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Doug Freedman – Analyst, RBC Capital Markets LLC
Christopher B. Danely – Analyst, JPMorgan Securities LLC
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Texas Instruments first quarter 2014 earnings conference call. At this time, I'd like to turn the conference over to Ron Slaymaker. Please go ahead, sir.

Ron Slaymaker, Vice President, Head of Investor Relations

Good afternoon, and thank you for joining our first quarter 2014 earnings conference call. As usual, Kevin March, TI's CFO, is with me today. For any of you who missed the release, you can find it and relevant non-GAAP reconciliations on our website at ti.com/ir. This call is being broadcast live over the web and can be accessed through TI's website. A replay will be available through the web.

This call will include forward-looking statements that involve risks and uncertainties that could cause TI's results to differ materially from management's current 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.

The first quarter was a good start to the year for TI. Our positions in Analog and Embedded Processing contributed strongly, with combined revenue for these products up 13% from a year ago. As important markets such as industrial and automotive continue to embrace electronics technology, Analog and Embedded Processing products are critical, and TI should benefit accordingly.

Revenue of $2.98 billion was in the upper half of our expected range that we communicated in January. Earnings per share of $0.44 was at the top of our expected range. EPS included $0.02 that was not in our prior guidance from sales of a site and other assets associated with previously announced restructuring actions. Free cash flow was $3.1 billion or 25% of revenue for the trailing

12-month period, right in line with the 20% to 30% range where we expect to operate over time. For those of you who missed our capital management call in March, we raised our expected range for free cash flow margin from 20% to 25% to 20% to 30% in that call.

Also over the past 12 months, we returned over $4 billion of cash to investors through a combination of dividends and stock repurchases. In the March call, Kevin explained that our updated model for cash returns to shareholders was to return all of our free cash flow, less the net debt amount that is retired, plus proceeds that we receive from exercises of equity compensation. Inclusion of the exercise proceeds was a new addition to the model from what we had previously communicated. Against this targeted return level, we returned 99% over the past 12 months.

In the first quarter, TI revenue grew 3% from a year ago. Excluding legacy wireless, revenue grew 11%, with double-digit growth in both Analog and Embedded Processing. Analog revenue grew 11% from a year ago, with all four major product lines up. Power Management and High Performance Analog led this growth and were each up about the same amount. Embedded Processing revenue grew 17% from year ago, with Microcontrollers leading the way. Our increased investments in this growth area over the past few years are yielding favorable results. In our Other segment, revenue declined $186 million or 28% from year ago due to legacy wireless, which has now declined to the single-digit millions of dollars.

Turning to distribution, resales increased 10% from a year ago, while distributors' inventory remains about the same and is just under 5 and a half weeks. From an end market perspective, the most growth from a year ago came from communications equipment, followed by industrial and automotive. Enterprise systems was about even, while revenue in personal electronics declined due to mobile phones and tablets, areas that previously used legacy wireless products from TI.

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

Kevin P. March, Senior Vice President and Chief Financial Officer

Thanks, Ron, and good afternoon, everyone.

Gross profit in the quarter was $1.61 billion or 53.9% of revenue. Gross profit increased 17% from the year-ago quarter. This is a solid increase in profitability considering the 3% growth in total revenue. The 630 basis point expansion in gross margin as a percent of revenue reflects an improved product portfolio, higher utilization of our manufacturing assets, and the efficiency of our manufacturing operations.

Moving to operating expenses, combined R&D and SG&A expense of $845 million was down $33 million from the year ago. The decline reflects restructuring associated with the wind-down of our legacy wireless products. As a reminder, we will begin to see the benefit of the previously announced restructuring in Embedded Processing and Japan in the second half of this year. While we are discontinuing R&D spending in areas that are no longer able to provide differentiated growth, we continue to invest aggressively in those areas that are providing growth, such as Analog, where we've increased our R&D investments by 77% since 2006, resulting in steady increases in market share or, as Ron mentioned, more recently with our stepped-up investments in Embedded Processing, which is now resulting in multiple quarters of year-over-year revenue growth.

Moving on, acquisition charges were $83 million, almost all of which is the ongoing amortization of intangibles, a non-cash expense. Restructuring and other charges included a charge of $32 million for the previously announced restructuring, about as we expected. There was also a gain of $37 million for sales of a site and other assets associated with earlier restructuring actions. As Ron mentioned, this gain contributed $0.02 to EPS in the quarter and was not included in our prior guidance. Operating profit was $690 million or 23.1% of revenue. Operating profit was up 75% from the year ago. Again, this was a solid increase considering total revenue was up 3% over this period. Net income in the first quarter was $487 million or $0.44 per share.

Let me now comment on our capital management, starting with our cash generation. Cash flow from operations was $462 million in the quarter. Inventory days were 112, consistent with our model of 105 to 115 days. Capital expenditures were $77 million in the quarter. On a trailing-12-month basis, cash flow from operations was $3.49 billion, up 5% from the same period a year ago. Trailing-12-month capital expenditures were $405 million, or 3% of revenue. Capital spending for the year-ago trailing-12-month period was $476 million or 4% of revenue. Consequently, free cash flow for the past 12 months was $3.08 billion, or 25% of revenue, in the middle of our expected 20% to 30% range. This is 8% higher than the free cash flow was a year ago when it was 23% of revenue.

Depreciation expense for the past 12 months was $864 million. Depreciation exceeded our capital expenditures by $459 million, or 3.7% of revenue. Our strategy to opportunistically time our purchases of manufacturing equipment has provided us a manufacturing capability today that has sufficient headroom to support growth for years ahead. Our current level of capital expenditures provides us with important new manufacturing technologies, while also continuing to expand our capacity. Over the next few years, as a result of this strategy, we expect to continue to hold capital spending at low levels, or at about 4% of revenue. Therefore, depreciation will decline to the rate of capital spending, and our gross margin will directly benefit.

As we have said, strong cash flow, particularly free cash flow, means that we can continue to provide significant cash returns to our shareholders. In the first quarter, TI paid $325 million in dividends and repurchased $720 million of our stock, for a total return of $1.05 billion.

Historically, we have described our capital management strategy was to return all of our free cash flow to shareholders, except for what we need to repay debt. In March, we updated this model to also include the return of proceeds that we receive from the exercise of equity compensation. In the past 12 months, free cash flow was $3.08 billion, our debt level was essentially unchanged, and we received $1.14 billion of proceeds from exercises. So our targeted return model would be about $4.22 billion. We actually returned $4.18 billion to shareholders, or 99% of the model. So our recent practice has been well aligned with the updated model. This percentage will likely move up in the second quarter as we retire debt that is due in May. Total cash returned in the past 12 months was 38% higher than a year ago. Dividends were up 48%, and stock repurchases were up 34%.

Fundamental to our cash strategy and our cash management are our cash management and tax practices. We ended the first quarter with $4.03 billion of cash and short-term investments with 84% of that amount owned by TI's U.S. entities. Because our cash is largely on-shore, it is readily available for a variety of uses, including paying dividends and repurchasing our stock. As a reminder, we issued $500 million of debt in the first quarter at an average coupon rate of 1.8% for three- and seven-year terms, and we plan to retire $1 billion when it comes due in May.

TI's orders in the quarter were $3.07 billion, up 4% from a year ago, and our book-to-bill ratio was 1.03.

Turning to our outlook, we expect TI revenue in the range of $3.14 billion to $3.40 billion in the second quarter. At the middle of this range, revenue would increase 7% from a year ago. If you exclude the $148 million of legacy wireless revenue from the year-ago quarter, revenue would increase 13%.

We expect second quarter earnings per share to be in the range of $0.55 to $0.63. Restructuring charges will be essentially nil, and acquisition charges will remain about even, which is the non-cash amortization charge that will be at this level for the next five years.

We have revised our expectation for our effective tax rate in 2014 to 28%, up a point from our prior estimate, reflecting our higher expectations for profitability in the year. This is the tax rate that you should use for the second quarter.

In summary, I think the first quarter provided a glimpse into the potential financial performance that TI should be capable of going forward. Our Analog and Embedded Processing product lines will benefit as the industrial and automotive markets continue to increasingly embrace technology. These are markets where we are investing and that offer the promise of sustainable growth, solid profitability, and good cash flow from operations. The low capital requirements for Analog and Embedded Processing, combined with our strategy to opportunistically acquire manufacturing assets, also means that we can deliver strong free cash flows, which should allow us to continue to provide strong returns to our shareholders in the form of dividends and share repurchases.

With that, let me turn it back to Ron.

Ron Slaymaker, Vice President, Head of Investor Relations

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 an additional follow-up. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we go first to John Pitzer with Credit Suisse.
<Q – John Pitzer – Credit Suisse Securities (USA) LLC (Broker)>: Good afternoon, guys. Thanks for letting me ask the question. And congratulations on the strong results. Kevin, helpful giving us top-line and bottom-line guidance for the June quarter. I'm just kind of curious, as we think about gross margin and OpEx, how does the OpEx saving kind of linearly fold into the model between now and December? And on the gross margin line, should we just think about sort of that 75% historical incremental gross margin against revenue growth?

<A – Kevin March – Texas Instruments Incorporated>: So, John, let me start with the OpEx. As you look into next quarter in particular, recall that in the – just step back for a moment – on an annual basis, we typically have our pay and benefit increases occurring in the first quarter. And typically two of the three months of the first quarter will incur that increase. So clearly as we go into second quarter, we'll have a full three months of that increase.

But to the point that you were bringing up on some of the savings that we'll see from the restructuring and Embedded Processing actions, we'll see a little bit of that savings begin to materialize in second quarter. So OpEx will probably be fairly flat. The majority of that savings will occur in the second half of the year. And just to remind everyone else, we're expecting about $130 million in annualized savings as a result of that announced restructuring.

On the gross profit, it's exactly as you said, John. You should be thinking that over the course of the cycle, our fall-through average is about 75% on the way up and on the way down, so that's a good long-term model to be using as you build your model.

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

<Q – John Pitzer – Credit Suisse Securities (USA) LLC (Broker)>: Yeah, guys – Ron, maybe you can help me out a bit. Given the reclassification of revenue you guys did, I'm just kind of curious: How does mix influence gross margin? And if you think about the new buckets of revenue, where do you expect to see faster, long-term growth versus slower longer-term growth, either by design or just by market forces?.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay, and when you talk about our reclassification of revenue, are you talking about by end market, or are you talking – ?

<Q – John Pitzer – Credit Suisse Securities (USA) LLC (Broker)>: By end market specifically, Ron. Thank you.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay. Well, even though your question was end market, let me first of all address it more by product line. So the biggest mix change has been as we've gotten out of legacy wireless. And even though that's essentially zero as of first quarter, you'll still see the impact on the year-on-year comparisons through the course of 2014. And in general, the legacy wireless gross margins were lower than corporate average. So getting out of those product areas was beneficial to gross margin.

From an end market standpoint, I probably – the way to think about it is that gross margin tends to be highest – and this is not unique to TI. You can just look across a broader range of companies. But gross margins tend to be highest where volumes tend to be lowest, meaning where – maybe the better way to say it is where the revenue is most diversified across customers and application areas. So, for example, industrial. You can see other companies that are highly focused on industrial, and we see it in our own results, where you're selling catalog products into lots and lots of different customers and different applications within the industrial space. And that tends to be at pretty nice gross margins.

Other areas, like automotive, where there are a lot of special requirements from the standpoint of quality, the design-in cycles tend to be long, the product life cycles, both in automotive and industrial tend to be long. And that tends to be beneficial for gross margins also. They probably tend to be lowest in the short-cycle, high-volume end market areas. And that's partly the nature of the competitiveness of those opportunities, combined with you don't really have time in terms of the life cycle of the products to engineer in cost reductions to get gross margins where you would really like to see them over time. And so there's lots of examples of that. And, again, you see it in our own results, and you would see it probably more broadly with other companies.

So, if you'd say where you would expect to see highest growth over time, I would say – just make a couple of observations. I think both industrial and automotive, from an application area, from their embracement of electronics technology, they're kind of at a tipping point where those very likely will be the fastest-growing semiconductor markets going forward, just by nature of the pervasion of semiconductor technology inside those applications.

Now, I would also say that we have a good position in those markets, and we believe Analog and Embedded are important. And we also believe, frankly, our sales force, and the breadth of our sales force, is an important competitive advantage for TI in reaching, especially in the industrial market, the broad base of customers there. So probably not surprisingly, and you've heard us say for some time now, they are priority areas for TI in terms of investment and in terms of our expected penetration into those markets and applications. And that doesn't necessarily mean that their revenue will grow faster as a percentage of TI's total, because you never know what will happen in a particular high-volume market. But, over time, I think you would expect that our position in those markets gets stronger. And, over time, the percent of our revenue that is coming from industrial and automotive will continue to grow as well.

Okay, John, thanks for your questions, and let's move to the next caller.

Operator: And we move next to Mark Lipacis with Jefferies.

<Q – Mark Lipacis – Jefferies LLC>: Thanks for taking my question. Kevin, I apologize if I'm asking you to repeat what you've read in your script, but could you just walk through the mechanics of the capital return for this quarter? You have the debt that you're going to pay down, but you issued some. So I understand that the free cash flow plus the proceeds on the options, minus the debt service, is what you expect to return. Is that – so if you have $1 billion, do we just subtract that $1 billion, or do we also factor in the $500 million in debt that you issued this quarter as part of that paydown?

<A – Kevin March – Texas Instruments Incorporated>: Mark, let me try to get to the way you're trying to ask that question. Again, at the high level, I'll repeat what you said there. Our cash return strategy is to return 100% of the free cash flow, less any amount used for net debt retirement, plus proceeds that we get from stock option exercises. During this past quarter, or during this past 12 months, there was virtually no net debt retirement. So it was really the proceeds from the free cash flow plus the stock option exercises, which is virtually all – we returned all of that to the shareholders in the last 12 months, 99% of that to the shareholders.

As you move into second quarter, we do have $1 billion of debt that is coming due in May that we will go ahead and pay off. And so when you rerun that math, you'll see some usage over that trailing 12 months of cash for debt retirement. And just mathematically that says the percentage we return, by the time we get to the end of second quarter, will probably be in excess of 100%, probably in excess of 110%. But that's just timing as you go through the course of the year, and that'll net itself as we move on through the year.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Let me just ask a clarification, Kevin. So in a quarter where you pay down debt, does that immediately come right out of repurchases, or is it a more smoothing type of application in terms of the way you look at the return formula?

<A – Kevin March – Texas Instruments Incorporated>: It's a more smoothing type of application. It will not affect the timing of our repurchases. We will continue to do repurchases as you've seen us in the past, which is very steady hand – a constant hand, as we go through time, and we don't try to time our repurchases. We just try to be very steady and methodical about it.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Did you have a follow-on, Mark?

<Q – Mark Lipacis – Jefferies LLC>: Yeah, I did, and thanks for asking that clarification, Ron. I appreciate that. In trying to model the cash flow through the year, normally you have Q1, you have accounts payable and accounts receivable are a big use of cash, which they were this quarter, and then – in Q4 account receivable becomes a nice source of cash. Is it fair to assume that that typical pattern is what we would expect to see, and is there any other working capital shifts that might happen this year that's different than what you've historically had? Thank you.

<A – Kevin March – Texas Instruments Incorporated>: Well, Mark, I think you've identified that quite well. Typically our first and second quarters are our lowest for cash flow and operating cash flow and free cash flow generation. First quarter we have pay and benefit increases, as I mentioned earlier. We also pay out our profit sharing and our performance bonuses during the first quarter. And then in second quarter, we of course have estimated tax payments that we have to make for the year that uses some cash. But as we travel through the year, our operating cash and our free cash flow have a tendency to increase first, second, to third to fourth and then decline again. And I don't see anything in 2014 that would suggest that would be any different than what we've seen for a number of years now.

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

Operator: We move to Doug Freedman with RBC.

<Q – Doug Freedman – RBC Capital Markets LLC>: Hi, guys. Congrats on the strong results, and thanks for letting me ask a question. If I could, could you dig into a little bit what you're seeing in terms of the mix of product, whether it be ASPs, units? And then a little bit of insight into maybe your backlog, what you're seeing in lead times, book-to-bill, and maybe the projected turns that you need to meet the midpoint.

<A – Ron Slaymaker – Texas Instruments Incorporated>: I can maybe give you a little bit on that. In terms of ASPs, Mark – or Doug, excuse me – I'm really not aware that there's been any significant shift one way or the other. And, again, that just tends to – shifts that takes place on ASPs when you have differentiated products such as we do tend to be more driven by mix than they would general pricing environments, you might say, or a competitive pricing environment. So, again, no substantial shift there other than, when you look over time, the longer-term impact of moving out of legacy wireless. Lead times are generally stable. At any point in time, you always have some mix differences that might cause lead times to move in or out from one product area versus another. But generally lead times are stable, and for TI what that means is the majority of our products are shipping with lead times of less than six weeks. And -

<A – Kevin March – Texas Instruments Incorporated>: I'll comment on backlog. Doug, you asked about that. We came into last quarter with a book-to-bill of 0.94. And we've come into this quarter with a book-to-bill of 1.03. So clearly we've got a little bit more visibility than we had last quarter or even the quarter before that. Just to put that in perspective, orders in the quarter, I think we mentioned earlier, were about 4% year over year. That works out to being up to about 7% quarter over quarter. So with those combined elements from a backlog standpoint, that leads us to expect that we will have pretty reasonable growth in total revenues as we go into second quarter, as indicated by the guidance that we've included with this release.

<A – Ron Slaymaker – Texas Instruments Incorporated>: And I know I've said this before, but let me just remind you that with a 1.03 book-to-bill today, about 45% of our revenue is supported by consignment and JIT programs. And so, for that revenue, book-to-bill is always 1.0. So the 1.03 is a blend of, really, only the revenue that's non-JIT or non-consignment, which is 55% of our revenue. So, if I just round and call that half of our revenue, the book-to-bill on those products that would be shipping on traditional backlog and order entry-type process, would be more like a 1.06. The total being a 1.03, because that 1.06 then gets blended with the JIT consignment products at a 1.0 book-to-bill.

Okay, hopefully that helps and didn't further confuse. Did you have a follow-on, Doug?

<Q – Doug Freedman – RBC Capital Markets LLC>: Great. Thanks, Ron. No, that was excellent color. I really do appreciate it. My follow-on is really about sort of the cost of running the business. I know that you guys are – executed your restructuring plan to lower some of the cost, but how should I think about the cost in OpEx going forward in relation to, say, revenue growth? If revenue growth continues at, say, a double-digit pace, does the core OpEx grow at that same double-digit pace, or is there some leverage there?

<A – Kevin March – Texas Instruments Incorporated>: Yeah, Doug, I think that we do have some leverage, certainly, in 2014, and that is the restructuring that we announced in Embedded Processing and Japan. That mostly will kick in during the second half. So, again, just to remind you, that's $130 million of annualized savings that we expect to capture by the end of the year. So as we roll into next year, we'll see that on an annual basis. That $130 million will spread roughly 65% in R&D, 20% in SG&A, and the balance of 15% in cost of revenue and costs of goods sold. So it'll kind of spread that way. Beyond 2014, again, I think we've commented a couple times on prior calls, our basic model for OpEx is to operate between 20% and 30% of revenue. So it will not go up or down, necessarily, at the same pace that revenue goes up or down. It'll be more of a steady change over time, with some of these one-off anomalies, like I just described, with the restructuring going on in Embedded Processing and Japan.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay, Doug. Thank you. Let's move to the next caller.

Operator: We move to Christopher Danely with JPMorgan.

<Q – Chris Danely – JPMorgan Securities LLC>: Hey, thanks, guys. Can you give us your thoughts on the relative growth rates of your Analog versus Embedded versus your, I guess, your Other category this year? And then maybe talk about just the various puts and takes of why Embedded was up so much, Analog was up a little bit less, and the Other was down so much this quarter?

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay, Chris, are you asking for comments on forward-looking? Or kind of why the historical results were what they were?

<Q – Chris Danely – JPMorgan Securities LLC>: Both would be great. If I had to choose one, I'd say forward, but both would be great.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay, well, forward will be a short discussion because we have – really, I can say legacy wireless will continue down through the rest of this year when compared against the year-ago period. But it's zero already.

So I think the reality is it'll be what it'll be. You'll see certain times when Analog grows faster than Embedded. You'll see periods where Embedded grows faster than Analog. I think Kevin, even in his opening remarks, mentioned that – I think it was back in 2010, where we stepped up investments in Embedded because we believed there was a great growth opportunity for TI in Microcontrollers. We've answered questions from you guys for a long time about where's the growth that goes along with that stepped-up investment. And, frankly, I think we're starting to see it now. And it makes sense because it takes time, first of all, for that R&D to translate to products, and then for products to get designed into customers, and them to get their products to the market. So I think what we're seeing now in Embedded, very specifically in the Microcontroller area, has to do with the stepped-up investments that we made a few years ago in Microcontrollers.

Certainly, also what's helping Embedded is – I think we mentioned that, from an end market standpoint, we're seeing strength in communications equipment as well, and clearly the DSP position, or processor position, we have in Embedded across pretty much all of the various OEMs that ship into that wireless base station market are benefiting now in terms of that market starting to lift for us.

In terms of Analog, same thing. You'll see over time periods where Power grows faster. In fact, probably that would be a trend that you'd say, if you look over an extended period of time, meaning five years or so, Power has pretty consistently led growth in Analog. And we think that's an opportunity that will just continue in the years ahead. And that has to do with the world wanting to get greener in terms of power efficiency, and it has to do with a lot more products in the end market becoming battery-powered. And that's a great Power Management opportunity for TI. Our leadership in that market means that, as that market lifts, we probably tend to lift more than most other players.

Outside of that, what we're doing in Silicon Valley Analog, what we're doing in High Performance Analog, both those areas in the industrial market are very clear beneficiaries of the industrial market continuing to lift. So I'll stop there. Those are some general comments.

But, again, we don't really try to manage it, Chris. We have certain areas, like industrial and automotive that are important to us, but, frankly, pretty much every product area, whether it's application-specific products, or processors, or catalog Analog devices, can reach into industrial and can reach into automotive and be beneficiaries of that strategy going forward.

Did you have a follow-on, Chris?

<Q – Chris Danely – JPMorgan Securities LLC>: Yeah. And I hopped on a little late, so I'm sorry if you already talked about it. But can you just go over what utilization rates were during the quarter, what you expect them to be this quarter? And then, given all the restructuring and fabs, et cetera, maybe just refresh us on what your sort of peak revenue level is and where you would need to start adding equipment in terms of a utilization rate level?

<A – Kevin March – Texas Instruments Incorporated>: Yeah, Chris, on utilization, again, we haven't disclosed the actual percentage utilization in quite some time. We tend to do that when it's really dramatic change, it's informative.

I will just say that our factory utilization from a starts basis was higher in the first quarter than it was in the fourth quarter. But the average wafers that moved through the factories was about the same in both quarters. So, consequently, the underutilization charge was the same in both quarters – both fourth quarter and first quarter at about $105 million. With the outlook that we have for the second quarter, with the guidance that we've offered, clearly we have been and will continue to increase the loadings in the factories to support that increased expected outlook revenue growth in the second quarter.

And then just to your last part of your question there, the installed capacity that we have today is equipped to the point to support, we believe, about $18 billion of revenue. As we go forward, we'll continue to look for opportunities to increase capacity at the lowest possible cost, as we have done for a number of years now, so that we can remain focused on maximizing continuous free cash flow over time, as opposed to trying to maximize factory utilization levels over time.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay, Chris. Thank you. Let's move to the next caller.

Operator: We move next to Blayne Curtis with Barclays.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Are you there, Blayne? Operator, why don't we move on, and if Blayne comes back in, maybe we can bring him back up.

Operator: We'll move next to Romit Shah with Nomura.

<Q – Romit Shah – Nomura Securities International, Inc.>: Yeah, hi, guys. Thanks. Just jumping on here a little bit late, but I noticed the guidance for EPS growth is significantly higher than revenue growth. Is capacity utilization – and, Kevin, I know you're not going to give us gross margin guidance – but is the utilization the biggest factor driving the faster earnings growth?

<A – Kevin March – Texas Instruments Incorporated>: I presume that you're talking in relation to the sequential growth when you're asking about that?

<Q – Romit Shah – Nomura Securities International, Inc.>: Yes, yeah, relation to Q1

<A – Kevin March – Texas Instruments Incorporated>: Yeah, I think you're going to see – certainly, you get some EPS growth just off the revenue growth itself. You will see some improvement on utilization. As I mentioned a moment ago, we are increasing the loadings in the factories. But you'll also see a similar improvement as you go to next quarter, just on lower manufacturing costs. Recall a couple years ago that we had announced that we were closing two older six-inch factories, one in Houston and one in Hiji, Japan. And those basically are behind us now. And so that cost savings is finding its way through. So you got a couple moving parts going on inside there.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Did you have a follow-on, Romit?

<Q – Romit Shah – Nomura Securities International, Inc.>: Yeah. And can you just talk a little bit about the impact of OpEx on EPS here in the second quarter as well? Thank you.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Romit, I believe Kevin addressed that earlier. And he said, basically, OpEx should be relatively flat. So, instead of repeating that, we'll move on to the next caller, please.

Operator: We move to Ross Seymore with Deutsche Bank.

<Q – Ross Seymore – Deutsche Bank Securities, Inc.>: Thanks for letting me ask the question. Ron, a couple quarters ago, there was a lot of talk about seasonality and what that was going to be going forward. And I think you chose a three-year average for your sequentials in the fourth quarter. As we look forward, is that still as good a bogey as any for the June quarter? And, from a sequential perspective, by my math, that yields about 8% up. You're guiding above that. What's better than seasonal in what you guys are seeing?

<A – Ron Slaymaker – Texas Instruments Incorporated>: Ross, I think two months after we gave you that number in fourth quarter, we then started to decline to provide it again. And the reality is, seasonality, the number you come up with for, call it an average growth for any particular quarter, will vary so widely based upon the time period that you use to collect that. And so, what we've decided, is instead of us giving you our view – we've historically provided a, what – call it a three-year or five average, five-year, whatever, the reality is, when we threw that number out, it was being perceived as an endorsement of that level of growth for TI. And that was never our intention. So I think what we've decided to do going forward is just let you guys go through that analysis and provide your own estimates on seasonality. If you need help with the math on whether it's a three-year or five-year average, I probably could help on that, but I'm not going to do it for you.

The other thing is – and I've noted, even just looking at reports coming into this current report, I mean, I think sell-side analysts I saw had anywhere from, call it a 4% average for second quarter sequential to up to 9%. And, again, that just reinforces that the range is so wide that, from our perspective, internally, we really just don't put much emphasis on seasonal average, given how wide that range is. So, if you think it's important, then we're going to let you go through that on your own.

Do you have a follow-on, Ross?

<Q – Ross Seymore – Deutsche Bank Securities, Inc.>: Sure. Maybe I'll be a little more successful with this one. Embedded Processing seemed like that was the segment that provided the upside in the quarter that you just reported. As you think about the Microcontroller area starting to deliver growth, given the prior investments that you've made, can you give us a little bit of color on some of the applications that are driving that growth? And, really, why did they start taking off finally now? And, maybe, looking forward, what's the roadmap from an end market perspective and application – anything that can give us a little color in helping us to kind of channel-check that segment would be helpful.

<A – Ron Slaymaker – Texas Instruments Incorporated>: I'd offer a couple things. Microcontrollers – the beauty of microcontrollers is they tend not to – they are so, so, so diversified across applications. And so good luck on that channel check. But they're very much so in industrial applications. Certainly automotive is a factor there. The other piece that I would mention for Embedded Processing that I already mentioned was communications equipment. Base stations clearly was a lift for TI.

The only thing I would caution against is the view that that would grow some significant upside. Because the reality is, I think for the most part, Analog and Embedded Processing came in about as expected. And, in fact, our revenue overall, I think, we were 1% or so above the midpoint of our guidance range. So, again, the quarter generally came in about as we expected, but what drove the strength there would probably be a mix of industrial, automotive, microcontroller applications, as well as communications equipment. But pretty much everything was broadly up in the quarter.

I guess that was your follow-up, Ross. Thank you. And we'll move to the next caller.

Operator: We move to Blayne Curtis with Barclays.

<Q – Blayne Curtis – Barclays Capital, Inc.>: Yes, can you hear me now?

<A – Ron Slaymaker – Texas Instruments Incorporated>: We can hear you now.

<Q – Blayne Curtis – Barclays Capital, Inc.>: Hey, perfect. Sorry about that. So I apologize also if you mentioned this earlier, but just on the outlook for June, outside of calculators, were there any outliers in terms of products, either up or down, in your outlook?

<A – Ron Slaymaker – Texas Instruments Incorporated>: Blayne, we don't specifically break our forecast out into particular end markets or product areas, but I think what I would be safe in saying is that it's a pretty broad-based traction that is taking place in second quarter and is driving that growth. That doesn't mean everything's up uniformly the same, but it is – we believe the strength will be pretty broad-based for us. And, as you pointed out, calculators probably is the one outlier where it just tends to have good back-to-school strength in the second quarter. And we do expect that as well this second quarter.

Did you have a follow-on, Blayne?

<Q – Blayne Curtis – Barclays Capital, Inc.>: Yeah, in terms of your restructuring efforts that you've talked about commonly, I was just wondering if you've taken any other actions in other product lines, particularly Microcontrollers. It seems like an area of investment. Have you kind of reallocated any resources there? Or any color on if there's any other segments that you've pared back on spending? Thanks.

<A – Kevin March – Texas Instruments Incorporated>: Blayne, last quarter when we discussed the restructuring efforts that we were taking, we included a discussion of Embedded Processing and Japan. So Japan is clearly one that is under way and will be complete for the most part by the end of second quarter. Or at the end of second quarter. And that was really to resize our presence in Japan from – principally from a support standpoint to be more commensurate with the size of the market opportunity there.

As it relates to Embedded Processing, we did discuss that we were, in some cases, reducing investments or discontinuing on some areas that were no longer showing growth opportunities, in other cases reallocating. And that affected our Processor side as well as our Microcontroller side to a lesser degree in Embedded Processing. Beyond those, there's no other actions that we've taken or intend to take that we discussed right now.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay, Blayne, thanks for your questions. I'm glad you were able to circle back in. And let's move to the next caller.

Operator: We move to Timothy Arcuri with Cowen and Company.

<Q – Tim Arcuri – Cowen & Co. LLC>: Hi, thanks. Can you just talk about, from a big-picture perspective, can you – I don't know if you try to segment out how much of your revenue is directly related to Internet of Things, but can you try to give us some sense of the percentage of the revenue that's related to IoT, what with a large semiconductor company actually creating that as an independent segment? Thanks.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Boy, Tim, we really don't. And, frankly, we shun all the hype that's around the term Internet of Things. I think if you look at our capability and market position, it probably is second to none. If you look across processors, microcontrollers that are just inherent in connecting the world, combine that with our connectivity capability, whether WiFi, Bluetooth, ZigBee, those types of capabilities that we have in our

Embedded business as well, that potential to then go pursue that opportunity of connecting lots of different things, I think, is probably second to none.

But that being said, as soon as the world goes and puts a big label on it and tries to calculate how much everybody has and this and that, that's really not what we're interested in. We love the diversity of what you're calling Internet of Things, meaning it's lots of different applications; they had different requirements that are across different customers. The idea of somehow circling it up into a common end market or whatever, we think is probably the wrong approach, just because there's not that much in common there from a technology standpoint or from a customer or an end market standpoint. But, again, we'll just try to stay away from the hype. We'll keep our heads down and go attack that opportunity.

Did you have a follow-on, Tim?

<Q – Tim Arcuri – Cowen & Co. LLC>: I did, actually, yeah. And I – sorry, I actually jumped on late; you might have already talked about this. But can you address sort of channel inventory, either your inventory and also inventory in the channel, and also maybe remind us of what normal seasonal is for Q3? Thanks.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay. We did hit on some of those things. I'll say channel inventory for TI we described as less than 5 and a half weeks, really unchanged from where it's been for some time now. And I would just say if you look more broadly, we think inventory – we would characterize that as lean. We would characterize customer inventory as lean. Maybe one of the best data points is cancellations from customers are incredibly low right now. And we think that reflects a combination of lean inventories as well as the growing demand environment that we're in. But I think both of the other pieces there we did address already.

Okay, Tim, thanks for your questions. We'll move to the next caller, please.

Operator: We move to Jim Covello with Goldman Sachs.

<Q – Jim Covello – Goldman Sachs & Co.>: – lot for taking the question. I appreciate it. I'm going to just ask one with no follow-ups, since a lot of good questions have been asked. You guys had broken out, as you usually do, your segments at the beginning of the year in terms of end market exposure, and I think it was 37%, was consumer. Kind of longer-term question: Is that a number you're comfortable with, or is that a number that you'd like to see decline over time through market share growth in other segments? Obviously consumer, I don't think, has grown as fast on a revenue basis as some of the other markets over time, because of pricing pressure and such there. So just a little perspective on where you'd like to see that number three years from now. Thanks a lot.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay. Thanks, Jim, and that's a good question. So let me do a couple things. I'll also give a little bit of the color of what happened in the quarter by end market, because nobody has asked that question. But, very clearly, we do talk about the one end market being personal electronics. And, in 2013, that was 37% of our revenue. That is not what you would historically or typically think of as consumer, though. It does have products like gaming products in there. It has television in there, set-top box. But it also includes mobile phones, notebook computers, printers, and also things like tablets. And so it will go down between 2013 and 2014, largely because of our exit from legacy wireless. So most of that revenue would have been shipping into the personal electronics space.

But, again, don't – and I've had a number of questions from analysts over the last few months that implied a lot of people think of personal electronics as consumer. It's not. It's, again, mobile phones, notebooks and that space as well. They do tend to be consumer buying decisions as opposed to enterprise, but they're not what you've typically thought of in the past as consumer electronics.

So I think in the prepared remarks, we gave a top-level overview of what drove revenue from a year ago, and maybe I can give a little more granularity on that. So I think we talked about communications equipment being the highest contributor of growth from a year ago. That very clearly tied to wireless infrastructure.

Next we said industrial. Interestingly, industrial, if you go out to our website, we break that down into multiple sectors, something like 12, 15 different sectors below that industrial level. Pretty much all of them were up in that year-on-year comparison, with most of them up at a double-digit growth level, so good strength and broad strength in industrial.

Automotive, similarly. If you go look at the sectors on our website, all of them were up. Infotainment products were the strongest, but all of the sectors inside automotive were up.

Enterprise systems, we said, were about even for TI, and that really is a combination of growth in projector revenue, which again is primarily DLP for TI, offset by declines in servers.

And then the last area which we started off with on personal electronics, it was down, but it was down pretty much only due to legacy wireless. If you would have excluded the legacy wireless revenue out of that comparison, then personal electronics would have been about even from a year ago. So, again, that's just a little more color of what happened inside there.

Jim, thank you for your questions, and let's move to the next caller.

Operator: We move to Vivek Arya with Bank of America Merrill Lynch.

<Q – Vivek Arya – Bank of America Merrill Lynch>: Thank you for taking my question. When I look at your first-half growth in Analog and Embedded, I think it's almost 13%, 14% year on year. Very strong, well above what we have seen from most of the peer group so far. Are you worried at all about double ordering, anything that suggests that trends could tail off in the second half? Do you have enough visibility in the second half, whether it would be roughly seasonal? Anything that suggests that the trends are sustainable versus not?

<A – Ron Slaymaker – Texas Instruments Incorporated>: I'll make a couple comments and, Kevin, if you have anything to add, certainly jump in. Vivek, we're not seeing, at this point, signs of that kind of overheated market. Typically that comes along with crazy expedites and things like that that, frankly, we just didn't see in the quarter. We saw customers giving us good visibility into their needs. We've been shipping at the lead times that we've been quoting them, and our lead times have been stable. So, in that environment, typically, there's no need for customers to start that double-ordering process that you mentioned. So, again, we really see no signs of that taking place.

In terms of visibility in the second half, again, we've got customers for the most part trying to give us visibility into their needs, but I would really not say we – I would not want to try to provide any specific comments about second-half visibility at this point.

Kevin, do you have any other comments?

<A – Kevin March – Texas Instruments Incorporated>: Not much different than what you're saying. I would – just looking over the numbers here, Vivek, to your point, we did have 13% year-over-year growth in first quarter when you combine Analog and Embedded Processing. That's up just a bit from last quarter when it was up 12% year over year. And up a little bit from the prior quarter, when it was up 7% year over year. What we're actually seeing is a slight acceleration in that to, it looks like, the low teens. And that's probably consistent with what we talked about at the last earnings release, when we said that we felt 2014 was shaping up to be a better year than 2013. And I think this is just reinforcing that.

And the big differences that we see is that in 2014, it appears the U.S. economy is attempting to grow at a faster pace than it has in the last few years. In 2014 for the first time in a number of years, you're seeing Europe begin to grow rather than shrink. And you continue to see growth broadly across Asia, albeit at a slightly slower rate, still growing quite strongly. So I think what we're really seeing here is the results of an improving broader economy and our efforts at trying to gain market share inside those spaces, combined are resulting in nice growth for TI. And as Ron said for the second half, we'll give you that forecast – or at least the first part of that forecast – in about 90 days.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Vivek, maybe the other thing I would just add real quick is you see our inventory numbers. We have good, healthy inventory. It's not getting drawn down. And, again, if customers were worried about supply from Texas Instruments, you would see probably some impact on those type metrics, and yet we don't right now.

Did you have a follow-on, Vivek?

<Q – Vivek Arya – Bank of America Merrill Lynch>: Yeah, thanks; thanks for answering that first question. You guys are the largest player in this space. It's very encouraging to see the kind of trends that you're reporting. As my follow-up question -just probably more a math question – but at what revenue level would underutilization charges be behind you? Or, asked in a different way, if you're saying you have installed capacity of $18 billion and your currency is at about, I don't know, say $13 billion, will we continue to see underutilization charges until you use all of your installed capacity? Or how should we think about that underutilization charge number that you report every quarter in relation to the amount of installed capacity that you have? And then, obviously, the implications on how we should model your gross margins going forward?

<A – Kevin March – Texas Instruments Incorporated>: Yeah, Vivek, I would suggest you think about it the way we do and the way most of our investors that we speak with seem to think about it, and that is not what is the underutilization capacity or the current-period gross profit margin or next-period gross profit margin, but what's the total free cash flow that we can generate with that available capacity? And what's the cheapest way to bring that capacity in house so that we can maximize cash flow going forward? And that's exactly how we think about it.

So, frankly, we do not focus on trying to figure out how to get the utilization charge down to zero. In fact, by definition, with our stated strategy of buying capacity opportunistically when we don't need it and prices are relatively low, that by definition means that we will always will have open capacity, and therefore will always be underutilized in the classic sense. But from a cash flow standpoint, when we do the math and the trade-off on that – and the last few years have certainly proven it out – we generate a heck of a lot more cash flow with that kind of behavior than we would if we focused purely on maximized utilization, which puts us at the risk of buying capacity at too expensive a price. So that's really the way we look at it, and I'd offer that you maybe think about it on a longer-term view like that as opposed to trying to model in near-term GPM percent swings and utilization swings.

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

Operator: We move to Stacy Rasgon with Sanford Bernstein.

<Q – Stacy Rasgon – Sanford C. Bernstein & Co. LLC>: Hey, guys, thanks for taking my question. I apologize if this has been covered. I hopped on a little late. But when I'm looking at your guidance for next quarter and I'm backing into sort of the implication for gross margin, I'm getting something that's reasonably close to 57%. It's almost 300 basis points increase. I think you'd mentioned higher revenue. I think you'd also talked about the six-inch fab closures. My understanding was those fab closures, though, were already in the numbers. Is this something that happened like as a lump improvement this quarter? Or any color you can give us on, I guess, the relative impact of drivers – revenue, cost savings, and mix – would be very helpful. And I guess just some indication of whether that 57% number is something that you guys actually are thinking for next quarter?

<A – Kevin March – Texas Instruments Incorporated>: Yeah, Stacy. On the margins, clearly they're going to be up, and they're going to be up quite a bit. And it's not dissimilar to what you saw a year ago. If you go to a year ago and take a look, you would have seen our gross margins from 1Q to 2Q increased in a similar manner. And, in part, that's just the natural effect of stepping up manufacturing production for a typically stronger second quarter versus one quarter. So if you take a look today on a year-over-year basis, your best way to think about it is it would continue to have improved product mix. A year ago, we still had wireless, and now we have virtually none. So it's mostly Analog and Embedded Processing. We have lower manufacturing costs versus a year ago. And, again, this is the Houston and Hiji factories now are completely out of the mix. And to a lesser extent we had some lower utilization charges, because in fact we are expecting revenue levels this 2Q to be higher than they were 2Q a year ago. And so that will take on a little bit more of our capacity. So there's a combination of things going on there. And the bottom line is is that, when you do the math, your gross margins are going to be stepping up rather nicely, as you just suggested.

<Q – Stacy Rasgon – Sanford C. Bernstein & Co. LLC>: Got it. And I guess to follow up on that same trend, presumably you'll continue to have higher revenues year over year than you had last year and you're sitting now – I think it's close to 600 basis points higher than you were last year. Does this mean that you could actually maybe even have visibility into the ballpark of 60% exiting the year and going in 2015? Is that something that you guys – I don't know if you guys think internally about gross margin targets anymore. But that's something that – is that something that could be actually be plausible at this point?

<A – Kevin March – Texas Instruments Incorporated>: Well, Stacy, I would say that a lot of numbers are plausible. We don't really spend time thinking or looking at it in that context. We spend, again, more time thinking in context of, are we taking steps that are going to maximize our free cash flow on a continuous basis? And, in doing that, then GPM just tends to fall out. So, from that standpoint, there's nothing structural that stops us from getting higher GPMs as we move forward. In fact, if we continue to be successful as we have been in increasing our Analog and Embedded Processing mix, at the same time of keeping very low-cost manufacturing underneath that mix, then clearly our margins not only are benefiting, as you're computing now, but will continue to benefit as we look into the future.

<A – Ron Slaymaker – Texas Instruments Incorporated>: Okay, Stacy. Thanks for your questions. And, operator, I think we have time for one final caller.

Operator: We'll move to Tore Svanberg with Stifel Nicolaus.

<Q – Erik Rasmussen – Stifel, Nicolaus & Co., Inc.>: Yeah, hi. It's Erik Rasmussen calling in for Tore. I appreciate you just getting me in here. I know lots been talked about the restructuring. But maybe just can you just talk about progress on the Embedded Processing business and boosting those operating margins there? I know last quarter, looked like just some outperformance, and the margins were up. But is there a target that you're shooting for internally? Is there something that you can maybe tell us for year-end and maybe help us measure the progress there?

<A – Kevin March – Texas Instruments Incorporated>: Yeah, Erik. I think the way to think about the Embedded Processing is that, again, we've been seeing some nice growth in that business. I think it's, if I recall, six quarters of year-over-year growth going on in that business. So we're beginning to see the payoff of prior investments result in real revenue growth. And that growth is in the right areas. I mean, it's where we've got sustainable product revenue streams and very attractive margins. Consequently, we're seeing profit margins beginning to improve rather nicely, and that's even before we see the benefit of the restructuring actions that we talked about for Embedded Processing.

That's not to say that we're done. There's still quite a bit more work to be done. But most importantly, what that business is focusing on is growing into its inherent cost base. And so, more growth is what's going to be really important there. And, clearly, at its current operating profit levels, it's not anywhere near what we think it could take us to. I won't go beyond that on forecasting what margins might be, but I think you know from how we operate the business here, we're focused on free cash flow, which means you've got to have some attractive margins in there, and this business still has quite a bit of work to do to get to where we expect entitlement is.

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

<Q – Erik Rasmussen – Stifel, Nicolaus & Co., Inc.>: Yeah, great; thanks for that. Yeah, CapEx, maybe. Where do you see your investments being focused? How do you plan on allocating your CapEx, I guess over the next 12 months? Thank you.

<A – Kevin March – Texas Instruments Incorporated>: Erik, we did announce that with the 1Q earnings – or, excuse me, with the 4Q earnings release that we had just acquired an assembly test site in Chengdu, China. And we will be spending money on that in 2014, bringing that building up to our standards and bringing the production line up and ready for output the second half or late this year. So the majority of our CapEx will tend to go toward our assembly and test operations, given that we already have significant capacity in our wafer fab operations.

Ron Slaymaker, Vice President, Head of Investor Relations

Okay, great, Erik. Thank you for your questions, and we're going to wrap at this point. Thank you for joining us. A replay of this call is available on our website. Good evening.

Operator: This concludes our conference. Thank you for your participation.