Q1 2020 Earnings Call

Company Participants

- Dave Pahl, Head of Investor Relations
- Rafael Lizardi, Senior Vice President, Chief Financial Officer
- Rich Templeton, chairman, president and CEO

Other Participants

- Ambrish Srivastava, Analyst
- Chris Danely, Analyst
- Craig Hettenbach, Analyst
- Harlan Sur, Analyst
- John Pitzer, Analyst
- Mark Lipacis, Analyst
- Ross Seymore, Analyst
- Stacy Rasgon, Analyst
- Timothy Arcuri, Analyst
- Tore Svanberg, Analyst
- Toshiya Hari, Analyst
- Vivek Arya, Analyst

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Texas Instruments First Quarter 2020 Earnings Release Conference Call. Today's call is being recorded. At this time, I would like to hand things over to Mr. Dave Pahl. Please go ahead, sir.

Dave Pahl {BIO 18870833 <GO>}

Good afternoon, and thank you for joining our first 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.

Given the likelihood of a significant economic recession due to COVID-19, we're changing the format for this quarter's earnings call. In addition to Rafael Lizardi, our CFO, will be joined by Rich Templeton, our Chairman and CEO. Rich will be covering a broader frame of how we're approaching the current environment.

I will then provide a summary of first quarter and Rafael will wrap up with the financial details of first quarter and our outlook for the second quarter. Our prepared remarks will be longer than usual as we hope to cover a range of anticipated questions.

Let me turn it over to Rich.

Rich Templeton {BIO 1514128 <GO>}

Thanks, Dave. At the highest level to understand how we will approach the likely significant recession resulting from COVID-19, I remind you of the three ambitions that for decades have driven all decisions inside of TI. These ambitions are: first, we will act like owners, who will own the Company for decades. Second, we will adapt and succeed in the world that is ever-changing. And third, we will be a company that you are proud to be part of and would be proud to have as a neighbor. When we pursue these ambitions our employees, customers, communities and owners, will all benefit.

These guiding ambitions have served us well for decades, but they are enormously valuable in these times because they help simplify many decisions in an uncertain environment.

Like many companies in the COVID-19 crisis, we have acted aggressively, keeping our people safe and able to support their families. We have kept our operations running to support our customers with special emphasis on our medical customers. And in the communities where we operate around the world, we have provided direct financial support and medical supplies to provide some relief. The list of actions is lengthy

So starting with the economic framework. No two economic recessions are identical, but the 2008 financial crisis provides us the most recent significant recession, and therefore, is the best example to study and informed decisions on operating plans, revenue forecast, and investment and spending plans.

As a reminder, if you look back to 2008 and specifically to September of 2008, our new orders turned off overnight, this led to a 26% sequential drop of revenue in the fourth quarter of 2008, and additional 16% sequential decline in the first quarter of 2009 and then a rapid snapback for the next six quarters. By the second quarter of 2010 or within two years of the start of the sharp decline, revenue moved back above the level for the third quarter of 2008. For the benefit of hindsight, our customers overcorrected to the downside and we then spent a year and a half chasing back up to support demand.

With this in mind, we are not trying to predict this economic recession and recovery, but instead, we want to ensure that we have the highest degree of optionality so that we can deal successfully with any outcome. Therefore, regarding our operating plan, looking at the pattern from pre and post-2008, in the second quarter of 2020 and quite likely the third quarter of 2020, we will be running our factories at about the level they ran in the first quarter of 2020. This will likely result in an increase in inventory during the second quarter, and this will be important to support our customers during a time when they have limited ability to forecast. Our product portfolio of primarily long-lived products makes us an easy decision and maximizes our optionality.

Regarding second quarter revenue guidance, Rafael will elaborate in a minute that with reduced visibility of customer demand, we have used the historical transitions that I mentioned from 2008 and adjusted for seasonality. We are not implying precision but explaining the assumptions. We are using an expanded range to account for the current uncertainty.

Regarding spending and investments. First, research and development spending will be essentially unchanged as these are five to 10-year time horizon decisions. We will continue to make ongoing portfolio adjustments, but these are unlikely to make meaningful changes to investment levels.

On SG&A, we will maintain critical investments in new capabilities such as strengthening ti.com, because these are important times to gain ground, where we can minimize expense, we are and we will certainly continue to do so.

On capital spending, our plans are generally unchanged, because the bulk of capital spending is driven by roadmap capacity needs in the 2022 to 2025 timeframe. We will continue with previously announced construction plans that are underway for the next generation 300-millimeter analog wafer fab in Richardson Texas.

Lastly, regarding how we are operating in the current environment, we were fortunately prepared for the unforeseen disruptions that COVID-19 has presented. We updated our customers in late March that our lead times remained short and unchanged and that we could respond to short-term demand. This is because we invested in inventory and a robust business continuity plan and invested in, in geographically diverse internal manufacturing footprint.

Our manufacturing teams are operating throughout the world, including countries like Malaysia and the Philippines, where local restrictions have resulted in partial operations. We've adopted protocols quickly to keep our people safe and minimize any disruptions. Our team was prepared and is comfortable getting our work done remotely. We continue to actively work new design wins with customers via virtual selling processes that we instituted several years ago.

On most days across TI, we are averaging a peak of 10,000 BPM connections then 2 million meeting minutes per day about 4 times higher than normal.

We all look forward to things getting back to normal, but in the meantime, we are focused on execution. Let me hand things back to Dave.

Dave Pahl {BIO 18870833 <GO>}

Thanks, Rich. I'll provide the standard comments of first quarter revenue by end market and then I'll add some additional insight about the quarter in light of COVID-19.

First for highlights on first quarter revenue by end market versus a year ago. Industrial increased mid-single digits from a year ago quarter and improved compared to fourth quarter.

Automotive declined mid-single digits and decelerated in the quarter as our customers' factory shutdowns impacted demand. Personal electronics declined mid-single digits but by sector was a mixed bag. Mobile phones declined low double digits, while by contrast, PCs increased low-double digits. Communications equipment declined about 50% as expected due to the comparison against a very strong first quarter 2019. Communications was up sequentially. And lastly, enterprise systems increased double digits on strong data center demand.

For additional insight, the first quarter ran as expected into Chinese New Year, but was slow coming out of a holiday as Chinese factories struggled to come back due to COVID-19. In early March, we saw a pickup in orders from most markets as supply chain disruptions led to increased customer concerns about being able to secure supply. This increase in demand that we experienced in March had continued into early April with the exception of automotive as manufacturers' plant closures reduced consumption. This increase in orders has steadily abated in April, but returned to levels we saw in early March. The midpoint of our range assumes that this decline continues through the quarter as customers have reduced visibility to end demand.

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

Rafael Lizardi {BIO 20006334 <GO>}

Thanks, Dave, and good afternoon, everyone. Revenue was $3.3 billion, down 7% from a year ago. Gross profit in the quarter was $2.1 billion or 63% of revenue. From a year ago, gross profit decreased due to lower revenue. Gross profit margin decreased 20 basis points. Operating expenses in the quarter were $794 million, about even 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 or 37% of revenue. Operating profit was down 10% from the year ago quarter. Net income in the first quarter was $1.2 billion or $1.24 per share, which included a $0.10 benefit for items that were not in our prior outlook as we have discussed.

Let me now comment on our capital management results, starting with our cash generation. Cash flow from operations was $851 million in the quarter. As a reminder, first quarter is typically the seasonally low point for cash flow from operations due to payout of profit sharing and bonuses. Capital expenditures were $161 million in the quarter. Free cash flow on a trailing 12-month basis was $5.6 billion. In the quarter, we paid $841 million in dividends and repurchased $1.6 billion of our stock for a total return to owners of $2.5 billion. In total, we have returned $6.6 billion in the past 12 months, consistent with our strategy to return all free cash flow. Over the same period, our dividends represented 55% of free cash flow, underscoring their sustainability.

Our balance sheet remains strong with $4.7 billion of cash and short-term investments at the end of the first quarter. In the quarter, we issued $750 million of debt with a coupon of 1.375% due in five years. This resulted in total debt of $6.6 billion with a weighted average coupon of 2.81%. Since then we have repaid $500 million of debt during 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 flat to fourth quarter and days were 145. Distribution owned inventory declined again in first quarter by about $50 million. The sixth consecutive quarter of planned reductions, as we continue the transition of our channel to have fewer distributors and bring more customers direct. We had about 4 weeks of distribution inventory, the lowest since third quarter of 2017. Tactically and strategically, we're very pleased. We have steadily decreased total inventory dollars while increasing the percent of inventory concentrated inside TI and therefore in fewer places.

This enabled us to maintain short lead times and high availability, which is critically important in an environment where end demand visibility for our customers will be limited. With a recession likely upon us, as Rich mentioned earlier, we're using the 2008 financial prices to inform our second quarter outlook, to reflect the increased uncertainty we have also expanded the range.

For the second quarter, we expect TI's revenue in the range of $2.61 billion to $3.19 billion and earnings per share to be in the range of $0.64 to $1.04.

Regarding our operating plan for running our factories, we expect that customers in this recession, similar to past recessions will overcorrect in the short term as their visibility of their end demand drops. We believe it will be an important advantage to maintain consistent lead times and to offer customers high levels of product availability. Our product portfolio of mostly long-lived parts affords us to have a steady hand. Therefore, we will be running our factories in second quarter at approximately the same level we've ran them in first quarter of 2020. TI inventory will likely grow during the second quarter, while distributor owned inventory will likely drain.

In closing, we continue to invest in our competitive advantages and make it our business stronger. History has shown us that this is -- in times like this, is when we can make the most strategic progress. With that, let me turn it back to Dave.

Dave Pahl {BIO 18870833 <GO>}

Thanks. Rafael. Operator, you can now open the lines up for questions. In order to provide as many of you a possibility to ask a question, please limit yourself to a single question. And after a response, we'll provide you an opportunity for a follow-up. Operator?

Questions And Answers

Operator

Thank you, sir. (Operator Instructions) We will take our first question today from Vivek Arya, Bank of America.

Q - Vivek Arya {BIO 6781604 <GO>}

Thanks for taking my question. For my first one, I understand visibility is low and I understand the way you are predicting Q2, but just a few weeks into Q2, have your orders or bookings played out the same way as it did during the financial crisis? Does your consignment program now provide you better visibility than last time? I'm just curious what you have actually seen so far in the quarter? So that we can get a better handle on the outlook that you are giving.

A - Rafael Lizardi {BIO 20006334 <GO>}

Yeah. So let me -- I'll start and Dave, you want to chime in on that. But as we said in the prepared remarks, April has in fact behaved very differently than 2008 in the comparison. March was -- not only April, but March, March was strong coming out of the Chinese New Year -- as we said in the prepared remarks, we came out a little slowly, but then things strengthen, and into April, the things have abated in the second half of April.

But we think that is due to the -- the concern that many customers have on supply disruption. So we -- our range and particularly the midpoint of our range implies an expectation that demand will drop as customers internalize better the end demand and frankly they're going to have very low visibility. We expect them to have very low visibility of demand. That's why the important point here is that we're keeping high optionality throughout this process, so that if things snap back we can support that -- we can support on the [ph] other side of this, Dave?

A - Dave Pahl {BIO 18870833 <GO>}

I think that's well said. Do you have a follow-on to that?

Q - Vivek Arya {BIO 6781604 <GO>}

Yeah. Thank you. You mentioned that you're continuing to run your factory loadings in Q2 as the same level as Q1. I'm curious if you can give us some color around what you're modeling days of inventory to be exiting Q2? Is there a certain maximum limit to the amount of inventory or in terms of days or dollars that you're willing to build before you have to start taking actions?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. Thanks for the question. So Vivek, just as you framed, I'm glad you framed it that way. It is a capital allocation decision, so we are allocating capital in the form of inventory. Capital is going to go into inventory instead of going to other places and the inventory will increase. We expect very likely to increase into second quarter, but that is -- that's what gives us the optionality that I mentioned earlier, having that inventory on hand, the keeping thing to remember. And you know it very well, we -- the vast majority of our products are long-lived, they're highly diverse, they sell to many, many customers, they live a long time on the shelf and the customers' product lifecycles are very long.

So that inventory will not go back. So it's an option, we are fairly low-cost upfront to have that option. That's great. Thank you, Vivek. We will go to the next caller, please.

Operator

Next up, we'll hear from Stacy Rasgon, Bernstein Research.

Q - Stacy Rasgon {BIO 16423886 <GO>}

Hi, guys. Thanks for taking my question. For the first one, and if I go back to 2008, I think the decline was a lot quicker, but if I look from Q3 '08 peak to Q1 '09 trough, revenues fell about 40%. This cycle has been longer, but if I take maybe the peak was Q3 '18 to your guide in Q2 '20, you'd be down about 30%, does that suggest that maybe there is still a little more to go for following the same kind of trajectory? And I guess also if the decline from peak to trough is longer, does that suggest that you might be thinking about the increase off the beak also being longer? Like how do we compare the two situations?

A - Rich Templeton {BIO 1514128 <GO>}

Stacy, this is Rich. Given the recollection of 2008, I'd be careful of too much precision in where you're trying to draw there too. I do think the valid comparison that -- and I think you know this very well from the history is that 2008 was a reasonably -- 2007 and first half of 2008 were reasonably hot semiconductor markets not overheated but pretty hot. And clearly 2019 and the first quarter of 2020 were cooler compared to the heat of 2017 and 2018.

So when you try to get peak-trough that's a little more complexed. We just tried to basically look through what do we think the demand was doing for a couple of years prior. And that was what helped inform and helped set where we would put the operating plans.

Q - Stacy Rasgon {BIO 16423886 <GO>}

Got it. For my follow-up, I know you generally don't have tons of visibility into what true end demand is doing. But do you have any way to gauge, just given the -- any way to get to the amount of pull forward that we might be seeing right now, whether it's gauging the pace of rush [ph] orders or anything like that. Is there anything that we can -- that you can give us to try to gauge how much of the strong near-term demand might be you have pulled forward versus anything else?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. Stacy, as you imagine, I don't think we have any precision on that. I think that as we saw after Chinese New Year's as we saw strength. We believe that was due to the customer concerns. It's hard to have any precision around what, what percentage of that was due to that concern with any degree of accuracy. But yeah, and Rafael, you want to add to that?

A - Rafael Lizardi {BIO 20006334 <GO>}

Yeah. I agree. The only thing I would add is that we know is the channel is clean, the distinct channel because as we said, we are four weeks, we drain about $50 million on that channel and we plan to continue draining for the next three quarters or so about another $200 million of self-planned drain as we convert more and more customers to go in direct. So the channel we know is clean and will continue to be clean, but as Dave alluded to, we really don't know the end customers when they pull, how much of that is true in demand versus stocking up for potential disruption.

A - Dave Pahl {BIO 18870833 <GO>}

And I might add to that, as you know, Stacy, 65% 70% of our revenues are on consignment. So we're not carrying backlog, but we see plans in our customer factories. But as they have reduced visibility, all those plans are not updated. So they're being updated slowly as they're deciding what to build in those factories. So those updated plans are rolling through. And that's what's creating the uncertainty as you would imagine. Okay. Thank you, Stacy. And we'll go to the next caller, please.

Operator

Next up from Morgan Stanley is Craig Hettenbach.

Q - Craig Hettenbach {BIO 6185428 <GO>}

Yes. Thank you. I appreciate the color on the OpEx side of things. Any additional thoughts around just kind of variable compensation and as revenue comes down, some mitigation in terms of EPS impact to [ph] next couple of quarters.

A - Rafael Lizardi {BIO 20006334 <GO>}

Sure. So as we said in the prepared remarks, in general, OpEx will be relatively unchanged. So R&D, those are long-term investments. SG&A, and we also have some investments area -- areas there with ti.com. In other places, we quite frankly run the Company pretty tight to begin with, but wherever we can tighten up more we do.

On your specific question on variable compensation that tends to be profit sharing and bonus, profit sharing moves according to a formula, so it's very formulaic. So depending on what happens that adjusts. And bonus is determined by the Board depending on relative performance on one to three years on several metrics.

A - Dave Pahl {BIO 18870833 <GO>}

You have follow-on Craig?

Q - Craig Hettenbach {BIO 6185428 <GO>}

I do. Thanks. And understand the different cadence by geography in terms of China was weak then came back and Europe and North America may be weaker now, but just love to get your thoughts just for Q2, how you're expecting kind of things within your guidance from a geographic perspective?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. I always give caution on when asked about the geographical revenue and sometimes we can see distinct patterns. But where we ship our product is very -- rarely where it's actually consumed, as you know. So we ship from a product ends up in a phone built in China, it may end up in Europe. So if there was something distinct in our guidance that was impacted by geography, we'd share that and we don't have anything specific to share with that right now. So thank you, Craig. And we'll go to the next caller, please.

Operator

Our next question is Ross Seymore, Deutsche Bank.

Q - Ross Seymore {BIO 20902787 <GO>}

Hi, guys. Thanks for all these additional details especially with Rich on the line. Maybe one for, Rich. In your comments earlier, you said you wanted to use 2008 as a template and that is about as fair a template is I could imagine as well. You also laid out about how the pattern was a steep fall then a steep rise back. Given that you're behaving -- your actions are very different this time where you're keeping the utilization flat et cetera. Is that because you view this cycle is being any different short duration matching the same one is a decade ago? Or is it simply just the optionality side of the equation at the end of the day that you're trying to maintain?

A - Rich Templeton {BIO 1514128 <GO>}

Let me have Rafael. Ross just to help on that I think Rafael covered this in some ways, if you think back to 2008 and you know what a bunch of folks, now we were very much different. We had a large wireless business, we had portfolio re-profiling we had to do, we had a high percentage of our product that wasn't exactly custom but it behaved a lot like custom. So building inventory was a much -- a much more difficult gain. And the beauty about where we are today as Rafael pointed out is that high percentage of the portfolio is long-lived product, we've got our R&D and our resources well deployed in the areas that we want to be long-term. And that's what really puts us in the wonderful position where the cost to have maximum optionality is actually pretty low in our particular case in 2020 versus where it was back in October of 2008.

Q - Ross Seymore {BIO 20902787 <GO>}

Great. Thank you for that. And I guess, as my follow up, just switching over to the cash return side of the equation, it looks like you guys had pretty much the second biggest buyback in a single quarter you've had in a decade. Can you just remind us on how you guys are thinking about the ability to return cash? I know your long-term policy of returning 100% of your free cash flow and it's not just dictated by any single quarter. I appreciate that as well. But this was significantly above what you guys generated in a single quarter and maybe even in a couple of quarters of free cash flow. So just talk about how much leverage you are willing to put on the balance sheet to take advantage opportunistically of a pullback in your stock when it's below what I guess you view to be your intrinsic value.

A - Rafael Lizardi {BIO 20006334 <GO>}

Sure. So let me first -- you alluded to it, but let me just remind everybody on the call that our objective when it comes to cash return is to return all free cash flow to the owners of the Company. And we do that through buybacks and dividend. So for example on a trailing 12-month basis, we generated $5.6 billion of free cash flow and we've returned $6.6 billion. So obviously all free cash flow there being returned.

And then you mentioned debt, and we have debt on the balance sheet as we said on the call $6.6 billion we finished on a net basis is $1.8 billion because we have $4.7 billion of cash on the balance sheet. But we use debt to increase the rate of return with some levers when it makes sense.

So that's how we view the returns and the debt for many, many years have we talked -- as we have talked about it on capital management.

A - Dave Pahl {BIO 18870833 <GO>}

Okay. Thank you, Ross. And we'll go to the next caller please.

Operator

Next up is John Pitzer, Credit Suisse.

Q - John Pitzer {BIO 1541792 <GO>}

Yeah. Good afternoon guys. Thanks for letting me ask the question. Dave, I just want to go back to your comments in your prepared remarks about bookings slowing as we've been coming to the end [ph] of April. Was there any end markets distinction you can talk about and I am particularly interested in kind of understanding how auto and industrial is behaving at the beginning of this pandemic forces maybe things like PC, data center and comps?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. John, I'd say that when we looked at last quarter, it was very distinct that we saw strength in PCs. We saw strength in data center we saw distinct flowing in auto as we talked about. I'd say that the relative strength in orders that we saw in the quarter that happened in March and continued into April was broad-based generally and it was across the board with the exception of auto. And then the slowing. I would say that, it is also broad-based. Do you have a follow-on?

Q - John Pitzer {BIO 1541792 <GO>}

Yeah. Then just as my follow-on returning to Ross' question about capital allocation return. Rich since you're on the call, you guys have always been good at sort of zagging where everybody else is zigging, and you've got a longer duration out there. I'm kind of curious about how you're viewing the current environment relative to M&A, and that's sort of an error in the strategic quiver as we go through the next couple of quarters, what's clearly going to be a recession.

A - Rich Templeton {BIO 1514128 <GO>}

John, if you think about it and you can even -- you've watched this for a long time. You can go back to 2008 and then look at what we did to 2009, '10 '11 and such. And clearly, if you think about capital allocation the things that I step through keeping on the right R&D investments, keeping on the right capital expenditures, making the right capability investments on, things like ti.com. That's where you get just very excited about, we will be getting stronger during this period and those strengths will help us even as these secular trends of more semiconductors in your life are growing.

To the degree that we have an opportunity to buy used equipment or used factories or potentially M&A is with anything on capital allocation, I think that one just goes down to the, it depends, type comment, meaning it would have to be probably a more prolonged downturn, if you think about what the mood was in 2010 and 2011 -- well, 2009, '10 '11, that mood had to be there for a while before opportunities became available, but we're certainly -- we try to just be wise over the long term.

A - Dave Pahl {BIO 18870833 <GO>}

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

Operator

And we'll go to Chris Danely, Citigroup.

Q - Chris Danely {BIO 3509857 <GO>}

Hey. Thanks, guys. And Rich thanks for making the cameo. My first question. Rich, do you think or do you anticipate any longer-term structural changes in the business either in terms of end markets or anything you're looking at as a result of this pandemic?

A - Rich Templeton {BIO 1514128 <GO>}

Chris, my -- I think it's early, I think, I know your world tries to get ahead on trying to guess what will happen. I in general, think that the secular trends that we've seen with semiconductors and more semiconductors coming into people's lives are going to continue. Okay? And I think somewhat as John alluded to in his question, it's obvious in the near term that server sales and PCs are going to do well as working from home continues. But I just think longer term, if you look at industrial products, industrial equipment and even automotive, even though in the near term, people will see SAAR numbers come down, the secular trend on semiconductor growth inside of automotive is going to make it a great market to be in for the long term.

So no, I don't think from that point there'll be a big structural change. I do think we've got a great advantage of having structural channel advantage. So the changes that we've been working towards for a number of years of building a closer direct relationship with customers, things you now see playing out with a higher and higher percentage of inventory being in our hands to where we can be more efficient. That's going to be a fantastic trend. TI is well prepared to take advantage of that with our breadth of channel reach through the industry.

Q - Chris Danely {BIO 3509857 <GO>}

Thanks. Do I get a follow-up?

A - Dave Pahl {BIO 18870833 <GO>}

Yes. Go for it, Chris.

Q - Chris Danely {BIO 3509857 <GO>}

Great, thanks. And then, Rich, to the extent you can, if you could give us any insight into what the customer conversations are like? What are they asking, what are their big concerns? And I guess at the root of it, you guys talked about it. I thought about this. Why aren't we seeing this sort of fall off in orders yet? Is everybody just kind of frozen in place out there, why is that happening?

A - Rich Templeton {BIO 1514128 <GO>}

Chris, I think if you -- and Dave, I thought he was very direct with what he described as we saw orders rise starting the pick at first, second week of March. You saw them rise up, you've seen them start to trend down, they're still at that level we saw approximately ending February and in early March. I think that starting to filter through. For us, especially, they will have the number, where we're 60%, 70% consignment. It takes a while for those consignment feeds to really get updated, because companies have got to start getting better numbers on that front.

So I think customers are just still processing through what their customers are telling them and we will see that playthrough. It's why we've made the assumptions that May would be down from April and June down versus April as well for the range.

A - Dave Pahl {BIO 18870833 <GO>}

Okay. Thank you, Chris. We will go to the next caller please.

Operator

Next up is Tore Svanberg, Stifel.

Q - Tore Svanberg {BIO 3658854 <GO>}

Yes. Thank you. And I appreciate the wide range of the guidance in this environment, but can you maybe elaborate a little bit on what the assumptions are sort of at the low end and the high end of the range?

A - Rafael Lizardi {BIO 20006334 <GO>}

Yeah. So I'll give you my take. Frankly, there is no signs on that as we talked about earlier, we're using 2008 as the model for that. Again it doesn't imply precision not even similarity, it's just that -- it's the most recent exogenous event that we can use. So we're using that. And the midpoint is the closest thing to that kind of adjusted for seasonality. What you normally would see in our first, second quarter transition, now you've seen a negative 13% at that midpoint, but the entire range and the other reason we widened -- the other reason we widened in the range is to reflect the great level of uncertainty that we have going on.

As Rich mentioned, many customers right now, they are still processing what's happening. And we've actually heard some of them haven't been able to update their feeds to us, right. So they got to go through all that process and so that is embedded in that wide range.

The biggest point I want to make, and we made it a couple of times already is the optionality that we're going to get based on how we're running the factories, right. So this thing can go multiple ways for second quarter and third quarter and beyond. But we have just great optionality, the way we're running the business both strategically, the type of parts we build and the end products and so forth. But tactically that we were running the factories and the inventory in second quarter. Do you have Follow-on Tore?

Q - Tore Svanberg {BIO 3658854 <GO>}

Yes. Thank you, Dave. The other question goes back to what you just mentioned Dave. So I'm sure your customers are probably thinking about this too and maybe a day or perhaps building some inventory to, to be able to respond to eventual demand. If that's indeed the case, how long would you be willing to have this sort of optionality or perhaps run the inventories a little bit longer than normal?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. It's going to depend on a number of factors that, that today we don't know right? And I think we and the world and the industry will learn over the coming weeks and months. And then we will adjust as necessary. I think the advantage we have with the way we're set up strategically with the type of parts we built and the type of customers we have and the type of end markets, is that we can afford to have this optionality, right? These parts are not going to go bad, it was very different in a custom-centric, custom far centric world in personal electronics type of centric world. That's not the case with the way we structured the Company. So we have great optionality to go through this beyond second quarter.

Okay. Thank you, Tore. We will go to the next caller, please.

Operator

And next from BMO is Ambrish Srivastava.

Q - Ambrish Srivastava {BIO 4109276 <GO>}

Hi, Thank you. Rich, good to hear your voice. I'm sure nobody really wanted to hear you in this kind of forum. I had a question back on capital allocation and going back to the 2008-2009 template or playbook. You raised your dividend in the fourth quarter back then, it was a small portion, but it was, I think on a percentage basis was pretty meaningful. So as we compare what -- where we are heading now versus -- I'm sure nobody has any idea what next quarter was going to be. What's the right way to think about capital allocation? Based on the comments you and Dave and Rafael are making, it sounds like no change in 100% free cash flow back, divi plus buyback. No change to that. Just kind of just help us understand the thinking or scenarios that you're playing out -- that you're thinking through which might lead to a near-term modification on that, Rich? And then I have a follow-up.

A - Rich Templeton {BIO 1514128 <GO>}

Yeah. (multiple speakers) set up and I'll let Rafael cover it. The answer is no change, Ambrish, because we really have -- tried to have very thoughtful long-term plan, but I think it's helpful for Rafael to summarize some of those points.

A - Rafael Lizardi {BIO 20006334 <GO>}

Yeah. So just to comment and Ambrish as you said and Rich just confirmed that. Yeah, there's no change in our -- the way we think about capital management and our long-term objective. So as I said earlier, cash return, return all free cash flow on dividends specifically as you, as you alluded to, the objective is provide a sustainable and growing dividend to appeal to a broader set of owners.

And as a reminder, on a trailing 12-month basis, our dividend was 55% of our free cash flow. Now, of course, as a backwards-looking metrics, I understand that. But it's a great place to start. Frankly, few companies are at that level in our industry and in the S&P 500 is a great place to start. But that objective of providing a sustainable and growing dividend, it has been and continues to be very important for us.

A - Dave Pahl {BIO 18870833 <GO>}

Follow on Ambrish?

Q - Ambrish Srivastava {BIO 4109276 <GO>}

Yeah. I did. And this is more to do with -- I think Chris asked a good question on structural changes. Given that we are all working from home at least those of us who can afford to work from home. How is that impacting the design activity that TI engages in multiple geos, multiple customers, so many end markets. What's the way to think about the changes that you're seeing there? And does it portend poorly for when we ultimately get to a more ''normal world"?

A - Rich Templeton {BIO 1514128 <GO>}

Ambrish, it's why we included in my remarks comments about how we're operating and it's one of these deals I produced some -- an update for internal. And basically, I had a bunch of people telling me, gosh, we got lucky on some things and I explained there is great quote that, luck is what happens when preparation meets opportunity. And we put in place this mass market selling really virtual selling techniques starting three years ago. It's an instituted standard process our sales teams work at applications, people work at comfortable with customers. And so it's almost been like nothing has changed in terms of where we spend our time working between ourselves and the customers. They all want to do it on the phone anyhow, our products group connecting in on that.

So the readiness that we had to operate in this world is actually enormously high having ti.com more capable to support customers' decisions to be able to support online commerce as we're bringing more customers direct. The comfort of our product groups, design engineers and people to work collaboratively because we've always had to do that is really very, very unchanged.

I do think people are working more hours just because of the days and hours tend to blend into one another, as I'm sure everybody on this call is experiencing. But it's very impressive to watch the -- watch the team performing and watching while it's getting done. We're even at the point, where all the set of customer visits even next week where those customer visits will be virtual as well. So we're just well into the way of operating this way.

A - Rafael Lizardi {BIO 20006334 <GO>}

Hey. I just want to comment on the slightly different topic but related in the spirit of preparation meeting opportunity. Just want to highlight and we talked about during the during the prepared remarks, but we were prepared for the unforeseen disruptions with a combination of our inventory strategy, our business continuity program and our geographically diverse manufacturing footprint, which of course is part of our one of our competitive advantages of manufacturing and technology. So we're having all of those together, we were able and continue to be able to provide our customers with short lead times and inventory availability in this time where they needed most. Now and in the coming quarters when the visibility will be impaired.

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. And I would say that we've had customers actually contact us and they're rather surprised that our lead times are stable and they can get the product that they need. So they're very, -- very happy with that. So thank you, Ambrish. We will go to the next caller going, please.

Operator

And next is Harlan Sur, JPMorgan.

Q - Harlan Sur {BIO 6539622 <GO>}

Good afternoon. Thanks for taking my question, and I appreciate the additional commentary on Rich being on the call today. I know you guys don't like to talk about sort of specific geographies. But fact of the matter is China is coming out of this pandemic and starting to open up the economy and growing quite a bit of stimulus added.

Are you seeing this being reflected in your order rates or consignment forecast for your domestic China customers, and roughly what percentage of your business today comes from domestic China consumption?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. I'll start and pleased to chime in Rafael, if you'd like. So we've -- again, I'll give the numbers of products of where we actually shipped the product, but always offer the caution that it's where the box ships from. So we've got 50% of our product ships from -- into China, but again, like cellular phones, as an example may be built there may be designed in California and end up in Europe, as an example.

So -- and yeah, we are seeing those factories coming back online as we talked about in our prepared remarks. But I think the uncertainty is how much demand will actually be there as those factories come back online. And I think that's what's creating that uncertainty. So do you have a follow on?

Q - Harlan Sur {BIO 6539622 <GO>}

Yeah. Thank you for that. So IHS [ph] and its most recent forecast is calling for global light vehicle production to drop almost 20% this year. This has placed the year-over-year drop as experienced in the '08-'09 financial crisis. Outside maybe just a near-term inventory correction to kind of normalize to the lower production trends, how is the TI team thinking about your content growth in auto to potentially partially offset significant decline in production this year?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. I think Harlan that -- I'll make a couple of comments and Rich, if you want to jump in afterwards, feel free to. And I think that what's important for us is the -- just the longer term opportunity in automotive remains unchanged. And we continue to invest in five different sectors inside of automotive, there will be more content per vehicle, as you know Harlan and as you're pointing to. We will respond tactically to those changes in demand, and we know how to do that and take care of that operationally, that's not something that we will be able to control. But we will keep our investment steady and be prepared to support that growing opportunity as it arrives. S, Rich, do you have anything to add to that?

A - Rich Templeton {BIO 1514128 <GO>}

Yeah. I would just Harlan amplify as I suggested earlier that the secular growth themes that are embedded in things like automotive or embedded in industrial or alive and well. Okay? They're going to be with us, they are not going to offset a 20% SAAR drop in any one year, and you know that, I think everybody does. But when it comes to making investments, as Dave said very well, you got to be looking five and six years out and we think automotive will continue to be a growth -- a great average upper of our long-term growth in our performance.

A - Dave Pahl {BIO 18870833 <GO>}

Okay. Thank you, Harlan. We will go to the next caller, please.

Operator

And up next is Toshiya Hari, Goldman Sachs.

Q - Toshiya Hari {BIO 6770302 <GO>}

Hi. Good afternoon. Thanks very much for taking the question. I just had one probably for Rich. I was hoping you could talk a little bit about the competitive landscape that you're seeing today both in Embedded Processing, as well as Analog, you guys have been pretty consistent share gainer over the past five, 10, 15 years. I wanted to get your thoughts on share growth potential going forward, obviously, you guys are going through this recession, which all else equal, I would think it would be positive for industry leaders like yourself, you're also going through the go-to-market strategy change, you've also got the trade tensions between the US and China. So when you think about those three items, if you can talk to your confidence level around share growth over the next, call it three to five years. That would be helpful. Thank you.

A - Rich Templeton {BIO 1514128 <GO>}

Yeah. Toshi, I think you almost answered the question. I think you described a couple of secular tailwinds, if we do our job well with the secular headwind depending on trade tensions. But even there, if we do our job well, I think we can mitigate some of that. I think you also -- and I'm sure Dave is smiling, you got to the right context, which is you got to look at this over two, three and four years. So I think he reminds everybody, all the time.

And so you look at the share we gained going kind of into and then the position we were coming out of the '09 downturn and we gained momentum in that. And that's certainly what our plans are right now and that's about both Analog and Embedded. And it's about the markets that we focus on, it's the customers, the products, the technology, the capabilities like ti.com that we took place and it's where, it's where all our energy is going on a weekly, and daily basis is to get better at that.

A - Dave Pahl {BIO 18870833 <GO>}

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

Operator

Next up is Timothy Arcuri, UBS.

Q - Timothy Arcuri {BIO 3824613 <GO>}

Thanks a lot. I have two. I guess the first one, which is another -- how to think about -- how does things (Technical Difficulty) Hello?

A - Dave Pahl {BIO 18870833 <GO>}

Hey, Tim. Yeah. We're having trouble hearing. Could you start over, please?

Q - Timothy Arcuri {BIO 3824613 <GO>}

Sure. Okay. So the first question really is around how the cycle evolves and how to think about it? And I guess I understand that the magnitude -- the peak to trough magnitude, it's hard to look back at '08 and to sort of look at that. But it seems like the near-term supply chain boost that -- the concerns that customers have about that, that's boosting near-term demand. It seems like for you that effect is sort of beginning to wane maybe a little earlier than others because of your consignment model.

So what you're seeing it first and I wonder if you agree with that, that it relates to the, to the consignment model. And I guess the question is does that agree that -- or does that argue that you would maybe see it out the other side first, as well?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah, Tim. So I don't know -- so first of all, we haven't seen what others have reported yet or what they've seen. So it's probably too early to do that and we've had a series of us seen it early and seen late just rather not weigh in on that debate and just report the facts that we have and let others debate it right?

We do believe that by pulling and controlling that inventory, we will get much cleaner signals, but as we've talked about before, our customers right now, they're not sure what their demand is going to look like. And so what they're telling us hasn't been updated yet, so even what they're telling us isn't completely clear.

So it's going to take a little bit of time before all that stuff is updated. So do you have a follow-on?

Q - Timothy Arcuri {BIO 3824613 <GO>}

I do. Yes, for Rafael. So I guess on inventory. So if I assume that it's sort of flat to up in dollar terms, obviously, days are going to go way up in June. Maybe they are 170, 180 days like that and possibly even up again in September. I guess, I was just wondering like, can you give us some sense of what the pain point is where you might cut utilization? Is it an inventory dollar thing? Is it (inaudible) thing or is it sort of just a duration of recovery thing? Thanks.

A - Rafael Lizardi {BIO 20006334 <GO>}

Yeah. No. Good question. First, let me step back and remind you that for us the objective of inventory is to maintain high levels of customer service, minimize obsolescence while we improve our manufacturing asset utilization. The target of $115 million to $145 million

[ph] frankly is it's kind of incidental, right? It's just a calculation. At the end of the day, this is a capital allocation decision. We're going to -- we have $2.7 billion of inventory that's real money that's on the balance sheet that if it wasn't there. It'd be back in the owner's market. So we're very thoughtful in how we're going to, how we make those decisions to build a potentially more, more inventory on their balance sheet, right? That's less cash that we have, but we just think it's going to give us great optionality throughout this thing, right. And like any decision when it comes to capital management, it's going to be depend, right. So that's the decision we're making now. We have to see how things develop in the coming months. And based on that, we'll adjust. The important thing, the inventory lasts a long time. This is inventory that the scrap levels on this inventory is very, very low. So the other -- well, there is working capital and opportunity cost to it, but it's very low given that is highly unlikely that it is going to be scrapped and it gives us just tremendous optionality on the other side.

A - Rich Templeton {BIO 1514128 <GO>}

Okay. Hey, just to follow-up, Rafael and Tim, Rafael said this before. So it's just me repeating his comment. The other thing to keep in mind and he spelled this out as while our inventory would be growing in the second quarter we will drain yet again, distribution inventory. So we just got to keep these multiple variables in mind and it just keeps putting us in a better and better position when we're doing that.

So our balance sheet may show higher inventory. But we love the fact that the channel inventory will be getting leaner and leaner and the inventory will be in one place where we can get the most effective use out of it.

A - Rafael Lizardi {BIO 20006334 <GO>}

Hey. And I'll go ahead add when new and old investors listening on the call when you compare us to most or maybe all of our competitors, our balance sheet is very different in that regard because we have many consignment arrangements, while 65% -- two-thirds of our revenue goes to consignment whether is through distribution or directly with the end customers. So that puts upwards pressure on that inventory level that we have. We also have our own manufacturing to -- including assembly test operation whereas to a very high degree, about 80% of our output goes through our, through our fabs and maybe 60 or 70 through our assembly test operations. So that's also very different than our competitors.

So that's why, it's not apples to apples when you compare our inventory levels to those of our competitors. But let me make the point though that we think owning and controlling that inventory is a strategic asset. So we're very pleased we have in those consignment arrangements. Clearly very pleased we've owned in our own manufacturing and what that has enabled us to do any time, but particularly in times of disruption like where we just experienced and continue to experience where you just really puts us in a much better position to support our customers.

A - Dave Pahl {BIO 18870833 <GO>}

Okay. I think we have time for one last, one last caller.

Operator

And we will go to Mark Lipacis, Jefferies.

Q - Mark Lipacis {BIO 2380059 <GO>}

Great, thanks for taking my question. So, I had one, our own field work in the supply chain downstream from you guys indicate that inventories R&D like normal if not lean [ph] levels and as the virus spreads around the world to places like Malaysia and Philippines, that the shortages of components understanding that your inventories are higher than at the high end of the range and not hearing anything about TI shortages, but basically, supply is being disruptive and there's a reticence to give up any excess inventories downstream for you.

I'm wondering if you could describe what you're seeing on your own supplier base that you want to run your factories at consistent levels here. Are you seeing any of these supply chain disruptions that your customers are seeing at other components. Are you seeing that and how are you managing that and there is a risk that you're not going to be able to run your capacity consistently because of your own supply disruptions. That's all I had. Thank you.

A - Rafael Lizardi {BIO 20006334 <GO>}

Yeah, sure. The short answer to that is, we're not seeing anything worth mentioning on this call. Little things here and there, but nothing that, that we cannot manage, remember I referred to our business continuity program and we've been -- in this call, we've been talking mainly about inventory, finished goods inventory that we carry, but that also applies on multiple other angles. So for example, we also carry raw material inventory buffer. We have many dual and triple and quadruple sourcing of key raw materials. And we also have -- as I talked about earlier, geographically diverse manufacturing footprint in Malaysia, in the Philippines, in Taiwan, in Mexico, in China. So that just really puts us in a very good position, also gives us leverage to work with those suppliers, which by the way, we pay them in 30 days. We make -- that's part of our thinking to be fair to those suppliers, and we don't play games on that.

So that, that's also from a long-term relationship standpoint, I think we are in very good shape with all of those suppliers.

A - Dave Pahl {BIO 18870833 <GO>}

Would you like to wrap it up?

A - Rafael Lizardi {BIO 20006334 <GO>}

Yeah. So let me just wrap up by reiterating what we have said previously history has shown us that it is times like this when we can make the most strategic progress, 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 the three ambitions Rich mentioned. 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're personally proud to be a part of and would be proud to have neighbor. When we are successful, our employees, customers, communities and owners will all benefit. It is this ambitions that will guide our decisions in the weeks and months ahead as we navigate these uncertain times. Our best to you and your families.

Operator

And ladies and gentlemen, that does conclude today's conference. Thank you all for your participation.