Operator

Good day ladies and gentlemen and welcome to the Third Quarter 2014 Intel Corporation Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions). As a reminder, today's conference is being recorded.

I would now like to turn the call over to Mark Henninger, Head of Intel Investor Relations. Please go ahead sir.

Mark Henninger

Thank you, Jamie. And welcome everyone to Intel's third quarter 2014 earnings conference call. By now, you should have received a copy of our earnings release and the CFO commentary that goes along with it. If you've not received both documents, they are available on our investor website intc.com.

I'm joined today by Brian Krzanich, our CEO; and Stacy Smith, our Chief Financial Officer. In a moment, we'll hear brief remarks from both of them followed by Q&A.

Before we begin, let me remind everyone that today's discussion contains forward-looking statements based on the environment as we currently see it and as such, does include risks and uncertainties. Please refer to our press release for more information on the specific risk factors that could cause actual results to differ materially. Also, if during this call we use any non-GAAP financial measures or references, we'll post the appropriate GAAP financial reconciliation to investor our website intc.com.

And finally, I'd like to remind everyone that we'll be hosting our annual investor meeting here in our Santa Clara headquarters on Thursday, November 20th. If you have questions about the event or logistics, please contact Investor Relations.

So with that, let me hand it over to Brian.

Brian Krzanich

Thanks Mark. Our third quarter results were consistent with our expectations and included a number of important milestones. Revenue and earnings per share both set new records with strong performances from the PC and the Data Center groups. The trends we observed in the PC market last quarter continued the stability in mature markets offset by ongoing declines in emerging markets.

The PC Client Group launched Core M, a new family of products with full core performance in both compute and graphics in a fanless design, enabling breakthrough designs and form factors. The first of these systems will be available by the end of this month.

In the Data Center, we saw double-digit revenue growth across all four major market segments. Enterprise grew 11%; networking grew 16%; and HPC; and cloud service providers grew 22% and 34%, respectively. We also launched the new Xeon E5 processor, formerly known as Grantley. This product family provides leadership, features and performance for compute; storage and network workloads. Formally launched just five weeks ago, E5 is already 10% of our DP or two-socket volume.

In the Mobile and Communications Group, losses declined sequentially and that's the trend we need to see continue. Tablet volume was nearly 15 million units and we remain on track to our 40 million unit goal for 2014. Third parties estimate that we are now the second largest tablet [assesses] vendor worldwide and the largest among merchant suppliers.

In addition, Samsung chose our Cat6 LTE modem with carrier aggregation known as the 7260, which recently announced Galaxy Alpha and Galaxy Note 4. The strategic importance of these capabilities continues to grow. Our LTE technology, which we originally developed for phone is becoming increasingly valuable in tablets and even PCs as wireless wide area network connectivity becomes increasingly common. We estimate for example that by 2018 the rate of baseband attached to tablets will roughly double and that PCs will rise to more than 15%.

Overall we've made some good progress during this quarter. Yet, we have an important work left to do. Within our factory network 14-nanometer yields improved meaningfully, but we're behind where we expect it to be. These challenges highlight just how difficult it has become to ramp advanced process technology.

I'm most pleased that our strategy for growth is beginning to yield results across a remarkably wide range of products. We sold record volumes of PC, server, Internet of Things, phone and tablet products. The diversity and scale of our products uniquely position us across the breadth of devices that competes and connects.

Importantly, our results demonstrate that we are building on our success in the PC and Data Center segments to successfully pursue adjacent opportunities. These businesses are the source of tremendous intellectual property and that IP creates valuable and important synergies that position us to compete in an increasingly diverse computing market.

Let me share a few examples. At IDF, I showed the world's thinnest tablet. A Dell Venue with Intel RealSense technology. It has an industry first 3D camera that enables features like after effect focusing and a host of capabilities that have the potential to change how people engage with their photography. That technology was first developed for PCs and was adapted for tablets. In this case we're in a position to differentiate in tablets precisely because we invested in next generation technology for PCs.

Another example of IP synergy is the Atom microarchitecture. We first brought Atom to market as an extension of the PC product family. We've purposely evolved that IP to the point that it now spans from smartphones to tablets and mainstream PCs and from storage, networking and compute devices in the data center to the Internet of Things.

Lastly I'm excited about the moves we're making to engage the ecosystem in new and potentially disruptive ways. We're establishing our position and capabilities in emerging sectors like wearables before they become mainstream. The data center team is customizing our Xeon products for specific customers and workloads. Custom SKUs now number roughly 35 and over the last year volume from custom SKUs has grown at 3x the rate of our off the shelf product. And we're also striking groundbreaking strategic agreement. Our recently announced collaborations with Rockchip and more recently, Spreadtrum will provide new sources of innovation and a new set of partners that will work with us to scale Intel architecture. Our vision is that if it's smart and connected, it's best with Intel. The breadth of our results this quarter, our progress against our strategic goals and the changes we're making in our approach to end markets, leaving convinced that our strategy is working.

With that, let me turn the call over to Stacy.

Stacy Smith

Thanks Brian. The third quarter was the highest revenue in the company's history with overall results demonstrating solid financial growth as we approach the end of this year.

Focusing on our third quarter results, revenue came in at $14.6 billion, up 8% from a year ago. Both the PC Client Group and the Data Center Group achieved better growth than we expected at the beginning of the quarter. PC Client Group revenue was up 9% from a year ago. We saw PC Client Group platform unit volumes growth 15% year-over-year and inclusive of tablets, we saw almost 30% unit growth. Of note, our notebook platform units grew over 20% year-over-year as we are enabling innovative two-in-one devices and growing our market segment share with Bay Trail at lower price points.

Our Data Center Group revenue grew 16% from a year ago with platform volumes up 6% and platform average selling prices up 9%. We are seeing robust growth rates across all the segments of our Data Center business.

Operating income for the third quarter was $4.5 billion, up $1 billion and 30% from a year ago. Operating income in the PC Client Group was $4.1 billion and in the Data Center Group operating income was $1.9 billion.

The Mobile and Communications Group had $1 billion of loss which is an $81 million improvement from the second quarter. The company generated $3.3 billion of net income for the third quarter, up 12% from a year ago. And earnings per share was $0.66, up 14% from a year ago.

Our net inventory levels rose modestly quarter-over-quarter as we are efficiently managing capacity while ramping Broadwell and 14-nanometer. The worldwide PC supply chain appears to be healthy with inventory levels appropriate in anticipation of the fourth quarter retail cycle.

Moving to gross margin, third quarter gross margin of 65% was up 0.5 point from the second quarter and down 1 point from our guidance. The increase from the second quarter was primarily due to lower platform unit costs on 22-nanometer and higher platform volume, mostly offset by higher production costs on 14-nanometer products. Spending came in at $4.8 billion, $100 million lower than our outlook. The overall decrease in spending was driven by efficiencies and one-time events like capital asset sales, partially offset by higher profit dependant expenses.

The business continues to generate significant cash with over $5.7 billion of cash from operations in Q3. We purchased $2.4 billion in capital assets, a $1.1 billion in dividend and repurchased over $4 billion of stock. Total cash balance at the end of the quarter was roughly $16 billion, down approximately $1.7 billion from the prior quarter. Our net cash balance, total cash less debt, is approximately $2 billion, and inclusive of our other longer term investments, it is more than $6 billion. This is down by almost $2 billion from the second quarter.

As we look forward to the fourth quarter of 2014, we are forecasting the midpoint of the revenue range at $14.7 billion, up 1% from the third quarter. This forecast is in line with the historical average seasonal increase for the fourth quarter. We are forecasting the midpoint of the gross margin range for the fourth quarter to be 64%. The one point decrease from the third quarter is driven by higher platform unit costs, higher factory start-up costs, primarily offset by lower production costs on 14-nanometer.

As we enter the fourth quarter, we are seeing our strategy play out in our financial results. In the third quarter, we grew revenue 8% and grew operating profit 30% versus last year. We also shipped over 100 million units for the first time in our history across a widening range of devices.

In the Client segment, we are seeing robust growth in the PC segment as a result of innovation and enabling lower price point.

We have grown to be the largest merchant supplier of tablet silicon and we are winning large designs at our LTE communications product. And our Internet of Things business is ramping out its products and growing. In the Data Center, we continue to innovate our products; bring increased differentiation and value to our customers. And underlying all of this is our manufacturing leadership. We have led the world to 14-nanometer and plan to do the same with 10-nanometer process technology.

With that, let me turn it back over to Mark.

Mark Henninger

Alright. Moving on to Q&A, as is our normal practice, we would ask each participant to ask one question and just one follow-up if you have one. Jenny, please go ahead and introduce our first questioner.

Question-and-Answer Session

Operator

(Operator Instructions). Our first question comes from Ross Seymore from Deutsche Bank.

Ross Seymore - Deutsche Bank

Hi guys. Congrats on the strong results. So, one bigger question then a smaller picture one for my second follow-up please. On the bigger picture one, your units in the PC Client Group being up 15% year-over-year, can you talk a little bit about what do you think is driving that in the PC market that I think most of the third party data provider says is flat? And do you think that delta can actually stay that large for a bit longer?

Stacy Smith

This is Stacy, I'll take and I'll start it and I think Brian will fill in some of the colored commentary about what we're seeing in the end markets. So yes, we've seen some of the third party data. When you adjust for some of the other form factors like Core-based tablets and things I'd say our view of the end market compared to say in IDC isn't terribly different in terms of growth rate, we would both say it's relatively flat year-on-year in the third quarter.

In terms of our billing results, I think there is couple of things driving that. First, we saw in Q2 that we gained a relatively significant amount of share once everybody had reported. If I had to branch predict, let's say we probably continue to gain some share in Q3, as is for usual, we'll wait to see all the third party results come in to know for sure, but our sense is that we gain some share in the third quarter so that helps.

And then we're also seeing our customers putting in place a normal supply line an anticipation of consumer led seasonal fourth quarter and that's different than what we saw a year ago where people were managing inventory levels very low in anticipation of a very muted fourth quarter. So, I think the combination of those two things does our billing results ahead of the IDC, but feels like it's pretty appropriate based on what I say.

Brian Krzanich

I think Stacy you covered it well, I think from what we've seen probably it covers most of the gap between the two numbers.

Ross Seymore - Deutsche Bank

Great. And I guess as my follow-up well it's not really meaningful to the revenue side it's really is to the bottom-line and that's for mobile and communications group. Can you talk a little bit about how we should expect that Concur revenue impact the trend overtime? And I believe in the past you said that you didn't think you'd get to profitability next year, but any sort of clues that you can provide on how we should expect either the revenue or the profitability to trend as we get into next year? Thank you.

Brian Krzanich

Sure. I'll start and then Stacy can kind of jump in because how you look at kind of how we're adjusting the products in engineering is a little bit ahead of where you see the financials move. And so we'll give you another two sides of that equation.

So from a product standpoint, you saw throughout this year we did a very good job of as we figure out how to get into this market and work with our customers and partners, how to reduce the cost just on the general bomb picking the right -- the right board layout. So reducing our product count all of those kinds of just fundamental engineering efforts is what we focused on.

As we got to the end of the year then we had brought out the Bay Trail cost reduce part which is really focused on -- the first part that was really focused on this segment of the market. We're starting to see systems come on to the shelves as we go through the holiday season with Bay Trail CR and that part will start to have really a designed in cost reduced effort.

We said that we'd have SoFIA, the 3G version out at the end of this year. We're on schedule. We've got SoFIA in the labs running; we are studying its validation effort. We said we'd have SoFIA LTE in the first half of next year. That's on schedule. And then we announced several partnerships; two main ones, Rockchip and then more recently Spreadtrum which are focused around the SoFIA architecture bringing parts for this mobile space really designed by people who are in that ecosystem are very cost efficient and are connected into both the China market and the worldwide market. You'll see those parts come out as we go to next year. So when we look at the end of next year, we'll look how the model SoFIA has built to have no contra revenue.

And so when you go through the next year, again, it will be somewhat mixed dependant as our product shift the mix and seasonal Stacy will talk to you a little bit about that, that's why it's a bit hard to predict exactly when. But you will see us mix Bay Trail cost reduce Cherry Trail and then a lot of SoFIA coming in, in both the tablet and phone space and that really is what drives the contra kind of out of this system.

Stacy Smith

Yes. So Ross let me just -- as Brian said, the way the contra accounting works, the contra dollars that we recognize are associated with that platforms as they actually ship. And so what you're seeing right now is the majority of our shipments, our products that are carrying a fairly high contra dollar per unit. As we ramp the Bay Trail CR and then the SoFIA products, you'll start to see the contra dollars per unit come down.

I'm not going to provide a specific forecast at this time for 2015; I'll stand-by in the prior statements. We plan to make a substantial improvement in the profitability of the segment next year, but don't get too far ahead of your SKUs. We're not at a point that we'll be profitable next year, it is still our goal, but it will take a little time to get there.

Ross Seymore - Deutsche Bank

Okay. Thank you.

Operator

The next question comes from Blaine Curtis from Barclays.

Blaine Curtis - Barclays Capital

Hey thanks for taking my question and nice quarter. Stacy I just want to follow-up, you talked about the more normal kind of supply chain this year and helping Q2, Q3. You're actually not guiding to down December, so it seems like you're staying at that elevated rate. I mean just some thoughts on seasonality; you also have Broadwell kind of launches in a typical point of year. Is there any sort of catch up before you kind of ramp Broadwell into late first half next year?

Stacy Smith

So I want to make sure I'm answering the right question. You had one question on seasonality and I'm not sure I understood the Broadwell question. So, let me go to the seasonality and I'll give it back over to you or if you want to clarify it now, that's also fine.

Blaine Curtis - Barclays Capital

I just was wondering out that you are launching a platform that kind of usually you launch it for back-to-school and holiday and it's coming -- the majority of the Broadwell clearly is coming kind of in the first half of the year. So it's just say a typical timing, so just thinking about seasonality. And then I just wanted to kind of clarify your comments; you kind of said that supply chain was building ahead, but it doesn't seem like it's pulling back, particularly much in Q4 just thought there.

Stacy Smith

Yes. So just to clarify on the supply chain and seasonality for Q4, I wouldn't term it as building ahead, what I'd say is appropriate amount of inventory in anticipation of a seasonal Q4. And if you go back here to Q3 of 2013, if you recall we are tracking about usually low inventory levels based on our customers, I think I used the word muted, having muted expectations about the fourth quarter. Today, I'd say they have kind of normal expectations about the third quarter. And so -- and our guidance for Q4 would be consistent with that. We're guiding 1% up, if you take midpoint of our guidance that's kind of the seasonality we've seen over the last several years. So it's pretty much in line with normal seasonality.

In terms of Broadwell and the impact of 2015 seasonality, I'm not providing a forecast yet for 2015; we'll talk more about 2015 when we get to the Investor Meeting which is just a few weeks away.

Blaine Curtis - Barclays Capital

Okay. And then just a follow-up on the gross margin given your full year guidance, you were looking at a step down in December and now it looks like the gross margin sustains quite nicely. Just what changed in that outlook and does any of those factors carry into first half of next year?

Stacy Smith

Yes, so the -- as you rightly pointed out, the gross margin forecast for the year is pretty much on; we were a little light in Q3, we look a little better in Q4 based on the algebra that I gave you on the last call. In essence, we're seeing more of the 14-nanometer cost coming through in the third quarter versus the fourth quarter and that's why you see that shift between quarters and the year staying on track. And again, it sounded little bit like a broken record. In terms of 2015, we're only a few weeks away from the Investor Meeting and that's a great forum for us to talk about longer-term trend. So, we're going to hold off on the 2015 questions until we get to the November Investor Meeting.

Blaine Curtis - Barclays Capital

Thanks a lot.

Operator

The next question comes from Harlan Sur from J.P. Morgan.

Harlan Sur - J.P. Morgan

Great. Thank you for taking my question and congratulations on the solid quarterly execution. DCG was up strongly in Q2 and again here in Q3 up 16% year-over-year strong growth in all end markets. Do you expect the breadth of spend to continue across the different customer base in Q4? I know cloud tends to be a bit lumpy. And then do you expect to see continued double-digit growth in DCG in the fourth quarter?

Brian Krzanich

Sure, this is Brian. I think what we said was, we believe we can grow this business around 15% year-over-year. And you kind of framed it correctly that we do especially in the cloud space it tends to be lumpy, but if you take a look at what we're projecting for the fourth quarter, we're projecting right in line for that 15% for the year and it's got the normal mix of what we see across the enterprise and the cloud and HPC and other data centers. So, we're expecting Q4 to kind of just progress from Q3 and we're not changing our forward-looking what we believe we can grow this business as.

Harlan Sur - J.P. Morgan

Great. And then -- thank you for that. And then I guess part of the reason for the lower gross margin profile in the fourth quarter is the ramp of 14-nanometer across multiple fabs. I think you said on the last call, it takes a couple of quarters to ramp up for full manufacturing capability after which time you would see ramp cost starting to come down. Is that how you still see it?

Stacy Smith

Yes. I think I said you see highly elevated cost for a couple of quarters then it starts coming down, but it takes a period of time for it to come down. That's the normal trend. We're certainly seeing those elevated costs in Q3. You can see it in the gross margin anytime. You'll still see high sell-through costs of those products are selling through in the fourth quarter. In 2015 I'll get a lot more specific on some of the unit cost trends next month at the investor meeting.

Harlan Sur - J.P. Morgan

Great. Thank you.

Stacy Smith

Thanks Harlan.

Operator

The next question comes from Jim Cabello from Goldman Sachs.

Jim Cabello - Goldman Sachs

Hey guys. Thanks so much. I appreciate it. You guys referenced the opportunity for consumer buying in the fourth quarter. We saw a really good demand in the third quarter from consumers driven by the new products that you and Microsoft combined introduced. There were great new products and the consumer uptick of them is very good. Do you think that impacts the fourth quarter versus third quarter buying at all?

And then I'll kind of make my follow-up as part of this question. Do you see the iPhone 6 cannibalizing any kind of a notebook demand just given the price points are the same; obviously the functionality isn't the same. But given that most of the top 10 selling notebooks are right around that same price point as the notebooks. Do you think there is any cannibalizing going on there as you get to the fourth quarter; is that part of the guidance? Thanks a lot.

Brian Krzanich

Let me start just on a kind of a general basis and Stacy can jump in. I'd say in general again we're predicting, we're forecasting a fourth quarter that's seasonal. So what we saw in the third quarter approximately 1% growth as we go into the fourth quarter, which is pretty typical if you go back over the last three years of what we see Q3 to Q4.

So we're seeing that same trend in consumer kind of being flat. It's a normal years of performance whole through the fourth quarter. Your question about iPhone 6, no, we don't really see, but typically we see a separation in that space between consumers going out and buying phones versus PCs. And as you say, there is a big difference in the functionality and usage models between those two. And I think people when they want the usage model and the functionality of the PC, they look at that cost. And as you said, it's very similar cost. I didn't say this is a really good value for the functionality on getting it, we typically haven't seen a cost between those two for the demand standpoint.

Stacy Smith

Can I just comeback and always you had big question. I don't think we saw extraordinary consumer demand in the third quarter. If you go back to the strength of end markets, I think we're pretty aligned with the third-party, it was pretty flat. From an end market standpoint, it was pretty flat. We didn't see anything unusual there. What we saw was some share gain, which caused us to have a nice bump in billings and we saw kind of a normal amount of inventory being put in, in the system relative to last year at the same time right before managing inventory levels low. So, I'd term it more stable PC markets and people betting on a normal consumer fourth quarter.

Jim Cabello - Goldman Sachs

Very helpful. Thank you. Congratulations.

Stacy Smith

Sure.

Brian Krzanich

Thanks Jim.

Operator

The next question comes from John Pitzer from Credit Suisse.

John Pitzer - Credit Suisse

Yes, good afternoon guys. Congratulations on the strong quarter. First question is for Stacy. Stacy when you look at the revenue in the PC Client Group, I think year-to-date you're up about $1.1 billion and your operating profits are up I think about twice that. I'm just wondering if you can talk a little bit about what you're doing in OpEx in that business around profitability and I guess how much more do you have left to drive profitability in the core PC Client Group?

Stacy Smith

So I'll answer the question with regards to this year and again I'll probably hold off on the discussion about '15 until we get to the investor meeting. But I think what you see going on this year is probably three things that are all contributing to the operating profit.

First, they've got a great product portfolio. And so when you look at where we're seeing growth, we're seeing nice growth in kind of the Core i5, i7 segments of the market. And then we've brought in some really good technology that's got a good cost structure at the low-end of the market that gives them a nice cost structure and allows them to go after a unit growth.

So I think this really all starts with the product portfolio. Adding to that I think we have a couple of tailwinds on gross margin in 2014. Our 22-nanometer processors are just spectacular. And we're at the low-end of the cycle in terms of how much start up cost flows through and PC Client Group picks up the majority of those.

And I also think the leadership of that team has done a nice job of prioritizing investments. So we've been making investments in the new areas where Brian and I thought it was pretty important. And so they've had a bit of a constrained budget. And I think they've done a nice job of bringing out technology that really helps our business while prioritizing within a pretty constrained budget. So that's what happen in '14 and '15 discussion will be part of their investor meeting next month.

John Pitzer - Credit Suisse

That's helpful Stacy. And as my follow-up for Brian, Brian you guys have been talking about a stabilizing PC market for the last couple of quarters, but over the last couple of quarters you've been laying a little more heavily on developed versus developing and corporate versus consumer. When you look at kind of the Q3 results and especially on the ASP line and your guidance for Q4, is this just seasonal consumer strength or do you actually think that both in the developed and developing market, you can now start talking about turning a corner relative to tablet cannibalization and perhaps PC stabilization in emerging market consumer?

Brian Krzanich

I think what we would phrase this as or what we did phrase this as is, it's seasonal. And so we're not saying that there is -- in fact we said that the consumer we believe is flat. There is seasonal growth as we move into the fourth quarter. We're still seeing that mature versus emerging market trends that we talked about in the previous quarters where the mature markets are a bit stronger, the U.S. especially, Western Europe though as well and the emerging markets China, Latin America and some of the others are still soft. And so those trends are continuing. And when you look at the consumer as we go into the fourth quarter, we've forecasted a seasonal growth for the consumer side.

John Pitzer - Credit Suisse

Perfect. Thanks guys. Congratulations again.

Operator

The next question comes from Joe Moore from Morgan Stanley.

Joe Moore - Morgan Stanley

Great, thank you. I wonder if I could just push a little bit more on the gap between sort of 15% unit growth versus the market. I think you attributed it to three factors to share gains to the core base tablet and to the inventory environment a year ago. Which of those factors do you think is most important just because of such a wide gap between the numbers?

Stacy Smith

I actually think they're all sizeable numbers and it's not unusual for us to have those kinds of differences from the third parties. I think coming back to the prior question we've had sustained share gains I think over a period of time, so it's probably a slightly larger number and then kind of a normal amount of inventory you put in the system, you do that math with the third element being the core base tablets which I think is going to be relatively smaller.

Joe Moore - Morgan Stanley

Okay, great. And then just so I understand the tablet differential, if it's got anything that has a Bay Trail M or Core is considered a PC unit the way that you're classifying, is that right?

Brian Krzanich

It’s more the Core. So products that have a core, I used the Microsoft surface as a great example, we classify that in a PC side.

Joe Moore - Morgan Stanley

Got it.

Brian Krzanich

That’s probably the cleanest example.

Stacy Smith

And IDC would classify that in a different category. So that’s adjustment you’ll always have to make. I’d also say there is a piece. We tend to have a difference with the third parties on an ongoing basis. And I think it comes down to the breadth of tracking in the white box deep in the emerging markets, the tier 3 tier 4, very hard to get your arms around that holistically. And so we tend to see over long periods of time, we have a slightly higher billing number, the nature of the market number and thus we can tell it’s just hard to get your arms around the diversity of the market when you get into white box channel in emerging markets. So that’s always going to be a difference between them.

Joe Moore - Morgan Stanley

Okay. Thank you very much.

Operator

The next question comes from Stacy Rasgon from Sanford Bernstein.

Stacy Rasgon - Sanford Bernstein

Hi guys. Thanks for taking my questions. I am sorry to harp on it but I want to go back to this as well. So I understand you’re saying for your own business you think consumer is kind of seasonal and I guess flattish for the year in Q4 but obviously you must -- you and I guess your channel partners must be expecting a much bigger ramp of consumer in Q4 given how much inventory you must have built in the channel in Q3. So I guess how do you get comfort that that consumer sell-through is going to be there in Q4 and what’s going to be the consequence if that consumer sell-through is not there? Is the corporate uptake still there; is that going to be enough to offset or like how do we I guess judge the potential scenarios around consumer demand in Q4 and the sensitivity of your guidance around that?

Stacy Smith

Well, that’s a lot of different questions in one. Let me take a short here though. I’d say first inventory -- this is Stacy by the way and Brian will jump in. But I think the inventory levels, what we see is when you look at it in terms of weeks of inventory, it’s appropriate levels of inventory, it’s kind of right in the range of what we’d expect. So you termed it as excessive inventory; I think we’re not seeing that.

As always, if demand doesn’t materialize, then customers adjust their buying pattern and bring inventory levels down. But what we see is kind of normal levels of inventory and it’s sufficient with seasonal Q4 that’s what our customers think will happen and that’s I think what we think will happen in terms of our seasonal results. You also had a question on consumer versus enterprise and the strength of enterprise, I’ll let Brian talk about those market trends.

Brian Krzanich

Yes, in fact, I’d just take it back to the inventory comments as well. We do what I believe is a really good job of watching our whole supply chain from below us looking at things like the motherboard ordering pattern at the OEMs in Asia and what’s happening there is really the pulls from our inventory hubs and a lot of our -- more than half our product ships out hub now and we actually control the inventory on it, so the OEM pulls it at the last moment of use. So we see the actual usage rates there.

Two what’s flying out the shelves at the point of sale? So we’re watching all of those and I think we’ve demonstrated in the past back in the variety of market moves, we’ll react very quickly. So as Stacy said, current inventory is very typical for this 1% seasonal growth that we’re forecasting for the fourth quarter and I’m comfortable and I’m also even more comfortable that we’ll be watching it. And if something did happen, we can adjust in either direction.

The comment about consumer versus enterprise, as we said, we forecasted a standard seasonal consumer. So, we’re expecting not a great holiday season, not a bad holiday season, a standard holiday season for the consumer in the PC segment.

We continue to see enterprise strength that’s shifting; it was strong in desktops earlier in the year, it’s kind of moved to notebooks as we move to the second half of the year as some of the markets that shifted a little bit, but overall the enterprise all the way from large enterprise to small and medium businesses stayed fairly strong through this year, still seeing mature market versus emerging markets trend, mature being stronger than the emerging. But those trends have stayed and we’ve just forecasted a seasonal consumer. So, I’m pretty comfortable with where we’re at and I think we’ve got the right tools in place to watch this.

Stacy Rasgon - Sanford Bernstein

Got it. So my follow-up, let me ask the question a different way then. How much the weeks of inventory in the channel go up in Q3 to keep -- to bring them to levels that you would now classify as sort of healthy and appropriate for the Q4 patterns that you’re talking about?

Stacy Smith

I’m going to hold up on quantifying that Stacy, but I’d say we look at a range of inventory in terms of forward looking weeks and we’re well within the normal band with that range. So, we’re not seeing a thing that’s out of the day.

Stacy Rasgon - Sanford Bernstein

Okay. Thank you.

Operator

The next question comes from C.J. Muse from ISI Group.

C.J. Muse - ISI Group

Yes, good afternoon. Thank you for the next question. I guess first question, curious in terms of whether your guidance changed at all in the last two to three weeks given macro concerns, decline in commodity prices, weakness Europe et cetera. Anything in terms of your guide changed with the vision, the seasonality maybe something little better would love to hear your thoughts?

Stacy Smith

No, I mean the only guide we provided is the one we provided a couple of hours ago. So, we watch the markets all the time. I think if your question is have we been kind of showing and doing something (inaudible) seeing some of the like the microchip results and things like that we did, we’re not seeing anything that’s unusual out there. So again, it’s not a surprising forecast for Q4, it’s kind of seasonally up on the back of a more or less seasonal Q3.

C.J. Muse - ISI Group

That’s helpful. And I guess as my follow-up question, to your specific comment on operating leverage, if we go back to your initial guide for the year at flat revenues and now up around 6% at the midpoint of your guide, during that same time you've grown your OpEx by 5% and in your prepared remarks you talked about IP synergy, curious how we should think about operating leverage going forward.

Stacy Smith

Yes. It's a long-term, short-term phenomenon that we've talked about and we will absolutely go into this more in November but we're still committed, Brian and I are still committed to bringing our spending as a percent of revenue down. We will be down a little bit, this year just by dent of the increase in revenue. On the flip side, this is very much a transitional time for us and we've been making some incremental investments over the course of the last year in areas where we felt like we needed to generate a long-term return. So, we're glad we're able to bring it down a little bit, particularly the back half of 2014 is better than the first half. We'll continue to bring it down, thought we knew we were doing during a time where we were making some elevated investments that we felt we needed to make.

C.J. Muse - ISI Group

Very helpful. Thank you.

Operator

The next question comes from Vivek Arya from Bank of America.

Vivek Arya - Bank of America

Thanks for taking my question. Can you talk about the carrier certification and some of the competitive landscape you're seeing in LTE base bands? And I guess the bigger question Brian there is that other than this rollup off the tablet, their contra revenues; are there other actions you can take to reduce losses in the mobile division?

Brian Krzanich

Sure. Let me try and answer your question. There is I believe two questions kind of built in there. The first was around where are we with certifications on our LTE, so where are we relative to our LTE roadmap?

What I would tell you is our 7260, as you heard has had several design wins. We've publicly said two of them with Samsung. There are others in the works that we're working on right now. As far as certifications with the carriers, we've begun certifications across the world. And you will see the systems in almost every geography, as they come out. We've been shipping with a variety of products throughout this year in a variety of other markets especially in Asia. So, we feel fairly strong; we also see there is only -- there is only two people out shipping Cat6 LTE modems right now and we're one of those two. So we feel good about our roadmap, roadmap moving forward, going beyond Cat6 that we feel is highly competitive and keeps us at or near the leading edge. So from a modem standpoint, we feel very strong right now.

You asked, is there other things that we can do to reduce our MCG spending, I think there is. If you take a look at what we're driving on our phone strategy, we're really driving a strategy that rather than pull and push on our own into the phone space, we're really going with strong partners that are in that space already and have the linkages and the customer relationships.

And really that spectrum is the most I'd say perfect example of that where they're strong in China, they're strong in other parts of the world, they are great supplier to several of the OEMs. And us bringing our SoFIA platform, our base I8 along with modem technology and then over time we'll likely come into our silicon as well. That gives us them and them a competitive advantage and a cost advantage we believe and a way to get into those markets very cost effective efficient way.

Stacy Smith

If I could add one thing, I think Brian is talking about -- the first step is great product, second step is getting the right investment level. And I think one of the things you're seeing from and in the company is a lot of innovation in terms of how we go to market. There is a third piece here too which is I think increasingly we're going to see that the IP that we're creating for the mobile group is useful and in fact becomes a competitive advantage across the breadth of our product line. And Brian talked in his prepared remarks, if as we think happens over time more of the computers of the world, the notebook computers of the world are connecting via Wireless LAN and we're one of the companies that has that IP, there is a lot of company synergy associated with us investing and leading in that technology?

Brian Krzanich

I think that's a great point. You're going to need those modems in IOT. We've said that roughly 15% of the PCs in a couple of years will need them. And then there is synergy, we're going to find in even down in this space bring some of that innovation and IP like the RealSense cameras and all the way through the mobile space as well which will help us differentiate our products and working with our partners allow them to differentiate as well.

Mark Henninger

Operator, we're going to take two more questions, if you can go ahead and introduce the next questioner please?

Operator

The next question comes from Doug Freedman from RBC Capital Markets.

Doug Freedman - RBC Capital Markets

Hi guys, thanks so much for allowing me to ask you question and congrats on the strong results as well. If I could dig in a little bit on what's going on in your tablet goal, it does seem I heard a 15 million number for the quarter that you shipped, that would mean that you need to ship actually I believe if I have added up right about 10 million next quarter. Does that mean that the subsidies have peaked in the third quarter or do you think you are going to exceed your tablet shipment goal by an equal amount?

Brian Krzanich

So, let me answer the question on volume and I'll let Stacy talk about the subsidies. Your numbers are very close; you rightly hit about 15 million, we think got 10 million to 12 million for Q4. We're not going to necessarily try and blow the number out, but we're also not going to miss it by 1 million or 2 million. So, my guess is somewhere between 40 million and 45 million is where we'll end up. Exactly where that is we'll make sure we're passed the 40, but not there is no need to go well above that.

As we said that puts us the largest merchant supplier to the tablet business. And we're really trying to move that space now as both our cost reductions but also differentiating with products like the Dell Venue which we believe is ph [unfinished]. And I have a lot of innovation with the first of the real subs; we have other products with our other OEM partners like Lenovo moving forward. I'll let Stacy talk about what that means for our subsidies or our contra.

Stacy Smith

Yes. So the contra answer is a little bit complex, because keep in mind it has to do with both volume and the mix of what we're shipping for the earlier answer to the question about the different platforms come with different subsidy dollars per unit. I'd expect net of all of that we're going to see revenue results in the segment are not terribly dissimilar from what we saw in Q3 and then we'll start to see reductions as we move into next year.

Doug Freedman - RBC Capital Markets

Okay, great. Thanks so much. If I could for my follow-up, just one on some start up accounting. Clearly it did impact gross margin this quarter and your guidance, is there any color that you can offer us on sort of what your outlook is sort in the way in which you think you're going to ramp 10-nanometer? It appears as though the 14-nanometer, the magnitude of ramp with the Broadwell platform is a little less than you might have expected as we entered the year. Is that something that you think might repeat on future nodes?

Stacy Smith

Yes. And apologies. This is Stacy, broken record Smith. I'll talk more about gross margin trends for '15 next month when we get to the investor meeting. But you are seeing in the fourth quarter, you're seeing the front edge of the startup cost associated with the 10-nanometer and that's kind of right in line with the historical timing of what you'd expect. We'll go through more excellent where we talk about how that might look over the next couple of years but we're seeing at least the front edge at the time I think you'd expect and that's about a point of gross margin next quarter.

Doug Freedman - RBC Capital Markets

Great, thanks so much. I had to try.

Stacy Smith

I understand.

Mark Henninger

Thanks Doug. Operator, if you could go ahead introduce our last question please.

Operator

Our final question comes from Mark Lipacis from Jefferies.

Mark Lipacis - Jefferies

Hi. Thanks for taking my question. The first question I had was on the tablet market. When you look at the units that you have shipped so far this year and as you look into what you're expecting to ship next year, to what extent are the tablets that you're shipping in to, are the Android versus Windows tablets? And has that played out differently than you expected that mix as Microsoft seems to have cut the price of the bundle of Windows and Office?

Brian Krzanich

The mix of Android versus Windows has pretty much played out as we forecasted. Probably 80% plus Android did with ours' mix represents pretty much what you see in the marketplace. So if you walk into any store. So, there hasn't been really any shift that has been through.

Mark Lipacis - Jefferies

Okay. Thank you. And then the second question if I may, there is a view out there that the PC growth that you've been seeing has been driven by mostly a Windows XP upgrade cycle. Could you update us on your thoughts on that topic? Do you feel better about the idea that's not just Windows XP but rather innovation driving the demand? Thank you.

Stacy Smith

Yes. This is Stacy. There is no data that's going to prove the point one way or the other but based on what we see in our surveys, there is a variety of things that are causing people to go and upgrade their PCs. Certainly the Windows refresh is one of them. But it's also form factors, it's the age of the PCs and the price points, I think all of that is playing in. And I think when we look across the breadth of our SKUs and knowing which of those are going into, there is large enterprise, small and medium consumer, we get a sense that we're seeing growth that's more broadly been just something where people are upgrading Windows.

I'd tell you the second part of your question in terms of where are we, we say in the back half of the year believe that the impact that we are seeing with XP is probably less than it was in the front half of the year but there is likely a pretty long tail that has some positive impact on the market for a while to come when you just look at the age of the install base and how many of those are now in support of supported operating systems.

Mark Lipacis - Jefferies

Thank you. It's very helpful.

Mark Henninger

Great. Thanks Mark. Alright, thank you all for joining us today. Jamie, please go ahead and wrap up the call.