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PRESENTATION

Operator

Good day, and welcome to the Texas Instruments 2Q '20 Earnings Release Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Dave Pahl. Please go ahead, sir.

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

Thank you. And good afternoon, and thank you for joining our second quarter 2020 earnings conference call. For any of you who missed the release, you can find it on our website at ti.com/ir. This call is being broadcast live over the web and can be accessed through our website. A replay will be available through the web.

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

Our Chief Financial Officer Rafael Lizardi is with me today, and we'll provide the following updates. First, I'll start with a reminder of the framework we described during the April earnings call for how we'll navigate the COVID-19 economy. Next, I'll provide insight into the second quarter revenue results with more details than usual by end market, including sequential performance since it's more informative at this time. And lastly, Rafael will cover financial results, some insight into one-time items and our guidance for the third quarter.

During the April call, we explained that we will use our three ambitions to drive our decisions as they are particularly helpful in uncertain times like we face with COVID-19. For decades, these ambitions have driven all decisions inside TI. They are: to act like owners who will own the company for decades; secondly, to adapt and succeed in a world that's ever changing; and third, to be a company that you're proud to be a part of and will be proud to have as a neighbor. When we pursue these ambitions, our employees, customers, communities and owners will all benefit.

While second quarter did not experience the depth of the decline we saw in the 2008 financial crisis, nonetheless, we remain cautious on how the economy might behave over the next few years.

As a reminder, in April, we provided a broader framework to help you understand how we'll operate through this environment. First, we will maintain high optionality with our operating plan so we can support customers, particularly during a time when their ability to forecast will be limited. Next, we'll maintain investments in R&D and in new capabilities like those for TI.com since they're five- to 10-year time horizon decisions and critical to building TI stronger. And finally, we will invest to ensure long-term manufacturing capacity, particularly for the 2022 to '25 time frame.

Making decisions with our ambitions in mind will continue to serve us well. And that, coupled with the framework I just mentioned, should help you understand our actions. We are particularly pleased with our decision to maintain an operating plan that allowed us to maximize our optionality. During the second quarter, we were able to respond to unforecasted demand. We will continue to maintain this posture in the third quarter.



Moving on, I will now provide some insight into our second quarter revenue. There are several key points that summarize what we're seeing in the market.

First, overall, the weakness was primarily from the automotive market. Automotive was down about 40% sequentially and down over 40% compared to a year ago. To help appreciate this impact, excluding automotive, TI was up 8% sequentially and down 3% versus a year ago. The automotive market appears to have bottomed in May as North American and European assembly plants resumed operations.

Next, the industrial market was up about 2% sequentially and also up 2% from a year ago. There are end markets that are weak and others that are understandably strong, like medical. We do believe that some customers are trying to maintain strong inventory positions to limit exposure to any supply chain disruptions.

Personal electronics was up over 20% sequentially and up about 10% compared to a year ago. This can best be explained by work-from-home trends and TI being in a position to support unforecasted demand in the second quarter.

Next, communications equipment was up 20% sequentially but down 15% compared to a year ago. Within this market, it's important to note that Analog achieved sequential and year-over-year growth, while Embedded was down in both comparisons, following our planned decline in this portion of the business.

Enterprise systems was up sequentially and year over year. This strength, similar to personal electronics, is best explained by work-from-home trends and TI being positioned to support unforecasted demand.

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

Rafael R. Lizardi *Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO*

Thanks, Dave, and good afternoon, everyone. Second quarter revenue was \$3.2 billion, down 12% from a year ago. Gross profit in the quarter was \$2.1 billion, or 64% of revenue. From a year ago, gross profit decreased due to lower revenue, and gross profit margin was even.

Operating expenses in the quarter were \$780 million, down 4% from a year ago and about as expected. On a trailing 12-month basis, operating expenses were 23% of revenue. Over the last 12 months, we have invested \$1.5 billion in R&D.

Operating profit was \$1.2 billion in the quarter, or 38% of revenue. Operating profit was down 18% from the year-ago quarter.

Net income in the second quarter was \$1.4 billion, or \$1.48 per share, which included a \$0.33 benefit primarily for tax-related items that were not in our prior outlook. The benefit included \$0.02 of restructuring charges to strengthen our Embedded business by focusing investments on the best opportunities for long-term growth.

Let me now comment on our capital management results, starting with our cash generation.

Cash flow from operations was \$1.7 billion in the quarter. Capital expenditures were \$130 million in the quarter. Free cash flow on a trailing 12-month basis was \$5.7 billion.

In the quarter, we paid \$823 million in dividends and repurchased \$882 million of our stock for a total return to owners of \$1.7 billion. In total, we have returned \$6.7 billion in the past 12 months, consistent with our strategy to return all free cash flow. Over the same period, our dividends represented 56% of free cash flow, underscoring their sustainability.

Our balance sheet remains strong with \$5 billion of cash and short-term investments at the end of the second quarter. In the quarter, we issued \$750 million of debt with a coupon of 1.75% due in 10 years. This resulted in total debt of \$6.8 billion, with a weighted average



coupon of 2.77%. We have repaid \$500 million of debt due in the second quarter, and we have no further debt due this year. We have \$550 million of debt due in 2021.

Regarding inventory, TI inventory dollars were up \$133 million from first quarter, and days were 166, about as expected. Distribution-owned inventory declined again in second quarter by about \$150 million, the seventh consecutive quarter of planned reductions as we continued the transition to have fewer distributors and bring more customers direct. Tactically and strategically, we are pleased. We have held total inventory dollars steady while increasing the percent of inventory held inside TI and therefore in fewer places. This enables us to continue to maintain short lead times and high availability to meet unforecasted customer demand.

For the third quarter, we expect TI revenue in the range of \$3.26 billion to \$3.54 billion and earnings per share to be in the range of \$1.14 to \$1.34.

Regarding our factory operating plan, as we have stated, we will maintain high optionality so we can continue to support customers' demand, particularly during a time when their ability to forecast may continue to be limited. We have informed our customers that lead times on our products remain short, and more than 40,000 products are available for immediate shipment on TI.com. Short lead times and high availability are important capabilities that allow us to continue to support our customers' near-term and unforecasted demand. Our product portfolio of mostly long-lived parts afford us to have a steady hand, and therefore, we will take a similar approach to our factory operating plan again in third quarter.

In closing, we continue to invest to strengthen our competitive advantages and in making our business stronger. History has shown us that it is in times like these when we can make the most strategic progress.

With that, let me turn it back to Dave.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Stacy Rasgon with Bernstein Research.

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

First question I have, you still mentioned that you think some of your industrial customers are trying to build, I guess, inventories and making sure that their own position is still strong. But if your lead times are short and you're building -- you have 40,000 products that are ready to ship, why would any of your customers actually have any need to pre-buy anything? And if so, do you think what you're seeing right now is maybe just more indicative of what the actual end demand state might look like? Like how do we square that circle?

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Yes, Stacy, it's a good question. I think as we've talked about last quarter, we saw some unusual order patterns as we talked about revenue running up really strong into March and things abating. They certainly didn't abate as we thought that they would. We saw supply constraints across the industry. And sometimes, as customers' orders -- as they look at building inventory, our visibility ends at their dock when we ship them products. So they may decide to build some finished good inventory, so we don't have visibility into that. So that's really not a number that we can look into a system to provide us that. It's really just more instinct and experience and also just talking to our field teams and getting input from that standpoint. So that's -- when we look at the numbers, that's what it's telling us.

Rafael R. Lizardi Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO

Yes, Stacy, just to add to that, a few comments. One, out of our 100,000 or so customers, I would guess 70,000 to 80,000 of those are in industrial, right? So it's frankly just difficult to draw conclusions with such a huge number of customers that have different idiosyncrasies in the way they behave. The other thing I would tell you is that if I'm a purchasing manager of one of these customers and I'm ordering

200 different parts for our board, are they really going to treat certain suppliers a little differently than others if they decided to build inventory to stock up and feel safer? Probably not, right? So that's another dynamic that maybe you should take into account.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

And not in all cases, right?

Rafael R. Lizardi Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO

Right.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Not in all cases. So there's probably some of that, and that's just the caution that we provide. You have a follow-up, Stacy?

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

Yes. I guess just to follow up on that a little bit, so if I look at kind of the trajectory you've had over the last few quarters, Q1, you were above seasonal; Q2 ex auto, you were above seasonal; your Q3 guide is kind of at the low end of the seasonal but kind of roughly. I mean so far, like at least outside of auto, it doesn't seem like the pandemic is having any real impact on you at all. I just find it a little surprising. I mean what are you hearing from your customers, if anything, as to that effect in terms of what they're seeing and the impact that the pandemic is having on the supply chain because as far as I can tell, it's not having much impact on you at all? I guess it's good.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Well, I'll remind you that the number we've turned in was down 12%, right? So...

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

Yes. But it was up 8% ex auto, right?

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Correct. Yes. And unfortunately, we have to report the numbers with auto in, so that is the reality. Auto was down 40%, so that is real. And the auto manufacturers closed down because of COVID, so I wouldn't quite go so far to say that it didn't have an impact.

And if you look inside of that, you saw strength in some areas like the work-from-home trends, like PCs and tablets and servers from the inside of enterprise, right? So we're seeing some strength that's due to that, which is also driving that. So there's some things that are moving around that we saw. And the other thing that I'd -- if you look longer term, when we -- as we entered the year, as you know, I think we described back in January that we were seeing signs of stabilization with the fourth quarter results. As we had worked our way through the bottom of the cycle, we're starting to see those signs of stabilization. Now with those signs of stabilization, again, we just turned in a down 12% overall.

So those are the results, and we do have to report the numbers all in. But I think it is important we wanted to give the color of auto because that was the driver of the weakness from a year ago. So thanks, Stacy.

Operator

We'll hear now from Vivek Arya with Bank of America.

Vivek Arya BofA Merrill Lynch, Research Division - Director

I wanted to actually pick up from that point on automotive. I'm curious, Rafael or Dave, what you are expecting your automotive business to do in Q3 because when I look at your auto sales, I think you mentioned down over 40%. They are kind of in line with units. And I know just picking on one quarter is not representative of the trend, but some of your auto peers have said they benefited from content growth and so forth. So my question is what do you think about just the broader automotive market heading into Q3? And do you think you can start to get back to a point where you get some content growth on top of whatever unit recovery that we might see?

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Yes. Yes, Vivek. I think that's a great clarification. So obviously, what we're reporting is just our shipments. When factories close, they stop taking product. You know that for our revenues overall, a large portion of our revenues overall are on consignment. So there's not inventory sitting between us and those manufacturing lines. In general, I described the automotive market as being a more mature supply chain. So those supply chains will react faster than, let's say, an industrial supply chain would perhaps. And so when those factories open back on, they begin to pull those units.

So we won't try to predict what the overall market is going to do. We can measure when customers are pulling that demand. Our confidence in content growth three and five years from now in automobiles remains very high. And -- but just try to draw the dots of a cyclical recovery, we just won't spend time trying to do that. So do you have a follow-on?

Vivek Arya BofA Merrill Lynch, Research Division - Director

Yes. So on the factory plan, I recall, Rafael, you mentioned that you expect your factory plan in Q3 to be the same as Q2. And we saw inventory go up in Q2. What do you think your inventory levels will do in Q3? And what I'm trying to do is try to align -- your Q3 guidance seems to be seasonal as was asked before. Even the range of outlook seems to be very in line with normal guidance. But your commentary seems to be more conservative. Certainly, visibility on the macro side seems to be a little more difficult. So I'm just trying to get a better sense for what does your plan for production in Q3 tell us about your visibility onto your end customers and the level of demand?

Rafael R. Lizardi Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO

Yes. No, sure. First, a couple of things. First, the environment continues to be uncertain. So I want to make sure that's clear. And we remain cautious how this economy will behave for the next several years, okay? So that is very, very important. That is part of the way we're looking at this.

At the same time, we want to keep our optionality, maximize our optionality. And what that means is be able to meet unforecasted demand from our customers, like we just did in second quarter. And we plan to continue that in third quarter and beyond. The reason we can do that, strategically, we're just very well-positioned. The parts that we sell are -- tend to be -- the majority of them catalog parts, they sell to many, many customers, that last a long, long time. So if we end up building inventory, that inventory is not going to go bad. We don't have to scrap it. So that plays very well in our favor. Essentially, it's a very asymmetrical bet that we're making, where the upside is really high, the downside is limited. So we're going to continue operating that way.

Operator

We'll hear now from Toshiya Hari with Goldman Sachs.

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

And congrats on the execution. I just wanted to go back to performance, your performance by segment. Obviously, in Q2, it was a significant beat in terms of revenue. And Dave, thanks very much for giving color on a sequential basis and a year-over-year basis. But relative to what you were thinking internally, where did the beat come from? Was it broad-based, or was it focused in one or two businesses?

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Well, I think that, in general, if you look at the areas of strength that we had, and certainly in areas that were driven by the work from home, the PCs, tablets, the servers, those were areas that we saw strength. Automotive, obviously, when things shut down, they shut down. And that was -- had turned off pretty much like a light switch as the numbers would show. And I think that inside of industrial, you've got the numbers of down -- or the 2% or so from a transition standpoint. So yes, definitely the strength that we saw we had in the work-from-home areas. Do you have a follow-on?

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

I do. As you guys know, M&A is clearly topical in the group right now. And Rafael, I was just hoping you can remind us what sort of the criteria is when it comes to M&A for you guys at TI. And sort of a two-part question, is it fair to say that your posture is a little bit more



conservative or cautious, given the current macro and geopolitical backdrop as well as where evaluations lie? Or is it pretty much business as usual for you guys on the M&A front?

Rafael R. Lizardi *Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO*

Yes. No, that's a good question. And it's interesting the way you framed it. So let me first remind everybody our framework, and any acquisition that we consider needs to meet two criteria. The first, it needs to be a good strategic fit. So that means an analog company with catalog parts, differentiated parts that then go into auto and industrial because that's where we focus, that's where the content growth is happening and that would align well with our strategy.

But the next piece is that the price needs to make sense. And that is after -- once you make the purchase, in three, four, five years, are you meeting the cost of capital? Are you beating the cost of capital? And think of it on a cash-on-cash standpoint. I invest \$100 and my cost of capital is 10%. When am I going to get \$10 after-tax on that investment? Can I beat that \$10 and get \$15 or \$20 over time? So that's our criteria. That's the one we've had for many years, and we continue to have it.

On your second part of your question, are we more -- are we conservative? Frankly, in an environment like we're going through today, it's a great time to make the most of opportunities. So we're not conservative. We're following the same framework that we have followed. And based on that framework, we evaluate M&A opportunities. But more importantly, we're continuing to invest internally. We're making our competitive advantages stronger. We continue to invest in R&D. We haven't scaled back that at all. We continue to invest in things like TI.com and our reach of market channels. And of course, our manufacturing and technology, where we are -- we broke ground on the new facility, the new -- the second RFAB in Richardson. And we're going to be investing to have that building ready over the next 18 to 24 months. So we continue to do that to strengthen the company, and now is a great time to do it. We're very well-positioned from a balance sheet standpoint, from a P&L, a free cash flow standpoint, a lot better than our competitors. So that's -- it's a good time to take advantage of that.

Operator

We'll hear from Ross Seymore with Deutsche Bank.

Ross Clark Seymore *Deutsche Bank AG, Research Division - MD*

And congrats on the strong results. I wanted to go into the source of the upside that Dave and Rafael, you guys talked about. The work-from-home side, I think everybody understands why that was better. But the big question that's still outstanding to me is the sustainability of that. So can you just talk about the upside surprise? Do you think it's sustainable? I know you're not guiding by end markets, you never do. But how do you envision the second half of the year in those same areas that upsid?

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

Yes. Ross, I think that when we look at our business longer term, we look at where we're investing for growth. Industrial and automotive is where the investments go, especially industrial. That's where we expect growth to be when we look at three- and five- and 10-year growth, perhaps for the next couple of decades. So we believe that growth is very sustainable, and that's really where we're focused. I'll say that some of the growth that we're seeing is due, because of the optionality that Rafael talked about. We've recently updated our customers. We've got 40,000 products that we have immediate availability on today. So if that demand is sustainable in the second half, we've got the products available to ship into any of those, any of our markets overall in the short term. But our long-term prospects, I think, are really what's more important. Do you have a follow-on?

Ross Clark Seymore *Deutsche Bank AG, Research Division - MD*

I do. I wanted to switch over to the two product segments, two main ones, Analog and Embedded. I just wanted to see if there's any update on your views on the Embedded side. I know you said there was a little bit of a restructuring built into that \$0.33 gain, I guess, as a little bit of an offset. But the big picture question is you're now down to the lowest percentage of sales Embedded has been since, at least in my model, like 2012. And the year-over-year decline is so much larger than the Analog side. So can you just talk a little bit about when do you think that business bottoms out? What sort of restructuring needs to be done? And then do you think that business is a growth driver over time for the company? Or is it something that we should just envision as remaining a much smaller part of the company than it once was?



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

Yes. I think when we look at the Embedded business, the embedded market, as we've talked about before, it shares many of the attributes that the analog market does. And we believe that it will be -- it has been and will continue to be a contributor to free cash flow growth. When you look at that business and look at the share gains that it's had, look at '16, '17 and really the better part of '18, it has had -- it's had share gains. It gave some of that back in '19, of course.

So -- but here, more recently, we talked about last quarter, you saw some sequential growth out of that business all in. We talked about the fact that without auto, you would have seen sequential growth in that business this quarter. So I think we're seeing the signs of stabilization inside of that business. So we have taken actions to strengthen that business. Once you dive into that, we've got, across Microcontrollers and Processors, there's eight businesses. Three of them, actually we've increased resources. Two of them, we've actually decreased the resources. And three of them have stayed about the same. So that's portfolio management that you've seen us take across our businesses over the years. So we do believe that, that business will be a contributor to free cash flow. So there's a lot of work going on to ensure that it is. So okay. Thank you very much, Ross.

Operator

We'll hear from Chris Danely with Citi.

Christopher Brett Danely *Citigroup Inc., Research Division - MD & Analyst*

Dave, I think you mentioned that you thought there's some inventory build out there. I believe you said it was just in industrial. Can you give us a sense of how much you think that helped? And what gives you confidence it's not occurring in any other product lines? And did you guys notice anything, any kind of strength by certain geographies out there?

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

Yes, Chris. You know that you've heard us talk, you've heard me say multiple times in the past that I've joked that I've never once taken a double order in order to -- for an inventory build. And obviously, customers don't mark it that way when they send an order in. So that is something that we can't see. As I've talked about before, with 60%, 65% of our revenue on consignment, we don't have inventory of our product sitting in front of the manufacturing line, so our visibility ends right there. So we don't have a system that tells us if customers are building inventory. But just when you look at the numbers and you look at the strength and you add things up, that's what our intuition tells us. So we're just mindful of that. We think it's important just to point that out. So could it be in other areas? It could be, but our belief is it's not significant, but we think it's important to point it out.

Rafael R. Lizardi *Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO*

Yes. And let me just add to that, on your -- your question was on the customer side. Let me remind you on the distribution side where we do have visibility. We drain \$150 million of distributor-owned inventory. That's on top of the \$50 million we drained last quarter. So, so far year-to-date, it's \$200 million. And we think we'll be able to drain another \$150 million or so for the rest of the year. So we'll probably end up draining \$350 million or so of inventory. And that makes a lot of sense just given the changes in distribution that we're making. We're bringing more customers direct. So then we can control -- that inventory will be on, essentially, on our balance sheet as we build more inventory on our balance sheet, so we can support those customers direct.

The other comment I'll make regarding that, that given that drain, now we only have about three weeks of inventory in the disty channel, down about a week from the prior quarter. But I will tell you that, that metric is already less meaningful than it was before. And it will continue to be less meaningful as we make that distribution channel smaller over time. So -- but I just wanted to give the data points so you have it. Do you have a follow-up, Chris?

Christopher Brett Danely *Citigroup Inc., Research Division - MD & Analyst*

So it's on that last statement. So you said that you've got three weeks of inventory in the disty channel. I guess if we look at your days of inventory right now, it's 170. It's, I mean, your balance looks like the Fed's from a first glance. Should we expect this to be the new normal going forward, like right around 170 days? Or should this be the same sort of dollar level? Or I guess, what should we sort of calibrate our models to for inventory going forward at TI?

Rafael R. Lizardi *Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO*

Yes. Well, a few comments. One is, as I just said, the distribution-owned inventory, we've been draining for seven quarters in a row. So if you look at the entire ecosystem, right, including the distribution inventory, plus our inventory, over the last couple of years, probably seven, eight quarters, is relatively flat, right? So you have to -- I think it makes sense. We think it makes sense to think about it that way.

And then the other angle, as I mentioned earlier and we talked about in our prepared remarks, is the great optionality that having that inventory gives us. And we just showed that in second quarter. And we'll continue to do it because it is an asymmetric bet that having that inventory, there's a working capital cost associated with that, but the scrap risk from that is really, really low. Yet the potential upside of serving our customers well with very low lead times, in many cases, as we said, immediate availability, we think that, longer term, is something the customers do and will continue to appreciate.

Operator

We'll take our next question from Ambrish Srivastava from BMO.

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

Dave, I apologize for the background noise. Economic activity is humming around where I live. Gross margin, the quarter margin was much higher than what a normal fall-through model would suggest. So I was wondering, is it just a factor of how low Embedded is, and that's the mix that's contributing to the gross margin being so strong this quarter? Or is there something else going on because your utilization was flat quarter-to-quarter end?

Rafael R. Lizardi *Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO*

Yes. What I would tell you, it's -- as we have guided for many years, you should think of revenue coming in and out at 70% to 75%. That's a good guide to use over the entire cycle. Of course, any one quarter could be a little more or a little less. And then over the longer term, of course, 300-millimeter and continuing to add revenue on 300-millimeter has a structural cost advantage that helps our margin just continue to be a tailwind on margins, has been and will continue to be.

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

Do you have a follow-on, Ambrish?

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

Yes. I did. Back to Microcontrollers, Embedded, now that you have been looking at the data, and I'm sure you've been looking at it before, but is there a -- and it's good to see that stabilizing and you're seeing some signs of stabilization, especially how low it is. Is there some insight you could provide us between the Connected and the Processors side that would help explain the divergence that we have seen from the overall Analog over the last -- not three years as you were just pointing out first? If we look back at three years, only in the last six or seven quarters has it really been diverging from the industry.

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

Yes. There's not that much difference in the trend between Microcontrollers and the Processors business. And really, if you look at the longer trend line, and that's really what -- share doesn't move around quickly inside of those businesses, whether it's Analog or Embedded overall and then if you drop down into Microcontrollers or Processors. So again, if you look at kind of '16 or '17 and the three quarters of '18, those businesses really did have a real strong track record of share gains. And the deterioration began to happen in '19, where it gave some of that back. So again, we're taking the actions to strengthen that business. We believe that what we're doing will get that business performing and having it be a strong contributor to free cash flow. So thank you, Ambrish.

Operator

We'll take our next question from William Stein with SunTrust.

William Stein *SunTrust Robinson Humphrey, Inc., Research Division - MD*

There's a very slow-moving, but I think long-term, relatively meaningful risk as it relates to China trying to develop a domestic, strong semiconductor capability. Some might argue that given the current state of affairs, both economically and politically, that perhaps there

could be some acceleration in that regard recently. And I'm hoping you might update us as to what you are seeing from this competitive threat.

Rafael R. Lizardi *Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO*

Yes. So just to give you some thoughts on that. We think of that in a way similar as we think of our competitors, meaning that our competitive advantages put us in a good place to compete against our American or European competitors just as well as the Chinese. And having, one, our own manufacturing with 300-millimeter, that puts us -- gives us a structural cost advantage. The other one is the broadest portfolio in the industry, close to 100,000 different parts. And that's particularly relevant with industrial and automotive, where in the case of industrial, for example, there are probably 80,000 different customers, right? So you want to be able to have the entire suite of parts in the Analog space and Embedded space. It makes it more likely that they will buy from you. It makes the investment on the sales side more worthwhile and then with the diversity, diverse long-lived positions that, that results into. And partially, because of those advantages and the way that is structured, it's just difficult to go after that space, right?

So what we have seen, where companies in China, or really anywhere, where they first go after is the kind of vertical markets in places like memory or digital spaces that is frankly just easier to go after, easier to get revenue growing quickly, and then you can reinvest that and go from there. In the Analog space, with average prices in the \$0.30 to \$0.40. Embedded is higher than that, but not that much higher. It's just hard. And then the 80,000 different customers that you go after, the 100,000 different parts, is a daunting task, right? It's not impossible, so we're very respectful of that. And our job is to stay ahead of all our competitors no matter where they are, American, European, Asian. So we want to -- we continue to invest in that -- those advantages, in manufacturing, in the broad portfolio and a reach of channels to make that climb even harder every year. Do you have a follow-up?

William Stein *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Yes. I appreciate that answer. It sounds like there's no meaningful change recently in this threat relative to any others. I wanted to follow up on the distribution commentary around, I think, another \$150 million of inventory to go. When we think about the \$50 million, the \$150 million done in the quarter, and I think you said \$150 million left in the back half, should we think about that as proportional to the amount or to the percentage of distribution business that's going to transition this year? And is that still on track to finish by the end of the year?

Rafael R. Lizardi *Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO*

Yes. So it is on track to finish by the end of the year. And what happens there is by the end of the year, we're just going to have a much smaller distribution footprint, the number of distributors that we engage with. And at the same time, we have -- we will have transitioned a fair amount of customers to shipping direct. So then fewer distributors -- what's left of distribution will be with fewer distributors, the more of our revenue going direct, and that is, yes, I guess it is proportional to that drain of inventory that you're referring to.

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

But it also includes a reduction in inventory of the distributors that will be with us as well.

Rafael R. Lizardi *Texas Instruments Incorporated - Senior VP of Finance & Operations, CFO and CAO*

That is the -- but yes, I'm glad you mentioned that. So yes. So part of what that reduction is, is that the distributors that are going to -- that we're going to stay with, for the most part, they will be on full consignment. So anything that we sell with them, and there's a few exceptions in Japan, for example, but other than that, it will -- they will be in full consignment. So really, they're going to have zero owned inventory for the most part. So that is also reflected in the \$350 million.

So I think that was the last question. So let me just wrap up by summarizing what we have said previously. We will continue to invest in and strengthen our four competitive advantages, which are manufacturing and technology, portfolio breadth, market reach and diverse and long-lived products. We will also continue to pursue our three ambitions. We will act like owners who will own the company for decades. We will adapt in a world that's ever changing. And we will be a company that we are personally proud to be part of and would be proud to have as a neighbor. When we are successful, our employees, customers, communities and owners will all benefit. Thank you very much.

Operator

Thank you. And that does conclude today's conference. Thank you all for your participation. You may now disconnect.

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