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TXN - Q4 2014 Texas Instruments Inc Earnings Call

EVENT DATE/TIME: JANUARY 26, 2015 / 10:30PM GMT

OVERVIEW:

TXN reported 4Q14 revenues of $3.27b and net income of $825m or $0.76 per share. Expects 1Q15 revenues of $3.07-3.33b and EPS of $0.57-0.67.

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PRESENTATION

Operator

Good day, and welcome to the Texas Instruments 4Q 2014 and 2014 year-end earnings conference call.

At this time, I'd like to turn the conference over to Dave Pahl. Please go ahead, sir.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Thank you, and good afternoon, and thank you for joining our fourth-quarter and year-end 2014 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 web 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 Safe Harbor Statement contained in the earnings release published today, as well as TI's most recent SEC filings, for a more complete description.

Before I review the quarter, let me provide some information that's important to your calendar. We plan to hold a call on February 4, at 10:00 AM Central time, to update our capital management strategy. Similar to what we've done for the last two years on this topic, Kevin March will provide insight into our strategy, and also answer some of the most frequently asked questions.

Turning to our earnings update, the fourth quarter marked another quarter of strong progress. Our core businesses of Analog and Embedded Processing grew again, with combined revenue up 13% from a year ago.

Revenue of $3.27 billion came in at the middle of the expected range that we communicated to you in October. Earnings per share were $0.76, and included a $0.05 benefit of for the reinstatement of the federal research tax credit, and a $0.02 benefit from gains on sales of assets. Without these two items, our earnings would have been in the middle of our expected range.

In the fourth quarter, our cash flow from operations was $1.3 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 year was $3.5 billion, up 18% from a year ago. Free cash flow was 27% of revenue, consistent with our targeted range of 20% to 30%. This is a 3 percentage point increase -- improvement from a year-ago period.

We believe this reflects our improved product portfolio, and the efficiencies of our manufacturing strategy, which includes our growing 300mm output and the opportunistic purchase of assets ahead of demand. We also believe that free cash flow will be valued only if it's returned to shareholders or productively invested in the business. In 2014, we returned $4.2 billion of cash to investors through a combination of stock repurchases and dividends.

In the fourth quarter, TI revenue grew 8% from a year ago, with growth in both Analog and Embedded Processing. Analog revenue grew 14% from a year ago, led by Power Management. High Volume Analog and Logic, High Performance Analog and Silicon Valley Analog also grew. This is the sixth quarter in a row of year-over-year growth for Analog.

Embedded Processing revenue grew 11% from a year ago, due to growth in processors, microcontrollers and connectivity, each of which increased by about the same amount. It is notable that connectivity grew at the fastest rate, as we continue to see more products being connected. This is the ninth consecutive quarter of year-over-year growth for Embedded Processing.

In our Other segment, revenues declined 14% from a year ago, due to legacy wireless and custom ASIC products.

Turning to distribution, re-sales increased 14% from a year ago, consistent with our combined revenue growth of Analog and Embedded Processing. Weeks of inventory decreased by a week from a year ago, to a historically low level of just under 4.5 weeks.

This level has decreased over the past few years because we've structurally changed how our inventory is managed in the distribution channel with our consignment program. This quarter, we continue to support more of our distribution sales from consignment inventory, and now have about 60% of our distribution revenue on consignment, up about 15 percentage points from a year ago.

With this program, inventory sits on TI's balance sheet, and revenue is recognized when our distributors pull products from our consignment inventory that's stored at the distributor's location. We carry higher loads our inventory on TI's balance sheet with this program, which has several benefits, such as minimizing impact due to changes in distribution channel inventory, and giving us greater flexibility to meet customer demand.

Turning to our end markets, in 2014, industrial and automotive combined were 44% of TI's revenue, up a couple of percentage points from last year. Specifically, industrial made up 31% of TI's revenue; automotive 13%; personal electronics 29%; communications equipment 17%; enterprise systems 6%; and other 4%.

We continue to refine our understanding of our customers' end markets, with better tools and software. On our website, we've included the last two years of updated market estimates, and we've identified the sectors inside of each of those markets for your reference.

Finally, let me make a few observations about the year overall. For 2014, Analog and Embedded Processing revenue grew a combined 12%, with Analog up 13% and Embedded up 12%. We gained market share in both businesses again in 2014.

These two key businesses were 83% of TI's revenue for the year, up from 79% in 2013. Because they now make up more of our revenue, they are driving top-line growth for the company. TI revenue overall grew 7% in 2014.

Now, Kevin will 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 $1.90 billion, or 58% of revenue. Gross profit increased 16% from the year-ago quarter. This gross profit reflects higher revenue, increased factory loadings, and an improved product portfolio, focused on analog and embedded processing, that benefits from our efficient manufacturing strategy.

Moving to operating expenses, combined R&D and SG&A expense of $740 million was down $67 million from a year ago. The decline primarily reflects the targeted reductions in Embedded Processing and Japan that were previously announced. That restructuring is now essentially complete, and we achieved a little more than our estimated annualized savings.

Acquisition charges were $82 million, almost all of which were the ongoing amortization of intangibles, a non-cash expense. Restructuring and other charges were a $27 million benefit, due to gains on sales of assets.

Operating profit was $1.10 billion, or 33.6% of revenue. Operating profit was up 60% from the year-ago quarter. Operating margin for Analog was 38.7%. Operating margin for Embedded Processing was 17%, more than doubling from a year ago, as we benefit from our investments for growth, and as we executed our restructuring plan to better align resources with the opportunities that we are pursuing.

While this is solid progress, we still have work to do in this business. We expect Embedded operating margins to continue to increase as our investments in R&D and SG&A will continue to drive top-line growth, while we hold these expenses flat.

Net income in the fourth quarter was $825 million, or $0.76 per share. As a reminder, earnings per share included a $0.05 benefit for the reinstatement of the federal research tax credit, and a benefit of $0.02 from the gains on sales of assets.

Let me now comment on our capital management results, starting with our cash generation. Cash flow from operations was $1.27 billion in the quarter.

Inventory days were 117, slightly above our model range, but a number that we are quite comfortable with. It is consistent with a growing portion of our product demands being supported with consignment inventory versus customer-owned inventory.

We believe these consignment arrangements give us better real-time feedback to end market demand that allow us to better manage our factories and maintain short lead times. We expect consignment inventory to continue to increase over the coming years, as distribution becomes a growing portion of our business. We will monitor the appropriateness of our current model of 105 to 115 days of inventory, and possibly update this model in the next year or so.

Capital expenditures were $125 million in the quarter. In 2014, cash flow from operations was $3.89 billion, up 15% from the same period a year ago.

For the year, capital expenditures were $385 million, or 3% of revenue. As reminder, our long-term expectation is for capital expenditures to be about 4% of revenue.

Free cash flow for the year was $3.50 billion, or 27% of revenue. Free cash flow was 18% 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 over if it is returned to shareholders or productively reinvested in the business. As we've noted, our intent is to return 100% of our free cash flow, plus any proceeds we received from exercises of equity compensation, minus net debt retirement.

In the fourth quarter, TI paid $356 million in dividends and repurchased $698 million of our stock, for a total return of $1.05 billion. Total cash returned in 2014 was $4.15 billion, which is 3% higher than the prior year.

Outstanding share count was reduced by 3.3% over the past 12 months, and by 39% at 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 fourth quarter with $3.54 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 orders in the quarter were $3.18 billion, up 11% 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 first quarter. At the middle of this range, revenue would increase 7% from a year ago. We expect first-quarter earnings per share to be in the range of $0.57 to $0.67. Restructuring charges will be essentially nil. Acquisition charges, which are non-cash amortization charges, will remain about even, and hold at about $80 million to $85 million per quarter for the next five years.

Our expectation for our annual effective tax rate in 2015 is about 30%, and this is the tax rate you should use for the first quarter and for the year. The rate is higher than the last year because of an expected increase in profits, and does not assume the reinstatement of the R&D tax credit.

In summary, the fourth quarter demonstrates the growing strength of TI's business model. Our strategy is anchored in Analog and Embedded Processing, and is bolstered by an efficient manufacturing operation and a broad sales channel. The result is a diverse and long-lived positions in many markets.

We remain intent on excellence in execution, being disciplined in allocating our capital, and our firm belief that free cash flow per share is the best long-term indicator of shareholder value.

With that, let me turn it back to Dave.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Vicki, you can now open the lines up 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. After our response, we will provide you an opportunity for an additional follow-up. Vicki?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Chris Danely, Citi.

Chris Danely - *Citigroup - Analyst*

Thanks, guys. Good quarter. Kevin, I guess if you had to characterize the overall environment now versus, say, a quarter ago or a year ago, would you say, broadly speaking, not much has changed we're still in this kind of fine roughly seasonal environment? Or have you seen any changes in visibility or your overall business?

Kevin March - *Texas Instruments Inc - CFO*

No, Chris, I think you said it well. It probably hasn't really changed all that much. There was a slight change in our book-to-bill on a year-over-year basis. This quarter was about 0.97. A year-ago quarter was 0.94. But frankly, because more and more of our orders are coming in on consignment, I think book-to-bill means less and less about a particular of where our revenue is going. So I think that, to summarize our sense, it's more steady as she goes, just like we've seen for the last few years of an economy just growing along at a steady basis. And we're trying to take advantage of [growing] a little bit faster than that.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes, and Chris, let me add, just, the other things that we see. If you look at our inventory, it's at a healthy level. Our channel inventories are actually down a week, as I said earlier, from a year ago, just to under 4 1/2 weeks. Our lead times remain consistent. Our cancellations and reschedules remain very, very low. And in addition, we continue to deliver our products on time for customers. So those types of things are always a good indication for the overall environment, too. Do you have a follow-up?

Chris Danely - *Citigroup - Analyst*

Yes. So it sounds like things are pretty normal, seasonal to disty too. Can you give us any sense of the relative growth rates of your major product lines this year? What you're expecting, between Analog, Embedded, and the Other stuff?

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

No, we don't try to forecast out a year on the major product lines, or even at the company level. I will point out that both of those product lines turned in another year of market share gains. And certainly, we're working really hard to do that for another year. And we'll just have to see how the year turns out. So thanks, Chris, and we will go to the next caller, please.

Operator

Ambrish Srivastava, BMO Capital Markets.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Thank you. On the inventory front, are we to assume now that your visibility now, vis-a-vis in the past, is higher also, because of a higher percentage is consignment off the disty? And within that, that gives you better visibility? Is that the right way to think about it? So the days are going up versus what your targeted range is, and really not comparable to, if we look at the last 5 year and 10 year median. And then I had a quick follow-up.

Kevin March - *Texas Instruments Inc - CFO*

Ambrish, I don't know that I would necessarily go to improved visibility. But we do get, I'd say, a much more improved or real-time feedback from what's actually going on with true end demand for our products. And the real benefit of that is that we can adjust our factories on a real-time basis. Whereas, as you point out, if you went back a number of years, we carried far fewer days of inventory.

But the signal as to how fast our products are actually being consumed in the end market also took a lot longer to get to us. And so we'd respond later. Now, we can respond much more quickly. So it's less a question of improved visibility as it is a question of much more real-time feedback as to just how fast our products are being consumed.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Okay, thanks for the clarification, Kevin. That's what I meant. Because we always get into this debate in end cycles about sell-in and sell-through. My quick question is, what should we be modeling for CapEx for this year? Thank you.

Kevin March - *Texas Instruments Inc - CFO*

Yes. I'd continue to recommend that you assume that we will average about 4% of our revenues on CapEx, on average, over multi-year periods. Some years might be a little lighter, like it was this past year, where we came in at about 3% in 2014. But on average, we expect 4%, and that's how we build our own internal models.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Great. Thanks, Ambrish. We will go to the next caller, please.

Operator

John Pitzer, Credit Suisse.

John Pitzer - *Credit Suisse - Analyst*

Good afternoon, guys. Congratulations on the good results. Kevin, 90 days ago, when you were talking about OpEx for the December quarter, you said that looking back a year ago, and how it flowed a year ago, was probably a good model. And you even mentioned that it would probably be a good model going into the calendar first quarter. Is that statement still hold? Or can you help us understand the puts and takes on OpEx going into the March quarter, especially around some seasonal costs?

Kevin March - *Texas Instruments Inc - CFO*

Yes, John, you're exactly right. So going from fourth quarter to first quarter, the best way to model that is to take a look -- really, the last year is a good starting point. We typically are up in the mid single digits from fourth to first on OpEx. And that's because of the absence of the holiday periods that we have in the fourth quarter, and the annual startup of pay and benefit increases that we have in first quarter.

This year, we might be up just a little bit more than that versus a year ago, simply because, on higher profitability that we are expecting for the year, we also expect higher variable compensation accruals. And so that may take our first up a little bit higher than what you saw about a year ago.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

You have a follow-on, John?

John Pitzer - *Credit Suisse - Analyst*

Yes, I do. Just going back to the Analog space, Dave. Maybe you can give us a little bit more color, because it's pretty impressive. You guys put up double-digit growth year-over-year this quarter, against pretty hard compares from the year-ago quarter. So I'm just kind of curious, to what extent do you think your market share gains could be accelerating around your consignment efforts? Or if you could just help me understand a little bit better? I know you talked about Power leading the way this quarter. Can you help me understand a little bit more why the growth seems to be doing much better than some of your peers?

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes. I think when you look year over year, first of all, it's good to have all four of those businesses contributing to the growth. Certainly, Power is benefiting from just a secular trend of things wanting to run more off of batteries, and things that do get plugged in becoming more efficient. We also have a very strong product line there, too. So I think that those things are helping us to gain share.

And if -- we've talked about, for some time, that it's not one thing inside of a business like Analog or Embedded Processing that allows you to gain share. There's a lot of things that you have to do to be a good analog company, and we've got a lot of competitors that fit that category. But we've got other things, like the scale of our -- and reach of our sales force, our presence on the web, our manufacturing footprint, the technology that we bring to bear, and the breath of the product portfolio. I think it's just all those things working together.

Kevin March - *Texas Instruments Inc - CFO*

I'd probably add one more thing there, too, is our strategy of -- that we've discussed for a couple years now of buying our capacity ahead of our needs, and always having ample capacity, quite frankly gives our customers, new and old, increased confidence that we have adequate capacity to meet their demand requirements. And they see us consistently maintaining short lead times. So that's just another element that helps us be able to win market share versus some of the other competitors that we're up against.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes. Good. That's good. Okay. Thanks, John. We will go to the next caller, please.

Operator

Harlan Sur, JPMorgan.

Harlan Sur - *JPMorgan - Analyst*

Good afternoon, and great job on the quarterly execution. Thank you for taking us through the OpEx step-up here in Q1. Now, with most of the Embedded in Japan restructuring behind you, but continued discipline on the team's part, how should we think about the OpEx trends beyond the first quarter? I think, Kevin, I heard you mention your Embedded OpEx holding flattish. But how should we think about the overall business beyond Q1?

Kevin March - *Texas Instruments Inc - CFO*

So Harlan, I think the best way to think about that is, we discussed -- I think it was back in 2011 -- that on average, we'd expect our OpEx to run between 20% and 30% of revenues. So like in a weak market, it might be at the 30% level, and in stronger markets, it would be in the 20% level. We're in a pretty good -- we're performing quite well in our markets right now, and so you're seeing that OpEx come down. In fact, most recently, in the second half of 2014, we were running around 23% of revenue. And so I would say that you would want to model us in the lower half of that range, as you try to think about how much our OpEx spend will be in 2015.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Great. You have a follow-on, Harlan?

Harlan Sur - *JPMorgan - Analyst*

Yes. Thank you for that. Your thoughts, directionally, on utilization levels here in Q1? Given the seasonality in your business, I would assume that it's down again, given the book-to-bill ratio and the revenue guidance for Q1. Is that also how we should think directionally about gross margins, as well?

Kevin March - *Texas Instruments Inc - CFO*

I think the way you need to think about utilization is first, by definition, because we buy capacity ahead of time, we will by definition be operating in an underutilized environment versus our maximum capacity -- theoretical capacity. But that aside, because of manufacturing cycle times, the material that we're starting in the first quarter, especially as we move into the second month of the first quarter, really is destined for second-quarter shipments.

So your utilization tends to proceed the quarter you're moving into, as to what your expectations are. And as the second quarter for the last three, four, five, years now, and normally for us, is a growth quarter compared to the first quarter, we will adjust our factory loadings accordingly to our expectation to second-quarter revenue expectations.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Okay. Thank you, Harlan, and we'll go to the next caller, please.

Operator

Stacy Rasgon, Bernstein.

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

Hi, guys. Thanks for taking my question. I think to follow up on that gross margin question, it looks to me your implied guidance for margins is maybe 57 -- maybe a little higher, so low 57, is down a little bit on revenues that are down slightly with inventories a little higher. Could you just give us some feeling of -- if you don't want to give numbers, at least some of the drivers for gross margins into Q1? And in particular, what are you planning to do with the inventory on your own balance sheet? How will that trend?

Kevin March - *Texas Instruments Inc - CFO*

Yes. I don't know that I necessarily have -- don't want to get into the GPM, per se. Let me just talk a little bit more about what our inventory levels might look like, and how that might drive us. We don't have an inventory forecast, per se. But given the growth in consignment, and the typically seasonally strong 2Q, we would expect our factory loadings to increase as we move through the quarter, as I mentioned a moment ago.

One of the things to keep in mind. When you adjust your factory loadings, if your quarterly loadings are really for the following quarter's expectations, then if you think about the pattern of movement through the quarter, you take your loadings coming into fourth quarter, our loadings would be dropping coming into the quarter. And going into first quarter, our loadings would start to increase during the quarter. And so you're always going to have a bit of a lag, when you try to track the GPM that follows with that, which I think is what you are asking for there, Stacy.

I think more importantly, what we see going forward is that our margins, we expect to continue to improve, along with our free cash flow. By virtue of the fact that Analog and Embedded Processing continue to become a larger portion of our total revenues, and by virtue of the fact that 300mm manufacturing continues to be a larger portion of our total production, as we go forward. And both of those result in both higher margins and higher free cash flow.

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

Got it. Thank you. That's helpful. For my follow-up, just to touch on the tax rate. So your guidance for next year, 30%, a little higher than your guidance for 2014 was, which I think was 28%. I just wanted to verify. Is the only real source of that just the higher profit versus expectation? I think you had told us before to tax every incremental dollar of profit around at the incremental tax rate, 35%.

Kevin March - *Texas Instruments Inc - CFO*

Yes. Stacy, that's correct. In fact, our tax rate in 2014, our guidance was, as you said, they rounded down to 28%. It actually came in just a little bit higher than that, if it weren't for the R&D credit. And so we're looking at it rounding up to 30%, as we move into 2015. So you're exactly right. As you model what you would expect our earnings and fall-through to be, you should tax that at approximately 35% Delta profit as it comes through during the year.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

And I'll just point out, too, Stacy, that that does not assume the reinstatement of the R&D tax credit that we got for 2014.

Kevin March - *Texas Instruments Inc - CFO*

Yes. If that does reinstate, that would be between 1 and 2 points of tax benefit.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

That's right. Good. Okay. We will go to the next caller, please.

Operator

Vivek Arya, Bank of America Merrill Lynch.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Thanks for taking my question. Actually, when I look at your Q4 results versus consensus estimates, you did better in your core Analog and Embedded segments. But there was some shortfall in the Other sales, which are actually down 6% year on year. I think they were down almost 11% last year. And I believe you mentioned some loss of ASIC business. I'm wondering, what is the right way, Kevin or Dave, to model this segment? Because it is a very profitable segment for you. It is still a decent size segment. And I think in the past, you have mentioned that it could be flattish, plus/minus 2% or so. So just conceptually, what is the right way to model the segment?

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes. If you look, Vivek, at the Other segment, the first thing I would point out is, it has our calculator revenue. And the seasonally strong back-to-school season happens in second and third quarter. So those tend to be the seasonally strongest quarter. Third to fourth, that biggest transition sequentially, of course, is due to the change of that business. If you look overall, you can look at the components that fit inside of Other. The first is DLP. And I described that as a more steady business, and one that might have some -- we've described as wild cards of new opportunities.

The vast majority of that business is in front projectors today, as well as in cinema. And we've got some -- what we call pico projectors, or small form factor projectors, that make up the revenue. But there's some opportunities inside of automotive, and other embedded opportunities, that could provide growth in the future. The next biggest piece of that revenue is calculators. And that business has been, I'd say, flat maybe slightly down over time.

And then royalties, have run steady, about $40 million to $50 million a quarter. And that's probably a good thing to look. And then we will have ASIC business that will transition over to EP over time. That is some business that's in communications infrastructure. And we believe that that will move over. So you net all that stuff together, and we think that the Other segment will be flat, maybe up or down 1 percentage point, as we've described in the past.

Kevin March - *Texas Instruments Inc - CFO*

And I think, Vivek, you also asked about year over year. Just recall that last year still had about $55 million or so of wireless revenue it. And this year is essentially zero. So that's your biggest decline on a year-over-year basis.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

That's correct. Did you have a --

Vivek Arya - *BofA Merrill Lynch - Analyst*

Ex the wireless. Yes. So as my follow-on, back to your core business, do you think you have the right scale in your Embedded business to take op margins into the 20s? So when I look at the three areas within that business: processors, connectivity, microcontrollers -- how would you rank TI against the best competitor in that segment? And really, I'm trying to understand how you can grow that segment, gain share, improve margins, while keeping investments flattish, while all your competitors are all investing in their respective businesses. Thank you.

Kevin March - *Texas Instruments Inc - CFO*

Vivek, I'll leave it to you to analyze the competitors. I'll speak to how TI is doing. You may recall back in late 2010 early 2011 timeframe, we significantly stepped up our investments in that particular segment in order to accelerate our product introductions, and therefore begin to accelerate our revenue growth. And if you take a look at what's happened over the last, as Dave mentioned in his opening remarks, nine quarters of sequential -- or continuous year-over-year growth, that strategy has paid off. So those products are really beginning to take.

And as you know, those kinds of products tend to have very long shelf lives, so we expect to see more of the same on that. Now while we took spending down this past year as a result of the restructuring actions we announced this time a year ago, we didn't eliminate them. The amount that we are investing is still quite high. And that's why the operating profit is still not quite where we think entitlement will take us to. So we continue to invest at quite a healthy level, just not at the level that you saw us invest in in the prior few years.

So those combined, the high levels of investment, a expanding product portfolio from heavier levels of investment in the prior few years, have all given us very strong growth in that segment, and will continue to give us growth. And quite frankly, based upon some of the best in class performance that you can look at out there, we have -- shall we say, expectations similar to at least as well as those companies are operating.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes. And I'd also add, Vivek, if you look at our product portfolio, like inside of microcontrollers, we've got two architectures there, where we'll introduce new products with new interfaces, and meet new standards, inside of that. A lot of our competitors will have half a dozen, or a dozen, different architectures where they've got to spread their R&D investment over. So we can be very efficient with that.

And in addition, if you remember, as part of the wireless restructuring, we brought over those connectivity products that really already had a pretty significant investment in those wireless technologies. So, we're supporting nearly a dozen different wireless standards today, and that group is really focused on growing the top line rather than having to develop baseline technologies. So that will -- thanks for that question, Vivek, and we'll go to the next caller, please.

Operator

Jim Covello, Goldman Sachs.

Jim Covello - *Goldman Sachs - Analyst*

Great, guys. Thanks so much for taking my question. Congratulations on good results. A lot of great questions asked already. My one question is just around the long term segment goals that you might have. Auto is low double digits, personal electronic is almost 30%, although that's coming down. Is the goal really, from a segment diversification standpoint, to continue to increase, in particular, that auto sub-category and decrease the personal electronics category, say, over the next two or three years?

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes Jim. I don't -- our goal is not necessarily to try to optimize that mix, per se. I would say that, if you look inside of personal electronics, as an example, we'll look for places where we can find sustainable revenue with a differentiated position. And if you look at some of our largest customers that we sell products into, we'll sell several hundred devices into those customers. And those products could be anywhere from $0.75 down to $0.05. And often times, they may have lives that live from one generation of a product to another.

So those are the types of opportunities that we try to look for in a space like Comms Equipment. Now certainly, from an investment -- incremental investment profile, if we had an extra $1 to spend and we had an opportunity to spend that in either industrial or automotive, those products in general just tend to have longer life cycles and better characteristics. So that may see an increase in investment. And then lastly, I'd just add that those two markets, I think, have the secular trends that you are well aware of. So we'll benefit from that, as the rest of the industry will. And of course, we hope to benefit disproportionately from those investments.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Do you have a follow-on, Jim?

Jim Covello - *Goldman Sachs - Analyst*

Yes. I guess I'll stick on that topic. So personal electronics has been coming down, but your view would be, it's not really a function of an intentional effort on the part of Texas Instruments. It's just more a function of the other businesses that you have, or just happen to be better long-term growth areas. And it's naturally coming down. Is that the right characterization?

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

And even more specific than that, I think, if you backed out legacy wireless, you'll see that it's actually been fairly stable, as a mix. So that change in percentage is more driven by the strategic decision to exit that one portion of the business. So thank you, Jim. And we'll go to the next caller, please.

Operator

Joe Moore, Morgan Stanley.

Joe Moore - *Morgan Stanley - Analyst*

Hi. Thank you. I also wanted to ask about the end market breakdown that you guys provide. If I look at where you were a year ago, I just -- and there was probably some reclassification. But it looked like industrial went from 24% in 2013 to 31% in 2014. And personal assistance from 37% to 29%. Those swings seem dramatic. I just wanted to see if there was some change in the way you were looking at the breakdown?

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes, Joe. We continued to refine our understanding of our customers and markets. And we've got better tools and software. So if you go out to our web now, you'll actually see two years of history that we have out there, as well as the identified sectors that those markets made up. So do you have a follow-on?

Joe Moore - *Morgan Stanley - Analyst*

No. That's all for me. Thank you very much.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Okay. Thank you. Next caller, please.

Operator

Craig Ellis, B. Riley.

Craig Ellis - *B. Riley & Company - Analyst*

Thanks for taking the question, guys, and nice job on the quarter. Kevin, just to follow up to Vivek's discussion on Embedded Processing and expense control, it's really the flip side of that. Can you talk a little bit about what you're looking at before you would start to invest more in the business? It's clear you want higher operating margins than you have now. But what are the things that TI is looking at before it will commit to incremental investment in that business?

Kevin March - *Texas Instruments Inc - CFO*

Yes, Craig, I would say they're probably -- we're probably quite a ways off before we even have to entertain a question like that. Our focus for the next few years is managing the total spend inside that business and driving top-line growth. And frankly, if we begin to see top-line growth, then begin to net the kind of bottom-line results that we can see happening in other players in that space, at that point in time we might entertain increasing our spending. But not until then.

Craig Ellis - *B. Riley & Company - Analyst*

Okay, thank you. And then the follow-up is really taking another swing at something that Chris brought up, which is longer-term growth on a segment basis. At least in my model, calendar 2014 was the first year in the last four or five where Embedded Processing and Analog had similar growth rates and they were both double digits. Just philosophically, as you look at those two businesses, which have had very different histories, are there reasons why they should have materially different growth rates going forward? Or given that they are both closer to operating on more optimal levels, should they be fairly similar?

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes. I think when you begin to look longer term at the growth rate and the potentials of those businesses, I'd start with, what do you believe the semiconductor market will grow at? We have held the position that we think that the semiconductor market roughly grows at twice the rate of GDP. There's some that will violently agree with this, and some that will violently disagree with that basic assumption. But whatever that assumption is, we think both Analog and Embedded Processing are big enough portions of the market that they will grow in line with that.

If you look at those businesses, certainly, over the last five years, they both have continued to gain share. And we believe that we're continuing to invest, and we've got a lot of room to gain share. And in fact, in Analog, we've got 18.3% market share. And inside of Embedded Processing, we've got around 15 percentage points. So lots of headroom to do that. So -- and we've gained probably 30, 40, sometimes more than that, in market share on a given year. We still have to have everyone report before all the final numbers are in, but we're confident that we'll gain share again this year. So Kevin, do you have anything to add to that?

Kevin March - *Texas Instruments Inc - CFO*

Yes. Craig, one thing I'd recommend you maybe take a look at. If you do look at those two segments, Analog and Embedded Processing, their quarterly growth rates -- I think that was the point you were making. They can vary quite markedly from one another. If you look at the two of them on a year-over-year basis, they actually are much more correlated than you might expect. They're both gaining share, as Dave was mentioning, and are both growing quite nicely on a year-over-year basis. So if you do some measurements for those two segments on year-over-year growth rates, and compare that back over the last half dozen quarters or so, I think you might be pleasantly surprised to see they grow pretty similarly to each other.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Okay, Craig, thanks for that question. And we will go to the next caller, please.

Operator

Mark Lipacis, Jefferies.

Mark Lipacis - *Jefferies & Company - Analyst*

Thanks for taking my question. Kevin, as you go into your capital management conference call next week, could you just remind us what your historical philosophy has been on levering the balance sheet to drive shareholder value?

Kevin March - *Texas Instruments Inc - CFO*

Mark, what we've talked about on debt that -- we have debt on the balance sheet today. It will be there until 2023, because that is when the last of the current outstanding bonds matures. And our attitude towards debt is that it will continue to be part of the balance sheet when the economics make sense. And for us, that economics making sense means that if we can borrow at interest rates that we perceive to be below what we expect our inflation rates to be, or correspondingly at less than our dividend yield, then we think that's probably a pretty good deal on behalf of our shareholders.

And so that will be the kind of parameters that we look at, as we continue to decide how much debt to carry on the balance sheet, and as bonds mature going forward. We do actually have $1 billion of debt maturing in 2015. We have $250 million maturing in April, and $750 million maturing in August of 2015.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

You have a follow-on, Mark?

Mark Lipacis - *Jefferies & Company - Analyst*

Yes. Thank you for that color. As we -- so the Analog business operating margins are about 2,000 basis points higher than the Embedded. As we think about the potential profitability of the Embedded business, is there -- are there structural reasons why Embedded profitability could not equal the Analog profitability, longer-term? Thank you.

Kevin March - *Texas Instruments Inc - CFO*

Mark, I think the simple answer, in my mind, is it's difficult for us to find evidence of somebody in the marketplace, outside of TI, who has been able to perform at those kind of levels. I think the economics are such that it'll be very attractive. It's going to be a great place for us to be in. But it probably doesn't quite get up to par of what you see in Analog. I think Analog is quite unique in what it can produce for companies, and for shareholders who own those companies, like we do.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

That's great. Thanks, Mark, and we will go to the next caller, please.

Operator

Timothy Arcuri, Cowen and Company.

Timothy Arcuri - *Cowen and Company - Analyst*

Thanks a lot. Just a question again on gross margin, and what the possible headroom is. I guess if you look at the Embedded business, you're up to 17%. But if you look at some of the well-run peers in that space, they're doing sort of mid-20s. So maybe ask a little bit different way, is there any reason why you can't get the Embedded margins up to the mid-20s?

Kevin March - *Texas Instruments Inc - CFO*

No. There is no reason why we can't do that.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Yes. We've made good progress. Obviously, Tim, we still have work to do. But we believe that we can get into that range with revenue growth. And so that's what we're planning to do. They've got a good start. You've got 9 quarters in a row of year-on-year growth, and are making progress towards moving that operating margin higher. Do you have a follow-on?

Timothy Arcuri - *Cowen and Company - Analyst*

Great. Okay. I do, yes. And then just relative to the inventory, certainly, some of it is structural, as you indicated. But is any of the rise in inventory related to your perception that June could be a little bit better than seasonal quarter?

Kevin March - *Texas Instruments Inc - CFO*

Tim, I would say that it's probably too early for us to call the entire second quarter. Right now, we're focused on first quarter. So the inventory that we've got staged today is designed to support our first-quarter needs. And then as we adjust our factory loadings in first quarter, that inventory that we build will be designed to deal with our second-quarter needs. And as I mentioned earlier, we expect we will be ramping up our factories, as we go through first quarter, in support of second quarter. And when we get to the end of the quarter, we will find out how much inventory we're holding at that point in time.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Okay. Thank you, Tim. And operator, we've got time for one more caller.

Operator

Doug Freedman, RBC Capital Markets.

Doug Freedman - *RBC Capital Markets - Analyst*

Hi, guys. Thanks so much for taking my question. I guess if I could dig deep into some of the results that you've reported, and maybe some of the outlook that you might have by key markets out there. I think investors are interested to hear what you're seeing in the PC and server power markets, as well as maybe the disk drive markets. And if you could offer some color on what you're seeing in the communications market, as well? I think those are -- maybe not that overly material to the TI story, but they are to investors in general.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Okay, Doug. I can -- let me share some end market trends that we've seen. I think that that may address some of those issues, maybe not down at the level that you are quite asking. So you were talking about PCs, and those would fall into our personal electronics products. Those were -- on a year-on-year basis, they were up, despite the declines that Kevin had mentioned earlier in legacy wireless. And that growth was led by mobile phones. If you look at industrial, and I want to point out, when we talk about industrial, we've been very intentional about how to measure that. And it's different than when investors talk about the industrial market.

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And the sectors, we've got a dozen sectors that make up industrial, and they include things like factory automation and control, medical/healthcare/fitness, building automation, smart grid, motor drives, displays, those types of things. The full list is out on our website. And we've seen that was up, led by medical/[and] healthcare/fitness. Appliance, factory automation, and smart grid were also up from a year ago. Coms equipment was up, due to wireless infrastructure. And then enterprise systems were up, primarily due to projectors. So with that, you have a follow-on?

Doug Freedman - *RBC Capital Markets - Analyst*

Yes. Great. I guess for my follow-on, just what are you seeing, in terms of any shift in the competitive landscape? I know investors are somewhat concerned over what we're seeing in China, from an investment standpoint. Is there anything in your markets that you're seeing that would point to any change in the competitive landscape?

Kevin March - *Texas Instruments Inc - CFO*

Doug, as it relates to China in particular, because you've mentioned that there, we've been in China for a very long time now. We have over -- I think over a dozen sales and R&D sites there. We have both a wafer fabrication facility and an assembly/test site there. In addition, we have thousands of customers buying thousands of parts. And consequently, we've become a very important supplier to a large number of Chinese companies across a very diverse set of markets.

So we see China as continuing to be a great opportunity for TI, regardless of any of the competitive environments out there. And our goal is to operate in China just like we do in the rest of the world, which is to make ourselves an integral part of their success, and an indispensable supplier. And we've got a great -- shall I say, a long way -- we're a long way into that already, and we feel pretty good about our position.

Dave Pahl - *Texas Instruments Inc - VP and Head of IR*

Okay. Great. Thanks for that question, Doug, and thank you all for joining us. We look forward to talking to you again on our February 4 capital management call. A replay of this call is available on our website. Good evening.

Operator

That does conclude today's conference. We thank you for your participation.
