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NSM - Q4 2010 National Semiconductor Earnings Conference Call

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PRESENTATION

Operator

Good afternoon. My name is Carrie and I will be your conference operator today. At this time, I would like to welcome everyone to the Q4 fiscal year 2010 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) I would now like to turn the conference over to Mr. Mark Veeh, Investor Relations Manager. Thank you, Mr. Veeh. You may begin your conference.

Mark Veeh - *National Semiconductor - IR Manager*

Thank you, Carrie. And welcome everyone to National Semiconductor's fourth quarter fiscal year 2010 earnings conference call. Joining me on the call today is our Chief Executive Officer, Don Macleod, and our Chief Financial Officer, Lewis Chew. During our prepared section of this call, we will be providing details around our Q4 results, background to our Q1 outlook and some

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commentary around our recent market trends and business environment. At the end of our prepared comments, we will then take questions until approximately 2:30 Pacific time.

As we begin our call, I would like to remind everyone that today's discussions will contain forward-looking statements that involve risk factors that could cause National Semiconductor's results to differ materially from management's current expectations. Please review the Safe Harbor statement contained in the press release published today as well as our most recent SEC filing for a complete description of those risks. Also in compliant with SEC Regulation FD, this call is being broadcast live over our Investor Relations website. For those of you who have missed the press release or would like to replay the call, you can find it by going to National's IR website at www.National.com. With that, I will now turn it over to Don.

Don Macleod - *National Semiconductor - CEO*

Thank you, Mark. So, I'd like to now attempt to anticipate your interest in our fourth quarter's results and our outlook by answering the following four questions. First, what drove our business in the fourth quarter? Second, what areas could provide National Semiconductor with additional revenue growth going forward? Third, given the economic situation, where do we see our business trending over the next quarter and why? And finally, how is our business model progressing?

So on the first topic, what drove our results for the fourth quarter? Looking at the trends by end markets, our sales to the industrial market grew by 11% over Q3 and accounted again for about 45% of sales. Our sales to the next most significant end market for us, mobile phones, grew sequentially by about 12% over Q3. Our sales to our third largest end market, which is communications and networking, had about 12% of our overall sales grew sequentially at 5% which is less than the overall Company, and was driven by a slower quarter of sales to China-based communications infrastructure companies. These three areas accounted for about 82% of our overall sales.

By geographical region, our sales to the Americas grew sequentially by about 13%, to Japan by 11%, to Asia-Pacific by 9%, and to Europe at 8%, i.e., all of four regions showed growth around the overall Company's 10% sales growth. Also, by sales channel, our sales to distributors grew by 12.5% over the third quarter, again, not far from the overall 10% Company rate. When I look at our product view of what drove our growth in the quarter, our largest product area, which is power management products, at 47% of our sales, grew sequentially by 11%.

Our amplifier products also grew by 11%, and represented 24% of our sales. Both, again, very close to the overall Company growth rate. So to close on the first topic, what drove our results for the fourth quarter, my message here is that our overall revenue growth was very broadly driven by a number of end use markets, by each of the geographical regions, by the channel, and by the major analog product areas, all at similar rates over the third quarter.

So, on to our second topic, which is where are we looking to see additional revenue growth beyond our current business going forward? Let me first cover our growth status in two existing market areas, that's mobile phones and industrial power management, before I talk about two of our new initiatives for growth which is in LED lighting and solar energy efficiency. First, our focus on power management and other analog solutions for mobile phones. In our last quarter's earnings call, I suggested that the third quarter might have represented the bottom of our declining sales into this mobile phone market. This fourth quarter's results supports that view.

Our sales to the mobile phone market grew sequentially by about 12%. Our bookings from that market in the quarter also grew sequentially by about 14%. And our higher order backlog going forward also indicates that we should grow our revenue to mobile phone customers again in the upcoming first quarter and into our seasonally strong second quarter. Some of this growth is coming from design wins obtained from the second half of calendar year 2009 onwards that are now ramping into production and some is coming from us being more aggressive in pursuing ongoing business opportunities that we might have walked away from in the past.

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Our second ongoing revenue growth opportunity is in industrial power management applications. Here, we've been traditionally the go-to brand for industrial power supply designers with their simple switchers and our ease of use web-based design tools, especially here in the Americas and in Europe. As we extend this ease of use customer functionality, we're seeing accelerating sales. Since about 95% of the sales of these simple switchers and other industrial power management products are to smaller customers worldwide through the distribution channel, a good indicator of the penetration is what the distributors are actually selling to their end customers, in other words, what we call the resales.

In this fourth quarter, our distributors' resales of our simple switchers grew just over 20% over the third quarter. We have two growth strategies to expand this simple switcher franchise. One is to create the same 20 year brand equity we already have in the US and Europe and add more focus on China and on the other is to bring more simple switcher modules that integrate our chips with passive devices into a single even easier to use package beyond those modules that we already brought to the market in February of this year. Our simple switcher product line represented about 10% to 11% of our overall Company revenues in the quarter.

So, now let me update you on our progress on two newer areas of future revenue growth, again, from our power management capability. First, driving LED lighting. For our revenues from this LED general lighting area increased again sequentially, they're still quite a small portion of our current revenues. The potential is, however, big. We have a very strong pipeline of design wins in LED light bulbs, outdoor, residential, architectural, automotive and street lighting applications. You can now purchase an LED-driven Edison light bulb replacement at Home Depot that incorporates our integrated circuit.

Our customers also plan on bringing LED light bulbs and LED-driven light fixtures to the shelves at other home appliance and large retail outlets in the near future and this is at a whole new set of price points. For example, what was available at $50 to $70 per bulb a year ago and $40 to $50 per bulb six months ago is now retailing at $20 per bulb and falling further. According to Strategies Unlimited, the LED replacement bulb forecast for 2013 is potentially 250 million units a year.

Also, last month at the Lightfair Trade Show in Las Vegas, our ICs were present in over 30 different lighting manufacturers' booths and these spanned many different lighting applications. Beyond these applications here in the US, over half of current sales and design wins for LED lighting applications are in China, which is clearly leading in the early adoption of LEDs for energy saving, innovative architectural applications and LED street lighting proliferation.

The second power management-based future growth area I would like to talk about is our focus on enabling new energy efficiency solutions in solar installations. Last week, we announced our SolarMagic chipset, specifically designed to work either in or with individual solar panels, to cost effectively maximize the harvest of energy from solar installations. Using our SolarMagic chipset, a solar panel can recover up to 70% of the energy lost due to panel mismatch, aging, shade, dust and other natural conditions. This chipset will typically be installed within the panel's junction box, with the cabling connectors attached to the solar panel and it incorporates ten different National Semiconductor integrated circuits, two of which are highly proprietary application specific system solutions.

At the Intersolar Trade Show in Munich this week, three of the largest junction box manufacturers, one each from US, Europe and China, all announced new junction boxes incorporating our chipset. We should see early limited revenue from this chipset in the remainder of this calendar year, and hopefully a ramp in calendar 2011, as solar panel manufacturers bring to the market their solar panels incorporating these new junction boxes.

So, to summarize on the two topics of what drove our revenue growth in the fourth quarter and where are the additional new revenue growth initiatives going forward. Our revenue growth in Q4 was very broadly based from a user end market geography channel and analog product perspective. Our power management and now also our products for mobile phone applications are drivers of our current growth. Our new growth opportunities in LED lighting applications and solar energy power efficiency are also gaining traction and can add to our revenue growth in the future.

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So now let me cover our third topic, which is how do we see our business going forward into the summer quarter? First of all, we're guiding another revenue growth quarter. Our June, July and August quarter is usually a seasonally down revenue quarter. However, this time our order backlog for delivery in the first quarter is up on the equivalent backlog going into the just-completed fourth quarter. We expect to grow our sales to both our OEM customers, especially those in the mobile phone market and our distributors in the quarter. We also expect to grow our sales to the European region in the quarter. And yes, grow these sales in US dollar equivalents, unless the Euro depreciates significantly further against the US dollar.

Globally, we expect our sales to our distributors to grow sequentially. We ended the fourth quarter with distributors' inventory weeks down over the third quarter. Our distributors are also telling us that their resales, i.e., what they sell out of our products, should also grow sequentially over the fourth quarter actuals. So going into this first quarter, our delivery lead times are under control. Our distributors and our OEM customers are not being induced to over-order on us and we have more control of our lead times as we manufacture 95%, plus of our products in-house, both the wafer fab and the back-end test and assembly.

Note that our bookings for the quarter grew at about 12% sequentially, i.e., they're pretty well-matched to the 10% sequential growth we experienced in the quarter. Like all of you, I have my antenna raised for any signs of slowdown in our customers, our channel partners and end markets, and especially for any signs of inventory building. At this time, our indicators point to a continuation of revenue growth over the summer albeit at a potentially slower 3% to 5% rate.

Now, to my last topic, which is how we're progressing in our business model. I really want to focus on two areas, our gross profit margin and our operating margin. Our 68.8% achievement in gross margin for Q4 really highlights the leverage in our business model. Over 80% of the sequential increase in revenues fell through to gross profit, and we have more leverage to come. Our Texas wafer fab closure, where the last wafers came out of the fab in May, will deliver additional gross margin over the upcoming first and second quarters as the inventory is used up.

Our operating margins also reached 30% for the quarter. And following on from me, Lewis Chew will guide you to lower operating expense dollars for the first quarter. In addition, we have a commitment to manage down our SG&A expense percentage over the medium term. All of this, I think, gives us an opportunity to translate more of our revenue growth into increased earnings per share as we go forward. So I'd now like to hand it over to Lewis to put some more flavor on our results and provide some detail on our forward business model. So Lewis, over to you.

Lewis Chew - *National Semiconductor - CFO*

Thanks, Don. So as Don said, the revenue outlook we're providing today is that Q1 is expected to increase sequentially over Q4 by a range of plus 3% to plus 5%, which would equate roughly to Q1 revenues of $410 million to $418 million. And if you look at the past history of our business, it's not unusual for National's revenues to decline by a couple of points in Q1, due mainly to summer seasonality, but that's not our expectation this year. So I'll spend a few minutes going through the key factors that played into our Q1 revenue projection and then as part of that, I'll cover the business activity we saw from distribution channel and direct customers during Q4. And then after that, I'll go over the outlook for the rest of the income statement and then cover a few points on balance sheet and operating metrics before turning it back over to Mark to handle questions and answers. And he's actually volunteered to take all the tough questions today, so Don and I are feeling very relaxed right now.

So let me start with the bookings activity we saw in Q4. Don mentioned that for the quarter as a whole, total Company bookings were 12% higher than they were in Q3, and this was driven mostly by our distribution channel, although bookings from direct customers were also up in Q4, just to a lesser degree. The Company's run rate of orders, total orders, that is, was highest in the March and April months of the quarter and then moderated a little bit in May, but all three months of Q4 had bookings running higher than billings, if I were to translate each of those months' orders to a quarterly equivalent.

Bookings were up in Q4 in each of our four major geographical regions with the highest percentage gains in Europe and North America. And as a subset of that, turns orders were also strong throughout Q4. Total turns for the quarter increased over Q3,

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and were better than what we originally expected. The higher than expected turns was driven by our core and our industrial businesses, which we serve mainly through our distribution channel, as we saw distributor resales up about 19% during the quarter and this rate of increase was also higher than we originally expected because we did come into the quarter thinking that resales were going to go up, but just not up 19%.

Because of the significantly higher resale rate in Q4, our ending weeks of distributor inventory was lower, although dollars of distributor inventory did go up. At the end of Q4, we had a little less than nine weeks of distributor inventory which is below the low end of the range that we like to operate at and in Q1, we anticipate that the weeks of distributor inventory will be somewhere between nine weeks and ten weeks, which we are comfortable with. Because the increased orders in Q4, our opening 13 week backlog heading into Q1 is higher. We currently anticipate that turns orders in Q1 will be lower than they were in Q4, due to summer seasonality and also recognizing the near-term backlog that we know was put in place during Q4. So all factors considered, led to our revenue outlook of up 3% to 5% in the first quarter of fiscal 2011.

So let's go on to the rest of the income statement, starting with gross margins. In Q4, our gross margin was 68.8%, up 150 basis points sequentially. Gross margin percentage in Q4 was helped by higher sales volume, cost benefits in our factories and favorable product mix. During the quarter, we saw a better than expected sales increase from our higher margin industrial type products and at the same time our fab utilization increased to about 64%, compared to 49% in Q3, and that's based on wafer starts.

Also, we finished production in our Texas fab, just a little ahead of schedule near the end of Q4. And as originally planned, we will now move forward with final decommissioning of that facility in FY 2011. So based on our revenue outlook and also considering the cost savings that we'll get from the Texas plant shutdown, we anticipate that gross margin in Q1 will range from 69% to 70%. This reflects the vast majority of savings from Texas, a little more should be realized in Q2 but I'll update you on that in three months when we give the Q2 outlook. As we continue with our shutdown activities of Texas in Q1, I anticipate that we will incur $8 million to $9 million of restructuring expense during the quarter, and we will continue to break these out separately for you. I do expect that these charges will decline in Q2, to a range of about $5 million, and I'll also update you on that in three months.

Now let me cover operating expenses. In Q1, even though revenues are projected up, I expect total operating expenses to go down a little as we start the new fiscal year. R&D expenses are expected to range from $71 million to $73 million. SG&A expenses are projected to range from $73 million to $76 million. And within our expense range, I am estimating total stock compensation expense, which was about $17 million in Q4, to be around $15 million in Q1, broken down approximately as follows -- $2 million in cost of sales, $4 million in R&D, and $9 million in SG&A. Other income and expense is estimated to be about $1 million of expense, and interest expense net is expected to be around $13.5 million as our debt balances are coming down during the quarter. The effective income tax rate in Q1 is projected to range from 29% to 31%.

Moving on to the balance sheet and operating metrics. Our capital expenditures in Q4 were about $19 million. In Q1, we estimate that capital expenditures will range from $25 million to $35 million, which includes investments to continue converting 6-inch capacity to 8-inch capacity in our Scotland fab as well as additional investments we are putting into our Malaysian assembly and test plants. Our long-term model for capital expenditures remains targeted at around 5% to 6% of annual sales. But the quarterly ratios, of course, will tend to fluctuate depending on the specific timing of when we purchase our equipment.

Our ending inventory for Q4 was $119 million, up about $5 million from Q3, which means that days of inventory on hand ended Q4 at around 87 days, which is close to the 88 days we had at the end of last quarter. Days of receivables at the end of Q4 was about 22 days, also similar to the previous quarter. During Q4, we had good linearity in our revenue and our cash collections continue to be timely. The Company's cash reserves ended Q4 at a little over $1 billion, up from $869 million in the prior quarter. $250 million of that came from a senior unsecured five-year bond that we floated during Q4 and that money is earmarked to pay off a $250 million bond that is maturing this month.

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During Q4, we also paid off our bank term loan, about two years ahead of schedule, and the balance on that loan was a little over $200 million when we paid it off. By the way, paying off this loan had the benefit of eliminating the two financial covenants that were attached to that debt, although I should note that we were always well in compliance with those covenants. Operating margin, as Don mentioned, in Q4 was back to 30%. And also return on invested capital was about 24%. Both of those include stock expense but not restructuring charges.

Regarding our business model, gross margins are now operating within our target range. Growing revenue is the Company's top priority and our manufacturing cost improvements will help us in that regard, especially given our strong our margins already are. With our fab utilization where it is, we have capacity to support immediate and longer term growth. And as revenues increase, we will continue to leverage our operating expense profile to drive that OpEx percentage back towards a target model of mid-30% which includes stock expense. Our follow-through from top line to operating profit should enable us to pursue higher revenue growth and still deliver operating margins consistently in the 30s. And now to handle all of your questions, let me turn the call back over to Mark Veeh. Mark?

Mark Veeh - *National Semiconductor - IR Manager*

Thanks, Lewis. So at this time, I'll ask the operator to open up the lines to begin the Q&A session. So Carrie, can we please have our first Q&A?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Craig Ellis with Caris & Company.

Craig Ellis - *Caris & Company - Analyst*

Thanks for taking the question. Don, I was hoping that you could go into a little bit more detail in terms of what you're seeing on the handset opportunity that you've got. Historically, I think you guys have done real well in the smartphone part of the market but as you look to grow opportunistically, are you moving down into the feature phone part of the market and as you gain share, which regions do you think you'll look to as the early signs of share gain?

Don Macleod - *National Semiconductor - CEO*

Yes, Craig, that's a good question, relative to our positioning in the handset market. Traditionally, we've had really two areas of strength. One is in generic power management solutions and handsets and the other is in audio and the nature of our products tended to support more smartphone applications, basically we don't have the chipset, the baseband and the other chipsets. So we tend to power for example peripheral functions that are driven off applications processors that tend to be in the higher end phones and likewise, in audio we tend to play in the audio subsystem area where the phones have more features.

Our position going forward has two features. One is that we are much more aggressively pursuing integrations in the mobile phone. For example, the PMIC or PMU space. We've always had a presence in that space. I think we tended to be more selective in the past. We are being more aggressive in pursuing those opportunities and some of these are featuring in our revenue as we go through this calendar year. Some of the other areas where we play are in some of the building block functions in the analog space around the mobile phone where we've always had a strong position in power and some of the other, for example, RF detection and other areas around the power amplifier.

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We've obviously been pursuing these. And I think if you look at this quarter's numbers, it's pretty clear that at least to me, anyway, that 12% revenue growth suggests that we're gaining position in that mobile phone marketplace from a pretty weak, if you want, calendar first quarter. So we're pursuing all of those and I would say we have a lot of room to grow here. It's not going to be easy and quick to turnaround in one or two quarters our position in the mobile phone space but we're clearly gaining traction with new designs that will be kicking in the second half of this calendar year and into the first half of next year. So that's a summary of where we fit into the mobile phone and that's what we're seeing at this point.

Craig Ellis - *Caris & Company - Analyst*

Okay, and as a follow-up to that, historically the Company's handset mix as a percent of total has been in a mid-20% to mid-30% range. Over what period do you foresee getting back to the mid- to high-end of that range? And then, there's a category that seems to be emerging in between PCs that used to be a big opportunity for National and handsets that still is big, this tablet category. How do you look at the tablet opportunity as a growth factor for National?

Don Macleod - *National Semiconductor - CEO*

You ask a difficult question from a percentage of sales perspective. Our goal clearly is to grow the mobile phone business and grow it at a better rate than we've been doing in the last few years. So it all depends on how the Company as a whole provides -- I mean, I'm very comfortable with 25%, 25% to 30% is a good number. You made a very interesting point of the convergence between the handset and the portable computing device, if you want. National has not played in the -- if you want, computing space and we view the opportunity that is now being provided by computing devices or hand-held devices that have larger displays that are really coming from the mobile phone heritage as an opportunity for us.

For example, we've long had a business where we drive back lights for displays and one of the key differentiating features in, for example, ebooks and other similar devices is the display and the clarity of that display in various different lighting conditions. Obviously, we've had a position in that area and we see this as a good opportunity for convergence, i.e., a way for us to capture more of these so-called computing type hand-held applications. So, we have efforts going on to get into that space and I think we'll be talking about these as time goes on.

Craig Ellis - *Caris & Company - Analyst*

Thanks, Donny.

Operator

Your next question comes from Mahesh Sanganeria with RBC Capital Markets.

Mahesh Sanganeria - *RBC Capital Markets - Analyst*

Thank you. Just a question on Europe, looks like all eyes are right now on Europe and people seem nervous. But from your perspective, have you seen any changes in order pattern from Europe?

Lewis Chew - *National Semiconductor - CFO*

Mark, did you want to that that one or -- ?

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Don Macleod - *National Semiconductor - CEO*

Clearly, that's a question of great sensitivity. We pose that all the time to see where our business in Europe is going. If you look at our business, overall for our Company, 45% of our sales are very broadly to the industrial space which spans everything from medical devices, automotive, and instrumentation, factory automation, et cetera, the whole spectrum. We have a very strong business in Europe in that industrial space, a lot of which goes through our distributors. My read on that marketplace at this point in time is that actually the current currency or economic issues that are impacting the currency are actually beneficial to that industrial business in Europe.

Our distributors and customers tell us that the potential of the weaker Euro is actually a [boom] to their business and going into this earnings call we spent a lot of time trying to flavor the guidance we could give for revenue growth in this upcoming first quarter over the fourth quarter, in particular with Europe. And the inputs we got were that our customers in that industrial space and, again, distributors, were looking to continue to grow their business and for us, the net growth of that is sufficient to overcome the new weakness of the Euro that we have against the US dollar. So unlike, I guess, daily conventional wisdom, our customers and distributors appear to be taking a more positive view of the industrial opportunity that is coming out of Europe.

The other portion of our business, of course, is the mobile phone space. The mobile phone market, as you know, is global and the drivers of that marketplace, even though some of the names happen to be headquartered in Europe, are essentially in developing countries and other growing regions of the world. So I would say that we have seen a very normal pattern in our mobile phone business globally, including from those customers who are driven out of Europe and we're looking for the usual seasonal pattern in that business, which is a stronger second half versus the first half.

So at this point, I don't see anything negative other than the effect of currency in our business in Europe and even on the currency side, you might want to note that we do have a wafer fab. One of our two remaining wafer fabs in the UK which to some extent is also benefiting a little bit from the weaker currency and that obviously helps our cost structure so that's where we were at this point on that one.

Mahesh Sanganeria - *RBC Capital Markets - Analyst*

That does sound very encouraging, considering the way the market is behaving. Just moving on, secondly on the communication part. You said that communication business was a little slower because of the China. Can you expand a little bit more, looking going forward, how do you see that business trending?

Don Macleod - *National Semiconductor - CEO*

The point I made in the prepared comments was that, that part of our business, which accounts for 11% to 12% of our Company, grew at 5% sequentially, less than the overall Company. And I think the well-known public comments that have been made regarding the slightly slower investment in 3G infrastructure in China. And some of the issues that have affected the export of GSM wireless base stations from China to India have clearly impacted the two major customers that we deal with and they've had a pause in their business. At this point in time that pause impacted our growth. I think the resumption of that growth going forward will be apparent but we had a pause through Q4 and the rest of our business in that communication space was okay.

Mahesh Sanganeria - *RBC Capital Markets - Analyst*

Okay. Thank you very much.

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Operator

Your next question comes from Stacy Rasgon with Sanford Bernstein.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

Hi, guys, thanks for taking my question. Lewis, first I had a quick question for you around the Texas fab closure and the gross margin impact. I know you said it sounds like you had another bit of pull-forward on that. Can you give us some feeling for how much of whatever was left in terms of basis points to gross margin that actually helped you this quarter? And is it correct to assume that the majority of the margin expansion for next quarter actually is going to be from that pull-forward or from the tie-up of that closure? I'm sorry.

Lewis Chew - *National Semiconductor - CFO*

Did you want to take that, Mark or --

Mark Veeh - *National Semiconductor - IR Manager*

Yes, I'd say, Stacy, I wondered how quickly someone would ask that. So if I had to rough it out, it's probably in the neighborhood of about a 0.5 point or let's say in the neighborhood of 50 basis points came from the early accomplishment in Texas. Just to give you guys some color around that, we had -- our original plan was to finish production right at the end of the quarter and we finished about four weeks early and so that's in our numbers.

And it is true to say that a large portion of our margin gain in Q1 will come from the additional savings we get from a full quarter's worth of those savings. And in a little bit comes from just the fall-through effects of higher volume, spreading our fixed costs over a bigger number. So right now, we are actually not baking in any significant increase in mix in Q1 because with how strong our distribution business was in the quarter we just finished. I'm not assuming that that grows bigger as a portion of our revenue.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

Got it. Great. And one question around -- I think it's probably been asked before on previous calls but it's getting a little more imminent now. The potential for one of your competitor's effort on 300-millimeter analog. So, TI talked about not just putting more commodity stuff in here but maybe even putting some power management in. Maybe about 5 points or 10 points cost advantage they could potentially use. I'm just curious to get your point of view on how much of a threat -- is that a potential threat? And what is -- do you think your response and maybe the broader competitive response as that starts to get bigger.

Don Macleod - *National Semiconductor - CEO*

This is Don Macleod. We get asked that question a lot. Clearly, as a Company, we manufacture all our own products in-house. We have all our own wafer fabs. If you look at reality, we ran our wafer fabs this quarter at 65% utilization. We're looking to ramp our wafer fabs a little bit up over the summer. We're going to be running in the low 70% over the summer quarter. What does that tell you? It tells you there's 25% to 35% available capacity in existing wafer fabs already paid for, fixed costs already incurred.

So marginal cost for an extra dollar's worth of revenue in our case is going to be substantially lower than the cost of wafers that's going could come out of a brand new, even if the equipment is used, 300-millimeter facility. If we were in fact buying our wafers from third party foundries, the marginal cost of that extra wafer is the full cost of the wafer. We're not in that situation. Some of our competitors are. So we don't view in the short-term the TI 300-millimeter fab as a threat. Obviously, long-term like

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everybody else when it comes to the point that we have to invest in the next dose of fab capacity, we'll be putting likely 300-millimeter capacity in place.

And at that point, you'll also be able to access the used equipment market which, a couple years down the road, three, four years down the road will be hopefully at even cheaper prices than are available today. So, I don't get too worried about that. Obviously if a competitor chooses to take an aggressive pricing posture in the marketplace, that might have an impact generally but it does not provide a cost advantage over National Semiconductor.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

Great. One more question, if you don't mind. Just looking at resales for you guys, up 19%, do see a lot of that is going into the industrial markets. Do you have any idea where that's going? Arguably, it's even hard to define the industrial market. But, I mean, arguably it's probably the case those markets have not been up nearly as much as maybe the level of industrial growth that you and several of your peers have been having over the last quarters. Do you have a feeling on whether it's end customer restocking or share gain or any particular markets that might be driving some of the upside that we've been seeing from you guys and from some of your other peers in these industrials?

Don Macleod - *National Semiconductor - CEO*

Distribution is a big topic for us today. We have new initiatives in place to work with our distributors. We have much closer relationships with them. So I think we have a better read of the distribution situation. To take it a little bit differently to your question, the area where we saw the strongest growth in distribution in resales was in Europe. And the second strongest growth in resales was actually here in the Americas, when you look at the sequential growth, and you can stand back and look at that.

In other words, Asia was still good but it wasn't all driven out of, let's call it, consumer-driven marketplaces in Asia. And this industrial aspect of the business is pretty widespread. We have a very broad spectrum of customers and the -- if you go back to where our business grew, I referred to our industrial power management business. Simple switcher power supply products, our resales actually grew by slightly more than 20% sequentially. So when you go back and look at where all of these power supplies are being designed into, it's very broad. And it's very broad geographically.

So I think this is to me, the evidence of across-the-board improving market conditions in this industrial market. I don't think there's any one particular market. When we talked to our distributors, customers' names come up. These customers that the distributors talk about, very broad spectrum of customers in many different marketplaces. And the other point, I think you mentioned about inventory building, yes, it's clear that some customers, in some of those distributor end markets, are putting some buffer inventories in place. And I think that's a natural condition of this improving market.

They run the buffers down too much in the previous market in the economic situation we had a year ago but now they're putting them back in place. And frankly, in the short term, even medium term, I don't see them using up these buffers. They will keep them in place. And I think that's reflected in the guidance that we have in our business going forward.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

Got it. Great. Thank you.

Operator

Your next question comes from Sumit Dhanda with Bank of America.

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Sumit Dhanda - *BofA Merrill Lynch - Analyst*

Yes, hi. Lewis, a couple questions, please. The moderation in May bookings that you talked about, could you quantify that a little bit, if possible? And is the expectation as you go into the August quarter that there's an implicit pickup in bookings from that level?

Lewis Chew - *National Semiconductor - CFO*

If you look at the shape of our bookings in any typical year, I would actually say that that's not uncommon to see strong bookings March coming off of that very weak February period, accelerating through April and then tailing off into May and so the pattern wasn't alarming to us. In this environment, where it seems like every other sentence has the word "double bookings" in it, we do watch that. And like I said in my prepared comments, even if I take the relatively weaker May and turn that into a quarter's worth of revenue, it still had a book-to-bill ratio above 1. In other words, the run rate was still strong enough to support on its own, the book-to-bill above 1.

So I think what we'll do as a management team is continue watching that through this quarter but so far in the beginning of June, which is very early for us, a week and-a-half, the bookings have held up (inaudible) and like I said in the guidance, we have higher backlog heading into Q1. We're actually taking a fairly modest stance on turns assumptions in Q1 because turns are just a subset of bookings, right? In case that there is a continued softness to the summer. But we do know that inventories are pretty low out there, so my guess is that during the course of Q1, we'll see the bookings pick back up as we get closer to August and people get ready for the Christmas season.

Sumit Dhanda - *BofA Merrill Lynch - Analyst*

Got it. And I had a couple of follow-ups. You talked about distribution being the stronger, resales up 19%. Could you talk about distribution, which is OEM bookings, you said qualitatively distribution was stronger but any numbers you could share on one versus the other?

Lewis Chew - *National Semiconductor - CFO*

We don't break those out separately but it is true that our bookings and distribution grew faster than OEM but both were up in the quarter.

Sumit Dhanda - *BofA Merrill Lynch - Analyst*

Okay. Last question. The inventory on the balance sheet, do you anticipate building more into the August quarter?

Lewis Chew - *National Semiconductor - CFO*

Yes. I don't know how much, but it will be relatively slight. Like you saw this quarter, we built about $5 million and I would gauge it in that same scale.

Sumit Dhanda - *BofA Merrill Lynch - Analyst*

Okay. Thank you very much, Lewis.

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Operator

Your next question comes from Ross Seymore with Deutsche Bank.

Ross Seymore - *Deutsche Bank - Analyst*

Hey, guys. Lewis, just a question on OpEx. SG&A, it looks like you're guiding it down pretty substantially. Can you talk about what's going on there and what we should think on that line even beyond this quarter?

Lewis Chew - *National Semiconductor - CFO*

Yes, Don said that if Mark was going to take all the questions that he was going to cut my pay, so --

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Ross Seymore - *Deutsche Bank - Analyst*

Any more details than that?

Lewis Chew - *National Semiconductor - CFO*

We actually have a reset, the biggest thing is that starting the new year we finished this year. In fact, that's one of the reasons why OpEx was a little higher this quarter than the guidance I gave, but as we start the new year with new targets that are obviously based on the new revenue levels, coming off of that drives a little bit. We have stock compensation coming down a little bit. It's a little bits here and there. We have, as part of our annual planning process, we head into the new year with new initiatives and some recalibration of spending, so all those things add up to the decline that you see. There's no one big thing I could mention. I can certainly say we didn't do some big layoff or something like that.

Ross Seymore - *Deutsche Bank - Analyst*

And then I guess, switching over to the revenue side of things, you mentioned that you expect [DSD] channel inventory to rise a bit, but into the normal range, but rising nonetheless. Can you just talk about, out of the up 3% to 5% that you just guided, roughly how much of that is just from filling the channel?

Lewis Chew - *National Semiconductor - CFO*

Yes, it would be pretty hard to quantify that. We do have a view on what we model the inventory to be up but for example, the quarter we just finished, Ross, we modeled the inventory to be up and we ended up being too high on that. We ended up with inventory being lower than we thought because the resales end up being stronger. So it's very hard for me to say, well of the 3% to 5%, two points of that comes from inventory growth, but it is in there. Like I said, if we -- and I gave a pretty wide range too. I said that the weeks of inventory would be between nine and ten. My guess would be it would be at the lower end of that range.

So we're not looking for a significant increase in just the inventory but the point is our normal operating range today is probably more in the nine to ten range than below nine. Nine feels a little bit low to us. We actually have one of our regions where it's even substantially below nine. Because you can imagine some regions have higher than that average. So, the ones that have lower, they're running pretty tight.

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Ross Seymore - *Deutsche Bank - Analyst*

Thank you.

Operator

Your next question comes from Christopher Danely with JPMorgan.

Unidentified Speaker - *JPMorgan Chase & Co. - Analyst*

Good afternoon. This is in [Lincoln] in for Chris Danely. Actually, I have three questions, but my first question is for Mark. Hey Mark, does Lewis always give you such a bad time? Does he pick on you all the time?

Mark Veeh - *National Semiconductor - IR Manager*

I know, I'm getting picked on today.

Unidentified Speaker - *JPMorgan Chase & Co. - Analyst*

All right. So, Mark has answered a question. Lewis, you better give him a good raise. Anyway, moving on. So I wanted to focus on gross margins a bit. Obviously, you've done a pretty good job of increasing gross margins substantially over the last few quarters and given that your top priority is to grow revenue, do you think 70% is the new norm for gross margins or do you have some wiggle room so you can still balance between revenue growth and margin?

Lewis Chew - *National Semiconductor - CFO*

Well, the way I've been trying to answer this question with people is giving you two paths to track. If we grow slow the margins will probably be higher and if we grow faster then the margins will fall into our target range. But, it's not unlikely that we'll hit 70% margins if that's what you're asking but I want to emphasize, I mean this is the same message to you guys as well as to all the employees, the top priority of the Company is to grow revenue. We have great resources to take advantage of right now.

The fact that we manufacture our own goods, which Don already said, and the fact that today at 60%-something utilization, we're producing nearly 69% margin, that's a great position to be in. And on top of that we have pretty awesome technology that addresses several of these markets that have already been asked about, including comm infrastructure not to mention wireless and displays. And so I think that the reality is that we're likely to have gross margin fall-throughs ranging from 70% to 80% and we're not going to apologize for that. But we want to pursue revenue growth.

Unidentified Speaker - *JPMorgan Chase & Co. - Analyst*

Okay. Great. That's helpful. And then one other question. You talked about your lead times being pretty stable over the last several quarters where we've seen competitors' lead times go up and then down. What is your view right now in terms of what's happening in the competitive landscape in terms of lead times? Are you seeing their lead times decline?

Don Macleod - *National Semiconductor - CEO*

This is Don Macleod. First of all, as you remarked, our comment is that our lead times are under control. They certainly are at this point. And our customers and distributors are telling us that our lead times are under control and our lead times are not

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inducing them to over-order or order for excessive quantities just to make sure we eventually deliver. Our read from the marketplace is that there are still some lead time issues out there that are causing our customers and distributors to have to expedite product. Our indications are that some of these longer lead times are improving in the marketplace. But at this point in time, we don't see it as directly impacting our own business.

We are gaining business in some areas where competitors have lead time problems and we're invited to compete for business. And we're taking aggressive posture to some of these opportunities to get back into some customers that we might have walked away from in the past. So it's clearly opening the door for us to get some business. And also, relative to our distributors, when we behave in this orderly manner towards our supply chain, clearly they are induced to ship products and support products and put investment in resales, sales into products like ours when they can get the product to sell. And I think it gives us an advantage at this point.

Frankly, my perspective, the big gorilla in the analog marketplace is actually losing share to people like us in the distribution marketplace because we have product available and we can support the distributors' needs. And this has been a phenomenon I think since the fourth quarter of last calendar year. So the lead time situation has been helping us. Hopefully it will be much nicer if the whole industry were clear and we didn't have this uncertainty about so-called double ordering behind (inaudible) business.

Unidentified Speaker - *JPMorgan Chase & Co. - Analyst*

Great. That's very helpful.

Operator

Your next question comes from Harsh Kumar with Morgan Keegan.

Harsh Kumar - *Morgan Keegan & Co., Inc. - Analyst*

So when I look at a broad level across the spectrum of companies, it seems like your industrial business is trailing in terms of growth compared to people like ADR, Linear Tech, et cetera. Don, is this a function simply of timing or your business has longer legs or is it just sales out versus sales in? Any color would be very helpful.

Don Macleod - *National Semiconductor - CEO*

Well, I think we did have a discussion about the fact that our inventories did decline in the quarter from the mid-nines to the high-eights in terms of weeks of inventory at our distributors. We did make comments that our resales actually grew by 19% in the quarter. Our distributor resales reflect that industrial business. So I don't know where your comment about relative growth is coming from. We think our industrial business is growing at least in a 19% rate through our distribution channel. At the end of the day, you don't see all of that reflected if the distributors take their weeks of inventory down over that point in time. So I think I'll just leave it at that.

Harsh Kumar - *Morgan Keegan & Co., Inc. - Analyst*

Okay. Fair enough. Question on wireless. Great job turning that business around. Would it be fair for us to assume that your traditional top five customers all grew? And any color on your Korean customer base in terms of share or business would be helpful.

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Don Macleod - *National Semiconductor - CEO*

The wireless marketplace today is really a market with seven major suppliers into that market. The traditional top five and the two big smartphone enterprise and consumer smartphone manufacturers that you all know. We deal with all of those seven and our business has traditionally been very strong with the traditional market leader. Business is also strong with the smartphone players. We have not typically had a huge business out of Korea. I think that's been a topic we've talked about in the past. One of our objectives going forward is to actually have more business with those Korean-based handset manufacturers, so we're making a lot of effort and some of the extra sales we'll see going forward the rest of this calendar year will come from that market.

Harsh Kumar - *Morgan Keegan & Co., Inc. - Analyst*

Great, great, guys. Just one last quick one and I'll move on. $320 million something in cash generation. Can you explain the strategy as far as debt is concerned keeping that? Or perhaps comment on buying growth at this point in time.

Lewis Chew - *National Semiconductor - CFO*

Sure. I guess at this point it would feel pretty tired if I threw that question over to Mark, so I'll take that. On the cash front, we actually have a $250 million bond coming due in about ten days here, Harsh, so we're going to pay that out of existing cash. That was all part of our strategy. And so that will take the cash balance down. The attitude on debt has been to delever a little as a result of that downturn we saw a year ago. But not in total. So strategically I would like to keep the debt in the neighborhood of $1 billion.

Currently, I would say in terms of the M&A front, there's nothing to say until you have something to say it. We never ignore that topic. So I'd just leave that at that. And then going forward, obviously as we continue to build up cash, it would be a nice problem to have but I will have to deal with where that goes, right? Do I buy back stock? Do I increase dividend? These are all things that are available to us but I probably can't add much more right now.

Harsh Kumar - *Morgan Keegan & Co., Inc. - Analyst*

Got it. Thanks, guys. Thank you.

Operator

Your next question comes from Uche Orji with UBS.

Uche Orji - *UBS - Analyst*

Thank you very much. Lewis, quick question for you. If I look at your bookings and your order book, is there any comment you can give us on the aging distribution. I want to know how much of these bookings is further out beyond, say, 30 or 60 days.

Lewis Chew - *National Semiconductor - CFO*

Sure. I would say the aging profile of our backlog today looks relatively normal compared to what it was last quarter. If anything, a little bit more of it is in the short-term, not long-term. So unlike, let's say, a comparable company in our space which had a significant growth in backlog on that tail that you can eliminate that comment from our discussion. Backlog growth that we had was well within this near term window that we're talking about.

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Uche Orji - *UBS - Analyst*

Okay.

Lewis Chew - *National Semiconductor - CFO*

Is that what your question was, Uche?

Uche Orji - *UBS - Analyst*

That's what my question was. Out of that, as a basic follow-up, as I look at your gross margins guidance of 69% to 70%, comparing that with where utilization rates are, from here onwards, how should we think about what utilization rates versus gross margin curve should look like? I mean, if you were to get to -- what could be a theoretical peak gross margin? And if you were to get there, I know there are other factors involved but what should we be thinking of theoretical peak utilization rate acquired to reach that gross margin --

Lewis Chew - *National Semiconductor - CFO*

Uche, that's okay. That's a fair question. You don't have to go on and on. So first off, I would say that given our mix today, it's not unreasonable to think that with full utilization, our margins will be in the low 70s and the challenge we have is how do we translate some of that advantage into growth. So that's probably the best way to sum it up. Undisturbed, yes.

We're heading towards low margins but as many of you have pointed out to us in the past few years, we've undergrown the market and we're taking significant steps now to turn that around and it won't happen overnight but we have a fabulous manufacturing organization standing behind us. So that's the way I look at it is if we can target margins in the high 60s and keep them there while growing better than we have, that will be the best combination.

Uche Orji - *UBS - Analyst*

Great. And just for Don, one last question. When you talk about gaining market share within distribution. One question I always wanted to ask is how permanent that share gain could be. When you ask some of your competitors they say, "well, these parts are not that easily swappable." You've said this a couple of times now. Just can you help me characterize if this a permanent share gain or not?

Don Macleod - *National Semiconductor - CEO*

Sure. And that's a very appropriate question. At the end of the day, what is our strategy in distribution? Our strategy in distribution is not to grow our commodity-based business. Our strategy is not to promote that business, even also in today's marketplace there could be a place for a strategy that promotes the growth in the commodity space, given the constraints that are out there in supply from some of our competitors. We have not changed our posture for the commodity business. Our strategy is to encourage our distributors through various incentives and others and programs, to design in the proprietary parts and to make it worth their while to do that.

And clearly, we have a strategy today. We have a differentiated distribution strategy that is differentiated for each of the major distributors and each has its place, each has its programs and each has its incentives relating to those programs. We -- I think, are doing something that's unique at this point. Our focus is on encouraging them to sell our products not to give them incentives to hold inventory or to give them programs that make it cheaper for them to hold inventory. Other people can, obviously, over

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time emulate these programs. [To be honest,] they stand on us to keep coming up with new innovations for this space. We are putting a lot more focus into distribution.

It's an important part, 60% of our sales this quarter, and I think it may -- in the industrial marketplace, it's really paying off. It's also the area where we enjoy the very best margins. We are not running out there today reducing prices in distribution. We are providing better incentives but the price structure per se is not changing. It's not just us buying the business, it's us incentivizing the distributors. And just as a general reflection of that importance of distribution, some of you might have noticed that a month or two ago we appointed to our Board of Directors a guy called Bill Mitchell, who was formerly the Chairman and CEO of Arrow. He's now retired. And what's another indication of our commitment and interest to the distribution channel which is to get experience and expertise in distribution on our Board of Directors. So this is a big part of the program going forward, it's a major element in our focus on revenue growth.

Uche Orji - *UBS - Analyst*

Thank you very much.

Operator

Your next question comes from Shawn Webster with McGuire.

Shawn Webster - *McGuire Capital - Analyst*

Yes. Hi, guys, can you hear me okay?

Mark Veeh - *National Semiconductor - IR Manager*

Yes.

Shawn Webster - *McGuire Capital - Analyst*

Okay. Great. On the lead times, I think last quarter you mentioned something like 80% were six weeks or less in terms of your order fulfillment. Can you give us an update on that?

Don Macleod - *National Semiconductor - CEO*

We're at about 75% of our products that are available six weeks or less at this point in time.

Shawn Webster - *McGuire Capital - Analyst*

Okay. What's the lowest you've seen it in recent years?

Lewis Chew - *National Semiconductor - CFO*

We've been at 85% Again, it won't be a lot more than that because we have a lot of products that naturally have longer lead times than that. The bulk of our products are available at six weeks or less, 75% at this point in time.

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Shawn Webster - *McGuire Capital - Analyst*

Okay. And then could you give us a sense on OpEx trends as we go through fiscal 2011? Are there certain quarters that you expect to see your OpEx tick up, either because of seasonality or because of new investment initiatives?

Lewis Chew - *National Semiconductor - CFO*

Sure. Over to you, Mark, or -- ?

Mark Veeh - *National Semiconductor - IR Manager*

Okay, OpEx. I told you guys this before. Hopefully this won't be a surprise. We typically have a little spike in our Q2 because that's where we do our annual focal salary increases and it tails off after that. Our objective is to get the model OpEx down closer to 35% than to 40% it's been running at and right now we're trying to manage it more from a dollar standpoint. So the level you see it at right now which is the mid- to high -140s we hold steady with probably a tick-up in Q2 and tailing off after that.

If you're looking for scale, typically when a Company like ours does focal, they're 3%, 4% type impact. That gives you a sense of scale. I'm not giving you guidance on Q2 OpEx. Know you guys like to have numbers to work with. So that's the pattern I would give you. And within that, too, is the fact we tend to have a little bit of a spike in our stock compensation in Q2 for a variety of reasons and then it tails off in Q3 and Q4.

Shawn Webster - *McGuire Capital - Analyst*

Okay, thank you. And then from your headcount perspective, did your headcount increase sequentially this quarter?

Mark Veeh - *National Semiconductor - IR Manager*

Yes, it did. Our headcount is increasing primarily in our low cost manufacturing areas like Malaysia to meet the higher demand. I would say from a corporate standpoint, yes, we actually are on a plan this year to increase headcount in our R&D area. It won't be a huge number but yes, we're going up not down in headcount.

Shawn Webster - *McGuire Capital - Analyst*

Okay. And then maybe could you guys share your perspective on the 19%, 20% resales growth in the quarter? Is that what you had considered typical for this time of year?

Lewis Chew - *National Semiconductor - CFO*

No. It was higher than we thought. We came into the quarter probably thinking more 12% to 15% but we were very happy to see it and Don spent a lot of time earlier answering a question saying that it was very broad-based.

Shawn Webster - *McGuire Capital - Analyst*

Okay. Thank you very much.

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Mark Veeh - *National Semiconductor - IR Manager*

All right. Operator, we'll have time for about one more question. So let's have one more, please.

Operator

Okay. Our final question comes from Tore Svanberg with Thomas Weisel Partners.

Tore Svanberg - *Thomas Weisel Partners - Analyst*

Yes, it's Tore Svanberg. . Thank you. So I have a question for Lewis so you can keep your pay. Lewis, it looks like we're back to normal seasonality when it comes to bookings and could you just remind us how bookings are usually throughout the summer

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Lewis Chew - *National Semiconductor - CFO*

Yes, usually we see it dropping off, let's say, June into July and then picking up July, heading into August and then accelerating through September, October. That's the normal pattern. Right now, it's just a guess but it wouldn't surprise me if you see the same pattern again this year.

Tore Svanberg - *Thomas Weisel Partners - Analyst*

Okay. Very good. And question for Don. Don, you said you're definitely spending more and more time with the distributors and just going back to this macro topic, what are they telling you as far as their outlook for second half? I mean, are they willing to maybe hold more inventory? Do they feel comfortable with what they're seeing from their end customers?

Don Macleod - *National Semiconductor - CEO*

Tore, perspectively on that, at the end of the first calendar quarter, my flavor from our distributors was that they were pretty cautious going into the calendar second quarter. As we talk through the calendar second quarter, I'm hearing a more positive attitude going into the third calendar quarter of what distributors are seeing from their customers and in particular, what they tend to look at is what backlog they have in place from customers for deliveries, one, two, and three months out from the present month. So, my impression is that they're getting more coverage from the customers and more visibility than they had perhaps at the latter part of the first calendar quarter.

And I think that's comforting because we're all looking for visibility into the third and fourth quarters. In other words, the second half of the year, and I think that's more, affirming our view on this modest growth over the summer quarter, rather than the typical view of a slower summer quarter than we might have had seasonally in more normal years.

Tore Svanberg - *Thomas Weisel Partners - Analyst*

That's very helpful and just one last question for Lewis. CapEx for fiscal 2011, should we just use this $30 million run rate or anything else that would happen throughout the year?

Lewis Chew - *National Semiconductor - CFO*

No, I think that's fair. Just use that run rate. We'll update you each quarter. But yes, that's probably fair to do.

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Tore Svanberg - *Thomas Weisel Partners - Analyst*

Great. Thank you.

Lewis Chew - *National Semiconductor - CFO*

All right.

Mark Veeh - *National Semiconductor - IR Manager*

All right, thanks Tore. So, with that, we're now going to end the call. Let me remind you that the replay will be available shortly on our website and thank you for joining our call today.

Operator

This concludes today's conference. You may now disconnect.

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