadsheets for now

---

Dave Pahl - *Texas Instruments Inc - IR*

Okay. Thank you, Ross. We can go to the next caller, please.

Operator

Tore Svanberg, Stifel. Your line is now open.

Eric Steele - *Stifel Nicolaus - Analyst*

Thanks. This is Eric calling in for Tori. A lot of questions have been asked but going back to the 300 mm strategy, can you give us an update on that?

You know exiting the year maybe how much of Analog would you expect to be coming out of the fabs to support that?

Dave Pahl - *Texas Instruments Inc - IR*

Hey Eric, I'll just say that we'll give an update to that in our February call, capital management call. I can just say that you know part of our plan was to qualify our DMOS 6 factories, so that qualification is planned to be done before the end of the year and so we're still tracking to that.

You know we've been releasing products to RFAB, or the Richardson fab, for some time, so we're going to continue to do that and that we still have quite a bit of capacity to be able to grow into. So you have a follow-on?

Eric Steele - *Stifel Nicolaus - Analyst*

Yes, no thank you, that's helpful. Embedded Processing obviously the operating margins look very good this quarter. Going forward, and I know you probably don't want to give too much guidance on this, but you know, what are the expectations for this business?

Will it be lumpy in terms of the improvements? Was this a little bit more of an out-sized quarter in terms of the improvement, or should we see -- what's some of the expectations for that group?

Kevin March - *Texas Instruments Inc - SVP & CFO*

Eric, those teams have been working pretty hard for number of years now to grow their revenue. We talked about their mission over the last couple of years has really been cost containment and growing the revenue and they are achieving very good results on that now.

Importantly, they're a strong contributor to our free cash flow growth and just as our free cash flow at the company level tends to be weaker in the first couple quarters and stronger in the second couple of quarters, I don't think it's any different than when we take a look at how some of the business units underneath will perform on that metric being as how they're the ones contributing to that free cash flow. We tend to look at these things over a longer period of time just because quarter to quarter can be pretty noisy.

But I think that team has done a very good job of getting its margins up to where we think its entitlement is at, and they should be performing at that level for the foreseeable future, in fact for the long-term is what we expect out of them.

Dave Pahl - *Texas Instruments Inc - IR*

And I'll just add, as Kevin mentioned the growth, has been coming through from the investments that we have made. You know we highlighted that they as well as Analog had achieved record levels of revenue as a result of those investments.

Together Analog and Embedded have grown for 9 quarters in a row, year-over-year. So and I think there was one quarter where Embedded actually did well but didn't grow year-over-year and that was last quarter that had the big headwind from wireless infrastructure, but there were other parts of that business obviously did very well.

Okay, I think we have time for one last caller. Operator?

Operator

David Wong, Wells Fargo. Your line is now open.

David Wong - *Wells Fargo Securities - Analyst*

Thanks very much. Just a detail of your earlier announcement. You noted that personal electronics was up because of demand from one customer. What about your broader segments? Would you have still seen year-over-year growth in both Analog and Embedded if it hadn't been for that same one customer.

Dave Pahl - *Texas Instruments Inc - IR*

Yes, I actually don't have that data broken out between the two segments, but I think that personal electronics is mostly inside of Analog and so our personal electronics business without that customer obviously wasn't up, so that would have impacted Analog.

Kevin March - *Texas Instruments Inc - SVP & CFO*

I want to remind you of the other side of that too. We had a significant change in foreign exchange rates year-over-year.

So actually in the third quarter and I think again in the fourth quarter we saw and expect about a $35 million negative top-line impact due to foreign exchange rates, so we can always pick out individual pieces. The beauty of the TI model is that we have tens of thousands of customers buying tens of thousands of parts into almost every electrical and electronic market that's out there, and the diversity is what is really paying off for our shareholders in free cash flow generation.

David Wong - *Wells Fargo Securities - Analyst*

Great. Thanks very much.

Dave Pahl - *Texas Instruments Inc - IR*

I guess you don't have a follow-up David?

David Wong - *Wells Fargo Securities - Analyst*

Well actually one quick one. As you move more towards 300 mm are you vacating any specific 200 mm facilities you might be able to close down or sell eventually?

Dave Pahl - *Texas Instruments Inc - IR*

Yes, David, we put in place that 300 mm capacity in the Richardson fab and put together the plans inside of DMOS 6, the second 300 mm factory to be able to support growth, and that's why that's there. It's really releasing new products into those factories and that's what they're there for and that will help us maximize free cash flow.

So, okay. Well thank you, David. And thank you all for joining us. I was expecting Marty McFly to actually get in the queue but he didn't.

So a replay of this call is available, and you can find it on our new and improved website. Good evening.

Operator

This does conclude today's teleconference. Thank you and have a good day.