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TXN - Q1 2017 Texas Instruments Inc Earnings Call

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OVERVIEW:

Co. reported 1Q17 net income of \$997m or \$0.97 per share. Expects 2Q17 revenue to be \$3.4-3.7b and EPS to be \$0.89-1.01.



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PRESENTATION

Operator

Good day, and welcome to the Texas Instruments First Quarter 2017 Earnings Release Conference Call. Today's call is being recorded.

And at this time, I would like to turn the conference over to Dave Pahl. Please go ahead, sir.

Dave Pahl - Texas Instruments Incorporated - Head of IR and VP

Good afternoon, and thank you for joining our first-quarter '17 earnings conference call. Rafael Lizardi, TI's chief financial officer, is with me today. For any of you who missed the release, you can find it on our website at ti.com/ir. This call is being broadcast live over the web and can be accessed through our website. A replay will be available through the web.

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

Revenue for the first quarter increased 13% from a year ago. Demand for our products continued to be strong in the automotive market and continued to strengthen in the industrial market. Personal electronics also grew compared with the weak year-ago quarter. In our core businesses, Analog revenue grew 20% and Embedded Processing revenue grew 10% compared with the same quarter a year ago. Operating margin increased in both businesses. Earnings per share were \$0.97, which included an additional \$0.08 discrete tax benefit not in our original guidance. With that backdrop, I'll provide details on our performance, which we believe continues to be representative of the ongoing strength of TI's business model.

In the first quarter, our cash flow from operations was \$795 million, and 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 \$4.2 billion, up 11% from a



year ago. Free cash flow margin was 30.7% of revenue, up from 29.5% a year ago. We continue to benefit from our improved product portfolio that is long lived and diverse and the efficiency of our manufacturing strategy, the latter of which includes our growing 300-millimeter Analog output and our opportunistic purchase of assets ahead of demand.

We believe that free cash flow will be valued only if it's productively invested in the business or returned to owners. For the trailing 12-month period, we returned \$3.8 billion of cash to owners through a combination of dividends and stock repurchases.

From a year ago, Analog revenue increased 20% due to growth in all 3 product lines: Power, Signal Chain and High Volume. Embedded Processing revenue increased by 10% from a year ago, due to growth in both product lines, Processors and Connected Microcontrollers, by about the same amount. In our Other segment, revenue declined \$57 million from a year ago, primarily due to a move of royalties to OI&E, which Rafael will explain later.

Now I'll provide some insight into this quarter's revenue performance by end market versus a year ago. Automotive demand remained strong, with most sectors growing double digits. Industrial demand continued to strengthen with broad-based growth. Personal electronics grew compared with the weak year-ago quarter. Communications equipment grew slightly from the year-ago and sequential period. And then, lastly, enterprise systems declined.

We continue to focus our strategy on the industrial and automotive markets, which are where we've been allocating our capital and driving initiatives. This is based on a belief that industrial and automotive will be the fastest-growing semiconductor markets due to their increasing semiconductor content and that they will provide diversity and longevity of product, which translates to a high terminal value of the portfolio.

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

Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

Thanks, Dave, and good afternoon, everyone. Gross profit in the quarter was \$2.14 billion, or 63% of revenue. From a year ago, gross profit increased primarily due to higher revenue. Gross profit margin increased 220 basis points. Operating expenses in the quarter were \$808 million or 23.8% of revenue. And on a trailing 12-month basis, they were 22.8% of revenue in the lower half of our model.

Over the last 12 months, we have invested \$1.4 billion in R&D, an important element of our capital allocation.

Acquisition charges were \$80 million, all of which was the ongoing amortization of intangibles, which is a noncash expense.

Operating profit was \$1.25 billion or 36.8% of revenue. Operating profit was up 27% from the year-ago quarter. Operating margin for Analog was 41.4%, up from 36.6% a year ago. Embedded Processing was 29.9%, up from 25.7% a year ago. Our focused investments on the best sustainable growth opportunities with differentiated positions enable both businesses to continue to contribute nicely to free cash flow growth.

Net income in the first quarter was \$997 million or \$0.97 per share, which included an additional \$0.08 discrete tax benefit that was not in our original guidance.

Let me now comment on our capital management results, starting with our cash generation. Cash flow from operations was \$795 million in the quarter. Inventory days were 132, consistent with our long-term model of 105 to 135 days. Capital expenditures were \$127 million in the quarter. On a trailing 12-month basis, cash flow from operations was \$4.76 billion, up 9% from the same period a year ago. Trailing 12-month capital expenditures were \$534 million or 4% of revenue. As a reminder, our long-term expectation for capital expenditures is about 4% of revenue.

Free cash flow for the past 12 months was \$4.22 billion or 30.7% of revenue. Free cash flow was 11% higher than a year ago. Our cash flow reflects the strength of our business model. As we have 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 productively invested in the business or returned to owners.



In the first quarter, we paid \$500 million in dividends and repurchased \$550 million of our own stock for a total return of \$1.05 billion. Total cash returned to owners in the past 12 months was \$3.82 billion. These combined returns demonstrate our confidence in our business model and our commitment to return excess cash to our owners. Over the last 12 months, we paid \$1.76 billion in dividends or 42% of trailing 12-month free cash flow, which demonstrates the affordability and sustainability of our dividend growth. Outstanding share count was reduced by 1% over the past 12 months and has been reduced by 42% since the end of 2004 when we initiated a program designed to reduce our share count. In fact, we have reduced shares every quarter year-on-year for 52 consecutive quarters.

In March, we retired \$250 million of debt. This leaves total debt of \$3.375 billion with a weighted average coupon rate of 2.32%. Our cash management and tax practices are fundamental to our commitment to return cash. We ended the first quarter with \$3.05 billion of cash and short-term investments, with our U.S. entities owning about 80% of our cash. This onshore cash is readily available for multiple uses.

Turning to our outlook for the second quarter, we expect revenue in the range of \$3.4 billion to \$3.7 billion and earnings per share in the range of \$0.89 to \$1.01, which includes an estimated \$30 million discrete tax benefit.

Before moving to Q&A, there are 3 changes that I want to explain to -- to help to better -- to help you better understand our first-quarter results and our second-quarter outlook. The first is to remind you that, in the fourth quarter of 2016, we adopted a new GAAP standard that impacted the accounting of taxes for stock-based compensation. While this adoption has no impact on our cash balance, it does result in a discrete tax item that impacts our respective tax rate and earnings per share. To help you model the tax rate and discrete tax items, I am sharing the quarterly assumptions and their impacts. We will continue to report how our results differ from our guidance, just as we did this quarter.

To start with, our operating tax rate for 2017 is estimated to be about 30%, unchanged from previous guidance. This operating tax rate assumes no discrete items and is what you will need to use as a starting point for your longer-term models.

Next, we are assuming discrete tax items of about \$30 million, \$20 million and \$10 million in the second, third and fourth quarters of 2017, respectively. Therefore, the effective tax rates, which include discrete tax items, translate to about 28%, 29% and 30% in the second, third and fourth quarters, respectively. These are the quarterly effective tax rates you should use for your 2017 models. If you do the math using these numbers, you will get an effective tax rate of 27% for the year. I advise you not to use 27% in any quarter, as the size of discrete tax items vary quarter-to-quarter, particularly in first quarter. We will post a chart summarizing our assumptions for these discrete tax items as well as their retrospective impact of this new standard on our website at ti.com/ir. Hopefully, providing these discrete tax item assumptions will be a good start in dealing with this new accounting standard.

The second item is a GAAP standard that we adopted in the first quarter of 2017 that requires us to report certain pension costs in Other Income and Expense, or OI&E, that were previously reported in OpEx and Cost of Revenue. This change is small, typically about \$15 million of costs in a quarter, with about 70% coming out of OpEx and the balance out of Cost of Revenue. A chart summarizing these changes and their retrospective impact will be available on our website.

The last change is also effective first quarter of 2017 and impacts how we handle royalties. We will no longer recognize royalties in revenue. Instead, they will be recorded as income in Other Income and Expense. As Analog and Embedded have become a much larger part of the company, royalties now represent a little less than 1% of our overall revenue. There were about \$30 million in the first quarter of 2017, about what they were a year ago. We expect royalties to continue to run generally at about this level for many years into the future. However, given their decreasing significance to our core operations, they are now recorded as Other Income and Expense, rather than in revenue, as of our first- quarter 2017 results.

I'm hopeful that spending some extra time talking through these accounting details will help you in understanding our results.

Now to wrap up, we remain focused on growing free cash flow per share over the long term and investing to strengthen our competitive advantages. We believe our first-quarter results continue to demonstrate our progress.

With that, let me turn it back to Dave.



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

Thanks, Rafael. Operator, you can now open up the lines for questions. (Operator Instructions) Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) At this time, we'll take our first question on the queue. This will be from Harlan Sur with JPMorgan.

Harlan Sur - *JP Morgan Chase & Co, Research Division - Senior Analyst*

From a product and end market perspective, it appears that demand is relatively broad based. I'm wondering if you can comment on demand by geographies. I'm assuming that, that's also fairly broad based as well, but wanted to see if there are any regions which are exhibiting any weakness.

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

Yes, Harlan. Yes, I would say that the demand was very broad-based and included regionals. Year-over-year, revenue was up in Asia, Europe and the U.S. and revenue was about even in Japan from a year ago. Do you have a follow-up?

Harlan Sur - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Yes, I do. Auto, solid market for the team last year, with that end market up 23%. I think, you mentioned that it's up double digits again in March. You've got a very diversified business here as well. There's been some concern around the global auto markets and the potential for a slowdown, given indications that production and/or demand after 2 solid years might start to slow. Just wanted to get the team's sense on the health of this market kind of near- to mid-term.

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

Yes. Definitely, as we stated in the opening remarks that we saw our demand for our products and automotive continues to be strong. And so like you said, we've built that business across a very diverse set of sectors and, in fact, we've got 5 sectors inside of automotive. So it's diverse not only in the products that we sell into, but it's diverse across customers, across geos. So we feel very good about our position in automotive. And then over the medium and longer term, we think that our pipeline of designs continues to be very strong. And if you look at the average content in a car today, I think, most people would put it somewhere between \$350 and \$400. That's roughly about 1% of -- a little more than 1% of the sales price of the car. And I think a lot of analysts inside of a 10-year time frame have that moving somewhere closer to 2%. So that's why we continue to invest in it and we're really pleased with the position that we've developed so far.

Operator

We'll now move to Stacy Rasgon with Bernstein Research.

Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

First, I wanted to ask about OpEx. Did that come in, in line with your original plan for the quarter? Or was it different? And how should we think about the OpEx trajectory into Q2?



Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

Yes, thanks for the call. I'll handle that one. On OpEx, everything came in about as expected. What I would tell you, the way you want to think about OpEx, high level, we've talked about our model where we want to run OpEx between 20% and 30% of revenue; and in stable markets at the lower end of that, the lower half. And that's exactly what we've been doing for the last couple of years. And in fact, on a trailing 12-month basis, we're just below that. So as you think forward, you should model us along those lines. If you're thinking kind of on a tactical level, first to second, I would remind you that second quarter does have 3 months of higher-pay and benefit raises versus only 2 months in the first quarter. So you may have some of that played in kind of similar to what happened last year, maybe a little less than that.

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

Do you have a follow-up, Stacy?

Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Yes, yes, I do. On your capital management update from a month or 2 ago, you'd given some indicators that were 300-millimeter loading was, but it only went up a little bit in 2016. I think, it went from about \$2.2 billion year-over-year to \$2.5 billion, so maybe \$300 million, suggesting a good amount of headroom left for that transition to continue. How should we expect that trajectory to evolve this year in 2017? Is it just dependent on growth? Is there volume in 200-millimeter that's ramping down as 300-millimeter is ramping up? How should we think about where that might end up exiting this year in a normal demand environment?

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

Yes, Stacy. In the capital management update, if you remember, we talked about the fact that we've put in place about \$8 billion of 300-millimeter capacity. Last year we had, as you stated, about \$2.5 billion. So we're in a great position to be able to support growth. And essentially, we've been releasing for some time now, really probably going back to 2010, almost all of our new Analog products to 300-millimeter. So there's some exceptions to that, of course, on some older technologies that don't make sense to do, but the vast majority of them have been released there. So as you think about the Analog business growing, you can think of that incremental growth essentially being built on 300-millimeter. And if you look at last year, that came pretty close to what happened. So we had about \$300 million of growth. So it was very consistent with that. So thanks, Stacy.

Operator

We'll now move to John Pitzer with Credit Suisse.

John William Pitzer - *Credit Suisse AG, Research Division - MD, Global Technology Strategist, Global Technology Sector Head, and Semiconductor/Semiconductor Capital Equipment Analyst*

Dave, you were kind enough in your prepared comments to go through sort of end markets in the March quarter on a year-over-year basis. I think the comm equipment was the only market you kind of gave sequential color. I'm just kind of curious if you can talk a little bit about the sequential growth into March. It was well above seasonal. And sort of in the same vein, to your guidance in June, you're sort of guiding below seasonal. So how should we think about that from an end market perspective?

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

Okay. So a couple of things. We thought the comms equipment market has been choppy in recent past, so we thought that, that would be helpful and that's why we provided it.



If I just kind of comment on the other markets sequentially, automotive market, as we said, continued to be strong and increased with most of the sectors growing. Industrial demand was strong across almost every sector that we ship into. And just as a reminder, we've got 14 different sectors there. I won't put everybody to sleep by going through them, but we do have quite a number of sectors that are inside of that and literally hundreds of end equipment that sits inside of that. So it's very, very broad-based. Personal electronics decreased. You usually see that seasonally. And then enterprise systems was about even.

So when we look at our guidance for second quarter, if we're looking at that sequentially, the low end of our guidance would suggest that revenues would be flat. The high end of the guidance suggest that it would be up 9%. But -- and if you look at that, John, on a year-on-year basis, it's -- the low end would be up 4% and the high end would be up 13%. So we think that, that's a fairly robust growth inside of the second quarter. So you have a follow-on, John?

John William Pitzer - *Credit Suisse AG, Research Division - MD, Global Technology Strategist, Global Technology Sector Head, and Semiconductor/Semiconductor Capital Equipment Analyst*

Yes, that's helpful. And I guess, as my follow-on, I might have missed this and I apologize, but did you give an orders number for the quarter? And just in general, how are lead times, either of your products or your competitor products, because there has been some buzz that perhaps lead times within the industry are starting to stretch out?

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

Yes. So orders were up 14% year-on-year to \$3.5 billion. They were up about 2% sequentially. And I think from a lead time standpoint, our lead times have remained stable. And just as important as that, our on-time delivery metrics also remain very high. So our shipping to our commitments that we make to customers remain very high. So with that said, we do have some isolated process and package combinations where lead times have stretched. But we work very aggressively on those. So we're just -- we're very pleased with where we are to be able to keep ahead of demand.

Operator

We'll now move to Toshiya Hari with Goldman Sachs.

Toshiya Hari - *Goldman Sachs Group Inc., Research Division - MD*

My first one is on inventory, Dave. I guess, exiting the quarter, inventory days were at 132 days toward the high end of your guided range. How comfortable are you with that level? And what are you seeing in terms of the distribution channel?

Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

Yes, we are -- well, I'll answer our inventory days, and then I'll Dave comment on the disty channel. But we're comfortable with our inventory days. It's well within our range. Always remember, inventory days are backwards-looking metrics. So what we have is, therefore, to support growth. And the other key point to remember is that we have focused our strategy more on industrial and automotive and on catalog type of parts. The risk of obsolescence on this part is really minimal. So it makes sense from a longer-term standpoint to have that inventory available to support revenue growth.



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

Yes. And from a disty standpoint, Toshiya, we saw our inventory days kind of remain near their current levels at 4 weeks. That benefits from our consignment programs we have with our distributors. It actually was down sequentially and it was down from a year ago. So we think that those are in good shape. You have a follow-on?

Toshiya Hari - *Goldman Sachs Group Inc., Research Division - MD*

Yes. I just want to get your updated thoughts on M&A. You guys have been pretty consistent in the past and you've pointed to valuation and the lack of opportunity as reasons to stay sidelined. But was hoping you could potentially give us an update there, if any changes.

Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

Yes, I'll be happy to comment. The update is no change. It's the same strategy for M&A. We looked at, well, with considering options and looking at things, but it has to be an opportunity that's focused on industrial, that's focused on automotive, catalog type of parts, Analog catalog. So we have to be a good strategic fit from that standpoint. But then, the other component that has to be there is that the numbers have to make sense. So when we have both of those combinations, then we're willing to move forward on considering that further.

Operator

We'll move now to Amit Daryanani with RBC Capital Markets.

Amit Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

A couple of questions from me as well. I guess, one, pretty impressive growth on the Analog side. I think it was up, like, 20% year-over-year. Is there a way to think about the growth in the segment, excluding the consumer side, where I think you may have had somewhat easier comps? Just trying to get a sense of what the baseline number could be on Analog as you go through the year.

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

Yes, I think, first of all, let me just make a comment from, at the company level. We talked about that the demand was driven from the strength that we saw in industrial market as well as automotive. That represented about 70% of the growth. And certainly, we did benefit and see growth inside of personal electronics off of the easy compare, as we all remember a year ago that we were working through an inventory correction with -- in that particular end market. So the great news is that's very consistent with what we saw inside of Analog. And so the growth is very, very broad based. So we've got contributions from the industrial market, contributions from the automotive market and as well as we did see contributions from the personal electronics market. So you have a follow-on?

Amit Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

I do. I guess, just from the automotive segment, could you just talk about -- there's a way to think about maybe what percent of your auto revenues today are infotainment-centric versus more mainly driven around fuel efficiency or battery management or safety? And is there a way to think about the geographic split in the auto business as well?

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

Yes, thanks. That's a great question, Amit, and thanks for the opportunity to comment on it. I think that the great thing that we've been trying to do or the thing we've been trying to do and why we're happy with the results is that our automotive business isn't just built on just either infotainment



or an ADAS business, but really is broad based. So when we look at kind of the order or the sizes of those businesses, infotainment is the largest, safety systems is the second, followed by advanced driver assistance systems, then PowerTrain, which includes hybrid and electric, and then body electronics and lighting. So -- and if you dive into any one of those areas, it's not dominated by one technology or one product. And we've got more than half of our 60 to 70 product lines that ship products into the automotive business. So we're very diverse from a product standpoint. We're also very diverse from a geography standpoint as well. So we're really seeing the benefit and additional revenue growth from all of the geos.

Operator

At this time, we will move to C.J. Muse with Evercore.

Christopher James Muse - *Evercore ISI, Research Division - Senior MD, Senior Equity Research Analyst and Fundamental Research Analyst*

Apologies for, I guess, first question. I got on a little bit late, so just have a point of clarification. In terms of the royalty commentary, the \$30 million, was that all included for Q1 as well? So net-net, with that, top line would have been \$30 million in gross margin, 100% of that \$30 million better, and then from here, we should be using that same amount?

Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

So the change in royalties, was included in our guidance, meaning that the royalties were in Other Income and Expense, just like how they came in, in results. And on a go-forward basis, they will stay in Other Income and Expense. So for modeling purposes, you can look at how that Other Income and Expense line came in and the model is similar to that on a go-forward basis.

Christopher James Muse - *Evercore ISI, Research Division - Senior MD, Senior Equity Research Analyst and Fundamental Research Analyst*

And I guess, as a follow-up, can you walk through some of the work that you're doing on the gross margin side? It sounds like, internally, 75% is not enough and you want to take that higher. Would love to hear what you're working on, and I'm assuming that includes not only front-end, but back-end manufacturing, and would love to get an update there, if you could.

Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

Yes, sure. As you think of the company on a go-forward basis, the biggest driver of our gross margin is revenue, revenue growth. And that's why we're focused on industrial and automotive. Those are the best opportunities that we have ahead of us because of the content growth of semiconductors in those spaces. Now beyond revenue growth, then we have 300-millimeter manufacturing, the efficiency of our manufacturing, particularly with 300-millimeter. As you probably recall from the capital management strategy, I walked through why 300-millimeter is such a competitive advantage. And that's because the cost of the chip is significantly less. In fact, it's 40% less at the chip level than on 200-millimeter. So what that translates to is not just higher gross margin, but more importantly, higher free cash flow. And then free cash flow per share that we can return to the owners of the company.

Operator

And the next question will be Chris Danely with Citi.

Christopher Brett Danely - *Citigroup Inc, Research Division - MD*

Just a couple of revenue clarifications. So in response to an earlier question on the, I guess, the stronger-than-expected revenue. So are you telling us that your automotive business was responsible for the upside in Q1 on revenue and comm was a little weak? And then on the Q2 guide, you're

basically guiding up, like, 4.5%. That's below seasonality and also below what you guided sequentially for last year. So you're not seeing any weakness or no change in the Q2 forecast over the last like month?

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

Yes. So the first is that our revenue came inside of our guidance, and so we didn't really have any surprises there. If you look at all of the businesses, and if you look at the end markets, we really saw strength across the board, Chris. So there really wasn't an area that we would point to that singularly drove the revenues in the quarter or from the midpoint of the guidance, if you will. So very broad-based overall. And then, secondly, again, I think, going back to John's question, when we look at our sequential growth rates of kind of low end of flat to up 9%, or on a year-on-year basis of 4% to 13%, we think that that's a pretty strong second quarter. So do you have a follow-on?

Christopher Brett Danely - *Citigroup Inc, Research Division - MD*

Yes, just a longer-term question. I think, you've talked about currently being outfitted for somewhere around \$18 billion in revenue capacity. What sort of revenue level would you start to need to order more equipment? I assume you wouldn't wait until you're 100% utilized before you start to put those orders in. Is it 90% utilization, 95%? Maybe give us some color there.

Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

Well, I'll give you some color and then I'll let Dave chime in. But we think of our strategy, as stated out in the capital management strategy for many years, is that we want to add capacity well ahead of demand. And that's because this is an asymmetrical bet. This capacity, we can buy. When we buy that way, we can buy used equipment, we can buy pennies on the dollar where the carrying cost is minimal. But the upside potential is tremendous for reasons that I talked about earlier and the great fall-through that we get to free cash flow. So we're thinking longer term, 10, 15 years out, when we're making capacity decisions.

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

Yes. And I'll just add, Chris. Like you pointed out, we had little over \$13 billion in revenue last year. We've got just under about \$6 billion of open 300-millimeter capacity. We have open 200-millimeter capacity inside of that footprint. So we've got plenty of room to grow for some time. But like Rafael said, if we had the opportunity tomorrow to buy another wafer fab or make a large purchase and it was at the right price, we'd make that move because it is an asymmetrical bet.

Operator

We'll now move to Blayne Curtis with Barclays.

Blayne Peter Curtis - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Maybe I'll ask the same related question here. When you look at the guidance -- well, actually, just looking at the overall business, you're not the only ones seeing double-digit year-over-year growth in all of your businesses even if you're taking out personal electronics, the rest of the business is strong, and the commentary actually would suggest that it remains strong. So I guess, kind of 2 parts here. One, how do you fill the gap between what -- I know there's content gains in semis, but between what some of the end markets are doing, do you think -- what's your perspective as you look out the rest of the year? Do you think the semi market is a little ahead of itself? And then, I guess, as you look at your June guidance, did you guys apply any sort of conservatism to that guidance to account for anything along those lines?



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

Yes. So I think, if you walk through the end markets, Blayne, as we've commented, automotive has remained strong. You saw that, that business last quarter had grown at over 20%. It's been growing very strongly for some time. And again, that business and that growth isn't built on just 1 OEM or 1 car model or 1 end market. So it's very, very diverse, and we feel good about that positioning.

When you look at the industrial market, that strength has continued to build. So we're seeing that come in nicely.

We talked -- already talked about the personal electronics markets and some of the other markets in detail.

So again, that strength, and as you pointed out, is broad-based. Others are seeing it as well.

So kind of on the other thing is, to your question, are we double-ordering or seeing inventories build? I'll just make the comment that, overall, the economy does feel a little stronger than it did a year ago. However, it's really still to be seen to what extent will we see this growth over a longer period of time. So we have no indications that inventories are growing or double-ordering. But I'll also point out that history suggests that you never really see that ahead of time, right? So I think it's important to qualify what we can see.

I mentioned earlier, our lead times have remained stable. When you look into inventory, we've got good visibility in the distribution inventory. And as I commented earlier, that remained steady, about 4 weeks. It's down sequentially. It's down from a year ago. So we think that's in real good shape. Our visibility in the customer inventories really varies depending on if they're on consignment or not. So on consigned OEMs, we've got great visibility into their inventory because we're holding it on our books, it's actually our inventory. They pull it only when they need it. And we're not seeing any unusual signs there, so things like expedites and things like that, that would suggest that there's an issue overall. And our visibility into inventory, of course, beyond our customers' manufacturing operations and down in their channels, of course, is very low.

So as we've been doing for a long time, with our manufacturing, our internal inventory strategies, we'll just stay focused on keeping lead times steady and delivery metrics very high, because that's ultimately what gives customers confidence that they can get support from us when they need it. Do you have a follow-on?

Blayne Peter Curtis - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Great. And I apologize if I missed the very beginning. So if you already said this, I apologize. But in terms of your guidance, I kind of get gross margins flattish, maybe down a little bit. I just wanted to make sure that, that's the right range.

Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

The way I would comment on that is we have said before that our revenues fall through between 70% and 75%. So if you do that math on a sequential basis, you'll get somewhere close to where you need to be.

Operator

We'll take a question now from David Wong with Wells Fargo.

David M. Wong - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Technology and Services Analyst*

You talked about how your investment priorities were in industrial and automotive. Can you give us some idea, within automotive, are there specific types of products or specific capabilities that you're directing your investments at?



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

Yes, David. We're -- as I mentioned before, we're very intentionally trying to make investments across a very broad number of areas. So they include things that are very popular like ADAS systems and infotainment systems, but also embody electronics and lighting. So those are -- we've commented before that, that includes areas like turn signals. There's a couple of dollars of content in an LED turn signal and our sales teams get pretty excited about things like that. But also, sensors on door handles, and inside of the infotainment system, the touch buttons to control the AC or the audio system, haptics systems that may sit inside of the steering wheel or in driver seats and LED lighting inside of a car. There's a lot of areas. So we're really trying to direct that investment to be very, very broad-based. Do you have a follow-on, David?

David M. Wong - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Technology and Services Analyst*

Yes. Well, similarly for industrial, are there -- you mentioned the 14 areas you were going to bore us with. Are there any additional areas on top of the 14 that you will be able to go into because of your investments?

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

Yes. So I'll resist the temptation to bore you and run you through those. But if I just take one, like, medical as an example, that sits inside of there, there's literally hundreds of end equipments that will fit inside of medical. And if you think at the high end there may be a magnetic resonance imaging machine that may sell for millions of dollars, and then all the way down at the other end, you have a blood glucose meter that will sell for less than \$50. So we actually have over 100 different end equipments that will fit inside of a sector like medical. And as we make investments, we look to funnel those investments, not just in one area like -- something like factory automation and control as an example -- we really want to funnel those investments on a very broad basis.

Operator

We'll now move to Tore Svanberg with Stifel.

Tore Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

My first question on lead times. So you mentioned your lead times are very stable. You may be seeing some stretching certainly in areas, specific areas. But if you kind of look at the general environment, does it feel like the supply chain is overly nervous about getting product? Or does it feel like it's pretty controlled?

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

Yes, Tore, again, I can really only speak for what we see and what we're doing. And again, I think we're advantaged because we've got a large portion of our revenues on consignment, so we're actually controlling that inventory up and to the point that it gets pulled. We also, for many customers, we'll get long-term forecasts. Those consignment forecasts literally sometimes can be on an hourly basis, but certainly on a daily or weekly basis, and typically go out for 6 months in some cases. Now that doesn't mean that they can't change very quickly, and we've seen that before in the past, and they can strengthen or weaken. And that usually happens very quickly. So again, our lead times are remaining very stable. Besides, those isolated areas that we're working very aggressively to fix, the vast majority of our products remain stable. Do you have a follow-on, Tore?



Tore Svanberg - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Yes, that's very helpful. As a follow-up, I think, you mentioned the industrial strengthening, so I assume that means it's going to be up more in June more than March. And again, is that strength broad-based? Or is there any region that's kind of waking up a little bit more than others? And I'm especially thinking about China because there's been some recent weakness there. I'm just wondering if that region is holding up as well in industrial.

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

Yes, Tore, the comment was around the quarter that we reported and we've seen industrial strengthen now for a number of quarters in a row. Our guidance for the second quarter, we just provide the top-level and EPS. If there's anything that's unusual going on in an end market, we're always -- we always provide that color to be helpful and we haven't had to provide that obviously for second quarter.

Operator

The question will be from Ambrish Srivastava with BMO.

Ambrish Srivastava - *BMO Capital Markets Equity Research - MD of Semiconductor Research and Senior Research Analyst*

I had a question on R&D and as it relates to OpEx. Rafael, you kind of articulated that the OpEx will be in the band that you had provided in the past, so no change there. But R&D, on a year-over-year basis and absolute dollars, has been growing. And in your last filing, you mentioned that you would be reallocating from manufacturing, as well as SG&A, into R&D. So just kind of a 2-part question. One, what should be the trajectory of R&D as we model through the year? And then kind of related to that, qualitatively, if you could help us understand where the focus is for the R&D investment.

Rafael R. Lizardi - *Texas Instruments Incorporated - CFO, CAO and SVP*

Yes. Let me address the second part of that question first. That's clear. We've been focusing on industrial and automotive. That's where we have been biasing our investments for a number of years and that's why we're getting strong results in both of those end markets. And now, over half of our revenue is coming from industrial and automotive. So those investments are paying off.

On your first part of your question, I would take you back to my earlier comment. We like our stated goal or our model is 20% to 30% OpEx. I know you're asking about R&D, but we like to look at it as OpEx because there are a lot of pieces there that we think of as investment. There are investments in sales, in the sales force and ti.com and a few other things that help us build those competitive advantages. So OpEx, 20% to 30%. In stable times, 22 -- in the bottom half of that, so 20% to 25%. And we have been running like that for now 27 months. So you should think about that way when you're modeling our OpEx. Dave, you want to add?

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

Yes. And I'll just add, Ambrish. As you know, when we look at making investments, whether it's in R&D or in OpEx, as we pointed out in our capital management presentation that we gave earlier, investing in the business is a top priority. So -- and what we're trying to do, as Rafael indicated by market, but we also want to strengthen our core competitive advantages. So those will include the first one, which is manufacturing and technology, ensuring that we're developing great process technologies and strengthening our position with 300-millimeter. The breadth of the portfolio is the second, and we've talked about that a lot and how that plays out through industrial and automotive. The third is the reach of our marketing channels and strengthening that, and that continues to be our investment in ti.com, as well as how that's coupled with our sales force and apps teams. And then we want all those things to lead to diversity and longevity. And that will lead to good free cash flow per share growth, and that's really what we want to do. Did you have a follow-up?



Ambrish Srivastava - *BMO Capital Markets Equity Research - MD of Semiconductor Research and Senior Research Analyst*

No, that was it.

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

Okay. Well, thank you, all, for joining us tonight. And a replay of this call is available on our website. Good evening.

Operator

And again, that does conclude today's call. Thank you, all, for your participation.

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