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TXN - Q1 2016 Texas Instruments Inc Earnings Call

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OVERVIEW:

Co. reported 1Q16 net income of \$668m and EPS of \$0.65. Expects 2Q16 revenue to be \$3.07-3.33b and EPS to be \$0.67-0.77.



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PRESENTATION

Operator

Good day and welcome to the Texas Instruments IQ (sic) 2016 earnings release conference. At this time, I'd like to turn the conference over to Dave Pahl. Please go ahead.

Dave Pahl - Texas Instruments Inc. - VP

Good afternoon and thank you for joining our first quarter 2016 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 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 as well.

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. Revenue for the quarter was in the upper half of our expected range. Compared with a year ago, notable market activity for our products included continuing strength in automotive as well as improvement in the industrial and communications equipment. Revenue was down 5% due to the weakness in personal electronics market, which declined as expected.



Our core businesses of Analog and Embedded Processing comprised 87% of first-quarter revenue. Analog revenue declined 8% while Embedded Processing revenue grew 8%. Earnings per share were \$0.65.

With that backdrop, Kevin and I will move on to the details of our performance, which we believe continues to be representative of the ongoing strength of our business model.

In the first quarter, our cash flow from operations was \$547 million. We believe that free cash flow growth, especially on a per-share basis, is most important to maximizing shareholder value in the long term. Free cash flow for the trailing 12-month period was \$3.7 billion, up 1% from a year ago.

Free cash flow margin was 28.4% of revenue, up from 27.3% a year ago and consistent with our targeted range of 20% to 30% of revenue. We continue to benefit from our improved product portfolio and the efficiencies of our manufacturing strategy, the latter of which includes our growing 300-millimeter Analog output and the opportunistic purchase of assets ahead of demand.

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

Analog revenue decreased 8% from a year ago. The decline was primarily due to High volume Analog & Logic. Power Management and High Performance Analog also declined while Silicon Valley Analog grew. Embedded Processing revenue increased 8% from a year ago, due to growth in all three product lines led by Processors. Our investments in Embedded are translating into tangible results as this quarter's revenue is a record.

In our Other segment, revenue declined 10% from a year ago primarily due to custom ASIC products. Compared with a year ago, distributor resales decreased 4% due to lower demand in personal electronics that I described earlier. Inventory increased a couple of days to about four-and-a-half weeks.

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

Now I'll provide some insight into this quarter's revenue performance by end market versus a year ago. Automotive demand remained very strong, driven by infotainment and hybrid electric vehicle and power train systems. Industrial demand strengthened broadly with most sectors growing. Within personal electronics, we had a portion of demand that declined about \$150 million, as expected. Overall, personal electronics was down more than that, primarily due to mobile phones. Communications equipment was about even from a year ago, an improvement from last quarter when it was down about 15% and finally enterprise systems declined.

We continued to focus on making our company stronger through manufacturing and technology, the breadth of our product portfolio, the reach of our market channels, and our diverse and long-lived positions. These four attributes, taken together, are at the core of what puts TI in a unique class of companies capable of long-term free cash flow growth.

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

Kevin March - *Texas Instruments Inc. - CFO*

Thanks, Dave, and good afternoon, everyone. Gross profit in the quarter was \$1.82 billion and was 60.6% of revenue, a new record. From a year ago, gross profit margin increased 290 basis points, primarily due to lower manufacturing costs as well as the higher percentage of more profitable products. Operating expenses were \$774 million, about even with the year-ago period.

Over the last 12 months, we have invested \$1.27 billion in R&D, an important element of our capital allocation. Acquisition charges were \$80 million, all of which were the ongoing amortization of intangibles, which is a non-cash expense. Operating profit was \$968 million or 32.2% of revenue. Operating profit was up 1% from the year-ago quarter.

Operating margin for Analog was 36.1%. Operating margin for Embedded Processing was 25.0%, 670 basis points higher than a year ago as we focused our investments on the best sustainable growth opportunities with differentiated positions. Net income in the first quarter was \$668 million or \$0.65 per share.

Let me now comment on our capital management results starting with our cash generation. Cash flow from operations was \$547 million in the quarter. Inventory days were 137 as we staged our inventory for increased shipments in the second quarter. Also included were three to four days of inventory associated with the portion of the personal electronics market that started flowing late in the fourth quarter. We expect to ship this material later this year.

Capital expenditures were \$124 million in the quarter. On a trailing 12-month basis, cash flow from operations was \$4.21 billion, up 4% from the same period a year ago. Trailing 12-month capital expenditures were \$552 million or 4% of revenue.

As a reminder, our long-term expectation is for capital expenditures to be about 4% of revenue, which include the expansion of our 300-millimeter Analog capacity. Free cash flow for the past 12 months was \$3.65 billion or 28.4% of revenue. Free cash flow was 1% higher than a year ago. This growth reflects the continued strength of our business model.

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

In the first quarter, we paid \$383 million in dividends, and repurchased \$630 million of our stock for a total of \$1.01 billion. Total cash returned to shareholders in the past 12 months was \$4.17 billion. Outstanding share count was reduced by 3.6% over the past 12 months and by 41% since the end of 2004 when we initiated a program designed to reduce our share count. These returns demonstrate our confidence in our 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 first quarter with \$2.80 billion of cash and short-term investments with our U.S. entities owning 80% of our cash. Because our cash is largely onshore, it is readily available for a variety of uses.

Our orders in the quarter were \$3.09 billion, down 4% from a year ago.

Turning to our outlook, for the second quarter we expect revenue in the range of \$3.07 billion to \$3.33 billion and earnings per share to be in the range of \$0.67 to \$0.77. Acquisition charges, which are non-cash amortization charges, will remain about even and hold at about \$80 million per quarter through the third quarter of 2019. They will then decline to about \$50 million per quarter for two additional years.

Our expectation for our annual effective tax rate in 2016 is about 30% and this is the tax rate you should use for the second quarter and for the year.

So in summary, we believe our first-quarter results demonstrate the strength of our business model. And with that, let me turn it back to Dave.

Dave Pahl - Texas Instruments Inc. - VP

Thanks, Kevin. Operator, you can now open the lines up for questions. In order to provide as many of you as possible an opportunity to ask your questions, please limit yourself to a single question. After our response, we will provide you an opportunity for additional follow-up. Erica?

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

We'll go first to the line of Romit Shah. Please go ahead.

Romit Shah - Nomura Securities Co., Ltd. - Analyst

Thank you and excellent results. Could you give us a little bit more color on what's driving the revenues in Q2 by end market?

Dave Pahl - Texas Instruments Inc. - VP

Yes, Romit, we don't typically provide a forecast by end market; however, if there's any large shifts, we will talk about that, much like we did last quarter within a sector in personal electronics. I can say that that demand, we would expect to grow sequentially but it will be down significantly from a year ago. And I'd also say that outside of that we would expect the rest of our business to grow both sequentially and year-over-year.

Romit Shah - Nomura Securities Co., Ltd. - Analyst

Okay, and I know that the conversion of the 300-millimeter has been an important part of the improving margin profile and I was wondering if you could just update us on how much of the portfolio is converted to 300 and how much is left?

Kevin March - Texas Instruments Inc. - CFO

Romit, I'll go ahead and talk to that. Roughly a quarter of our Analog revenue was generated on 300-millimeter last year. We have total internal capability of about \$8 billion, so we're using about a quarter of that capability at this point in time.

Just to remind everybody else who's listening, the reason the 300-millimeter is so important to us is really the economics at the factory level. We get about 2.3 times as many chips per wafer on a 300-millimeter versus a 200-millimeter. The wafer processing cost is about 1.4 times as much, so if you do the math, that means the actual die cost is only about 60% as much on a 300-millimeter wafer as a 200-millimeter wafer.

When you take that all the way through to finished goods, all things being equal, we wind up with a higher gross margin on those chips we manufacture on 300-millimeter, so that's increasingly important to us. As we look out in the future, again, we've got about probably \$6 billion of growth capacity in 300-millimeter and we continue to increase our loadings in that space. In fact, on a year-over-year basis, we actually had more starts on 300-millimeter than we did a year ago.

Dave Pahl - Texas Instruments Inc. - VP

That's good. And I'll just add to Kevin's comment that as we reported last quarter, we qualified our second 300-millimeter fab which is DMOS 6 and we do have product running in that fab today. So thank you, Romit, and we'll go to the next caller, please.



Operator

We'll take our next question from the line of John Pitzer.

John Pitzer - *Credit Suisse - Analyst*

Yes, good afternoon guys, solid execution as always. Kevin, I guess if you could talk a little bit about the Embedded Processing op margin improvements. If memory served me correct, when you got out of the Wireless business you didn't get out of all of the cost and you put a lot of that cost into the Embedded Processing market.

If I look at the incremental op margin sequentially, it's greater than 60%. Are we sort of at a tipping point here with that's kind of the incremental op margin we should start to see about this business? And is there any reason why the Embedded op margin shouldn't converge with the Analog op margins over time?

Kevin March - *Texas Instruments Inc. - CFO*

Yes, John, what you might recall is that a year ago we were still in the process of winding up some restructuring actions in the Embedded Processing segment. That finished about the middle of the second quarter, it was a little bit that bled over into the middle of the second quarter. And so consequently now we're seeing the benefit of those cost restructurings.

The margin improvement that we'll see -- we're right at on this business now is a solid 25% operating profit in the quarter and that's really much closer to what we expect from that business segment. As you noted, we had about, quarter-over-quarter about a 62% fall through to operating profit from the revenue growth. And as we go forward, the focus of that division will be primarily on very solid cost containment and cost management but a lot of energy on growing the top line and growing revenue so that it can continue to drop through more profit as we go forward.

I won't attempt to characterize whether or not it achieves the same sort of levels as Analog, but we are confident there remains room of improvement in that overall P & L, primarily from continued cost containment and a drive towards revenue growth.

John Pitzer - *Credit Suisse - Analyst*

Then you mentioned -- as my follow-up, you mentioned in your prepared comments some of the inventory growth you saw in the March quarter. Just kind of curious how long it takes to get that closer to trend. As you exit June would you expect to see days closer to your trend line or how should we think about that?

Kevin March - *Texas Instruments Inc. - CFO*

Yes, what's actually interesting, John, is our dollars of inventory are actually down year-over-year. And as mentioned in prepared remarks, our days of inventory were up and that's up on the expectation of increased shipments in the second quarter and plus there's a few extra days that are inside that 1Q inventory as a result of the slowdown in personal electronics that we mentioned 90 days ago.

We expect that material is going to ship over the balance of the year and between the increased shipments in 2Q and the shipments of that personal electronics material, we'll see the days of inventory drift back down comfortably inside our model very similar to what we saw last year. If you go back and take a look last year, we were also a little bit higher in the first quarter, in anticipation of second quarter growth and then days drifted down as we came through the year.

Dave Pahl - *Texas Instruments Inc. - VP*

Okay, thank you, John. Next caller, please?

Operator

We'll take our next question from Toshiya Hari.

Charles Long - *Analyst*

This is Charles on for Toshiya. Your Q2 guide at the midpoint implies flat to down year-over-year growth. I'm wondering when you expect to return to growth and what the drivers of that will be?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, so I think if you look at the midpoint, you're right, that year-over-year growth would be down about 1%. As we talked about before, we, on a year-over-year basis, will still have the growth impacted due to the weakness inside of personal electronics. Outside of that, we expect to see our businesses growing both sequentially and year on year. And, again, I think that we're in a good position to capitalize on the trend of industrial and automotive.

We think longer term that that's where the growth in our industry will come from. And just as a reminder, we had last year about 46% of our revenues driven by there, so we feel good with where our products are positioned.

Charles Long - *Analyst*

Got it. And then gross margin performance was strong in Q1. Outside of lower depreciation and incremental 300-millimeter revenues, where are the other factors that are going to drive upside from here?

Kevin March - *Texas Instruments Inc. - CFO*

Well, you hit the two important ones. So we had lower manufacturing costs year-over-year driven by, as you mentioned, lower depreciation and increased 300-millimeter wafer starts. But we also had a richer mix of overall products. As Dave mentioned in his prepared remarks, industrial was up very solidly for us and in the industrial space we enjoy a very nice mix of overall profitability.

So you have that combination of events going on. And again to Dave's comments a moment ago, as we continue to see content growth in industrial and automotive, we would expect to continue to see an improvement in our mix from a profitability standpoint too as we look out over the quarters and years. So it's all coming together very nicely for us right now.

Dave Pahl - *Texas Instruments Inc. - VP*

Okay, great, thank you, and we'll go to our next caller, please.

Operator

Our next question comes from the line of Stacey Rasgon.



Stacy Rasgon - *Bernstein - Analyst*

Hi, guys, thanks for taking my questions. In the quarter, OpEx came in a little high. Was wondering if you could tell us the driver, what drove that, and what your thoughts are for OpEx for Q2?

Kevin March - *Texas Instruments Inc. - CFO*

Yes, Stacy, OpEx did come in a little bit higher than what we had planned for. There really wasn't any one thing that drove that. There was just a number of small things that were being taken care of in the quarter.

As we look into second quarter, recall that 1Q includes about two months' worth of our annual pay and benefit increases, so as we look into Q2 you'll need to account for that, that we would have the full three months of pay and benefit increases. I'd expect the change quarter to quarter to be very similar to what you saw last year.

Stacy Rasgon - *Bernstein - Analyst*

Got it, thank you; that's helpful. For my follow-up, I wanted to dig a little bit into the Comm infrastructure impact on both Embedded Processing as well as Other, so Embedded is up 8% year-over-year. You noted within your Other business that your custom ASICs are down year-over-year. I think both of those tend to be driven very highly by Comm infrastructure. Can you help us understand the differential between those two businesses? Is one of them eating the other, for example?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, so first let me talk about our Embedded business. So our Embedded business, as you remember, has three product lines inside of it. Microcontrollers and Processors are both about 45% of that revenue and Connectivity makes up about 10% of that revenue, so we saw growth in all three of those businesses, they all grew very nicely but it was led by Processors. So our communications infrastructure processors would be inside of that business, but we also sell automotive products that are inside of that business that drove that growth.

In the Other business, the custom ASIC business, I'll just say that we sell a different mix of products to customers, so it's not always the same. We've got some customers where we only sell both just Embedded and Analog into those customers. And that said, just as a reminder longer term, we do expect that the custom ASIC business will decline because that functionality is being absorbed into our SOCs inside of the Embedded business.

Stacy Rasgon - *Bernstein - Analyst*

Thank you.

Dave Pahl - *Texas Instruments Inc. - VP*

We'll go to the next caller please.

Operator

Our next question comes from Blayne Curtis.



Blayne Curtis - *Barclays Capital - Analyst*

Hi, guys, thanks for taking my question. Could you just talk about the outperformance in gross margin? You said 300-millimeter. I was just curious what the utilization rates are? And as you look into Q2, it seems like guidance implies sustaining at that level. Just want to make sure that was right and what you're expecting to do with utilizations there.

Kevin March - *Texas Instruments Inc. - CFO*

The utilizations actually haven't changed that much in a number of quarters and we don't expect it to change much in the next quarter or two either. The amount of wafers we're starting are pretty consistent as we go across the quarters. And, Blayne, you can kind of see that in when our days of inventory go up in 1Q as we're building for increased shipments in 2Q, that allows us to run the factories pretty close to similar utilizations quarter-over-quarter rather than ramping them up and down to meet the in-quarter demand. So I wouldn't expect utilization to change that much going into the next couple quarters, just as it hasn't in the last number of quarters.

Blayne Curtis - *Barclays Capital - Analyst*

And then as my follow-up, you had a correction in consumer as you pointed out. As you look into the back half of the year, you said you expected to sell-through, so do you expect your content in those types of applications to be roughly similar this year and therefore you should see a similar ramp like you did last year?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, we haven't given color on how much content we have. I'll just say that when we do engage where we like to be able to engage inside of personal electronics are those types of products that will sell across multiple generations of products. And that's not always the case on every product we make an investment in, but that's where we want to steer our investment dollars. So we're confident that as we build that inventory we'll have demand in the back half. We won't try to predict at this point what that demand will look like.

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

Operator

Our next question comes from the site of Harlan Sur.

Harlan Sur - *JPMorgan - Analyst*

Hi, good afternoon; thanks for taking my question. Another solid showing by the Embedded business. You pointed out particular strength in Processors. I think you guys talked about Comms as a driver there and maybe some automotive, but your MCU products also grew nicely year-over-year. Maybe you can just give us some insights on the end market/applications that drove the growth in that sub segment?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, our MCU business is really a great business that we're building. And as you know, we've been investing in that business for some time. We've got and continue to invest both in TI-based architectures as well as ARM-based architectures and we've got customers that want to have both of those and we continue to be selective on where we make those investments. Part of the way that you differentiate those products is by having peripherals that are optimized for different types of applications.



We developed microcontrollers that are targeted for ultra low power battery-backed operations that will be in fielded for, in some cases, decades, as well as very high-performance-based microcontrollers. And we've got very strong connectivity solutions, both wired but as well as wireless, and that crosses over into our Connectivity business that we've got there and we support over a dozen different interface or wireless standards inside of that business.

So, again, very, very broad based and we really are encouraged by the results of that business. Do you have a follow-on?

Harlan Sur - *JPMorgan - Analyst*

Yes. Within the industrial markets, which was obviously an area of strength for you guys in the March quarter, you guys have talked previously about servicing like I think 14 different sub segments, so very broad. You've also talked about content gains in industrial, which is kind of a similar dynamic to the automotive segment. Any of those sub segments within industrial that are showing more of a bias towards more dollar content gains on a go-forward basis?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, I think the one nice thing about automotive is we can more easily identify what unit SAR growth is. And there's enough analysts that follow that market that we can track with the semiconductor content gain. And we think that there's probably somewhere around \$350 on average that sells into an automotive. That's a number that's been growing very nicely.

And when I look at that, that's probably about 1% of the average sales price of a car, so it's not too hard to imagine that that number will continue to grow and grow significantly over the future. When you contrast that to industrial and we think we are in the very early stages of maybe where we were three, five years ago in the automotive market with industrial, you really can't do that same type of analysis, unfortunately, because we've got 14 different sectors that we sell into.

Underneath that there are literally hundreds of different end equipments that we track and develop solutions for and there's just a very, very wide variety of applications. So we can see it going on. And the beauty of it is it's not just one thing. It really is growth on a very broad basis. And I think that's reflected in our numbers, not only this quarter but it's been reflected in the numbers for a number of quarters now. So we really look forward to that opportunity in the future.

Operator

The next question comes from the line of Vivek Arya.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Thanks for taking my question. One more on gross margins. Is the 60.6% the new baseline and we should model the flow through from this level or are there any mix benefits that are helping you in the first half that might reverse when the smartphone shipments start to ramp in the second half?

Kevin March - *Texas Instruments Inc. - CFO*

Well, you'll have several things going on across that. That's a pretty tough call to make when we're trying to get too precise. We would expect industrial and automotive to continue to be a growing portion of our revenue over time. That's where we are focusing our attention, especially our R & D dollars. And we would also expect more starts as we look out into the future, proportionately more starts on 300-millimeter, which is lower cost wafers.



We would also expect the depreciation declines that we've been seeing this past year to continue, albeit at a slower pace than what we've seen in the last few quarters. So those will give you tailwinds, so even if you do have some of these other products start back up, you have enough mix going on inside there that these margins that we're offering at right now are probably pretty representative of what the portfolio can do for our shareholders.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Got it; very helpful, Kevin. And as my follow-up, you mentioned that sales growth in Q1 plus what you're guiding to Q2, excluding I don't recall whether you said personal electronics or just your largest customer, but sales growth is actually up year on year. Could you help us quantify what that growth trend is versus last year?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, Vivek, we aren't being that precise. We just wanted to give some color generally that where we had seen that headwind and the demand changing late in fourth quarter that that portion of our demand inside of personal electronics that we expect that it will grow sequentially, but be down significantly year-over-year. And we just haven't gotten more precise than that. Thank you, and we'll move on to the next caller, please.

Operator

Our next question comes from the line of Ross Seymore.

Ross Seymore - *Deutsche Bank - Analyst*

Thanks for letting me ask a question, guys. I guess the first question would be your first quarter came in at the high end of the range. Can you just talk about what was the positive surprise in the quarter and maybe associated with that, Dave, I think in the past you have given a sequential end-market performance to match what you've given and then year-over-year. If that helps to answer both questions, that would be great.

Dave Pahl - *Texas Instruments Inc. - VP*

Okay. Yes, so, again, as we had said earlier, that portion of demand where we saw weakness came in about as we expected. The strength was more broad based. And we continued, obviously, to see strength in automotive and then the improvement in industrial and Comms equipment. So very, very broad based strength that we saw.

So the second part of your question was, sequentially, what we saw from the trends. There, no surprise that automotive remained very strong and it was driven by infotainment as well as the hybrid electric and power train systems.

Industrial, again, we had growth across almost every sector inside of industrial. Personal electronics down with most sectors declining. And Comms equipment was up sequentially. And that was the third quarter in a row that it actually grew. And then enterprise systems was up due to projectors. So did you have a follow-on, Ross?

Ross Seymore - *Deutsche Bank - Analyst*

Yes, I'll make it quick. And you just talked about the Comms side, the third quarter in a row it's been up. Generally how do you think about that versus where we are now after burning a ton of inventory and now coming back. Are we to the point where we're shipping to end demand and now we can grow or shrink with that or is there some other dynamics going on?



Dave Pahl - *Texas Instruments Inc. - VP*

Can you repeat the first part of the question because you cut out a little bit on our side.

Ross Seymore - *Deutsche Bank - Analyst*

Sure, I'm sorry. So you said your Comms business was actually up for the third quarter in a row. Obviously that had fallen due to the end market before that. So the question is do you think you're back to shipping to end demand and what do you view to be the growth trajectory of that business longer term?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, thank you. I would say that that business, as you know, Ross, has always remained choppy. And we had a very strong period of growth going back a year ago, followed by the declines that we saw last year. It's just really tough to be able to predict what's going to happen in that market. And we just position product and inventory to be able to respond if that demand will continue to strengthen. And if it doesn't, we know how to react in that environment too.

So it still continues to be a really good business for us. We continue to make investments in it and we just know that it will be choppy. Longer term, we don't view it as a market that will be a growth. We don't think that operators will take their CapEx spending up over the next five, 10, 15 years, but we do think there will continue to be shifts in how they spend that money, so we continue to make investments where we believe that growth will be in the future.

So thank you very much and we'll move to the next caller, please.

Operator

We'll take our next question from the site of Chris Danelly.

Chris Danelly - *JPMorgan - Analyst*

Hey, thanks, guys. I apologize if these questions have been asked before. I got on here late. I was listening to Xilinx, slamming my head against my desk.

It sounds like you're guiding for a roughly seasonal or slightly below seasonal environment? If you could just compare now versus a quarter ago versus a year ago or the last six months, how you feel overall about the overall environment? Is it seasonal, a little below seasonal? Better than seasonal? Getting better, getting worse? Any comments there?

Dave Pahl - *Texas Instruments Inc. - VP*

Well, I'd just make the observation that we believe we're just continuing to operate in a very similar macro environment that we've seen in the last few quarters and even in the recent year. And our guidance, obviously, is our best estimate of how we'll perform.

So we try to stay away from making any precise comments on what a seasonal quarter looks like, as you know, Chris, because if you look at the numbers, there's usually a pretty wide variation on what an average would tell you that it would be. So, again, just a very similar macro environment to what we've seen. Do you have a follow-on?



Chris Danely - *JPMorgan - Analyst*

Yes, real quick, just on channel inventory and distribution inventory. I think you said that channel inventory was up a couple days, around four and a half weeks. Do you expect channel inventory or just the inventory to go up again in Q2?

And if you could just give us the range that channel inventory/disty inventory has been in for the last, call it two or three years. Is this basically at the bottom or is it a little off the bottom or close to the peak or where would that be?

Dave Pahl - *Texas Instruments Inc. - VP*

Well, as you know, we've, several years ago, implemented our consignment programs, so I think we still continue to learn what the right level in the channel will be. And I'd just say that if we could actually convert all of our shipments in distribution to consignment and carry that inventory ourselves, we would actually prefer to do that. So, if anything, we would encourage our distributors to take advantage of those programs.

We've operated, I'd say, around four weeks to four-and-a-half weeks, I think, for some time. That number probably somewhere in that range, even if it drifted up a little bit, it always depends on the product that's out there and the speed at which it turns. But we've got other peers that measure their inventory in months and not weeks, so we're very efficient on how we use that channel.

And it works out really well for both us and our distributor partners, so we feel very good about where that level is overall.

So thank you, Chris, and we'll go to the next caller, please.

Operator

Our next question comes from Amit Daryanani.

Amit Daryanani - *eClerx - Analyst*

Thanks a lot. I guess a question from me, I think the lower depreciation helped you guys on the gross margins, about 130 basis points year-over-year at least. Do you think that magnitude can sustain throughout calendar 2016 or should we think about depreciation dollars being more or less flat from these levels.

Kevin March - *Texas Instruments Inc. - CFO*

Amit, I made the comment a few minutes ago that the rate of depreciation and decline that we have seen over the past year will slow down meaningfully as we go into 2016. Recall that from a capital spending standpoint our model is to spend about 4% of our revenues on CapEx, which we have been doing for the last couple of years and we expect to continue doing this year.

Our depreciation runs more than 4%, so clearly they will have to converge at some point. Our depreciable life of most of our equipment is five years. And you may recall it was about five years ago when we brought on several new factories, one in Aizu, some equipment we brought into RFAB here in the Dallas area, and a factory we bought in China.

And so we're seeing those depreciation curves roll down now. So the rate of decline that we saw over the last few quarters this past year will slow down although it will still decline as we go into 2016.

Amit Daryanani - *eClerx - Analyst*

Got it. And if I can just follow up, I think you have about \$1 billion of debt that's due in the month of May. Is the thought process to just pay that off with cash on hand or roll it forward? And what would that implication have for your interest expense line as you go forward?

Kevin March - *Texas Instruments Inc. - CFO*

Well, if we pay it off, the interest expense will clearly decline. But I expect that we'll probably do what we've done similarly in the last couple of cycles on this where we have -- if the interest rates are favorable by the time we go back into the market, we'll likely pay off a portion and roll the balance into a new issue. In either case, whether we pay off the entire amount or just pay off a portion and roll over the balance, I would expect interest costs will decline by several million dollars a quarter.

Dave Pahl - *Texas Instruments Inc. - VP*

Okay, thank you, Amit. And we'll go to the next caller, please.

Operator

Tore Svanberg, your line is open.

Tore Svanberg - *Stifel Nicolaus - Analyst*

So Silicon Valley Analog was up year-over-year and that's better than the industry, better than your peers. Was that mainly due to industrial and automotive strength or were there some share gains or other things going on there?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, Tore, SVA does have a good exposure to both industrial and automotive and that certainly helped that business.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Okay, and as my follow-up for Kevin. Do you have a CapEx number for us for this year or should we just take 4% of whatever revenue we come up with?

Kevin March - *Texas Instruments Inc. - CFO*

Well, keep it simple. Just take 4% of your expected revenue number and you're going to be pretty close to what we're spending.

Tore Svanberg - *Stifel Nicolaus - Analyst*

Sounds good. Great job, thank you.

Dave Pahl - *Texas Instruments Inc. - VP*

Thank you, Tore. We'll go to the next caller, please.



Operator

We'll go next to the line of Ambrish Srivastava. Please go ahead.

Ambrish Srivastava - BMO Capital Markets - Analyst

Hi, thank you. I had a question on the automotive business, Dave. We haven't talked about the momentum that you guys seem to be witnessing here. Big sizeable business, bigger than your peers and year after year, just like the rest of the business, it's boring but it grows.

So the question I had was where are the new opportunities that you guys are now designed in and if we were to look at where automotive for TI was, say, a couple years ago, so what should we be thinking over the next couple of years? Thank you.

Dave Pahl - Texas Instruments Inc. - VP

Sure, Ambrish. The automotive business that we're building continues to be very, very broad based, so we've got strong participation in both Analog as well as Embedded. Inside of Embedded we've got both Processors and Microcontrollers, as well as even some Connectivity designs inside of that business.

From an Analog standpoint, it actually is very, very broad based. And one of the things that we've been focused on is broadening the number of business units that the company participates in in automotive. And I think if you went back five, 10 years ago, we might have had one or two business units participating in that marketplace. And today, out of our 70 or so different business units, I think over half of them actually ship products into that marketplace, so it's very, very broad based.

We've got five what we call sectors that make up the automotive market. And, again, the largest one is not more than mid-single digits as a percentage of our revenue last year. So they are -- the five segments are infotainment and cluster; passive safety; advanced driver assist systems or ADAS, as it's known; body electronics, which also includes lighting; and then the hybrid electric vehicle and power train. So we've seen growth across all of those sectors, very, very robust growth and a very broad range. So do you have a follow-on?

Ambrish Srivastava - BMO Capital Markets - Analyst

No, that was it for me, Dave, thank you.

Dave Pahl - Texas Instruments Inc. - VP

Okay, Operator, we've got time for one more caller.

Operator

Okay, we will take our final question from the line of William Stein.

William Stein - SunTrust Robinson Humphrey - Analyst

Great; thanks for squeezing me in. Dave, around the middle of last year, I think was the first time you highlighted the potential for a 10% customer and maybe we've been sort of dancing around this point, but I wonder if you expect that that customer will repeat at a similar magnitude in this year?

Dave Pahl - *Texas Instruments Inc. - VP*

Yes, that's a projection that I won't make on today's call. I think that they and all of our customers -- we've got teams that work very, very hard to get products designed into. And with that largest customer, as we talked about before, we sell them hundreds of products. We participate in all of their major platforms. And, of course, the revenue would always be skewed to where they ship their products.

And I think they publicly report that about two-thirds of their revenues would be in phones, so our revenues will mirror those types of shipments, so we've got good growth in automotive. We're seeing strengthening, a broad strengthening inside of industrial. And so that's a trend. We'll see how those trends continue for the balance of the year. There's a lot of time between now and the end of the year. And then we'll see what happens inside of personal electronics as well. So do you have a follow-up?

William Stein - *SunTrust Robinson Humphrey - Analyst*

Yes, one on capacity, if I can. I'm wondering if you acquired any capacity as you do periodically and if there's any update on the planned fab closure in Scotland?

Kevin March - *Texas Instruments Inc. - CFO*

I'll go ahead and answer that one. We continued to acquire capacity. No new factories here lately, but we do continue to pick up equipment that was quite expensive new for pretty good prices when you buy them the way we buy them.

As it relates to the closure of the factory in Scotland, just as a reminder, we expect that factory will not close before the end of 2018. As it has been with other factories in the past, when we close those things, it usually takes a couple years as you slowly do lifetime builds on the inventory and on certain other parts in those factories you'll re-qual into other existing factories. And that's just a multi-year effort. So it's progressing as planned. And we, again, don't expect it to actually complete until about the end of 2018.

Dave Pahl - *Texas Instruments Inc. - VP*

Thank you very much, Will, and thank you all for joining us. A replay of this call is available on our website. Good evening.

Operator

I would like to thank everybody for their participation. Please feel free to disconnect your line at any time.

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