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TXN - Q2 2018 Texas Instruments Inc Earnings Call

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OVERVIEW:

TXN reported 2Q18 YoverY revenue growth of 9% and net income of \$1.41b or \$1.40 per share. Co. expects 3Q18 revenue to be \$4.11-4.45b and EPS to be \$1.41-1.63.



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PRESENTATION

Operator

Good day, and welcome to the Texas Instruments Second-Quarter 2018 Earnings Release Conference Call. Today's conference is being recorded.

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 & VP*

Thank you. Good afternoon, and thank you for joining our Second-Quarter 2018 Earnings Conference Call.

Rafael Lizardi, TI's chief financial officer, is with me today.

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 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 the earnings release published today as well as TI's most recent SEC filings for a more complete description.

You likely saw last week we announced that Rich Templeton had resumed the role as the President and CEO, along with his current role as Chairman. Rich has successfully led TI for the past 14 years and, under his continuing leadership, we look forward to making TI even stronger and better. I've met with Rich several times over the last couple of weeks and I can tell you he's excited to be back. He'll be attending several conferences in the near future and will be meeting with investors over the next few months. As you might imagine, he's fully engaged and doing -- and busy doing what he does best, and that's executing our strategy, strengthening our competitive advantages and running our operations with laser focus.

Turning to this quarter's results, I'll start with a quick summary.



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Revenue for the second quarter increased 9% from a year ago as demand for our products remained strong in the industrial and automotive markets. In our core businesses, Analog revenue grew 12% and Embedded Processing revenue grew 9% compared to the same quarter a year ago. Operating margins increased in both businesses. Earnings per share were \$1.40, including a \$0.03 discrete tax benefit not in our original guidance.

With that backdrop, I'll provide some details on our performance, which we believe continues to be representative of the ongoing strength of our business model. In the second quarter, our cash flow from operations was \$1.8 billion. We believe that free cash flow growth, especially on a per share basis, is most important to maximizing shareholder value in the long term.

Free cash flow for the trailing 12-month period was \$5.7 billion, up 42% from a year ago. Free cash flow margin for the same period was 36.6% of revenue. We continue to benefit from the quality of our product portfolio that's long-lived and diverse and the efficiency of our manufacturing strategy, the latter of which includes our growing 300-millimeter Analog output.

We believe that free cash flow will be valued only if it's productively invested in the business or returned to owners. For the trailing 12-month period, we returned \$5.6 billion of cash to owners through a combination of dividends and stock repurchases. Our commitment to return all of our free cash flow to owners remain unchanged.

I'll now provide some details by segment. From a year-ago quarter, Analog revenue grew 12% due to Power and Signal Chain. High Volume declined.

Embedded Processing revenue increased 9% from a year-ago quarter due to about equal growth in both Processors and Connected Microcontrollers.

In our Other segment, revenue declined 7% from a year ago, primarily due to custom ASIC.

Now, I'll provide some insight into this quarter's revenue performance by end market versus a year ago. Industrial and automotive demand remained strong due to broad-based growth. We continue to be pleased with our investments, which are directed across 14 sectors in industrial and 5 sectors in automotive and continued to deliver broad-based and diverse revenue growth. Personal electronics grew low single digits with increases across several sectors and customers. These increases were offset by declines at some customers. Communication equipment declined from a year ago and declined low- to mid-single digits sequentially. And lastly, enterprise systems grew.

In summary, we continue to focus our strategy on the industrial and automotive markets where we have been allocating our capital and driving initiatives to strengthen our position. This is based on a belief that industrial and automotive will be the fastest-growing semiconductor markets. They have increasing semiconductor content and these markets provide diversity and longevity. All of this translates to a high terminal value of our portfolio.

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

Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

Thanks, Dave, and good afternoon, everyone.

Gross profit in the quarter was \$2.62 billion or 65.2% of revenue. From a year ago, gross profit increased, primarily due to higher revenue. Gross profit margin increased 90 basis points.

Operating expenses in the quarter were \$825 million, a 2% increase from a year ago and about as expected. On a trailing 12-month basis, operating expenses were 20.6% of revenue, within our range of expectations.

Over the last 12 months, we have invested \$1.53 billion in R&D. We are pleased with our disciplined process of allocating capital to R&D that allows us to continue to grow our top line and gain market share.

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Acquisition charges, a noncash expense, were \$79 million. Acquisition charges will be about \$80 million per quarter through the third quarter of 2019 then decline to about \$50 million per quarter for 2 remaining years.

Operating profit was \$1.71 billion or 42.6% of revenue. Operating profit was up 16% from the year-ago quarter. Operating margin for Analog was 47%, up from 44.7% a year ago. And for Embedded Processing, it was 35.4%, up from 31.2% a year ago. Our focused investment on the best sustainable growth opportunities with differentiated positions enabled both businesses to continue to contribute nicely to free cash flow growth.

Net income in the second quarter was \$1.41 billion, or \$1.40 per share.

Let me now comment on our capital management results, starting with our cash generation. Cash flow from operations was \$1.83 billion in the quarter. It increased \$909 million from the year-ago quarter, primarily due to a lower tax rate as well as higher revenue, which includes more 300-millimeter Analog revenue. Capital expenditures were \$249 million in the quarter. Free cash flow was \$5.73 billion on a trailing 12-month basis, up 42% from a year ago.

In the second quarter, we paid \$606 million in dividends and repurchased \$1.02 billion of our own stock for a total return of \$1.62 billion in the second quarter. We have returned \$5.6 billion to owners in the past 12 months, consistent with our strategy to return to owners all of our free cash flow. Over the same period, our dividends represented 41% of free cash flow, underscoring their sustainability.

Our balance sheet remains strong with \$5.13 billion of cash and short-term investments at the end of the second quarter. In the quarter, we retired \$0.5 billion of debt as it became due and raised \$1.5 billion of 30-year debt with a coupon of 4.15%. We currently have total debt of \$5.1 billion with a weighted average coupon of 2.77%.

Inventory days were 135, up 2 days from a year ago and within our expected range. We continue to believe there is strategic value in owning and controlling our inventory.

Turning to our outlook for the third quarter, we expect TI revenue in the range of \$4.11 billion to \$4.45 billion and earnings per share to be in the range of \$1.41 to \$1.63, which includes an estimated \$10 million discrete tax benefit.

We continue to expect our ongoing annual operating tax rate to be about 20% in 2018 and 16% starting in 2019. Just as a reminder, the higher tax rate this year is due to noncash charges. More detail of our expectations for taxes can be found on our website under Financial Summary Data.

In closing, I'll note that the strength of our business model was demonstrated throughout our financial performance over the last few years from top-line growth and margin expansion to free cash flow generation. We continue to invest in our competitive advantages, which are manufacturing and technology, portfolio breadth, market reach and diverse and long-lived products. We will continue to strengthen these advantages through disciplined capital allocation and by focusing on the best products, analog and embedded processing, and the best markets, industrial and automotive, which I believe will enable us to continue to improve and deliver free cash flow per share growth for a long time to come.

With that, let me turn it back to Dave.

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

Thanks, Rafael.

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



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question from John Pitzer from Credit Suisse.

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

David, my first question is just on the High Volume Analog segment. I think in your prepared comments, you had mentioned that it declined year-over-year in the June quarter. I'm kind of curious, to what extent was that by choice as you pruned the portfolio? To what extent then do you think that that's just a handset phenomenon as it builds last year for product cycles were more robust than this year? And to what extent do you feel that might be a leading indicator for maybe some excess in the "cycle"?

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

Yes, John. Thanks for asking that question. I think what we're seeing there is a result of how we've been allocating our resources in R&D. And if you remember back in February in our capital management calls, we went through that and we've got a pretty disciplined process. And essentially, what we're trying to do is steer more money to long-lived revenue opportunities where we've got some level of differentiation, and we'll have that for some time.

So I think when you look at the results overall, revenue grew 12% year-over-year. That's inclusive of what happened inside of High Volume. And again, I think that that's a result of allocating resources to the best sustainable opportunities.

If you drop down into there in the prepared comments, obviously, industrial and automotive continued to do well. Inside of HVAL, you'd see that industrial and automotive did well as well. It just doesn't make up as much of a percentage of that revenue.

So anyway, we're pleased with that outcome and not surprised by it. You have a follow on, John?

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

Yes, Dave. That was helpful. And then, Rafael, as my follow-on, I know it's probably better to look at the business trends on a year-over-year basis rather than sequential. And on a year-over-year, you showed really good operating margin leverage in the Embedded business, but sequentially, it was flat on up revenue and then there's still that gap between Embedded op margins and Analog op margins. How do you think about the leverage in the Embedded market from here? And will we ever close that gap between Embedded and Analog?

Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

So let me step back and take you back to our capital management strategy and some of the things that we say there and how we think about driving value for the owners of the company. And to us, it all comes down to growing free cash flow per share. So it's not operating margin. It's not gross margin. It's not Analog versus Embedded. It's all about growing free cash flow per share. Both of those business are in and we expect to continue to be contributors to that free cash flow per share.

So the focus is growing the top line. As we continue to invest in what we think are the best markets, industrial and automotive, and in the case of Analog, as we continue to expand our 300-millimeter footprint that -- where we have a structural cost advantage.

Operator

And we have Timothy Arcuri from UBS on.

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

I had a question on the guidance. The June numbers were a little bit below seasonal. And I know that seasonal is hard to really figure out what's actually normal, but that was kind of coming off more difficult Q1 comps. But if I look at the September quarter guidance, it's a few hundred basis points below seasonal and it's up like 300 basis points year-over-year, which is the lowest in a couple of years. Is there any element of more difficult comps? Or is there, in fact, some kind of channel inventory headwinds?

Dave Pahl - Texas Instruments Incorporated - Head of IR & VP

Yes, Tim. I'd just say that when we put together our guidance, the 2 strongest signals that we see are orders that we get from customers as well as the demand that we -- demand feeds that we get through our consignment programs. And I would just say that -- if there's something specific to call out, as we have in the past, if there was a specific customer or specific end market or something like that, that was changing, we would let you know about that. And as example, lead times remain stable. Cancellations remain low. Reschedules remain low. We look at inventory and the channels, that remains steady at about 4 weeks. So we really don't see any changes from that standpoint.

And the other thing -- and as you pointed out, when you look at a couple of data points, it's hard to describe what is exactly seasonal. And so if you look over the last 5 years, we've had a 9% sequential growth. Three of those 5 years has been at 6%. And if you look over a 10-year period, it's 7%. So certainly, our guidance from a seasonal standpoint is certainly within the range of things that we've seen in the past.

You have a follow-on?

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

And then, I guess, just as a quick follow-on, Dave, can you give what orders and book-to-bill were?

Dave Pahl - Texas Instruments Incorporated - Head of IR & VP

I can give that. Let me just find it. Yes, so orders -- book-to-bill -- orders were up 10% sequentially. Book-to-bill was 1.06. I'll point out it was 1.06 a year ago and 1.03 last quarter. I always feel the need to comment on book-to-bill with about 60% of our revenue going through consignment programs where we don't get any orders in advance pull from that demand. So book-to-bill isn't as strong of a signal or at least as clear of a signal as what it used to be in the past.

Operator

And we'll take our next caller from Ross Seymore from Deutsche Bank.

Ross Clark Seymore - Deutsche Bank AG, Research Division - MD

Dave, just want to ask about from -- not necessarily a cyclical point of view, but from a macro point of view. With all the discussion of trade wars, tariffs, et cetera, I know you haven't called out seeing anything per your answer to the last question, but just how does TI in general think about that dynamic as potentially impacting your business? And are you, in fact, seeing any impact as of yet?



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Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

Yes, Ross. I'll go ahead and take that. First, let me state TI's long-term support of free trade and strong IP protection. And those are both important to TI and the broader SC industry. So we continue -- we feel that way. We have stated, we had been in that position for a long time and we continue to do that and advocate that.

Specifically on the tariffs that have been announced on integrated circuits, those are still subject to public comment through the end of July, so those are not in place yet. If -- once they go into effect or if they go into effect, remember, they will apply to goods that are deemed of Chinese origin that are then imported into the United States. For TI, only about 13% of our revenue is imported into the United States. In other words, 87% of our revenue is exports, so not subject to U.S. tariffs. And that 13%, only a sliver of that has Chinese origin as a -- would be deemed as Chinese origin. So bottom line, only about 1% of our revenue would have those tariffs applied to it. And that's before we make any potential -- any adjustments, supply chain and other things that we could do to even minimize that impact further. So at the end of the day, we don't see a major or even any direct impact other than some minimal impact.

Now, that's not to say that at a macro level, that could have an impact, but that's a very macro comment that goes beyond TI and beyond the semiconductor industry that free trade -- anything against free trade between the 2 largest economies in the world, that could eventually have a macro effect that would be detrimental to everybody.

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

You have a follow-on Ross?

Ross Clark Seymore - *Deutsche Bank AG, Research Division - MD*

Yes, I do. Just switching back to your product segments, it seemed like Analog sequentially was pretty much in line what we've seen for the last few years, but Embedded was lower and Other was much higher than what we've seen. And I know you guys think of things year-over-year, but if we look at it sequentially, is there any reasons behind the Embedded being lower and the Other being so much higher?

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

Yes. I think if you look at Embedded, it has a higher percentage of comms equipment. So it was impacted by that. And then in Other, don't forget that we've got calculators sit inside of that business. So we've got strong seasonality in second and third quarter.

Operator

We have our next question from Amit Daryanani from RBC Capital Markets.

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

I guess, 2 questions for me as well. Maybe first off, could you quantify the revenue impact you had from -- not your word, mine -- but product rationalization or product optimization that you guys went through in the June quarter? And does that revenue headwind, if you may, flow into the September quarter as well to some degree?

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

Amit, can you clarify what you mean by product rationalization?

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Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

Yes. I think, Dave, when you talked about the consumer-centric markets, you talked about how some of the revenue declines there were driven by the fact that you just decided not to participate in some of these markets, a reflection of how your R&D budgets are tracked over time. Is that fair? And if so, I guess, how much was that revenue impact driven by?

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

Well, I think if you look -- and we shared this back in February on our capital management call. As we looked at allocating resources across end markets and specifically in personal electronics, when you compare our spend there versus 5 and 10 years ago, it's lower. Now, it's not 0. There's still good opportunities that we find inside of personal electronics and continue to invest. We're just looking for sustainable growth opportunities inside of that space. So that's really what we're talking about.

So again, the first question came in specifically about one of the businesses inside of our Analog segment. I think you have to judge the efficiency of our capital allocation by the total results. And that's where we're quite pleased with.

So does that help to answer your question?

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

No, that's helpful. And I guess, if I could just follow-up, you guys have had multiple quarters of gross margin expansion, very consistent on a year-over-year basis. As you think about the back half of '18, can you maybe talk about what are the levers that could enable gross margins to continue to expand from here? And do you feel comfortable that gross margin should expand in the back half?

Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

Yes. I'll go ahead and take that, Amit. As we have talked about in capital management and in other settings, our focus for value creation for the owners of the company is free cash flow per share. It's not gross margin. It's not operating margin. It's dollars of free cash flow per share. So the opportunity for expanding that and continuing to grow that are simple. It's the top line as we continue to invest in the best products and the best markets and the best markets because that's where the semiconductor content is expanding and we continue to gain share there. And then, 300-millimeter. We have talked about that for a number of years. As of last year, about \$4 billion of our revenue went through 300-millimeter, 4 out of 10 in the Analog space. So that leaves a lot of room for continued expansion on 300-millimeter and continuing to grow that free cash flow per share.

Operator

We'll take our next question from Harlan Sur from JP Morgan.

Harlan Sur - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Solid job on the quarterly execution and strong free cash flow generation. Your focused markets, automotive, you've got 5 subsegments. Industrial, you've got 14 subsegments. Can you guys just give us a sense on the breadth of the year-over-year growth in these markets? Were a majority of these subsegments up year-over-year? Any color here would be helpful.



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

Yes, Amit -- I'm sorry, Harlan. The -- when you look at that growth, we're really pleased with it. It's very broad-based. And when you look at all of the sectors, out of the 19 combined that we had, 18 of them actually grew. So it's very broad-based. I think when you look across these different products, different investments and we look at our design-ins in our pipeline, those continue to be very broad-based. So that gives us confidence in the sustainability of that growth. And of course, it doesn't mean that we won't see cyclical headwinds at some point. But when you look at it from a 5- and 10-year standpoint, we feel really good about the progress that we've made.

Do you have a follow-on, Harlan?

Harlan Sur - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Yes. And so kind of to follow-up on that, maybe from a geographical perspective, right? I think last quarter, all regions -- and I know this is ship to, right? This is ship to data, but still, nevertheless, important, but last quarter, I think all regions were up except for Japan. What did you see this quarter?

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

That is the same story. And my friends in Japan, I've talked to them a couple of times. They're -- give them a shout-out to them that the revenue is down, but when you look at -- we've got some reporting tools that allow us to look through what we call channel independent reporting. And as you mentioned, it's a ship to. So they're continuing to make progress with the customers there. Just a lot of that revenue ends up shipping either somewhere in Asia or it ships in Europe or in the U.S. even though it's designed in there. So -- but the actual measurement that we have is the shipping label on the box. So unfortunately, they're still called out on the conference call, which I know they're not happy about.

Operator

And we'll take our next question from Vivek Arya from Bank of America.

Vivek Arya - *BofA Merrill Lynch, Research Division - Director*

For the first one, your CapEx is now -- I think it was over 6% in Q2. I think trailing 4 quarters, it's 5.5%. Depreciation is now below CapEx. So where are all these incremental investments going? And what is the right long-term model we should assume for CapEx and depreciation?

Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

Yes. Let me take that. First, let me step back to remind you what the objective is, right, for CapEx. It's to invest to support new technology development and revenue growth and specifically to extend our low-cost manufacturing advantage, including 300-millimeter, which maximizes our opportunity to grow free cash flow per share for the long term. So we -- it's the percent of revenue is an interesting metric to have in mind, but the real driver is that long-term growth of free cash flow per share. So we have been -- and in periods of sustained strong demand, that CapEx tends to go up and that's part of what you're seeing. That CapEx is going to -- is going primarily to support 300-millimeter. There are other things. There's assembly test. There's even other factories where we invest some of that CapEx, but predominantly, it's to continue to expand that footprint of 300-millimeter within RFAB and DMOS6, existing fabs.

Before you go to the next question, I want to go ahead and make a point on free cash flow -- on our free cash flow growth. In the trailing 12 months, free cash flow grew \$1.7 billion from about \$4 billion to \$5.7 billion, that's a 42% increase. So what was that driven -- what drove that? First and foremost, our profit before tax grew about \$1 billion in that comparison. So that is higher revenue, more revenue driven by industrial and automotive, which, again, drove the majority of the revenue growth; and more 300-millimeter, which, to the question earlier, that continues to help with the



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expansion of free cash flow. Then second and obviously, tax reform. So in the United States, we had a -- we have tax reform and, as we have talked about, that did lower our tax rate in 2018 versus the previous year in a significant way. Additionally, we had about \$200 million year-to-date of one-time tax-related benefits that are also associated with tax reform. So that also played a factor in that comparison.

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

Okay. Vivek, do you have a follow-up?

Vivek Arya - *BofA Merrill Lynch, Research Division - Director*

Yes, Thanks, Dave. Beyond just the trade issue, I know there has been talk of shortages of passive components. I know you guys don't supply that, but your other peers do. But have you seen your customers behave in a different way, stock up, stock down on various things that might impact your trajectory just because your customers might be short of other components to help complete their systems?

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

Yes, Vivek. I think one thing that we've spent a lot of time trying to do and remain focused on is keeping lead times stable. And for the vast majority of our products, they continue to remain stable. And that doesn't mean that we don't have hotspots and, of course, we'll work with customers to close those gaps as aggressively as we can.

And the other important metric that we look at inside of that is on-time shipping performance. So you've got a stated lead time and if you're not shipping inside of that, customers tend to get nervous. And that has continued to remain at very, very high levels. So we can't see any bottlenecks from customers not being able to get product from other places that shows up in the order book specifically. Could it be there? It certainly could be, but it's not something that we would have visibility into. So I think we just remain focused on what we can control, which is the lead times and shipping performance, customers can have confidence in getting product from us.

Operator

And we'll take our next question from Stacy Rasgon from Bernstein Research.

Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

My first one is ask about the near-term OpEx trajectory. Normally in Q3, you'd probably be down a little bit sequentially. Is there any drivers or anything that could be going on that would make things into this Q3 different than what we might ordinarily have seen given, I guess, some of the historical trends that we've seen leading into this?

Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

Well, Stacy, as you know, we give revenue guidance and EPS guidance and stop it at that unless there were any unusual trends and if so -- right between the lines, and if so, we would point that out. We're not pointing that out because there's nothing unusual. So you should expect just our usual trends within reasonable ranges.

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

Do you have a follow-on, Stacy?



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Stacy Aaron Rasgon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

I do. There's an earlier question on CapEx. And we know it's elevated now because you guys are out looking for other assets. At the same time, obviously, as you continue to grow, you're filling up 300-millimeter and that's a margin benefit. Do you think, over time, the benefit from increasing penetration in 300-millimeter more than offsets the depreciation expense on your gross margins?

Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

Well, so the way I like to look at this is from a cash standpoint. So I think of that investment as cash flowing out, the first cell on your spreadsheet, and then after that is return. I don't think about it for those purposes from a depreciation standpoint. So as we continue to invest on 300, we think that is -- those are very good, long-term investments that will last for a long time. Any time we put any of these tools in place and the cash fall-through on those investments is pretty high.

Operator

And we have one more question from Joe Moore from Morgan Stanley.

Joseph Lawrence Moore - *Morgan Stanley, Research Division - Executive Director*

Great. You said that some of your personal electronics markets were up and some were down. Can you give me a bit more color on which? And I know smartphones, in particular, I think grew in Q1. Did smartphones continue to grow into Q2?

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

Yes, Joe. I won't go into that level of detail. We did want to give some color on what was going on inside of personal electronics that we see -- we saw multiple sectors growing inside of there. We had some customers that were growing, but also wanted to point out not all customers were growing. So that's what we saw.

I think what that illustrates is the power of having a diverse product portfolio and being able to sell to multiple customers. And kind of to my point earlier, we look at the opportunity inside of personal electronics, longer term, we don't see that as a significant growth engine for us, but it is a place that we continue to invest. And we really believe that the majority of the growth is really going to come from industrial and automotive. So incrementally, as we've taken up our spend, we've moved it more into those growth areas. So -- but again, we're going to have handsets and PCs and those other things for decades to come. So we find good opportunities inside of there and want to continue to invest in them.

You have a follow-on, Joe?

Joseph Lawrence Moore - *Morgan Stanley, Research Division - Executive Director*

Yes. In terms of the longer-term question on communication infrastructure, obviously, it's been soft for everyone the last few quarters. How do you think about the 5G opportunity? I think the comment that you've made just now and repeatedly that the investment areas are industrial and automotive. Do you think there's an opportunity around 5G that you need to invest in? And just to help us understand how that will affect TI.

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

Sure. Yes. So I think, again, I'd refer back to our capital management presentation as we walked through that thinking remains consistent with that. So from a comms equipment standpoint, I would say that our investments have shifted over time. If you look at the 5G standards and the things



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needed to support the new things, new frequencies being added, things like the massive MIMO, antennas that are going in for beamforming and other things like that, that is all complexity that you find in the radio itself. And for us, that translates into Analog products to be able to support that.

So our spend in Analog is up for supporting that 5G transition. It has been for some time when we look at our spend versus, say, 5 and 10 years ago. But at the same time, that same change in standards and mix really doesn't impact the digital side. So our spend actually is down on that.

So again, I'd describe our growth primarily coming from industrial and automotive as we look over the next decade. So that's where we've tried to increase spending, but we will shift spending around to take advantage of things like 5G. And I'd just say that, in general, very confident in our position. And we've got -- we're building off of a great position inside of 4G as well. So we're very pleased with those investments.

Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

Yes. So that was the last call?

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

Correct.

Rafael R. Lizardi - *Texas Instruments Incorporated - Senior VP, CFO, CAO, Finance & Operations*

Yes. So before we close, I just want to make a point because it wasn't asked, but our results, among other things, demonstrate our continued discipline and execution on capital management strategy. We generated on a trailing 12-month basis \$5.7 billion of free cash flow and we returned \$5.6 billion of free cash flow in that time frame. So virtually, all free cash flow generated was returned to the owners of the company. That was both through dividends and buybacks. In the case of dividends, on that comparison, it was 41% of free cash flow, so right between our 40% and 60% guidance, but clearly towards the lower end. So that just underscores the sustainability of those dividends.

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

Okay. Thank you, Rafael, and thank you, all, for joining us. A replay of this call will be available on our website. Good evening.

Operator

And that concludes today's conference. Thank you for your participation. You may now disconnect.

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