

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TXN - Texas Instruments Inc Capital Management Strategy Webcast
- 2016

EVENT DATE/TIME: FEBRUARY 09, 2016 / 4:00PM GMT

OVERVIEW:

TXN reviewed its capital management strategy.



CORPORATE PARTICIPANTS

Dave Pahl *Texas Instruments Incorporated - Head of IR*

Kevin March *Texas Instruments Incorporated - CFO*

CONFERENCE CALL PARTICIPANTS

Vivek Arya *BofA Merrill Lynch - Analyst*

Ross Seymore *Deutsche Bank - Analyst*

John Pitzer *Credit Suisse - Analyst*

Harlan Sur *JPMorgan - Analyst*

Tore Svanberg *Stifel Nicolaus - Analyst*

Ambrish Srivastava *BMO Capital Markets - Analyst*

Will Stein *SunTrust Robinson Humphrey - Analyst*

Timothy Arcuri *Cowen and Company - Analyst*

Ian Ing *MKM Partners - Analyst*

PRESENTATION

Operator

Good day, and welcome to Texas Instruments Capital Management Strategy conference call. At this time, I'd like to turn the conference over to Dave Pahl. Please go ahead, sir.

Dave Pahl - Texas Instruments Incorporated - Head of IR

Thank you, good morning and thank you for joining our 2016 Capital Management call. Kevin March, TI's Chief Financial Officer, is with me today. This call is being broadcast live over the web, and can be accessed through our website at TI.com/IR. A replay will be available through the web.

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

During today's presentation, we will begin with a quick recap of our capital management strategy and our scorecard for 2015. Then we will provide a historical summary of our capital allocation, as well as deeper insight into specific areas of investment and a view of our free cash flow per share performance. We will provide more detail than we have in prior capital management presentations. We believe the key points that investors can take away remain consistent.

But first, we continue to be disciplined in our capital allocation, including our R&D decisions, and this discipline continued to translate into double-digit free cash flow share growth in 2015. Second, our 300-millimeter Analog manufacturing plan is on target, and will provide competitive advantages to TI well into the future. And third, our early mover acquisition of National Semiconductor in 2011 has delivered on its strategic and financial objectives, and continues to be an advantage for us.

As a reminder, we believe TI is in a unique class of companies that can grow, generate and return significant cash. We're focused in the best semiconductor markets, which are analog and embedded. We have a leading position in both markets, and we continue to expand market share in both of those markets gaining in both last year.

And finally, our strategy is designed around four competitive advantages that provide tangible benefits and are difficult to replicate. Those are manufacturing and differentiated technology, our broadest portfolio of Analog and Embedded products, the reach of our market channels, and finally diverse and long-lived positions, which leads to a high terminal value.

With that, I'll turn it over to Kevin and he will review our capital management strategy. Kevin?

Kevin March - *Texas Instruments Incorporated - CFO*

Thanks, Dave, and good morning, everyone.

When we think of capital management, we think of more than just how we allocate cash towards dividends and stock repurchases. We think of how we allocate all of the capital that is available to us, and today I'm going to take you a little deeper into how we look at this.

Our objective in this thinking is focused on maximizing long-term growth and free cash flow per share, because we believe this is the most important way to maximize shareholder value. And with that mindset, we are focused on being disciplined allocators of capital in order to ensure that we generate the best returns we know how.

I think this graphic is the single best illustration of our comprehensive view of disciplined capital allocation. It starts with a great business model, and for us that means being in what we believe are the two best markets in semiconductors, analog and embedded processing.

We have designed a business that is capable of growing, generating, and returning cash to our shareholders, but that can only be done if the cash is available for those purposes. This means employing an effective tax strategy designed to maximize our access to the cash that we generate.

We work to maintain a strong balance sheet, which includes fully funding large liabilities such as our pension plans, in order to have available to us the full size of the balance sheet to support strategic opportunities when they arise. We employ a highly disciplined approach to continuous investments to maintain and strengthen our competitive advantages by investing in technology, manufacturing, our channel advantages, as well as working capital and when it makes sense, acquisitions. And finally, with the cash that's left over, we have a thoughtful, consistent approach for returning that cash to our shareholders, and periodically paying down debt.

So how did we do this year? Let's begin with free cash flow generation.

Free cash flow margin expanded to 28.6% of revenue, consistent with our belief that we can sustain 30% free cash flow margins in good markets. Inventory closed at 115 days at the top end of our prior model. I will point out that we are expanding our inventory model to a range of 105 to 135 days from 105 to 115 days, as we expect to continue to see an increasing portion of our revenue going to distribution and also being on consignment programs.

Cash retained in the U.S. entities closed at 82%. I will also note that we are slightly adjusting this target from more than 80% to about 80%, as we expect to use more cash offshore in support of expanding our assembly and test sites and growing consigned inventory programs.

Cash levels, pensions and debt are on target, and these targets remain unchanged. Capital expenditures also came in on target at 4% of revenue. And finally, we returned a total of \$4.2 billion of cash, a bit above our target.

In summary, our capital management strategy continues to serve us and our shareholders well. Free cash flow per share continues to grow in low double digits, while we continue investing in long-term competitive advantages.

So now I'd like to spend a few minutes providing you with some additional insight on our capital allocations, as well as update you on several important investments. We think it's helpful to look at all categories to which we allocate capital, and to look at it over time.



In this chart, we have summarized five years of capital allocation, and have broken it down into four categories. Research and development, sales and marketing, capital expenditures and changes in inventory as one category. Share repurchases as another category, acquisitions as another, and finally dividends as a fourth category.

The logic behind grouping the R&D, sales and marketing and CapEx and changes in inventory together is that they are investments that we make to drive organic growth. Combining them together is consistent with our approach of funding strategies not projects.

There are two key points on this slide. First, with almost \$40 billion of capital allocated over the past five years, you can quickly appreciate why capital allocation is a job that we take seriously, and one that has a significant impact on shareholder returns.

Second, most questions from investors around capital allocation typically focus on acquisitions, buybacks or dividends, all of which, of course, are important. I'll provide some insight into those investments and returns as well in just a few minutes.

However, like many companies, the largest category of capital that we allocate is the retained earnings that we use for R&D, sales and marketing, capital expenditures and cash used for inventory. These are the investments we make to generate organic growth. Therefore, we spend significant time ensuring these investments are delivering long-term competitiveness and generating returns greater than our cost of capital. We have a clear purpose for why each of these investments is made.

As I already commented, R&D, sales and marketing, CapEx and inventory are for organic growth of our business. Share repurchases are intended to generate the accretive capture of free cash flow for long-term investors. Acquisitions are intended for inorganic growth, and dividends are to help us appeal to our broader set of investors.

If you drill down to the next level, we also have a very clear focus for each of these investment areas. For R&D, sales and marketing, CapEx and inventory, our focus drives significant actions across the company.

We invest in new products like conductive sensing, or in new technologies like FRAM or GAN or new isolation processes. We invest in capabilities that strengthen our long-term competitive advantages.

This could be 300-millimeter manufacturing, expanding TI.com, or growing system solutions to help our industrial customers solve their problems and get to market quickly. We invest and adjust our investments in our product portfolio, which I'll describe more in a moment.

Finally, we had a great focus on execution, which can simply be thought of as getting more output per dollar of input. This includes the continued improvement in product execution, or free cash flow generated as a percentage of property, plant and equipment plus inventory or sales productivity. Share repurchases are focused on consistent repurchases when the present stock price is below the intrinsic value using modest growth assumptions.

Acquisitions are evaluated through two primary factors. First is strategic match, meaning analog focused with high exposure to industrial and automotive, and second is financial results that generate a return greater than our weighted average cost of capital within three to four years. And finally, dividends are focused on sustainability and growth for obvious reasons.

With that framework in mind, let me go a little deeper into several of these areas. As you may recall, our broad portfolio of analog and embedded products is an important competitive advantage. This breadth of portfolio brings more customers to TI each year.

It's also critical that we continually grow and strengthen this portfolio with highly differentiated products that are developed with an eye on the best market opportunities over the next 10 years. At the highest level, we see good opportunities in all market segments, but we believe that industrial and automotive will be the best markets over the next 10 years. This is primarily because semiconductor content and industrial and automotive will significantly increase as companies make their equipment smarter, better connected, safer and more efficient.



This chart summarizes the direction across the market segments of our R&D investments, and also provides the revenue break out for 2015. In industrial and automotive, we continue to broadly increase investments, and we are pleased with the continued progress on revenue as these segments now comprise about 46% of TI revenue.

Personal electronics is an important market segment, and while investment level in total is down, we do invest selectively. It is perhaps helpful to note that even though we have a personal electronics customer that comprises 11% of our revenue, our overall exposure to personal electronics remains quite steady at about 30%.

In communications equipment, we announced several years ago that we were reducing our Embedded investments, but that our Analog still had growth opportunity. The revenue variation for 2014 being up significantly in 2015 being down significantly, is driven by market specifics, not by changes in our R&D allocation.

Let me turn now to an update on our revenue plan for our 300-millimeter analog. On this call last year, we introduced our plan to have two 300-millimeter fabs supporting our Analog business. When both of these fabs are fully utilized, they will be capable of producing about \$8 billion a year in Analog revenue.

You may recall, the two factories are both here in the Dallas area. RFAB, a factory we opened in 2009 dedicated to 300-millimeter Analog production and DMOS6, a factory we opened in 2001 originally dedicated to wireless products that we are now converting to also handle 300-millimeter analog production, along with embedded processing production.

We made good progress on this plan in 2015. RFAB increased to 45% utilization in the year, up from 40% last year, and DMOS6 has qualified on schedule in the 4Q 2015, and early production has already started.

As a reminder on why 300-millimeter wafer diameter really matters, here is a comparison for manufacturing costs of 200-millimeter compared to 300-millimeter wafers. By virtue of geometry, a 300-millimeter wafer has 2.25 times more surface area than a 200-millimeter wafer, which in turn means that we get about 2.3 times more chips per wafer, but the 300-millimeter wafer only costs about 40% more to process than the 200-millimeter wafer. The net result is that a chip built on 300-millimeter wafers costs about 40% less than the same chip built on a 200-millimeter wafer.

To understand how a 40% cheaper chip impacts gross margin, it's easiest to use an example of a part built on 200-millimeter compared to 300-millimeter. This example shows a theoretical part that sells for \$1 with a gross margin of 60%.

The chip itself would cost about \$0.20 when built on 200-millimeter, but only about \$0.12 when built on 300-millimeter. The rest of the costs such as assembly and test are the same regardless of where the chip was sourced. The net result is that gross margin improves by 8 percentage points.

Now for a quick update on the acquisition of National Semiconductor. When we are asked about acquisitions, we consistently explain that a potential acquisition has to first achieve our strategic objectives and second it has to earn TI's cost of capital within three to four years. Given that we closed the acquisition of National Semiconductor about four years ago in September 2011, we think it's an appropriate time to provide an update on its performance.

On the strategic front, we are pleased with the products that we received, as they were solidly anchored in catalog/analog with high exposure in industrial and automotive. We are also very pleased with the team and their ability to continue generating great parts, such as inductive sensing, high-speed automotive communications, and general power management devices.

On the financial front, I'll remind you that the purchase price was \$6.5 billion, with many investors were calling a significant premium. What didn't get as much attention was that it also came with an almost 5% free cash flow yield on the \$6.5 billion purchase price based on their prior two years of pre-acquisition results. In 2015, our return on invested capital for this acquisition exceeded 8%, and our current projections using modest growth assumptions indicate low double-digit internal rates of return on this investment.

As you can imagine, not every assumption on our financial model happened exactly as planned. Revenues were good, but not as high as modeled, but OpEx synergies turned out to be better than we planned.

The National acquisition was a great strategic addition and is generating strong financial results, but is also a great reminder that the starting point is critical. What you pay for the free cash flow it generates before synergies makes all the difference in the final outcome.

Our objective in buying back shares is the accretive capture of free cash flow for long-term investors. We focus on consistently buying back shares when the current stock price is below the intrinsic value of the company.

By using discount factors of 8% to 9% with modest growth assumptions to calculate the intrinsic stock value, we are aiming to have a high degree of confidence that investments made in the stock buybacks are in fact earning rates of return greater than our cost of capital. While the ultimate assessment of return on investment depends on the future cash flow stream, our track record of this approach is encouraging.

If you make the very conservative assumption that TI's future free cash flow remained flat for the next 10 years, we will be earning about 10% annualized return on all stock repurchases made back to 2004. Since 2004, when we began actively buying back shares with the intent of reducing our shares outstanding, we have reduced total shares outstanding by 41%, including the 3.4% reduction in 2015.

As we commented earlier, our objective with dividends is to appeal to a broader set of investors, and our focus is on both growth and sustainability. We've increased our dividend for 12 consecutive years, and averaged 22% growth over the past five years.

We used a dividend budget calculation based on 50% of the full year trailing free cash flow as a guideline from which we apply judgment. This insures the single year's results, either good or bad, don't over weigh the dividend decision. This approach combined with our consistent growth of free cash flow resulted in our dividend in 2015 consuming only 39% of 2015's free cash flow, supporting our objective of growth and sustainability.

As we described at the beginning, our overall objective is to maximize long-term free cash flow per share. We believe this is not only the best metric to judge our performance, it is also the one that owners ultimately care about.

Over the past 11 years, we have average free cash flow per share growth of 12%. In 2015, we continued this trend with about 10% growth of free cash flow per share, driven by our free cash flow margin increasing to 28.6% and a 3.4% share count reduction. Going forward, we should have three drivers to continue to grow the free cash flow per share: top-line revenue driven by Analog and Embedded, incremental free cash flow margin increases, and additional share count reduction depending on the stock price.

So just to wrap up, we believe TI is in a unique class of companies that can grow, generate, and return cash. We are focused on the best markets in the semiconductor business being analog and embedded.

Our business model is designed around four competitive advantages that deliver tangible benefits, and are unique and difficult to replicate by our competitors. Our manufacturing and technology, our breadth of products, the broad reach of our channels, and the diversity of longevity of our products and positions in those markets.

If we focus on free cash flow per share as the ultimate objective and have a disciplined processing culture to ensure that we are building competitive advantages stronger and that we are generating the maximum return for the investments we make, and industrial and automotive markets lead the growth in the semiconductor market, Analog and Embedded will drive our top-line growth. Combining this with incremental improvement on free cash flow margins as our 300-millimeter wafer plans continue to develop, we will strive to continue delivering double-digit free cash flow growth per share.

Our objective in today's call was to highlight these three areas of focus. We hope that we have given you further insight into how we have continued to grow free cash flow per share at double-digit rates, update you on our 300-millimeter investments, and review our progress of the acquisitions of National Semiconductor.

With that, I'll turn it back to Dave.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Okay. Thank you, Kevin. Operator, you can now open up the lines for questions.

In order to provide as many of you as possible an opportunity to ask your questions, please limit yourself to a single question. After our response, we'll provide you an opportunity for an additional follow-up. Jessica?

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

We'll go first to Vivek Arya with Bank of America.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Thank you for taking my question, and congratulations on this very consistently outstanding execution record. My question is, when I look at the last 10 to 11 year performance, a big part of free cash flow growth was contributed by gross margin expansion. Which I think the exit from mobile was a part of that, your depreciation was much higher than CapEx so that also had -- and your OpEx efficiency improved substantially.

But now if I look over the next three to five years, I'm wondering what can really drive free cash flow at the same pace? And whether sales growth will be a much bigger impact on your free cash flow versus what you had in the past? So any commentary around that would be helpful.

Kevin March - *Texas Instruments Incorporated - CFO*

I'll make some comments on that, and Dave can chime in as well. I think you've assessed it pretty well.

There's been a number of moving parts that have been driving our free cash flow growth over the last few years. But as we look out into the future, we think that 300-millimeter analog, which is a unique advantage that we have, is going to have a significant impact on our margins. So there's still lots of room to grow in the margins, and in turn, that's going to fall all the way through to free cash flow.

In addition, the stickiness of that free cash flow should probably improve as well, as we see increasing amounts of revenue coming from industrial and automotive and more catalog products versus custom products. As you pointed out, depreciation has been declining and that's mostly an effect on gross profit margin and not so much on CapEx. The strategy that we've had to buy capital well in advance of our needs means that we will not be spending as much CapEx in the future as we did over that period that you looked at, and that will continue to benefit us as well.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Yes, I'll just add from a top-line standpoint, Vivek, if you look over that last 10-year period, we didn't get any help from the top line to help drive free cash flow per share growth. Now that -- and that's primarily because we were focusing the company on Analog and Embedded, which now



represent 85% of our revenue. So those two businesses when you look over that period have grown about at a 9% compounded annual growth rate, and we've gained share for each of the last six years in both of those markets.

So that's what we will continue to focus on. And I'll say that we've gained share primarily because of those unique advantages that we talked about earlier. So we're continuing to focus on strengthening those four areas, and we believe that that will allow us to continue to gain share in those markets. Do you have a follow-up, Vivek?

Vivek Arya - *BofA Merrill Lynch - Analyst*

Yes, thank you, Dave. So in terms of 300-millimeter, can you give us a sense of what proportion of your wafers are on 300-millimeter versus your 200-millimeter? And how is the utilization of 300-millimeter fabs right now, and where do you expect that utilization to be a year or two years down the road? Thank you.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Vivek, if you look -- as we said in the presentation, about 45% of RFAB is utilized. And when that factory is full, we expect it of course to produce about \$5 billion worth of revenue. DMOS6 essentially doesn't have very much loadings. We're just putting new products into that.

The qualification was complete in fourth quarter of last year. And so essentially when you think about our growth in Analog product going forward, for the most part, you can think of that growth as coming on 300-millimeter. So of course, we'll still release products to 200-millimeter, but just as that mix and as we look forward, essentially the next \$6 billion worth of Analog growth will be on 300-millimeter.

Kevin March - *Texas Instruments Incorporated - CFO*

I might add just one other point on the comment that Dave made about RFAB and DMOS6. Because of their proximity, we have the ability to use those as a mega fab, if you will, which means we can partially process wafers in one fab and complete the process in another fab. So this will give us added flexibility versus being dependent upon a single wafer fab facility.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

That's great. Thank you, Vivek, and we'll go to the next caller please.

Operator

We'll now take a question from Ross Seymore from Deutsche Bank.

Ross Seymore - *Deutsche Bank - Analyst*

Hello, guys, echoing in the congrats on giving back cash consistently. On that RFAB or even the 300-millimeter fab comment. If your revenue growth continued at the rate that it has been, so making no assumptions of any big acceleration there, just roughly how long do you think it would take to get those fabs to be fully utilized?

And I guess the underlying question is, are you putting just new products you're designing on those fabs, or are you actually redesigning existing products? Given the life span of analog and embedded products in that equation, I wonder if it could take quite some time or if there's something you're doing to expedite the process.



Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Yes, so I think the first part of your question really comes down to what growth rate you would assume the analog market, and therefore, our revenue would grow at. If you look at the last 10 years as a proxy, that number would be in the upper single digits.

I'll let you complete the math on that, but it wouldn't take too long to fill it up. If your expectation is it's going to be much lower, obviously it would take some time and we're ready for that growth and prepared for it. So customers like that ability that we can respond quickly to any upsides that they've got in demand by having that open capacity.

Kevin March - *Texas Instruments Incorporated - CFO*

And, Ross, the second part of the question was we're releasing new products to 300-millimeter, we aren't converting old products to 300-millimeter.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

That's right. Do you have a follow-up, Ross?

Ross Seymore - *Deutsche Bank - Analyst*

Yes, if I could please. You guys updated the inventory target, I think you added 20 days to the higher end, and you talked a little bit about the reasons why. Can you just talk about the costs and the benefits of doing so, and what might lead you to the 135 day end of that spectrum?

Kevin March - *Texas Instruments Incorporated - CFO*

The cost is minimal, given the carrying cost of inventory really isn't that much. Especially in a catalog environment, which is what we've built our inventory on where we have very little market risk to being able to resell that product once it's been produced.

One of the principal objectives for carrying more inventory than we have in the past is, quite frankly, that's how our markets tend to work. In that our customers tend to be smaller, and so therefore, they tend to expect inventory to be delivered pretty much upon request. So it's incumbent upon us to carry more inventory.

In addition, we have been converting distributor channels to consignment arrangements, which has given us a bit more real-time feedback, if you will, as to real end-market demand. And we expect to increase those consignment programs as we go into 2016 and 2017.

So combined, those things are leading us to carry more inventory so that we can have excellent customer service, not just to our largest customers, but also to our very smallest customers. And so that we can also gain additional real end-market demand through consignment arrangements as opposed to stock arrangements.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Okay, great. Thank you, Ross, and we can go to the next caller please.

Operator

We'll now take a question from John Pitzer from Credit Suisse.



John Pitzer - *Credit Suisse - Analyst*

Hey, guys. Thanks for letting me ask the question. Kevin, I guess you have historically resisted giving Wall Street an operating margin target or a gross margin target, operating margin target. I'm wondering though if you can talk a little bit about the margin expansion opportunity from here?

Because the perception seems to be that the best is behind you. But if you look at your incremental gross margin leverage, can you remind us again what that is and how long you think you can sustain that?

And more importantly, Embedded was straddled with a lot of the cost as you got out of the wireless business, so it seems like there would be some scale advantage on the op margin line for Embedded. Could you just remind us on both gross margin and op margin how we should think about leverage from here?

Kevin March - *Texas Instruments Incorporated - CFO*

Well, John, I think a good place to start is go back to a comment that Dave made early on that pretty much all of our incremental revenue going forward is being released on 300-millimeter. And 300-millimeter produces significantly lower chip costs, and so we get higher margins. And I stepped through that example of a chip giving you 60% gross margin on 200-millimeter, and deliver you 68% gross margin on 300-millimeter.

So clearly with most of our incremental growth coming on 300-millimeter, we're going to have some pretty good tailwinds behind us helping drive gross margins up. But more importantly to us, other than just the accounts on gross margin was the fact that it simply costs less for the amount of revenue that we'll acquire, so we'll deliver even more free cash flow as a result of that.

In addition to that, as we see more and more content going into industrial and automotive, which typically enjoy higher overall margins than say personal electronics, that would give us an additional incremental lift to our margins going forward. And as you already pointed out, a lot of cost goes inside Embedded Processing, we've removed that.

One of the more attractive markets in the embedded processing space is in coms infrastructure. Clearly last year despite a significant headwind year-over-year going into the coms infrastructure, Embedded Processing was still able to improve its results significantly. So we're quite encouraged by what that might entail when demand actually begins to return for the communications infrastructure space.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Okay, John, do you have a follow-up?

John Pitzer - *Credit Suisse - Analyst*

Yes, just quickly on the follow-up. I'm wondering if you'd talk a little bit about how you guys view terminal market share in the markets that you're in. And specifically, it seems like consumer few customers high volume, it might be easier to gain share there than the industrial and auto market. And so as you think about your share gains from here, is there a terminal value at which you think share gains are more difficult, and does it become more difficult to gain share as you try to drive the mix towards industrial and auto?

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Yes, John, if you look at analog, the beauty of that market is it's very large. And even though we have a number one position there, we have just over 18% market share.



We've gained on average somewhere between 30 and 40 basis points. This past year where we were on the below that average, but we have been consistently gaining share. And as you know, in both analog and embedded, Embedded we've got a little over 15% share. Those share gains are hard to come by, and so you don't see a lot of movement between the players and the market.

And that's one of the attractive parts of the market that those products tend to be sticky. They tend to live for a very long period of time. So we don't see any natural barriers on the horizon for us in either of those markets.

We've got quite a bit of runway. We think that we are uniquely positioned with the breadth of our portfolio in markets like industrial as well as automotive to continue to gain share. We think those four competitive advantages that we talk about help us to a large degree in those markets even more than you'd see inside of personal electronics.

So to your point, it's easier to identify a socket at a large personal electronics manufacturer. And there, we want to engage. We continue to make investments, but we're just very selective of the investments that we make there.

And again, we're looking for places where we can find a product that will live multiple generations. Perhaps it's a product that can be used across customers or even across markets, and so when we can find those opportunities those are the ones that we like to invest in.

Kevin March - *Texas Instruments Incorporated - CFO*

And I might just add as an observation there. Personal electronics is a well-known market for semiconductors. Automotive has become an increasingly important as people are well aware now, and it's been becoming an increasingly important market for probably 10 plus years.

We're still in very early days of industrial. And where the industrial space is so much different is that in personal electronics, you can name the customers. In automotive, you can probably name most of the customers.

But when it comes to industrial, you're talking about tens of thousands of potential customers. And so your channel advantages become extremely important, and your opportunity becomes huge.

We're in very early days of industrial customers being to adopt semiconductor technologies. And the ability to be able to reach those customers becomes increasingly important in a semiconductor space by how you can approach your market and the size of your sales force, the breadth of your portfolio, the ease of what your customers can come to your websites and find the parts they need, so how you sell begins to make a difference.

And I think that's where we get pretty excited. We have been investing for several years on those four pillars of our competitive strategy, one of them being our channel to market, and we think that's going to be quite difficult for others to replicate.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Thank you, John. And we'll go to the next caller please?

Operator

We'll now take a question from Harlan Sur with JPMorgan.

Harlan Sur - *JPMorgan - Analyst*

Morning, and thank you for hosting this call. First question focuses on use of free cash flow to maintain your leadership and growth in Analog, specifically focused on the extension and augmentation of your channel advantages.



What are the key initiatives that the team is focused on currently to continue to build your presence, diversification in the channels? TI.com is a good example of more reach, expanding the catalog portfolio, what else is the team doing?

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

It's a great question, Harlan. Obviously, we've been focused on what we call demand creation. So we've had and put in place going back a number of years ago a sales and application teams that are close to our customers, and have been engaged. So we've been working very hard on improving our website to make it easier for designers to find products, be able to identify like products that they may want to use if they're searching on specific types of products.

Certainly we know that there are companion products that go with that, so somewhat of a cross-selling opportunity for us. And then linking that information with our sales teams and making them more efficient with their time, and with the time that they spend with their customers and being able to help the customers.

So those are some of the, at a high level, some of the things that we're doing. We've been working on that for a number of years, and we believe the benefits -- we're just now starting to see some of the benefits of those investments. Do you have a follow-on?

Harlan Sur - *JPMorgan - Analyst*

Yes I do, thanks for the insights there. I'm thinking a bit longer term here, but it looks like about 25% of DMOS6 supports your Embedded business. As these products move to next generation nodes over the next few years, is the idea to outsource these over time and free up even more of DMOS6 capacity for Analog manufacturing?

Kevin March - *Texas Instruments Incorporated - CFO*

Harlan, right now, your assessment is correct, about 25% of that factory is in the support of Embedded Processing. And as we've stated in the past, we intend to build internally the bulk of our production down to 40-nanometers, but beyond that we will use foundries and we do today, and we will continue to do that as the market demands requires it.

And that's particularly a statement as it relates to Embedded Processing. So it's kind of what the ratio is today, and I wouldn't expect it to change any time in the next few years. Because frankly, those technologies are migrating on a slower path than you might suspect or than what they might have done in years past.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

And I'll just also add, Harlan, there's a number of embedded products, specifically microcontrollers, that integrate analog functionality into the peripherals. And they will have lives and use more mature processes and technologies that will be in those fabs for a long time to come, so just a portion of our Embedded products use that advanced DMOS that we would outsource. Okay, thank you, and we'll go to the next caller please?

Operator

We'll now take a question from Tore Svanberg from Stifel.



Tore Svanberg - *Stifel Nicolaus - Analyst*

Thank you. First question, when I look at R&D, that's obviously a very important capital investment for you. And I think some investors are being a little bit concerned about the level of R&D, less than 10%. Could you talk a little bit more about how you think about the R&D line, and I guess a really important question of course is how you make decisions on where to allocate that R&D?

Kevin March - *Texas Instruments Incorporated - CFO*

Well it's an interesting question and observation, and I think I'd point out a couple things. One, when you compare our R&D as a percent of revenue versus some of our competitors, it tends to overlook an important benefit that we get just from sheer scale. There are certain underlying foundational R&D spends that you have to do such as tools and spice rules and things of that nature that every analog company has to engage in.

Because we have such large scale, that spend is actually shared across our four major product lines inside Analog. So that gives us an ability to spend less R&D as a percent of revenue.

If you take it to the next level, where you spend your R&D tends to be really, really important. And while we can spend lots of R&D, for example, in personal electronics, the revenue stream that we capture on that R&D tends to be shorter than that same dollar of R&D for a product that's going to go into automotive or industrial.

So we spend a lot more time figuring out where to spend the money to make sure that we get a return for many, many years as opposed to a quick return for just a year or two. And that allows us to be a lot more disciplined in how we allocate our R&D dollars.

I showed a slide a little bit earlier that indicated that where our R&D spend is up broadly in industrial and automotive. It's down in personal electronics, although highly selective. And up a little bit for Analog and communications equipment, but down quite a bit for Embedded Processing and communication equipment.

So that directional spend is what we focus on. And again, we focus on an R&D dollar spent on a product, where can we most likely get a long revenue stream on that, and that allows your way of thinking to change. Now Brian Crutcher focuses a great deal when he analyzes his businesses to look at are we really getting a true return on the investment on the R&D? And based upon our market share gains in the past six years, I'd offer to you that we are getting a return on that.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Tore, do you have a follow-up?

Tore Svanberg - *Stifel Nicolaus - Analyst*

Yes, thank you for that clarification. Just looking at debt, could you remind us where we are, when do some of those -- well let me put it this way. When are you expected to pay back some of the debt? And in this environment with investors being quite nervous and stuff like that, any chance you could maybe use your capital to pay down some of that debt a little bit earlier? Thank you.

Kevin March - *Texas Instruments Incorporated - CFO*

Okay, Tore, we have about \$4.125 billion of debt remaining, and we have \$1 billion of debt coming due this May. We are fully capable of paying this debt off as it comes due.

I would point out over the last few years what you've seen us do is that as we've had debt come due, we've paid off roughly \$500 million a year and then rolled over the balance. I'm not necessarily going to predict that we will do exactly that in the future, but odds are, we'll continue to do that in this very low interest rate environment.

From all of the credit metrics that we're given, I'd remind you that we're rated an A1 A+ by the rating agencies, which is a very high credit rating. And I think this would also give a lot of assurance to our stockholders, especially those who own TI stock for purposes of a dividend.

The rating agencies say we are highly reliable for our debt, and so our stockholders should also feel very confident that our dividends are going to be very sustainable. So I think that's probably the best way I can summarize how we're looking at debt right now.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Great, thank you, Tore. And we'll go to the next caller please?

Operator

We'll take our next question from Ambrish Srivastava, Bank of Montreal.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Hello, thank you very much and a lot interesting details there, guys. My question on growth, and the data shows that you guys have been taking share over a long period of time. Maybe just in terms of investments, could you focus on the microcontroller segment please?

And I say that because, and I won't name anybody, but your name is taken in vain by other microcontroller companies. You guys have both ARM as well as your own internal solutions. So just kind of help us understand where the investment is going in microcontrollers, and then I had a follow-up please.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Sure, Ambrish. I think first I'd say like every market, you have to be selective of where you make investments. Microcontroller is no different from that standpoint. We've had cores that we've developed 15, 20 plus years ago that customers still find helpful in their designs, they continue to use them.

We also offer, as you said ARM products in certain areas. If you were just doing bare deck ARM products with no differentiated peripherals, you're going to find that those markets, if they haven't commoditized though they will be commoditizing our belief in the future. So we focus on those areas that we believe that either through integration of specific peripherals or interfaces or capabilities.

And I'd also add that with our connectivity products, the lines between those two products of if you're connecting to an Ethernet port, or connecting to a CAN bus for an automotive application, or connecting to Bluetooth that those microcontrollers are available in both of those product lines. So we've got a highly differentiated product line with connectivity, as well as where we're making investments in microcontrollers and those investments are turning into solid growth that we've seen out of both of those businesses. Do you have a follow-on, Ambrish?

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Yes I did, thanks for that, Dave. On the M&A front, and you folks have been very consistent for a very long time on how you look at M&A and the metrics internal, the ROIC should be greater than the WACC.



In the current environment, or actually not just in the current environment, do you look at strategic fit versus valuation and say, all right, this is when we feel that it is getting to a point where it would make sense in that framework? Or it's more that you have identified in the past you've shared with us that you would be going after analog and power management and industrial and automotives? And that's the way to think about how -- is that the right way to capture your thoughts on M&A? Thank you.

Kevin March - *Texas Instruments Incorporated - CFO*

Ambrish, let me just perhaps restate and not presume that all of the other listeners are as aware of our M&A posture as you are, and give a bit more background on it. We have four attributes that I mentioned earlier that we believe in combination are unique to TI, and very difficult for others to duplicate. That includes our approach to manufacturing technology, the breadth of our product portfolio, the reach of our market channels, and the diversity and long-lived positions we have in those markets.

So from an M&A standpoint, when we take a look at what most companies are doing in M&A, it appears to us that they are trying to change their business focus or build scale or maybe both. We already have significant scale advantage, and we're focused on the two best opportunities, in our opinion, in the market today, that's analog and embedded. So if we were doing M&A, as you observed, our first and foremost question that we have to answer for ourselves, is this the right strategic fit where we can generate long-term returns and excess free cash flows, in other words, the numbers have to work.

By strategic fit, it's a bias towards analog that would likely be a company with broad catalog portfolio, with a diverse customer base. It would hopefully be a company that has a talented R&D team that we could retain, and a company that's really probably getting quite a bit of its revenue from industrial and automotive markets for all of the reasons that I mentioned earlier as to where we see the growth for semiconductors as we look out in the next 5, 10, 15 years.

From a return perspective, it has got to simply be a good deal for our customers, our shareholders. Meaning that its return on invested capital must exceed our weighted average cost of capital within three to four years. That's just simply how we take a look at it.

From that perspective, if you look at the valuations that people have been paying for semiconductor companies in the last 12 to 18 months, it's a little bit difficult for us to understand how they are going to get the kind of return that their shareholders should expect on those investments. So while strategic consideration is the most important, financial consideration is right on up there to make sure that it works.

So in the meantime, we're going to continue to do what we have been doing for a long time and buy, as I've said in the past, our favorite semiconductor company through just steady repurchases every quarter like we have been, and that's buying back our shares. And quite frankly, in our recent prices and free cash flow yield we're delivering to our shareholders a risk free 7% yield just by buying back those shares, and we'll continue doing that.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Great, thank you, Kevin. Thank you Ambrish, and we'll go to our next caller please.

Operator

We'll now take a question from Will Stein from SunTrust.

Will Stein - *SunTrust Robinson Humphrey - Analyst*

Thanks. Appreciate all the details and the updates. And regarding the 300-millimeter capacity, I'm wondering if you can sort of expand the discussion and talk about your overall as tooled utilization today?

Kevin March - *Texas Instruments Incorporated - CFO*

Our overall as tooled utilization you said, Will?

Will Stein - *SunTrust Robinson Humphrey - Analyst*

Yes.

Kevin March - *Texas Instruments Incorporated - CFO*

Well I would say that we have equipment for 300-millimeter beyond what our present production is, and we bring that equipment online as we need it. And so essentially, the equipment that's installed today is near fully utilized, but the equipment capacity of RFAB, for example, is only about 45% utilized.

When that building is fully equipped and done, we can support about \$5 billion of Analog revenue there and about another \$3 billion of Analog revenue in DMOS6. So clearly with that kind of growth, we've got quite a bit of utilization capability in front of us just by diverting and selling equipment that for the most part is already available to us.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

And I'll just add, so that we've got our next \$6 billion in Analog capacity available on 300-millimeter. We've got some open 200-millimeter capacity that we can expand into as well. And if you remember the factories that we bought, one in Chengdu and the other in Aizu, Japan, both had available shells next to them that were available, and that's on a wafer fab standpoint.

If you remember, it was a year before last I believe it was in December, that we acquired an assembly/test facility in Chengdu. Since that period of time, we've qualified and began production in that facility. So we've got open capacity there from a floor space there to be able to support back-end growth as well. Do you have a follow-on, Will?

Will Stein - *SunTrust Robinson Humphrey - Analyst*

Yes, well just maybe a clarification. I really meant not just relative to the 300-millimeter but globally, and you gave me a good idea that it's -- you aren't bumping up into any very high level of utilization.

And so relative to that and given that in the past you've made acquisitions of assets when you don't need them, so you don't have to deal with stretched lead times or higher asset prices. I'm wondering if you can update us as to whether you've made any such purchases recently, or if those purchases look relatively more or less attractive to you today?

Kevin March - *Texas Instruments Incorporated - CFO*

Okay, Will, I understand what you're getting to there. The answer is yes, we continue to make those purchases, especially on the equipment front. That is part of the 4% of revenue that we talked about as our model, some of that just goes to repair and maintenance, but some of it goes to continue to incrementally increase capacity.

And we do continue to be in the market looking for a very inexpensive, high-quality used equipment, and every quarter we're picking up something. And from time to time, we also pick up a facility and we may do that again at some point in the future if one reaches the right economics for us.

But the best example is what Dave referred to as just about two years ago when we bought the fully operational assembly/test facility in Chengdu, ahead of demand, and we're quite pleased that we did because now we've got production going through that factory.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Thank you, Will, and we'll go to the next caller please.

Operator

We'll now take a question from Timothy Arcuri with Cowen and Company.

Timothy Arcuri - *Cowen and Company - Analyst*

Hello, thanks. I had two. I guess the first, Kevin, you didn't give an update to the portion of Analog revenue that's coming from 300-millimeter, you said that it's 25% exiting 2014. It looks like given the numbers you gave, it's about 30% now, so I just wanted to confirm that's the right number?

Kevin March - *Texas Instruments Incorporated - CFO*

You can do the quick math on that, Tim. RFAB is all 300-millimeter Analog, and it was about 45% utilized in 2015, and I believe we had about \$8.3 billion of Analog revenue if I recall in 2015. So you can pretty much get your math worked pretty handily that way.

Timothy Arcuri - *Cowen and Company - Analyst*

Yes, I did. I guess just going forward, how much of the free cash flow per share growth do you think is going to come from net income growth versus buybacks going forward?

Kevin March - *Texas Instruments Incorporated - CFO*

Yes, Tim, we tend not to look at net income growth per se because it gets a bit messed up with non-cash kind of accounting transactions that have to flow through the income statement. So we tend to focus more on free cash flow.

So if you take a look at this past year, 2015 is a really good example, our free cash flow per share grew at about 10% year over year. And about two-thirds of that came from expanding free cash flow margin, and about a third of that, a 3.4% reduction in total shares outstanding. So there's a mix going on inside there, but those two have been for multiple years and will continue to be contributors to free cash flow per share growth at pretty strong levels.

So clearly, net income does have a bearing in there. But because of some of the non-cash accounting transactions you have to flow through your income statement, we actually think it's more meaningful to look at free cash flow margin and how that's growing, and then share count reduction and how that's progressing.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Okay, thank you, Tim. And we've got time for one more caller.



Operator

We'll now take a question from Ian Ing with MKM Partners.

Ian Ing - *MKM Partners - Analyst*

Yes, thanks, for fitting me in. So page 14, you talk about over investing in industrial and auto. But what's your view on market segment coverage as you make these investments in things like FRAM and GAN? It seems you want to go beyond industrial markets to get some of the higher volume, faster time-to-market opportunities also capture those perhaps?

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Yes, so I'd say that directionally we've taken our R&D investment up in industrial and automotive. We wouldn't describe that over investment. We are investing there because we believe that that's where the growth is.

And there are opportunities across these markets with those newer technologies for us. So we believe that industrial and automotive, as an example, will benefit from investments in both of those technologies. So it's really not a desire to go into a different market or change our product strategy. So do you have a follow-on, Ian?

Ian Ing - *MKM Partners - Analyst*

Perhaps just a little bit on terms of granularity on your manufacturing benefits. You have an example, 60% to 68% moving to 300-millimeter. Any granularity in terms of HVAL, power management, HPA, Silicon Valley Analog?

Kevin March - *Texas Instruments Incorporated - CFO*

I'll make it real simple. All four of them have products in that factory, and all four of them achieve that same economic benefit. And you're seeing that consequently as a result of overall very solid and increasingly high levels of profitability for our Analog segment.

Dave Pahl - *Texas Instruments Incorporated - Head of IR*

Yes, and I'll just add that sometimes there's confusion that because 300-millimeter can do very high volume, it doesn't mean that it has to. So because the equipment is completely automated, meaning that someone doesn't touch the wafers from the time they hit the dock inbound to the time they hit the dock outbound, we can build really any size of lots with that equipment. So as Kevin said, that's one of the reasons why we've got products from all four of our Analog businesses.

Okay, thank you, Ian, for the question and thank you all for joining us today. A replay of this call will be available on our website, as well as the slides that we used in today's call. Additionally for those of you that have not joined our capital management calls in the past, we'll have a comprehensive presentation on our website, which will also cover topics that we've discussed in previous calls. Good day.

Operator

This concludes today's conference. Thank you for your participation.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2016, Thomson Reuters. All Rights Reserved.