Good day and welcome to the Texas Instruments Q3 2021 Earnings Release Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Dave Pahl. Please go ahead.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Good afternoon, and thank you for joining our third quarter 2021 earnings conference call. For any of you who missed the release, you can find it on our website at ti.com/ir. This call is being broadcast live over the web and can be accessed through our website. A replay will be available through the web.

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

Our Chief Financial Officer Rafael Lizardi is with me today, and we'll provide the following updates. First, I'll start with a quick overview of the quarter. Next, I'll provide insight into third quarter revenue results with some details of what we're seeing in respect to the customers and markets. And I'll also provide details by end market, including some sequential performance, as we have the last few quarters. As sequential data begins to be less insightful, we'll move back to reporting only year over year, per our normal practice. And lastly, Rafael will cover the financial results, an update of our capacity expansion plans and our guidance for fourth quarter 2021.

Starting with a quick overview of the quarter. Revenue in the quarter was $4.6 billion, an increase of 1% sequentially and 22% year over year, driven by demand in industrial, automotive and personal electronics. On a sequential basis, Analog grew 2% and Embedded Processing declined 5%. On a year-over-year basis, Analog revenue grew 24% and Embedded Processing grew 13%. Our "Other" segment grew 19% from the year-ago quarter.

Now let me comment on the current environment to provide some context of what we're seeing with our customers and markets. Overall, the quarter came in generally as we expected across the product segments, end markets and geographies.

Lead times for the majority of our products remain stable, but hot spots continue to exist. However, customers are becoming more selective in their expedite requests, focusing on products that complete a "matched set" rather than expediting products across the board. This behavior is not specific to any product family, end market or geography.

Discussions with customers confirm a high level of interest in our commitment to expanding our internal manufacturing capacity roadmap, including 300-millimeter wafer fabs RFAB2 and Lehi -- or what we call LFAB -- and the associated assembly test expansions. These investments to strengthen our manufacturing and technology competitive advantage will provide lower costs and greater control
of our supply chain. And while there is a growing recognition that the near-term supply/demand imbalance will end at some point, the secular growth of semiconductor content per system will continue to grow, and this requires a robust manufacturing capacity roadmap for 2025 and beyond.

Moving on, I'll provide some insight into our third quarter revenue by end market.

First, the industrial market was down mid-single digits sequentially and up about 40% from a year ago. The changes both sequentially and from the year ago were generally consistent across the diverse set of sectors.

The automotive market again grew sequentially and was up more than 20% from the year ago. When comparing to pre-pandemic levels of Q4 2019, revenue is up almost 30%.

Personal electronics grew low-double digits sequentially and was up low-double digits compared to a year ago. The strength sequentially and the year ago was due to mobile phones, PC/notebooks and tablets.

Next, communications equipment was down mid-single digits sequentially and was down upper teens from a year ago.

Enterprise systems grew sequentially and from the year-ago quarter.

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

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

Thanks, Dave, and good afternoon, everyone. As Dave mentioned, third quarter revenue was $4.6 billion, up 22% from a year ago. Gross profit in the quarter was $3.2 billion, or 68% of revenue. From a year ago, gross profit margin increased 360 basis points.

Operating expenses in the quarter were $800 million, up 1% from a year ago and about as expected. On a trailing 12-month basis, operating expenses were 18% of revenue. Over the last 12 months, we have invested $1.6 billion in R&D.

Acquisition charges, a noncash expense, were $47 million in the third quarter and will go to zero beginning in fourth quarter of 2021.

Operating profit was $2.3 billion in the quarter, or 50% of revenue. Operating profit was up 43% from the year-ago quarter.

Net income in the third quarter was $1.9 billion, or $2.07 per share.

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

Cash flow from operations was $2.4 billion in the quarter. Capital expenditures were $486 million in the quarter. Free cash flow on a trailing 12-month basis was $7.1 billion.

In September, we announced we would increase our dividend by 13% effective this month, marking our 18th consecutive year of dividend increases. In the quarter, we paid $942 million in dividends and repurchased $139 million of our stock. In total, we have returned $4.2 billion in the past 12 months. Over the same period, our dividend represented 53% of free cash flow, underscoring its sustainability.

Our balance sheet remains strong with $9.8 billion of cash and short-term investments at the end of the third quarter. In the quarter, we've issued $1.5 billion of debt in three tranches of $500 million each. The first has a coupon of 1.125%, which is due in five years; the second a 1.9% due in 10 years; and the last, a 2.7% due in 30 years. This resulted in total debt of $7.8 billion with a weighted average coupon of 2.6%.

Regarding inventory, TI inventory dollars were up $7 million from the prior quarter, and days were 112, up one day sequentially but still below desired levels.
For the fourth quarter, we expect TI revenue in the range of $4.22 billion to $4.58 billion and earnings per share to be in the range of $1.83 to $2.07. The Lehi acquisition closed last Friday, but the costs are not included in our guidance. We will provide those details when we report fourth quarter results. Just as a reminder, the purchase price was about $900 million, and we expect ongoing cost of about $75 million per quarter through 2022.

We continue to expect our annual operating tax rate for 2021 to be about 14% and our effective tax rate to be about 13%. As you are looking at your models for 2022, without any changes to tax law, we would expect our annual operating and effective tax rates to remain about what they are this year with a similar quarterly profile of discrete tax benefits that are higher in the first quarter compared to the rest of the year.

In closing, we continue to invest to strengthen our competitive advantages and in making our business stronger. Our investments in our long-term roadmap for capacity expansion both in LFAB and RFAB2 are great examples. As a reminder, our CapEx will be higher on an absolute level as well as a percentage of revenue as we strengthen this advantage. We are working through detailed plans of our long-term roadmap, and we'll have specifics of timing and CapEx spending in our capital management call in February. We continue to believe owning and controlling our supply chain will be of growing strategic importance.

With that, let me turn it back to Dave.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we will go first to John Pitzer of Credit Suisse.

John William Pitzer Crédit Suisse AG, Research Division - MD, Global Technology Strategist and Global Technology Sector Head

Dave, I know in this sort of environment, seasonality doesn't make a lot of sense. But when you look at the September quarter, I'm just kind of curious, the June quarter came in well above your guidance range. September was well above the midpoint but still within the guidance range. We're hearing of logistical constraints and supply constraints across the economy. I'm kind of curious, when you look at sort of the lower level of upside in the September quarter versus the June quarter, to what extent might have there been supply constraints outside of your control? To what extent do you think it's customers just being more selective about what they're pulling from you? Any color there would be helpful.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Sure, John, and thanks for the question. Yes, I really think it depends on the customers' bill of material. I think that there are supply constraints that are widely reported across different components. And as we mentioned in our prepared remarks, the behavior that we're seeing that's different, our customers are showing up and requesting we have meetings with them rather than showing up with long list of devices that they're asking us to expedite. They're really just short lists. So they're looking for particular parts that complete those matched sets so that they can complete those builds for them. So it is a different behavior that we're seeing this quarter versus the prior quarters. So do you have a follow-on?

John William Pitzer Crédit Suisse AG, Research Division - MD, Global Technology Strategist and Global Technology Sector Head

Yes. Just as a follow-on, I know you're going to give us more color about LFAB expenses and RFAB expenses as we get into next year. But I'm wondering if you could just help us set the stage a little bit. Next year is obviously going to be kind of a capacity build-out year for you. And I guess all else being equal, how should we think about the gross margin impact on calendar year '22 as you layer in these investments?
Rafael R. Lizardi Texas Instruments Incorporated - CFO and Senior VP of Finance & Operations

Yes. I'll take that one. First, as you know, you've known us for a long time, we don't manage the business to gross margins. We manage for the long-term growth of free cash flow per share, and that starts with driving the top line. And that's why we're making these investments, right, to support revenue growth, and as we do that, it is extending our low-cost manufacturing advantage that gives us the great structural cost advantage with 300-millimeter. And in addition to that, we're controlling the supply chain.

And specifically on your question, take RFAB2, all in, that's about a $6 billion expense. About a billion of that is a building which depreciates over 30 years or so. The balance of the rest is equipment, and we're going to be putting in that equipment starting next year and over the coming years.

With LFAB, obviously, a $900 million purchase price. And that -- some of that is building, some of that is equipment. And then on top of that, we'll put about $3 billion of CapEx over a number of years as we ramp that up. So we'll give you additional details on that and the bigger longer-term picture of how we're going to support the longer-term growth. We'll give you those details in February at the capital management call.

Operator

And we'll go next to Timothy Arcuri of UBS.

Timothy Michael Arcuri UBS Investment Bank, Research Division - MD and Head of Semiconductors & Semiconductor Equipment

Rafael, I was wondering if you can talk about pricing. Obviously, you're seeing some increases in your input costs. Can you talk about whether you're passing those on to customers and sort of how ubiquitous any price increases on your side might be?

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

Yes. What I would tell you, our strategy on pricing has not changed. We regularly monitor that, and our goal is to be competitive. And it's really, frankly, independent of the input cost to the largest degree. But our goal is to be competitive. And if prices move higher, we adjust those over time, and we have been adjusting those over time.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Follow-on, Tim?

Timothy Michael Arcuri UBS Investment Bank, Research Division - MD and Head of Semiconductors & Semiconductor Equipment

I did, Dave. And I guess I'll ask the same question that I've asked the last, I think, three calls about share repo. It was pretty low again. I guess is there sort of -- can you help us think through maybe what the triggers might be for you to start to buy back more stock? Is there a target cash level where maybe you'd say that the balance sheet is getting a little bit overcapitalized and you'd start to buy back more stock? I'm just kind of -- obviously, you're not buying back much, but I'm just kind of wondering if you can talk us through what triggers you might be looking for to start that back again.

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

Yes. Stepping back and just to remind everybody how we think about returns, our objective is to return all free cash flow to the owners of the company over the long term, and we do that through dividends and buybacks. If you look at our 18-year history on that, it's really consistent. In fact, we've -- many years -- most years, we've averaged well over 100% of return.

During that time, we have -- I would remind you, we have increased the proportion of the return that comes into dividends. So that also plays into that. But as long as we think the buybacks are accretive to our long-term owners, we're going to have some buybacks. And as you have seen, as you pointed out, in the last three quarters, we have -- in fact, I don't think there's been a single quarter in the last 18 years or so that we have not purchased -- returned cash to the owners through buybacks in one form or another.

Operator

We'll go next to Harlan Sur of JPMorgan.
Harlan Sur JPMorgan Chase & Co, Research Division - Senior Analyst

On finished goods inventory, most of which I assume is sitting at customer consignment hubs, this has come down faster than overall inventories, right? Finished goods dropped 8% sequentially in Q3, dropped 9% in Q2. They're down 25% from the beginning of this year and down 33% pre-COVID-19, I assume, due to the strong demand profile from your direct customers. So how far below normal are consignment inventories relative to your customers' target levels? And is part of the muted Q4 outlook to replenish these very low inventories? Or does the demand profile backlog and forecast actually reflect a sequential decline here in the fourth quarter?

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

Yes. So I'll start and, Dave, you want to chime in after that. But I think where you're going with that -- let me maybe step back. Yes, obviously, inventory levels are below desired levels, right? We're at 112 days. Our target is 130 to 190 days. So clearly, we're well below where we want to be.

And inside of that, as you pointed out, finished goods -- all finished goods, whether it's in consignment or at our product distribution centers, are the ones that are decreasing most. In fact, even though inventory -- total inventory levels stayed about flat, slightly up second to third quarter, finished goods decreased. And then raw materials increased a little bit to offset that.

So our goal, as soon as capacity increases, if there's an adjustment in demand, we will build those inventory levels back up to be at more healthy levels. And given our business model, it's just a great bet just given the low obsolescence of our inventory, the diversity of positions, diversity of products that we can afford. Not only can we afford, it makes sense for us to build that inventory, have it ready for the secular growth that we're confident will happen beyond that.

And I think maybe tactically where you were going on consignment inventory, frankly, those tend to be pretty lean to begin with. That's how that process is designed to just keep a couple of weeks. So I wouldn't expect that by itself to build significantly purely consignment. Where I would expect the build to happen is more at our product distribution centers, and that gives us more flexibility to then ship where the demand is most needed. Dave, do you have...

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

I think that's well said. I think just tactically, where we -- whether we keep it in our hubs where we would prefer it or if we push it out to a consignment center, that will just be reflective of our expectation that a customer will pull it. So that's just a tactical decision.

I'd also point out that, as you said, Rafael, we do plan to bring on more capacity incrementally as we have each quarter through this year and through the middle of next year. And in the back half of 2022, RFAB2 will come online and then that will be followed by LFAB. It's been -- as Rafael pointed out, we did close on that factory on Friday of last week. And so that is on target to come online in early 2023 to support growth in the future.

So did you have a follow-on, Harlan?

Harlan Sur JPMorgan Chase & Co, Research Division - Senior Analyst

Yes. I appreciate the insightful answer. So exiting last year, the direct business, which includes consignment, that was about 65% of revenues. Where does that mix roughly sit today? And did the team drive a positive book-to-bill ratio in Q3, if you could maybe quantify?

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

So on the book-to-bill, we don't think that's relevant, frankly, and -- we haven't disclosed that in a while, and we're not disclosing that anymore.

On your first question on percent, I think you asked percent of our revenue from consignment? Is that right?

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

I didn't quite...
Rafael R. Lizardi  Texas Instruments Incorporated - CFO and Senior VP of Finance & Operations
Yes, that first part.

Dave Pahl  Texas Instruments Incorporated - Head of IR & VP
Yes, could you just repeat it, Harlan, so we got -- make sure we got it right, what you're asking, the first question?

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

Harlan, are you there?

Harlan Sur  JPMorgan Chase & Co, Research Division - Senior Analyst
Yes. Just percentage of the overall direct business.

Dave Pahl  Texas Instruments Incorporated - Head of IR & VP
Oh, direct business. Yes -- so yes. So we left last year with about two-thirds of our revenues direct. So we expect that, that percentage will increase over time. We'll provide an update of what we've done with that this year in our February call -- cap management call in February of actually what that looks like. But just to say over time that we do expect that, that will move up slightly over time.

So -- and just the other color with Rafael talking about book-to-bill, as we've got a lot of our revenue on consignment, we've got TI.com, the actual backlog isn't quite as meaningful as what it used to be. So as he said, it's just not a number that we look at or measure or we've talked about in some time. So it isn't quite as helpful as what it used to be.

Operator
And we'll go next to Stacy Rasgon of Bernstein Research.

Stacy Aaron Rasgon  Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst
For the first one, I wanted to ask about the near-term Micron impact. I know you said $75 million in cost impact in the model next year. Those costs don't go away, right? That $75 million a quarter is people, correct? And does it include depreciation or anything else or is it just people, does it? Like how do you think about that, like what that incremental cost long term?

Rafael R. Lizardi  Texas Instruments Incorporated - CFO and Senior VP of Finance & Operations
Very good, Stacy. Good direct question. So yes, that $75 million is mainly people and direct costs, not depreciation. Depreciation will not start until about first quarter '23 when we start production, just the way the rules work on that front.

And that $75 million, we're still working through the details, but we currently believe that the most likely scenario is that most of that cost will go to the restructuring charges/other line until we start production, right? And then at that point, the majority of the cost would go to the COR line.

Now the costs actually do increase over time as we increase production, right? But I think where you're going is that as that happens and those costs are then absorbed by revenue, right? Now how quickly those are absorbed beyond utilization, underutilization, et cetera, that just depends how quickly we ramp that factory, right? Clearly, at the beginning, there won't be 100% absorption, and we'll get to that at some point.

But we'll -- we're not going to -- that's in 2023. So we'll get to that at some point to give you some details. And in February, at the capital management call, I think we'll frame it kind of the bigger picture of that, along with our other CapEx investment, and you'll get a better sense of how that's going to play out.

Dave Pahl  Texas Instruments Incorporated - Head of IR & VP
A follow-on, Stace?
Operator
And it looks like Stacy has disconnected.

Dave Pahl, Texas Instruments Incorporated - Head of IR & VP
Okay. If you have a follow-on, let us know, Stacy.

Operator
And we’ll go next to Ross Seymore of Deutsche Bank.

Ross Clark Seymore, Deutsche Bank AG, Research Division - MD
Dave and Rafael, I want to talk about the quarter you reported and get into some of the supply-demand dynamics. It was the smallest beat to your original revenue guidance you guys have had in a year, and I realize that it’s been exceedingly volatile in the last year. But I wondered, was that the demand profile changing from those investors, that selectivity changing that you’re talking about? Or did supply play a role in that, where you just couldn’t meet up to the demand? Just trying to get what really changed versus whatever level of conservatism you had built into the prior quarters when you beat by bigger deltas.

Dave Pahl, Texas Instruments Incorporated - Head of IR & VP
Yes. I think you said demand from investors. I think you meant to say demand from customers, right, Ross?

Ross Clark Seymore, Deutsche Bank AG, Research Division - MD
Yes. Sorry about that, yes.

Dave Pahl, Texas Instruments Incorporated - Head of IR & VP
Yes. No, that’s okay. Certainly, if any investors want to buy semiconductors from us, we’ll be happy to sell them, but yes. So I’d just say that overall, the quarter came in as we expected it to, right? And that’s a statement as we said in the prepared remarks and when you looked across geographies and products and product groups and end markets, those types of cuts -- so there wasn’t like one area that was underperformed or outperformed what we were expecting.

But again, the main thing of what was different this quarter versus last quarter was really where customers were coming in and requesting expedites and upsides from us, and those upsides were much, much more narrow and focused just on a few products. So that was really what the difference was. If you’re looking for what was different this quarter versus last quarter and those types of things, that’s what I would point to, to say what’s changed in the last 90 days.

Ross Clark Seymore, Deutsche Bank AG, Research Division - MD
And I guess as my follow-up, a similarly toned question. You mentioned that lead times remain extended but are stable, and then you talked about that whole selectivity dynamic. What would you imagine would change the lead times? Is it going to be your supply incrementally rising or more so with Lehi? Or is the selectivity something -- as you guys look back and are students of cycles, is the demand side net selectivity side more likely to impact the lead times going forward?

Dave Pahl, Texas Instruments Incorporated - Head of IR & VP
Well, as you know, you’ve been through many cycles with us, right? It’s always a combination of both. And we will and continue to add incremental capacity as we have planned for some time. And certainly, as we go out in time, as we get the bigger tranches of capacity coming on with RFAB2 and then LFAB, we’ll be able to make more progress on that front.

And at some point, we know that things will change from a demand standpoint. And so we don’t spend time trying to predict that, but we’ll be ready for it. We know what we’ll want to do. And as Rafael talked about, one of the top things there is we’ll want to rebuild inventory to prepare for the next time that the demand strengthens. So we have a long list of things that we’re doing to invest in the company to make it stronger. So we won’t control the timing of that, but we’ll be ready for them for sure.
Rafael R. Lizardi  Texas Instruments Incorporated - CFO and Senior VP of Finance & Operations

And just to emphasize that point, when that adjustment happens, whenever that is, we will continue investing in R&D, focus on the areas auto and industrial, for the secular long-term growth. We'll continue to invest on CapEx and to set up the company for the next 10 to 15 years with a great long-term roadmap. And we will build inventory. That’s -- as Dave mentioned, the range is 130 to 190 days. Frankly, we'll probably end up being at the higher end of that range just because we're still so good about the business model and how good that inventory will be and how it sets us up for the next upturn on the other side given the long-lived nature of that inventory.

Dave Pahl  Texas Instruments Incorporated - Head of IR & VP

That's right.

Operator

We'll go next to Vivek Arya of Bank of America.

Vivek Arya  BofA Securities, Research Division - Director

I just want to get the supply side right. Are customers not ordering as much from you because they don't have enough from you on the component side? Or they don't have enough from others that they need to complete their bill of materials?

Dave Pahl  Texas Instruments Incorporated - Head of IR & VP

It's both, Vivek. There is -- there are instances of both of those. And sometimes, it's not even semiconductors, right? It may be other components that they may be missing. So yes, it's a combination of those things. Supply chains are complex, depends on the bill of materials and the systems that they're building. So it depends.

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

Yes. And Vivek, the nuance changes. 90 days ago, 180 days ago, they were expecting everything, almost regardless of matched set position. Now they're more selective in what they're expediting, right?

Dave Pahl  Texas Instruments Incorporated - Head of IR & VP

You have a follow-on, Vivek?

Vivek Arya  BofA Securities, Research Division - Director

Yes. Could you talk specifically to the automotive market? This year, it's clear the production has not been that strong, but auto semiconductor sales have been pretty strong. So as it applies to TI, what do you think has been kind of the interplay between content and mix? Or do you think that there is perhaps inventory stuck in the automotive supply chain somewhere that we should watch out for?

Dave Pahl  Texas Instruments Incorporated - Head of IR & VP

Yes. I'll comment on automotive. I think I'll even extend it into industrial. And those are two markets that we have long talked about that we believe that there is content growth in those markets -- content per system that's easy to see in cars and well reported on. I know, Vivek, in your reports that you've reported on that content growth. You can see it in automotive. It's happening in industrial across 13 different sectors, so harder to see.

And we invest in all the markets, but we have a strategic focus on automotive and industrial. So you're beginning to see some of the benefits of those -- that strategic bias that we have, our channel advantages, the breadth of our products, advantages in those markets as well. So there's components of that.

But that said, any time that we have supply shortages in the industry, customer behavior is always very consistent, and that behavior is that they will want to build inventory to protect themselves. So whether they've already begun that or have already done that, they certainly will want to do that. And at some point, they'll have too much product, and that's what creates the cycles in our industry.

So it won't surprise us if the cycle comes to an end at some point. We'll be prepared for that, and we'll know what we'll want to do at that point. So thank you for those questions.
Operator

We'll go to Joe Moore of Morgan Stanley.

Joseph Lawrence Moore Morgan Stanley, Research Division - Executive Director

I wonder if you could talk to the hot spots. Is there any particular pattern that's driving which products you have in short supply? I mean it seems like we see it most in areas like enterprise and some of the personal electronics, higher-volume stuff. Is that something that you guys would agree with? And do you think -- is it -- is there more foundry versus internal fabs? Like is there anything in particular driving those hot spots?

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Yes. I wouldn't put it down on any one thing, Joe. Certainly, there's reports of the tightness across foundry. So obviously, we see that as well. So there's tightness in some leadframes. So we see that as well. Other input raw materials, mold compounds -- we have testers, in some cases, some process technologies, some particular products themselves that have a large number of customers. So -- and those hot spots move around as our operations teams will sometimes move capacity from one area to the other. So they're not always consistent or persistent. Sometimes they are, but sometimes they're not. And there's things that we can do to mitigate those or actually completely alleviate them.

So -- and that's why as we describe them, it's not just one particular product area or one particular product set that -- or even one particular market, or even -- I'd say, even one particular customer that would be impacted by that, that you may see.

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

And just to highlight something for new listeners. Dave mentioned the foundries. Only about 20% of our wafers are -- come from foundries. The vast majority, 80% and growing with our investments in 300-millimeter, are internal wafers and that just gives us a much better control of our destiny and for all the reasons Dave mentioned and then the low-cost structure or low cost that we get with 300-millimeter.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Yes. And I think that makes it especially clear why we believe that continues to be a strategic advantage for us in times like this. So you have a follow-on, Joe?

Joseph Lawrence Moore Morgan Stanley, Research Division - Executive Director

Yes. I wonder also with the hot spots, is there a situation where you can't respond to upside in demand and that's why it's tight? Or are there actual areas where -- I know there's always a little bit of this, but on a broad scale where you're not meeting kind of commitments that you have made because of some of those things that are upstream from you?

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

I think there's probably both of those that exist.

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

I mean at 112 days of inventory, it is harder to respond to upside than if we were at 150, 160, 190 days, of course, so yes.

Dave Pahl Texas Instruments Incorporated - Head of IR & VP

Yes. Yes, for sure. So okay. Well, thank you, Joe.

Operator

And next question comes from Chris Danely of Citi.
So Dave and Rafael, you mentioned that the lead times haven’t really changed, but expedites are getting better or less bad. Why do you think that is? Do you think that your competitors are reducing lead times? Do you think that the supply chain has had a little bit of a chance to build some buffer inventory? Why do you think the situation is getting, I guess, either better or less bad?

Yes, Chris, I think that’s a great question. I don’t know that we know the answer specifically to that question. So I think we’re trying to stick to the facts of -- we can observe that behavior change. I think you’re offering some good theories of why that behavior may be changing. But what we’re trying to do is to stick to the facts of what’s going on. There’s multiple reasons why it might be changing, and we’d rather not venture into guessing or predicting or calling what’s driving that behavior. So do you have a follow-on?

Yes. I guess you can leave the guessing and predicting up to us sell-siders. On the...

Since you guys don’t talk about gross margin, but you did talk about free cash flow margin. I think you had an all-time high in free cash flow margin in Q3. And it looks like there’s some headwinds coming down the pike in the, I guess, near to medium term. Is there any reason for us to believe that you’ve seen your all-time peak in free cash flow margin? Or eventually, could it get back above where it was in the most recent quarter?

Sure. So I’ll take that, Chris. And Chris, you know us very well. You follow us for a long time. You know we do not manage to free cash flow margin percent, right? That is not what drives long-term value for the owners. It’s the long-term growth of free cash flow dollars, right?

And to your point, there are some headwinds on that with the CapEx that we’re talking about to set up the company well for the future. But of course, we’re only doing that because we think that is going to drive even faster growth of the long-term trend of free cash flow dollars. So we’ll continue to focus on that because we think that is what drives value for the long-term owners.

Okay. Thank you, Chris, and we’ve got time for one more call.

And we’ll go to Tore Svanberg of Stifel.

As far as the question on controlling the supply chain, you talked about 80% outsourced now. I believe that’s kind of the more advanced nodes. But should we assume that, that 80% is just going to grow and that you’re going to rely less and less on foundries going forward?

Yes. So you said 80% outsourced. It's 80% insourced, just to make sure. 80%...

Sorry about that. Yes. Sorry.
So 80% are own wafers. And yes, that should grow over time as we continue to add these wafer fabs that we’re talking about, all in 300-millimeter, which with -- the efficiency of the 300-millimeter is huge, right, because a 300-millimeter wafer accounts for almost 2.3x a 200-millimeter wafer. And these are pretty large wafers for efficiency purposes. In fact, RFAB2 is going to be bigger than RFAB1. So yes, it’s reasonable to deduce that, that percent will increase over time.

Very good. And as a follow-up, and I don’t want to steal your thunder from February, but in the past, you talked about capacity of $22 billion. Obviously, you’re going to go through capacity expansion here for the next 12 to 18 months. Would you share any new numbers with those, I don’t know, $25 billion, $28 billion, anything at all?

Yes. No, so great question. Thanks for the setup for February. We will talk about that in February. So until then, what I would tell you is you’ve heard us talk about DMOS6 and RFAB1. Roughly, that’s a potential of about $8 billion of annual revenue on 300-millimeter then RFAB2. And this is all dependent -- highly dependent on mix, right? So these are not exact numbers. But RFAB2 -- with that caveat, RFAB2 should add another $5 billion of annual revenue, again, when it’s fully priced, and obviously, not on day 1. And Lehi should add $3 billion to $4 billion of annual revenue. So we’re thinking in terms of that, and we’re thinking even beyond that, right? Because as we look at the company’s potential for growth into the next 10 and 15 years, then we’re not stopping, just thinking in the next four or five years. We’re thinking 10, 15 years. And we’ll talk about that in February in more detail.

That’s great. And I think we can go ahead and wrap up, Rafael, if you would like.

Okay. So let me wrap up by reiterating what we have said previously. At our core, we’re engineers and technology is the foundation of our company. But ultimately, our objective and the best metric to measure progress and generate long-term value for owners is the growth of free cash flow per share. While we strive to achieve our objective, we will continue to pursue our three ambitions. We will act like owners who will own the company for decades. We will adapt and succeed in a world that’s ever changing, and we will be a company that we’re personally proud to be a part of and would want as our neighbor. When we are successful, our employees, customers, communities and owners all benefit. Thank you, and have a good evening.

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