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TEL - Q1 2014 TE Connectivity Ltd. Earnings Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the TE Connectivity first-quarter earnings call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to our host, Keith Kolstrom, Vice President of Investor Relations. Please go ahead.

Keith Kolstrom - *TE Connectivity Ltd. - VP, IR*

Good morning and thank you for joining our conference call to discuss TE Connectivity's first-quarter fiscal 2014 results. With me today are Chairman and Chief Executive Officer Tom Lynch and Chief Financial Officer Bob Hau.

During the course of this call we will be providing certain forward-looking information and we ask you to review the forward-looking cautionary statements included in today's press release. In addition, we will use certain non-GAAP measures in our discussion this morning.

We ask you to review the sections of our press release and the accompanying slide presentation that address the use of these items. The press release and related tables, along with the slide presentation, can be found on the Investor Relations portion of our website at TE.com.

Finally, I would ask for participants on the Q&A portion of today's call that everyone try to limit themselves to one follow-up question to allow enough time for everyone to get their questions in during the allotted time. Now let me turn the call over to Tom for some opening comments.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Thanks, Keith, and good morning, everyone. If you turn to slide -- look at slide three that is a summary of our results.

The Company is off to a very good start in Q1. The majority of the markets we serve continue to improve and we are executing well. The following are some of the key highlights of the quarter.

Orders increased 8% in the quarter and our book to bill was 1.03, excluding our SubCom business. This is the third consecutive quarter of organic orders growth and this strength was broad based across all regions and in the majority of our businesses.

Organically sales were up 7% overall and up 8% excluding SubCom. The transportation market continues to be very strong and we are the clear leader in this market in capitalizing on this strength. Our industrial markets and our telecom markets continue to improve in the quarter. This more than offset continued weakness in SubCom and DataCom.

Adjusted operating margins were 14.6%, up 220 basis points over the prior year. Stronger revenue, productivity gains driven by our TEOA program, increased savings from restructuring and metal tailwinds drove this improvement. We are on track to exceed 15% adjusted operating margins for the full year at a $14 billion sales level.

Adjusted earnings per share of $0.82 was up 26% versus last year and $0.06 better than the midpoint of our guidance. Free cash flow was $266 million. That puts us on track for another year of 10%-plus cash flow as a percent of revenue.

As a result of the strong Q1 and strong orders performance we are raising the midpoint of our full-year adjusted EPS guidance by $0.10 to $3.75. This is an increase of 16% versus our prior-year performance. Additionally, our Board has recommended that our annual meeting in March our shareholders approve a 16% increase in the dividend.

Please turn to slide four. This slide summarizes revenue by segment. I will now go into each segment in more detail. Unless I indicate otherwise, all changes are on an organic basis which reflect the effect of currency, acquisitions, and divestitures.

Please turn to slide five. We had another strong quarter in Transportation. Sales of $1.44 billion were up 14% over the prior year and orders were up 13% with a book to bill of 1.02.

Global auto demand continues to be strong, running a little ahead of historical long-term vehicle growth levels. Vehicle production in the quarter was about 20.8 million units, up 4% from last year. Revenue from the heavy truck market was also very strong in the quarter due to the improving economy and the acceleration of purchases in advance of new emission standards in Europe and China.

As I said last quarter, the Deutsch acquisition is really helping in this market.

Revenue grew in all regions this quarter. Europe was up about 11% due to strong exports and slight improvements in local demand. We are encouraged by increased new car registrations across most of Europe in December, the first time it has been this broad based in a while. We do believe pent-up demand and gradual improvement in the economy are driving this and expect to have another solid revenue year with our European customers.

In the Americas, revenues were up 15% due to continued strong demand and share gains from our investments made during the downturn. We expect solid production growth to continue through FY14.

Asia revenues were up 17% with 30% growth in China and 27% in Japan. We expect to continue our momentum across Asia through the year. Our margin improvement was due to a combination of favorable mix with more heavy trucks in the industrial transportation market, stronger overall volume, productivity improvements driven by our TEOA program, and favorable metal costs. We expect another quarter of double-digit growth in Q2 and mid to high single-digit sales growth in the second half.

Please turn to page six. Market demand in the Industrial Solutions segment continued to strengthen through the quarter and our revenues were up 6% and orders were up 9%. This performance was in line with our expectations.

Similar to last quarter, the industrial equipment, commercial aerospace, and oil and gas markets continued to have strong demand and we expect this to continue for the balance of the year. Our energy business grew 4% in the quarter, but we do see signs of softening in the next couple of quarters, especially in Europe. We also believe the defense portion of our business should pick up a bit based on the resolution of the US government budget.

Looking forward, we expect another good quarter in Q2 with sales up about 6% due to the trends we discussed.

Please turn to page seven. Performance in our Network Solutions segment was mixed in the quarter and overall in line with expectations. Sales of $713 million were flat versus the prior year. On the positive side, the telecom networks business grew 11% in the quarter driven by increased investment in fiber optic networks.

The enterprise business was up 6% with growth in all regions. Offsetting that our DataCom business was down 8%. We are making progress in high-speed system wins, but we do continue to lag the market in mid and lower speeds which is where most of the volume is today.

SubCom market continues to be slow in projects going into force, but our backlog of awards continues to be strong. We still expect the business to pick up in the second half due to two new projects which we expect to come into force this quarter.

Margins in this segment were adversely impacted by two asset write-offs, excluding these write-offs adjusted operating margins were about flat to last year. We expect Q2 results to be up slightly versus Q1 and I would expect our normal seasonal second-half pick up in this segment in addition to an increase in SubCom revenues as these new contracts come into force.

Adjusted operating margins in the second half are expected to be back to double digits based on -- low double digits based on the expected volume increase.

Please turn to slide eight. Revenue in our Consumer Solutions business was up slightly in the quarter. The overall trends in this quarter were similar to Q4 of last year, improving demand in the appliance market, declining PC demand, strength in tablets and smartphones.

We are capitalizing on the stronger appliance markets where we have the leading market share. We have adjusted to the PC decline in our consumer devices business and are making gradual progress in smartphones and tablets. Adjusted operating margins in the segment were similar to the prior year. In Q2 we expect revenues to be down 3% to 4% versus the prior year; however, adjusted margins are expected to be similar to prior-year levels.

Now let me turn it over to Bob Hau to cover the financials in more detail.

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

Thanks, Tom, and good morning, everyone. A quick footnote to Tom's market comments, effective for the first quarter of fiscal 2014 we realigned certain businesses, principally the relay products business, within our segment reporting structure to better align our product portfolio.

Approximately $100 million of annual revenue which was previously reported as part of the appliance business inside the Consumer segment has been moved to the industrial equipment business in the Industrial segment. We have included a slide in the appendix of today's presentation which provides the impact of each of the quarters of fiscal 2013 and 2012 for reference.

Now let me discuss earnings which start on slide nine. Adjusted operating income was $486 million, up 25% from the prior year. GAAP operating income was $479 million and includes $7 million of restructuring charges in the quarter. As I mentioned on the earnings call in October, we anticipate

a substantial reduction in the level of restructuring activity in fiscal 2014 with charges for the full year of approximately $50 million versus $311 million of charges in fiscal 2013.

Adjusted operating margin was 14.6%, up 220 basis points from Q1 last year. The improvement is a continuation of the strong momentum that was achieved through the course of fiscal 2013 and a change versus the prior year is driven by 7% organic sales growth, productivity from TEOA, class savings from restructuring actions taken in the last couple of years, and favorable metals costs.

Adjusted earnings per share were $0.82 and GAAP earnings per share were $0.85 for the quarter. GAAP EPS included $0.01 of restructuring and other charges and $0.04 of income related to legacy share tax liabilities.

Turning to slide 10, our gross margin in the quarter was 33.6%. This is a 200 basis point increase versus the prior year due to volume increases, increased productivity from TEOA or lean programs, and cost savings from restructuring. Total OpEx spending was $631 million in the quarter, which was up 5% versus the prior year. The increase resulted primarily from increased selling expenses to support higher sales levels and increased variable compensation costs, partially offset by cost savings attributable to restructuring actions.

On the right side of the slide, net interest expense was $29 million in the first quarter and I expect approximately $27 million of expense in the second quarter and similar levels through the remainder of the year. Adjusted other income, which primarily relates to our tax sharing agreement, was $7 million and in line with guidance. In the second quarter I expect other income of about $6 million.

The adjusted effective tax rate was 26.1%, which was higher than our guidance of 24% to 25%, due primarily to a one-time expense of approximately $10 million related to a change in tax laws in Europe. Expect the tax rate to return to the 24% to 25% range through the remainder of the fiscal year.

Turning to slide 11, I will discuss our balance sheet and free cash flow. Cash from continuing operations was $387 million and our free cash flow in Q1 was $266 million. Net capital spending during the quarter was $121 million or about 4% of sales. I continue to expect capital spending rate to be approximately 4% to 5% of sales for the full year.

Receivable days outstanding were 62 days, which is down slightly versus the prior year and inventory days on hand was 74 days consistent with prior-year levels. Both metrics remain in line with our expectations.

Now let me discuss sources and uses of cash outside of free cash flow shown on the right side of the slide. We began and ended the quarter with $1.4 billion of cash.

During the quarter we returned a total of $315 million to shareholders, we paid dividends of $103 million, and repurchased about 4 million shares for $212 million. We expect additional share repurchases of $150 million to $250 million per quarter during fiscal 2014. Our outstanding debt was $3 billion at the end of the quarter.

Now I will turn it back over to Tom.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Thanks, Bob. Please turn to slide 12 and I will cover our outlook. As I said earlier, this was a very good start to the year for TE driven by a strong transportation market, continued improvement in most industrial markets, and strong execution across the Company. Order trends were strong in most of our businesses.

Based on these trends, we expect Q2 revenue of $3.4 billion to $3.5 billion, which is an organic growth rate of 5% to 8%. We expect adjusted earnings per share of $0.88 to $0.92, an increase of 16% to 21%.

In Q2 we expect another strong quarter in Transportation and a good quarter in the Industrial segment. Networks and Consumer results will be largely similar to Q1. For the full year we expect revenue of $13.8 billion to $14.2 billion, which is organic growth of 4% to 7%. We expect adjusted earnings per share of $3.65 to $3.85 and this is an increase of 13% to 19%. And, as Bob mentioned, a $0.10 increase in our guidance from last quarter for the year.

Just to close, the momentum we saw in most of our markets in the second half of our last year continued through the first four months of this year. These improving market conditions, coupled with our operating leverage improvements, driven by TEOA and the accelerated restructuring last year, should enable us to deliver strong performance in fiscal 2014.

Now let's open it up for questions. Operator, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Mike Wood, Macquarie.

Mike Wood - *Macquarie Research - Analyst*

Thank you. Congratulations on the quarter. In terms of just some more color on the European growth on the transportation side, it looks like you are forecasting 3% vehicle production growth for the full-year next quarter. Recently you have been exceeding that by a substantial margin in terms of your sales.

You have mentioned exports; how much of that is actually related to any kind of a pre-buy in the C&I side of the business in Deutsch related to the emission standards changing?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

There is clearly some of that. Just to keep in mind, of our total Transportation, industrial transportation is in the neighborhood of 15%. So while it is definitely a good thing, it is not that much overall leverage on the segment.

The European light vehicle market has, especially with the German OEMs, a significant amount of exports and a lot of that is premium cars to the US and China where we have very nice content. So that helps offset what has been for several years now weak global demand in Europe. But as I mentioned, we are encouraged to see over the last couple of months, especially in December, a pickup in year-over-year new car registrations.

It is not a long trend yet, but it feels like in talking to our customers it is moving in the right direction. So we expect another solid year with our European customers.

Mike Wood - *Macquarie Research - Analyst*

And in DataCom you had spoken previously about skipping a product generation there, moving to quickly to more advance speed connector, but you were redesigning the 10 gigabyte speed connector. How is that acceptance going? Are you just too late to make traction in that particular product?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

I would say we are doing well in high speed in terms of customers selecting us for next generation. It is going slower than we would have thought a year ago. And that whole market, if you watch the big equipment OEMs, there is a lot of dynamics in that market right now and the net effect for us is the switch to new higher speed solutions is taking longer. So it is going to be, I think, a couple of years before we meaningfully move the meter in our DataCom business given that.

I mean it is a good product line, important product line to us, and it is also great products that ultimately move into other parts of our business down the road, but it has been slower than we would have thought for the reasons I said.

Mike Wood - *Macquarie Research - Analyst*

Okay, thank you.

Operator

Wamsi Mohan, Bank of America Merrill Lynch.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Thank you. Good morning. Which geographic regions did you see the strength in Industrial transport? And, Tom, even for that 15% of revs that you are talking about what sort of growth did you actually see in that part of Industrial transportation? And I have a quick follow-up on margins.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Sure. The overall growth was well north of 10%; very, very robust double digits. Again, some of that is pull forward. We did see very, very nice growth in China and Europe, solid growth in the US.

What I would expect will happen is that will moderate, especially in China and Europe where the new standards are being implemented. That will moderate in the second half, but I would expect the US to continue to improve as the economy improves.

Mike Wood - *Macquarie Research - Analyst*

Thanks, Tom. On margins then should we expect the margins to sort of play out at this level, so maybe the mix becomes less of a benefit but you continue to see volume growth as Europe improves through the course of year?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Yes, Wamsi, that is a good way to think about it. We won't have as much favorable mix from the Industrial transportation group. We will continue to see nice volumes and get the benefits of that.

The metal levels they have been pretty steady now for a couple of quarters so, while there is year-over-year tailwinds sequentially through the year, I wouldn't expect that. I would think of the transportation business continued nice sales growth, really solid sales growth in this margin neighborhood.

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

Wamsi, I would expect that mix of moderate which means year-over-year margin expansion will slow. This quarter we are looking at 440 basis points. We won't continue to see that, but we will continue to see very good margins across the segment going forward.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Great, thanks a lot.

Operator

Matt Sheerin, Stifel.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Obviously you have had nice margin expansion in Transportation; Industrial as well. But looking at the other businesses, particularly the computing, the Consumer business, what drives those margins? Is it volumes at this point?

And looking within that business, I know you have some PC exposure. You talked about weakness there; it looks like demand is beginning to stabilize. And then also in terms of your position on the mobility side, what is your outlook in terms of market share opportunities there?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Matt, regarding the margin question, I think your characterization is accurate that we are -- in the transportation and industrial business we are getting lift due to volume and productivity. In the Networks and Consumer business I feel good what the team is doing productivity-wise, but we are not getting the volume yet. Different reasons.

Overall in Networks we have got a very SubCom business and the DataCom that I already talked to. In consumer, while PC is -- hopefully the rate of decline will start to level off, which will help us, but we are making, let's say, slow, steady progress in the tablet and smartphone. It doesn't really have -- even though the product cycles are shorter than in the Industrial business for sure, it's still you got to win one design in at a time. So until we begin to see our overall volume in consumer devices get consistently over 5% or 6%, that is what it is going to take to begin to move the margin up.

In the Consumer Solutions segment, the appliance business is a very nice margin business at about company average. And we are starting to grow again with the improving economy.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Okay, great. Then question for Bob on the margins. In some of the commentary you talked about some materials benefits, particularly metals, but could you talk about other things like copper and gold, for instance, and any tailwinds there in terms of margins and benefits on costs?

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

So overall in the first quarter we did definitely see a tailwind of metals, which for us is really copper, silver, and gold. And there was probably about a $15 million, $16 million benefit in the quarter. For the full year we are actually expecting about $50 million or $60 million, so that quarterly $15 million, $16 million or so will remain in effect for the balance of the year.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Okay. Thanks very much.

Operator

Amit Daryanani, RBC Capital Markets.

Amit Daryanani - *RBC Capital Markets - Analyst*

Thanks a lot. Good morning, guys. I've two questions as well. Maybe just start off on the Transportation side.

For the last couple of quarters, and especially the December quarter, your business was up 14%, production was up 4%. If I look at that 10% of outperformance, if you may, it seems to be a lot more than just content growth of the Euro -- E6 mandate helping you out. I'm curious; maybe you could talk about that 10%. How much do you think is content versus potential share gains versus new platform wins? I'm trying to get a sense of can you sustain this kind of outperformance going forward.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

I think very strong performance for a couple of reasons. Some of it is mix again with the Industrial transportation business where we have a very strong position as a result of combining Deutsch with our legacy TE Industrial transportation business. And that business is growing much faster right now than the auto business, which is still growing. Light vehicles are still up plus 10% to us.

In certain markets in China and the US we think we continue to gain share. We really have invested in those markets, particularly during the downturn, and now that is starting to show up in our revenue. But I do think you would expect to see us drop down to high single-digit growth in the second half of the year in the overall Transportation segment. It feels like we have gained a little bit of share year over year.

Amit Daryanani - *RBC Capital Markets - Analyst*

That is all. Then just on the Network Solutions side, demand has been challenging for you guys for several quarters now. And if you think of the headwinds in DataCom and Subsea really, do you think you have to look at options to potentially further rightsize this business, or do you feel comfortable looking at the book to bill that demand will come back in the back half and you just got to wait for that revenues to flow in?

I'm just curious how you think about rightsizing the business versus waiting for demand in the back half right now.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

So I think there is two different answers to that. SubCom I think we are well positioned. It has been slower than we thought, but I would be more worried if there wasn't as much product activity as there is. Those projects have to turn into -- come into force, so we feel reasonably confident, although this market has slid on us for the last two or three quarters.

But we are very strong in the market. I don't think we have ever been stronger in terms of our product offering. So as that market comes back with our strength in it, we are confident we will do very well and we think we will start to see that in the second half.

DataCom is a little bit different. We are not strong in that market. We have done a lot to adjust our cost structure to reflect that without -- we haven't reduced our engineering investment and so we do have a significant engineering investment for high-speed type solutions there both in fiber and copper. As I mentioned, they are going slower. We have no intention to take more costs out of the business.

It is an important business for us. We believe it is really upside for us, but I think if you go back to where I thought we would be a year from now, I thought there would be more deployment of high speed than there is. So it is definitely pushing out the improvement in the business for us. But tweaking the strategy, yes, but no fundamental change to it.

Amit Daryanani - *RBC Capital Markets - Analyst*

Got it. Thanks a lot and congratulations on a good quarter.

Operator

Shawn Harrison, Longbow Research.

Shawn Harrison - *Longbow Research - Analyst*

I'm going to be Networks maybe dead in a bit. But even margins flat year over year; I would have thought with the metals tailwind with a little bit of restructuring you would have been able to do better. Is the margin at DataCom that much richer compared to everything else in the business and so that, with DataCom being down substantially year over year, explains why margins would have been a little bit better?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

There is a number of points I think, Shawn, around all that. The telecom business is growing and improving. The SubCom business is at one of the lowest points in the last six or seven years, so we are getting really zero leverage out of that business right now. We think we are at the bottom, as I said earlier.

The DataCom business is it's in a turnaround really for us, there is just no question about that. It has the potential for high margins. We did write a few assets off in networks which further -- took a low margin lower. We think there is opportunity to improve it, but it is not going to be sudden. We are going to need more volume.

I feel good about the cost structure because, as you pointed out, we did take costs out. We are just not getting the volume to take advantage of that right now. But in telecom we have a leading product line in fiber optics. SubCom we have a leading product line.

In DataCom we trail, although for the future we have a good product line, but that has got to turn into reality. And in enterprise we have a solid product line net business. It's historically a low growth business and we are right in there with that.

Shawn Harrison - *Longbow Research - Analyst*

But let's say I take an optimistic, glass half-full view and two years out DataCom recovers, is the margin profile in that business better than the networking average, which should be mid-teens, and so you would get, I guess, a greater lift as that business accelerates? Is that really what needs to happen?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Yes, we need more revenue and we need particularly the industry to start moving to high speed. When you dissect that business without getting into too much detail the high-speed stuff is a loss leader and our core business. While we are not a leader in mid to low speed solutions, it is a solid business.

We have been investing a fair amount in high-speed fiber and copper, so with very little revenue in there it has the effect of exacerbating the margin in a downward way in that business.

Shawn Harrison - *Longbow Research - Analyst*

Okay. Then just as a brief follow-up, Bob, I think last quarter it was $60 million to $70 million in restructuring savings that were supposed to benefit the model this year. Did that change?

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

We are actually seeing slightly better than that. Right now restructuring is a little bit closer to $70 million to $80 million.

Shawn Harrison - *Longbow Research - Analyst*

Then the aggregate number of $100 million; did that change at all?

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

No, a little North of that, which is what we have been saying previously.

Shawn Harrison - *Longbow Research - Analyst*

Thanks so much and congrats on the quarter and guidance.

Operator

Jim Suva, Citi.

Jim Suva - *Citi - Analyst*

Thank you and congratulations to you and your team there on good results. A quick financial question for Bob, and that is on restructuring, followed by a more fundamental question probably for your team.

I think you had mentioned that restructuring looks like it is going to be coming down lower this year. Can you help us quantify that a little bit more? I think you gave a little bit of numbers there.

And is that then a recurring rate sustainable at that, or were you looking at a lower rate one time this year? And if so, it appeared like this rate could be so low; are we looking at folding it into your normal operations?

Then for the more operational question, when we look at content growth for vehicles, I think in the past you gave some commentary of kind of long term 6% to 8%. With cars going more and more to hybrid and safety and emissions always continuing to improve is there a chance that that 6% to 8% actually starts to increase or goes to the higher end or even above the higher end of that? Thank you.

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

Jim, it is Bob. On the restructuring, we spent about $7 million this quarter, roughly in line with what we anticipated. Previous guidance and still guidance today is about $50 million on a full-year basis. That is down dramatically from prior years. Last year we spent just north of $300 million.

And we think ongoing natural restructuring charges with a business of our size, given the nature of our markets and end customers, is probably $50 million to $75 million, so we are a bit below, quote-unquote, normal right now but it is largely given the amount we spent last year.

As we have said before, we talked a little bit about it in our investor day. We are looking at ways to fold it in. I think it is important to describe it and disclose it externally, whether investors dial it out or roll it back in it is up to them. We will give them the information.

One of the big reasons that we still have today adjusted earnings versus GAAP earnings is we are still dealing with the tax sharing agreement pre-split and some of those numbers can move significantly. It would be very disingenuous to only talk about GAAP earnings, but we certainly look to A) settling the tax sharing agreement over the next couple of years and B) much lower restructuring charges.

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

Jim, on your other question, we have typically talked about content of 4% to 6% and I do think that there is more likely for that to go higher than lower. That is the way I would say. I walked around Detroit last week and walked through the auto show and you can feel it really.

We obviously see it in our business and it is our biggest business, but when you see 100 cars on the floor and you can track them with the features they have versus their prior iteration of a particular model, you can feel it. So I do think it is more likely to go up slightly than down.

It goes at a metered pace just because of the product cycles and it doesn't happen overnight to design-in new features, but it is a really good trend and it is why we are excited about the business so much. Also historical production rates have tended to be 2% to 3%. We think for the next few years or the industry, I should say, thinks that could be up 1 point, 1.5 points. And that is with a very, very low growth in demand, local demand in Europe.

So I think most of the trends are positive. In China you have dealers starting to finally expand in the Tier 3 to 6 cities so you are going to, we expect to continue to have a robust automotive market there. So the combination of more likely upside in production than downside versus historical rate and more likely upside in content then downside I think makes this a very attractive market for many, many years.

Jim Suva - *Citi - Analyst*

Great. I think I got my numbers. Of the 4% to 6% that is content growth and 6% to 8% is then when you add on the global SAR or the global units of the auto production. And so 6% to 8% is what the sales rate is and content of 4% to 6% is that kind of what you are seeing?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Yes, that is what we are seeing. Of course netted into that is price, which is moving up a little bit. But as we are, as you can see in our margins, we are able to give the customer the price that they need and keep the margins moving in the right direction.

Jim Suva - *Citi - Analyst*

Great. Thank you and congratulations again to you and your team.

Operator

Mark Delaney, Goldman Sachs.

Mark Delaney - *Goldman Sachs - Analyst*

Great. Thanks very much for taking the question and congratulations on a strong quarter. I don't understand; on the margins there has been a tremendous amount of year-over-year improvement in the adjusted operating margin, 14.6% this December quarter versus about 12.5% a year prior.

I am hoping you can help me understand within the March quarter guidance, maybe the bridge from last year. So specifically, by my math, the March quarter implied operating margin guidance is right around 15%? Then the revenue level at the midpoint is pretty similar to the revenue that you guys did for the September 2013 quarter.

I would think that there is maybe some metal pricing benefits versus the September 2013 quarter and then some restructuring benefits that are coming through. Given that you did the 15.7% in the September quarter, I'm just trying to hope you can walk me through how you are thinking about getting to the 15% or so in the March quarter of fiscal 2014.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

The way I would describe it, Mark, is continued steady volume growth where we will get the lift there. The metal difference isn't that much from two quarters ago. It has been a nice tailwind, but it is not that much incremental.

We are investing more with no question, so we are, we believe, continuing to strengthen the product line, continuing to invest in the emerging markets in engineering and selling. So we are continuing to invest, but overall would expect to continue to drive the margin up. And we are pleased with the productivity.

Price erosion is up a little bit. Not dramatically, but there is no question that, as typically happens, with particularly copper hanging around at this rate for a while relative to where it was 18 months ago that customers are expecting, appropriately, some of that back. So we have pluses and minuses but net-net very good momentum in the margin.

Mark Delaney - *Goldman Sachs - Analyst*

Understood, thank you for that. For my follow-up question, at the analyst day, Tom and Bob, you guys talked about looking at doing more acquisitions I think maybe on the tuck-in type of size. Can you give us an update on how that is progressing?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

We did the two big ones and we have been continuing to build our pipeline, especially focused in anything related to transportation and the broader industrial markets, so we keep plugging away there. It is an active pipeline. We are always talking to people, but we are thoughtful about it.

You've got to, number one, really fit strategically and obviously we have got to be able to create value with it. So we expect it to be an important part of how we grow the Company on an ongoing basis. But we feel good about the organic momentum, particularly obviously in Transportation and Industrial, and we have to continue -- we have to get it going in the other two.

Mark Delaney - *Goldman Sachs - Analyst*

Understood, thanks. And congratulations again on a good quarter.

Operator

William Stein, SunTrust Robinson Humphrey.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Morning, thanks for taking my question. I am hoping you can clarify the comments about the changes in demand in the automotive end market related to the new emission standards. I assume you are talking about Euro 6.

Can you clarify whether that relates to light cars or heavy trucks and verify your comments about pull in in light cars to get ahead of this rollout?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

I am glad you asked so I can clarify. It's really in the truck market, that is where we see what looks like accelerated demand of the older version trucks because the new ones are more expensive. Not an unusual thing in this market.

It is not a major thing driving it. We believe improving economic environment plus the age of the trucks on the road are an even bigger part of that. But, clearly, for the first half of this year the very high growth rates [of course] in the Industrial transportation, which is only 15% of transportation, are being driven by the -- our customers are ordering earlier.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Great, that is helpful. And if I can ask one follow-up; I'm hoping to hear a bit about demand in inventories in the channel relative to your direct business.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

The channel was a little bit slower in December than we expected. Still a solid business, but we did see the kind of excitement, really not unusual calendar year-end inventory tightening. Not a big number and not different from our expectations, kind of in line with our expectations. When you look at it more sequentially from our fourth quarter into the first quarter definitely a little bit softer because of adjustment, but don't see any overhang or anything like that out there in talking to our distributor partners.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Great, thank you.

Operator

Sherri Scribner, Deutsche Bank.

Sherri Scribner - *Deutsche Bank - Analyst*

Thank you. I just wanted to dig a little bit into the improvement you are expecting in the second half of the year in the networking and consumer business. I know you talked about some orders that you are anticipating and it sounded like you are expecting some additional strength in the SubCom market, so I was just hoping for a little more detail on the strength in the networking piece in the second half of the year.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

In Networks we will typically have a seasonal peak, so in telecom especially, primarily in telecom, as the weather gets better we see the business pick up. So we are really in that business pretty much looking for a similar pickup first half, second half that we saw last year.

SubCom is much more related to contracts coming into force and the big thing is we are counting on two contracts to drive that. We have got the contracts. We signed the contracts, all that, so we would expect that they will go into force. But until they do anything can happen, so that is a big thing driving Network.

In Consumer it is a little more of continuing to gain traction. In appliance I would say, if the economy continues to improve, that business naturally follows the economy, so that is less seasonal and more economic related. Consumer, of course, has its peaks in the quarter or the quarter-and-a-half before the Christmas season.

But we are not looking for anything dramatic in the second half in the Consumer business. I mean it's relatively -- that is a small business for us, so relatively it is nice, but absolutely in terms of its effect on the overall company it is kind of a $0.01, $0.25 I think, Bob, in that range. It is not a big lever. We are trying to make it a bigger lever.

Sherri Scribner - *Deutsche Bank - Analyst*

Okay. Then based on the guidance, if I do the math, it looks like at the midpoint for your fiscal 2014 guidance at $14 billion in revenue your operating margins are somewhere around 15.5%. I know you have said that you could do plus 15%, but are you comfortable with sort of a 15.5% operating margin for the year that would suggest some decent operating margin leverage in the second half?

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

At midpoint of that $14 billion the operating margin is about 15.3%. And, yes, we are comfortable with that given the progress we saw it really through much of last year and into the first quarter around overall benefits of our lean initiatives, what we call TEOA, as well as the improved benefits from restructuring and the metals tailwind gives us confidence of that 15.3 that generates the $3.75 earnings at midpoint.

Sherri Scribner - *Deutsche Bank - Analyst*

Okay. Is that assuming the SG&A is relatively flat from first-quarter levels or do you see some declines in that based on the productivity improvements? Thanks.

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

Overall for the year SG&A is about 13.5% sales for the year.

Sherri Scribner - *Deutsche Bank - Analyst*

Okay, thanks.

Operator

Steven Fox, Cross Research.

Steven Fox - *Cross Research - Analyst*

Thanks, good morning. Just going back to the operating margins for a second; if I look at the Transportation and Industrial margins, it seems like there was a greater drop-through effect on both sides of the business on a quarter-over-quarter basis. So on the positive sales from Transportation you pulled down a greater-than-average drop-through and the reverse was happening on industrial.

Can you just sort of breakdown how much more was related to metals in those segments versus -- I don't believe there was a lot of restructuring, but what else was driving that? Because I am just having trouble [footing] those numbers. Thanks.

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

Steve, I think I would point to the two things. Number one, better volume, better revenue lift in those two segments, so you get the benefit of the volume leverage into our factories. And then from a metal standpoint, in particular relative to networks, the other three segments have much more metal content, so you see that $15 million or $16 million year-over-year benefit really layered into the other three segments where Networks doesn't participate.

All of our businesses clearly involved in TEOA and lead, but there is a significant extra lever when you get the volume leverage.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

What I would add when you compare auto or transportation to industrial as well is there is sales per part in transportation and higher, so that is a higher volume business in industrial. So you are not going to typically have the same fall-through, but we feel in the industrial business overall there is nice opportunity to do fundamental margin improvement through TEOA. We are further along with that in transportation than we are in industrial so we expect to see the same kind of improvements.

Steven Fox - *Cross Research - Analyst*

Great, that is helpful. Then just quick follow-up on China, Tom. Given how fast it is growing, could you just talk a little bit about within the China market, especially on the auto side, where you think you are picking up share from a content standpoint? Is it helping or hurting the overall content growth for the Company within auto, given the mix differences, and why you think you are picking up that share? A little bit more color would be helpful. Thanks.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Well, I think the momentum piece is -- we have been in China a long time and we are -- our whole team is local so we have a very, very strong seasoned team that is a local team that has been in the business a long time. They have been developed by our other teams around the world, so we have a lot of know-how there and we work with every customer. And we bring to bear the technologies from the other parts of the world.

We are as strong with the local customers as we are with the multinationals. While the content per vehicle in the locally-produced cars is less, it is rapidly rising at a greater rate because in order to compete in that market you have to have the features that the multinationals have. So I think it's -- while the overall content per vehicle in China is less than it is in Germany for sure, it is raising at a faster rate.

And in China, for the local customers, we provide in some cases a much broader product range than we do other places because the customers need the expertise. So that has helped us. Four or five years ago we decided to kind of get -- I don't want to say services in the sense that we charge for services, because we don't really do that, but we help a lot in the design of the electrical system for the local customers because they wanted the help.

So that has helped us, that has helped us a lot. We did see the continued expansion and especially demand for high-end cars. So while the low-end car overall there is a lower content, you are selling a lot of premium cars, particularly from Germany, into that market where we have a significant content.

Steven Fox - *Cross Research - Analyst*

(multiple speakers) Thanks very much. I appreciate it.

Operator

Amitabh Passi, UBS.

Amitabh Passi - *UBS - Analyst*

Thank you, Tom. I had a question and then a follow-up. I guess the first one was just a big picture question.

It seems to me when you embarked on the ADC acquisition and Deutsch part of the motivation was to sort of diversify your growth drivers and your portfolio. Yet if I look at the numbers today about almost 45% of your sales are coming from transportation and about 60% of your EBIT dollars.

So just curious as you look at your portfolio, and I know you touched on this but would like to get more details, is there an appetite maybe to accelerate the inorganic element to continue to sort of balance out the portfolio, both from a growth and profitability perspective?

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Amitabh, I would say the way -- the underlying strategy of Deutsch was harsh environment. So our sweet spot, where we are best at and where we think the most value we can add and the most value we can extract, is in the really harsh environments.

So I am not worried at all about the transportation business getting bigger if it is for natural reasons. The market is growing; we are strong. We do well there; the customers really value the full value proposition we bring to support them in every part of the world.

I think the Industrial business benefited from Deutsch too, so half of the revenue that came from Deutsch half when into Transportation, half went into our Industrial Solutions business in [Mill Arrow] which now we have almost a $1.1 billion business as a result of that acquisition. Again, enabling us to do other things that we wouldn't have because of the width and the breadth of the product line.

If you think of us, we like the harsh environment. That is what we are best at. We are clearly better at it than we are in consumer. Consumer and DataCom and Networks are important to us and we think we have a lot of value to add there, but we are really not on a strategy to try to lessen our participation in transportation. Because if you just look at the underlying trends, there is just more content and there is still a long way to go. So we want to continue to be strong there.

And, of course, we want to -- the way I would characterize our core businesses: Transportation is a great business and we are really good at it. Industrial is a good business and we are good at it with the opportunity to be better.

Network Solutions kind of mixed, but a solid business. We believe the fiber part is a really good business to be in because of the bandwidth demand and we are good at it. And Consumer we are getting better, but we are not good. We have a terrific team in there that is changing it so we view that as opportunity. Selective opportunity, as we said.

That is how we think of the portfolio. We think all four of the segments need to have the right attention in order to be successful. We are not really trying to deemphasize Transportation.

Amitabh Passi - *UBS - Analyst*

Okay, perfect. Then just as a quick follow-up, I would like a little more insight into the telecom networks piece of Network Solutions. You grew almost 11% year over year. I think you are guiding to 5% growth.

Verizon seems to be deemphasizing investments in wireline. MDN was the hot topic two years ago; it kind of fizzled out. So just as you look at project activity which areas and regions are you most excited about and why, after growing 11% in the first quarter, do you still think it is a mid single-digit growing segment this year?

Bob Hau - *TE Connectivity Ltd. - EVP & CFO*

I think 11% was driven very strong by some wins in South America, some accelerated activity in Europe. We expect those to level off. There is uncertainty around MDN. It is still in an early stage, far enough that I don't think anybody is going to turn back, but there is a question of how deep will they drive the fiber. It probably won't be everybody gets fiber to the home, but it is going to be fiber deep, which is still a really good business. You go back the prior quarter it was a different part of the world.

The important thing, the encouraging thing, but we would need to see it quarter after quarter after quarter, is there is just more projects. So as I said at investor day, there is a lot more projects in the last year than there were the year before that but it tends to be a lumpy business.

Our fundamental belief is that when you model dataflow you have got to have the fiber network deeper than it is. You don't have to go fiber to the home to give the consumer a good experience, but you need to have fiber spinning the offload, even from an LTE network, deeper than it is generally in the networks around the world, which is why we think it is a 5% to 6% growth business over time. But it does take fortitude to ride through the cycle.

Last year we took a lot of costs out to make sure that whatever cycle it is that we were solidly above cost of capital kind of return. So that is how we see it right now. We don't expect 11% growth over the balance of the year.

Amitabh Passi - *UBS - Analyst*

Okay, got it. Thank you so much and good luck.

Tom Lynch - *TE Connectivity Ltd. - Chairman & CEO*

Thank you very much and for those of you, like us, who fought through the snow to participate we appreciate it. Again, a good quarter and more than anything I think it reflects a lot of the actions we have taken over the last several years.

Certainly it is very nice to see general economic improvement. We are not giddy about this, hey, all of a sudden we are in the high-growth area. We continue to be focused and we look forward to talking to you in the not-too-distant future. Thanks for joining us.

Operator

Thank you. That does conclude our conference for today. Thank you for your participation and for using AT&T executive teleconference. You may now disconnect.