

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TXN - Texas Instruments Capital Management Strategy
Conference Call - 2015

EVENT DATE/TIME: FEBRUARY 04, 2015 / 04:00PM GMT

OVERVIEW:

TXN announced its capital management strategy and returned more than 100% of free cash flow to shareholders.



CORPORATE PARTICIPANTS

Dave Pahl *Texas Instruments Inc - Head of IR*

Kevin March *Texas Instruments Inc - CFO*

CONFERENCE CALL PARTICIPANTS

Harlan Sur *JPMorgan - Analyst*

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

Ross Seymore *Deutsche Bank - Analyst*

Mark Lipacis *Jefferies & Company - Analyst*

Vivek Arya *BofA Merrill Lynch - Analyst*

William Stein *SunTrust - Analyst*

Ambrish Srivastava *BMO Capital Markets - Analyst*

C.J. Muse *Evercore ISI - Analyst*

Blayne Curtis *Barclays Capital - Analyst*

Christopher Rowland *FBR Capital Markets - Analyst*

Tore Svanberg *Stifel Nicolaus - Analyst*

Steve Smigie *Raymond James & Associates, Inc. - Analyst*

PRESENTATION

Operator

Good day and welcome to the Texas Instruments capital management strategy conference call. At this time, I would like to turn the conference over to Dave Pahl. Please go ahead, sir.

Dave Pahl - Texas Instruments Inc - Head of IR

Thank you. Good morning and thank you all for joining our conference call and allowing us to share an update on our capital management strategy with you. Kevin March, TI's CFO, is with me today and provide details and to answer your questions.

This call is being broadcast live over the web and can be accessed through our website at TI.com/IR. From the website you will be up to see our presentation slides today. A replay will be available through the web as well as any relevant non-GAAP reconciliations.

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 Safe Harbor Statement contained in the presentation slides as well as TI's most recent SEC filings for a more complete description.

Today we will provide you an update of our capital management strategy. Our goal is to provide insight into a few key areas as well as review our 2014 performance.

We had strong results in 2014, and it was a year that we believe was a preview of the performance we think TI can deliver in the years ahead. We gained share in our core markets of analog and embedded, delivered solid revenue growth, expanded our free cash flow margin to 27% and returned more than 100% of our free cash flow to our shareholders.



We believe that our performance is best viewed through the lens of our capital management strategy. The strategic elements of this strategy, taken together, contribute to our ability to grow, generate and return cash to shareholders.

With that as a backdrop, let me it over to Kevin to share the details.

Kevin March - Texas Instruments Inc - CFO

Thanks, Dave, and good morning to everyone. We really appreciate you making the time to join us in this call today. Let me go ahead and get started.

Today I'm going to summarize TI's capital management strategy and our 2014 results. I will outline our plans for expanded 300 mm analog manufacturing capacity, and then I will review our free cash flow growth as well as our outlook for continued free cash flow growth.

So with that, let me begin with our capital management strategy and our 2014 results. Many of you are very familiar with TI, but I think it is worth noting again that we believe TI is in a unique class of companies that is able to grow, able to generate and, importantly, able to return significant cash to our shareholders for a very long time to come.

Our business model has been carefully designed around several significant competitive advantages. We quite simply have the broadest portfolio of analog and embedded products in the industry.

We have firmly anchored ourselves with a low-cost manufacturing strategy that includes highly differentiated manufacturing technology. We have the broadest sales channel in the semiconductor industry today. All of which, when combined, results in diverse and long-lived market positions that deliver meaningful, high terminal value to our shareholders.

As to our capital management strategy, it reflects our belief that free cash flow growth, particularly on a per-share basis, is the most important performance measure to maximizing shareholder value in the long term; that free cash flow will only be valued if it is returned to shareholders or productively reinvested in the business and that good execution and disciplined capital allocation are the most important responsibilities as business leaders today.

I think our capital management strategy is nicely summed up by this graphic. At its core, we enjoy a great business model because we focus on analog and embedded processing - what we believe to be the most attractive markets in semiconductors. Rather than just generate a lot of cash, we believe it is important to have that cash readily available for our business needs and our shareholders.

To that end, we have chosen to employ an effective tax strategy that enables us to bring the majority of our cash back home. This results in us having a very strong balance sheet with well-funded pension plans and other liabilities, in turn maximizing our access to debt when the economics make sense.

This further allows us to deploy cash in support of our competitive advantages, including investments in technology, manufacturing, extending our channel advantages, working capital and, when available, acquisitions. Once these investment needs have been met, we then return our excess cash to our shareholders in the form of dividends and stock repurchases, as well as periodically repaying debt.

It is been a couple of years now since we originally introduced our capital management strategy and a year since we last updated it. Before I move on to the other topics I have to discuss this morning, let me just take a few minutes to provide an update on how we performed in 2014 against our capital management metrics.

In the area of cash flow, free cash flow generation, our target model is to generate or convert between 20% and 30% of our revenue into free cash flow and for 2014 the score was 27%. As to cash on hand, our model is to keep 10% of our trailing 12-months revenue, plus our next 12 months expected dividends and debt repayment, as cash on hand, and at the end of the year we had 95% of that target metric of cash on hand.

As to cash onshore, our model is to keep at least 80% of our cash onshore and, in fact, we ended the year with 82% of our cash onshore. For our pension obligations, our target model is to keep our pensions fully funded on a tax-efficient basis, and our global pension plans, when you take a look at year end, were funded to the 97% level.

Debt is, in fact, a part of our capital structure and we expect it to continue to be with the economics make sense. For 2014, we ended the year with \$4.6 billion of total debt with an average coupon of 2.15%. It is interesting to note that we actually assumed some debt with the National acquisition and the fact of the debt that TI has actually issued itself, we've issued about \$4 billion of debt of that \$4.6 billion, with an average coupon of 1.62%.



In capital expenditures, our target is to keep, or to average, about 4% of revenue to be converted, to be spent on capital each year, and last year we spent about 3% of revenue on capital. Our inventory model for customer services, for services to have about 105 to 115 days of inventory on hand, and we ended the year just a little bit above that with 117 days.

Our cash return target is to return 100% of our free cash flow, plus the proceeds from exercises, minus any cash that is used to retire debt. In 2014, we returned 115% of that total.

On dividends, our model is to allocate about 50% of our trailing four-years' average free cash flow as a dividend budget (technical difficulty) on dividends. In fact, in 2014 we worked out to about 52% of that amount. And then for repurchases it is simply to take our cash return target minus what we use for dividends and return the balance of that in the form of repurchases and that worked out to 123% in 2014.

Speaking of dividends and repurchases, since 2004 we have steadily increased our dividend, with 2014 marking the 11th consecutive year of increases. As I mentioned, our budget for dividends is to use about 50% of our trailing four-years' average free cash flow.

Because we believe regular dividend increases are important to many shareholders, in years when this math may not suggest a dividend increase, we would still expect to recommend one. The reason is because this formula makes our dividend quite affordable. In fact, this formula resulted in our 2014 dividends equating to about 38% of our 2014 free cash flow, leaving us plenty of headroom to meet this obligation.

On the subject of repurchases, 2014 marks the 11th year in a row of steadily declining shares outstanding as a result of our stock repurchases, with our total share count down 39% over this period. For 2014 itself, total shares outstanding dropped by 3.3%.

As I've discussed in the past, our plan is to steadily repurchase shares when we believe the company's intrinsic value exceeds its market value. The amount of spend that we allocate annually for repurchases is our free cash flow plus proceeds from stock option exercises, minus amounts to be used for dividends and debt repayment in that year. As of the year-end 2014, we had a remaining stock repurchase authorization from our board of \$3.2 billion.

Shifting gears now, I would like to update you on our 300 mm Analog manufacturing plans. Late last year, we begin implementing what we refer to as our 300 mm \$8 billion Analog plan. This plan begins with RFAB, which most of you are already familiar with.

To remind you, when fully built out, RFAB will be able to support \$5 billion in annual revenue. We already have the majority of the equipment on hand. In 2014, it became our largest revenue-generating factory, turning out \$2 billion of Analog revenue.

The second element of our plan entails DMOS6. This factory was originally built to support our wireless products, but until recently has only been supporting our Embedded products. We are now in the process of converting capacity in this factory that will be able to support another \$3 billion of 300 mm Analog revenue. Qualification is already underway for initial production to begin at the end of 2015.

When complete, the two factories combined will be able to support \$8 billion of 300 mm Analog revenue, which means when this capacity is fully used, over half of our Analog business will be supported by internal 300 mm wafer production. Importantly, this plan fits comfortably within our 4% of revenue CapEx guidance.

These are photos of the two factories that I am talking about. RFAB was opened in 2009 as the world's first dedicated 300 mm Analog wafer fab. This is a big factory, with 220,000 square feet of clean room space, currently about 40% utilized, generating \$2 billion of revenue in 2014 out of a fully loaded capability of \$5 billion in Analog revenue.

Just a few miles down the road from RFAB, DMOS6 was opened eight years earlier, in 2001, as our 300 mm fab supporting our former wireless products. It's only a bit smaller than RFAB, with about 85% of the clean room space, or about 190,000 square feet of clean room. Currently about a quarter of its capacity is presently being used to support Embedded, and as I mentioned, Analog qualification is underway.

When fully loaded, we expect it will generate an additional \$3 billion of Analog revenue. In addition, we expect the close proximity of these two wafer fabs to one another will enable us to benefit from rapid learning cycles and allow a significant leverage of resources between the two factories, meaning bringing up our second 300 mm Analog wafer fab should occur even more efficiently than our first one.

Let me take you through the math of why 300 mm wafers really matter. This chart shows the relative sizes of the wafers to one another. A 300 mm wafer has about 2.25 times the surface area of a 200 mm wafer and, given the average size of an analog chip, allows us to produce about 2.3 times as many chips per wafer.



To process the larger 300 mm wafer, it only cost about 1.4 times what it costs to process a 200 mm wafer. So when you do the math, this means the same chip processed on a 300 mm wafer cost about 61% as much as a chip processed on a 200 mm wafer, or about 40% less cost per chip.

So what does that mean to gross margin? If, for example, you take a device selling for \$1 that is currently generating 60% gross margin, here is the 200 mm versus 300 mm math that results.

The sales price is the same, no matter if it is sourced from 300 or 200 mm. The die cost on 300 mm declines 40%, from \$0.20 to \$0.12. Assembly, test and up costs are unchanged at \$0.20. The total cost of goods in this example declines from \$0.40 to \$0.32, driving gross profit margin up by 8 points to 68%.

In 2014, we generated over \$8 billion of Analog revenue, with \$2 billion of that, or about 25% of that revenue, coming from RFAB. While we expect some incremental revenue growth in our existing 200 mm wafer fabs, the preponderance of our growth will come from 300 mm.

When fully implemented, our new plan will produce an additional \$6 billion of 300 mm Analog revenue for a total of \$8 billion of internally sourced 300 mm Analog revenue, meaning that more than half of our Analog revenue will come from our own 300 mm factories. As I previously mentioned, we expect this capacity improvement will all fit comfortably within our 4% of revenue CapEx model.

Now let me switch topics and move into -- onto a look at our free cash flow growth over the past few years and what our outlook is for free cash flow growth going forward. Looking back over the last 10 years or so, we have seen essentially zero top-line growth as we have worked to reposition the portfolio into one made up of Analog and Embedded from one that was previously dominated by wireless.

So while Analog and Embedded were growing, given its size, the unwind of wireless completely dampened that growth such that total TI revenue has been essentially flat throughout this period. Yet despite that flat lining of the top line, the product mix shift to Analog and Embedded, supported by the production shift of 300 mm and the significant lower CapEx that we now enjoy as we engage in our opportunistic purchase of capacity, have all combined to drive our free cash flow as a percent of revenue from the mid-teens 10 years ago to 27% in the most recent year. Or, to say it another way, despite no top-line growth, but with substantial margin improvements and benefits from our CapEx strategy, we've been able to actually grow free cash flow at a 7% compound annual growth rate over the last 10 years.

In addition to our portfolio on manufacturing shifts, as I mentioned earlier in the call, we employ a tax strategy that results in the preponderance of our cash being readily available not only to invest in the business but to return to our shareholders that cash that we don't need. As a result of consistent accretive buybacks over the past 10 years, we've reduced our shares outstanding by 39% over that same period of flat-line revenue growth.

The result has been to add another five points to free cash flow per share growth. So when you put it all together, despite no top-line growth, our product mix and CapEx strategies, combined with our share repurchases, have resulted in our shareholders enjoying a 13% compound annual growth in free cash flow per share.

As we look into the future, what we get excited about is that the transition to Analog and Embedded is now complete. In fact, it completed in 2013, although 2013 itself still included meaningful amounts of wireless revenue, somewhat dampening our 2014 year-on-year growth comparison to 7%. Nonetheless, 2014 represents our first year-on-year growth since 2010, and as we move into 2015, our year-over-year comparisons will no longer be dragged down by this legacy business.

The real strength of our product portfolio of Analog and Embedded will be now be driving TI's top-line growth without any further drag from our legacy wireless unwind. And given a 10-year track record of 9% compound annual growth for Analog and Embedded, our free cash flow growth going forward will now have the added benefit of top-line revenue growth shining through at the company level.

Just to summarize, looking back, two of our three levers for expanding free cash flow per share have been working for us, resulting in a 13% compound annual growth rate to free cash flow per share. Our first lever has actually been neutral, in that we have experienced no top-line growth as we shifted our portfolio to Analog and Embedded. With our second lever, we have expanded free cash flow margin through our product mix, 300 mm production and opportunistic capacity additions, resulting in a very low CapEx spending. And with our third level [lever], we have made steady accretive stock repurchases, resulting in 39% fewer shares outstanding.

Looking forward, we expect all three levers to be working for us as we work to continue to expand our free cash flow per share. We now expect top-line growth to resume. We expect free cash flow margin to continue to improve to 30% of revenue on a sustainable basis on continued 300 mm expansion and model levels of CapEx, and we expect to continue share repurchases as long as the economics continue to make sense.

Just to wrap up, we believe TI is in a unique class of companies able to grow, generate and return cash to shareholders for a very long time to come. Our business model is uniquely designed around significant competitive advantages, the broadest portfolio of analog and embedded products in the industry, soundly anchored in low-cost



manufacturing and differentiated technology, with the broadest sales channels of any of our competitors. All of which results in diverse and long-lived market positions, yielding high terminal value for our shareholders.

Looking forward, we see continued growth of free cash flow as the top line starts to help, the 300 mm capacity becomes a growing advantage and our free cash flow margin expands to 30% of revenue on a sustained basis in good markets.

With that, let me turn it back to Dave.

Dave Pahl - Texas Instruments Inc - Head of IR

Thanks, Kevin. Operator, you can now open the lines for questions. In order to provide as many of you as possible the opportunity to ask a question, please limit yourself to a single question. After our response, we will provide you an opportunity for an additional follow-up. Operator?

QUESTION AND ANSWER

Operator

(Operator Instructions)

Harlan Sur, JPMorgan.

Harlan Sur - JPMorgan - Analyst

Good morning. Thank you for hosting this call. On the DMOS6 conversion and the continued move into RFAB, is the plan to layer in primarily new Analog revenue opportunities into both fabs or are you planning on moving some existing 200 mm high-volume products into these fabs as well, to take advantage of the cost reductions as you outlined? And then, how does the team allocate manufacturing between DMOS6 and RFAB on a go-forward basis?

Dave Pahl - Texas Instruments Inc - Head of IR

OK, Harlan. Thanks for those questions. On the first, the plan that we put in place is to support growth, and really the vast majority of our incremental revenue will be built on 300 mm. It's not designed to try to optimize existing products. It just takes a long time to be able to move those products from one fab to the other.

The second question is, is that how we allocate. In RFAB today, we actually have products that run from all four of our product lines, so high-volume analog and logic, Silicon Valley analog, high-performance analog and power all run inside of there, and essentially what we do is we target specific technologies, or we call them process flows, into a factory. As an example, today we have got enough of those process technologies in our fab to support \$2 billion. We will do a similar type of thing with DMOS6.

Do you have a follow-on?

Harlan Sur - JPMorgan - Analyst

Thanks for that, Dave. As it relates to driving your free cash flow margin to the 30% level, as the company continues to build scale in its target markets, how should we think about your OpEx trajectory relative to your revenue growth? I know it has trended toward the lower end of your target of 20% to 30% of revenues and it seems that you are increasing scale alone within tight continued leverage on the OpEx, so is it fair to assume that TI grows its OpEx slower than its revenue growth over a multi-year period? Any way to try to help us quantify that?

Kevin March - Texas Instruments Inc - CFO



Yes, Harlan, I would say that certainly would be an objective is to keep OpEx well contained. As we have talked in the past, we expect OpEx to run in the range of between 20% and 30% of revenue. So in weak markets, that OpEx would probably run up to the higher end; in stronger markets, more towards the lower end.

In 2014, we averaged about 25% during the year and if I recall, about 23% during the second half of 2014. As we continue to grow going forward, and our growth objectives are to continue to gain market share, as we have been doing with Analog and Embedded for multiple years now, which means we continue to expect to grow -- outgrow those markets on a continuing basis. To that end, we expect those markets, the semi- markets, to continue to grow at about 2X the global GDP, about 2 times the global GDP, and that is really on the back of increasing semiconductor content into electronics, especially in industrial and automotive. So when you put all that together, we would naturally expect our revenue to be growing faster than our OpEx and keeping ourselves highly profitable and generating a lot of free cash flow.

Operator

Stacy Rasgon, Bernstein.

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

Thanks for taking my questions. First, I wanted to see about the equipment assumptions for DMOS6. Do you already have that equipment in-house? And if you don't, where are you planning to acquire it?

Dave Pahl - Texas Instruments Inc - Head of IR

Stacy, we actually -- DMOS6, as you know, was built and originally supported our Wireless business, so the vast majority of that equipment is in place and has actually been depreciated. The actual tools that we need to convert it is actually fairly small, and we've been active in the used equipment market over the last few years, so essentially all the equipment that we need to support the full plan to \$8 billion on 300 mm Analog is in place today.

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

Got it. Thank you, that's helpful. For my follow-up, I just wanted to verify, it does sound like you are raising your commitment on free cash flow margin. You were sitting at 20% to 30%. This is now a commitment to actually deliver sustainable 30%? Just to verify that is the case and can you give us some feeling of timeframe?

Kevin March - Texas Instruments Inc - CFO

Stacy, what we're talking about here is that we just raised the top end of our free cash flow conversion range to 30% last year, so 20% to 30%, as you noted, is our stated range. We delivered 27%. A lot of that is coming on the back of increasing 300 mm revenue coming through our portfolio.

What we described here today is that we continue to see that margin expanding and we should be able to sustain 30% of free cash flow conversion in strong markets, in solid markets. That is really what we're trying to characterize here today. We're not changing the range or trying to up the range, we are simply describing that we see a clear path to get to that 30% and sustain that 30% when get there in solid markets.

Operator

Ross Seymore, Deutsche Bank.

Ross Seymore - Deutsche Bank - Analyst

Just a follow-up on the last one. I know you're not changing the range, Kevin, but can you walk us through a little bit about how you view getting from what you just delivered at 27% free cash flow margin to the 30%? What are some of the levers to create that incremental 3 points?

Kevin March - Texas Instruments Inc - CFO



Going forward, Ross, we really have three drivers to be thinking about. We now have top-line growth working for us, which we didn't have in the past. We have margin expansion that will continue as we have more 300 mm production making up our total production as well as overall product mix.

And then just really continue our share buybacks. So from a free cash flow per share standpoint, we've got those three things going. Certainly, just taking a look at the expansion of 300 mm as a portion of our revenue, that alone is going to be a solid contributor, not only to our profitability but also our free cash flow generation as we drive that up to a higher percent of revenue.

Ross Seymore - Deutsche Bank - Analyst

As my one follow-up, any sort of thought about how linear this move can be to that \$8 billion number? I notice you didn't put any timetables on when you would have that full-on capacity rolled out.

Is it something that will be linear or are there big chunks that we should think about? And if there's any depreciation impact within that, that would be helpful as well.

Dave Pahl - Texas Instruments Inc - Head of IR

There is really not any big chunks. I think as we ramped RFAB, we did that in a orderly fashion. Really, the reason why we are qualifying and going through that process now is it takes time to qualify, it takes time to release the products, it obviously takes time for those products to get qualified and used in our customers' system. We're not expecting any big moves or shifts but just a continual improvement, much like you saw with the ramp of RFAB.

Kevin March - Texas Instruments Inc - CFO

I might add, just to remind everybody, that we've had RFAB in operation for a little over four years now and we've gone from zero to \$2 billion of Analog revenue in that space during that period of time. Again, it is a multi-year trajectory that we are on to fill these factories up. It is really going to be a function of how well the market performs, and clearly we're performing well inside that market as we continue to steadily gain market share against our competitors.

Operator

Mark Lipacis, Jefferies.

Mark Lipacis - Jefferies & Company - Analyst

Thanks for hosting the call and for taking my question. Kevin, on one of the slides, you show that after \$8 billion of capacity with the two factories you will have over 50% of manufacturing of your Analog manufactured internally, which I guess implies a healthy slug of Analog manufactured outside. My question is, can you review where you are on the split right now, internal versus external? And if you have such a big cost advantage, why not just manufacture everything inside, internally?

Dave Pahl - Texas Instruments Inc - Head of IR

Mark, I would say that slide, number one, is it is 50% of 300 mm. It is the balance of that we expect to manufacture on 200 mm.

As Kevin indicated in the presentation, we actually still have incremental room on 200 mm, although that will still see most of the revenue growth come on 300 mm. We will continue to use some outsourcing, but for Analog, the vast majority of our wafers are built internally.

Embedded Processing will need some advanced CMOS, and as you know, we use all of that external. I think if you look at our total mix in 2014, I think less than 20% of our total wafers were sourced through foundries. Do you have a follow-up?

Mark Lipacis - Jefferies & Company - Analyst



Yes. Thank you for that clarification. You guys have made several large acquisitions, it seems, in support of your goal to generate a lot of free cash flow and return it. How is, how should we think about the role of large acquisitions to continue to achieve those growth and free cash flow goals going forward? What is the appetite for large acquisitions going forward?

Kevin March - Texas Instruments Inc - CFO

Mark, I would say our appetite is unchanged from the past, meaning it is more a function of how we look at acquisitions. As you pointed out, obviously we look at them to generate copious amounts of free cash flow for us. The real metric that we use, first off, the preference that we will have for acquisitions will be as it has been in the past, and that is focused on Analog, for continuing to enrich our Analog portfolio and strengthen our position in the analog market.

Beyond that, as we take a look at acquisitions, the most important thing after it being an Analog is, does it strategically makes sense for us, be in markets that are attractive that we want to be involved in and then does it mathematically make sense. The numbers have to work.

By that, the measures that we use is that the acquisition has to be ROIC-accretive. In other words, what we pay for it has to be accretive to our weighted average cost of capital within a four-year time frame. We've got to be able to take a look at what we think we would have to pay for an acquisition, run that math and see if it is actually accretive from that standpoint.

That is the metric that we use; that is the metric we will keep on using going forward. When we see an opportunity that presents itself, we will make an appropriate decision at that time.

Operator

Vivek Arya, Bank of America Merrill Lynch.

Vivek Arya - BofA Merrill Lynch - Analyst

Thank you for taking my call. You use the word of the phrase in good markets and you mentioned returning to top-line growth. So last year, your sales grew about 6.9% year-on-year. Is that the kind of top-line growth, Kevin, you need to sustain this 30% free cash flow to sales?

Kevin March - Texas Instruments Inc - CFO

I think that, that rate of top-line growth will certainly get us there. Again, we have to continue to convert more of our revenue onto 300 mm as we grow and so that will come through. Certainly, that kind of rate will help get us there.

Underneath that, keep in mind Analog and Embedded Processing combined grew considerably faster than the total company. That is what we are counting on as we go forward, that we continue to benefit from the success of those two segments outgrowing their respective markets in driving top-line growth.

Ideally, the answer is yes, that was a pretty strong market last year. You saw us step from 24% free cash flow in 2013 to 27% in 2014 and so if we continue to enjoy a strong market, we will see ourselves continue to step up towards that 30% and then be able to sustain it.

Vivek Arya - BofA Merrill Lynch - Analyst

As a follow-up, since you decided to exit a lot of the wireless exposure, gross margins have expanded by 600, 700 basis points or so, but that is also the timeframe in which you have started to use a lot of more of your 300 mm capability. Is it possible to quantify how much gross margin benefit you have achieved from 300 mm already?

Kevin March - Texas Instruments Inc - CFO



I think you could probably do some backwards calculations on the example I showed on that slide that had the math of the cost benefit we get from 200 mm. You can probably work that out. The fact of the matter is, as we see more and more 300 mm-sourced Analog revenues running through our portfolio, we will expect to see that gross margin continue to expand and expand to the 60% and beyond level.

Dave Pahl - Texas Instruments Inc - Head of IR

It has been a nice driver. When you are doing that math, you will see that. Thanks, Vivek, and we will go to the next caller, please.

Operator

William Stein, SunTrust.

William Stein - SunTrust - Analyst

Thanks for taking my question. A moment ago, you were asked about your appetite for acquisitions and I would like to ask it maybe in a bit more of a capital-focused way. Your cash flow generation is quite consistent. Even in the 2009 downturn you generated a lot of cash.

Yet, your gross leverage is now below one turn, your net leverage is about 0.2 turns, your interest coverage is about 50 times. Why not consider taking a more active stance on the capital structure of the business, raise more debt to do something to accelerate earnings growth and cash-flow growth?

Kevin March - Texas Instruments Inc - CFO

William, again, our focus is on what we can do to accelerate free cash flow growth and to that end, when it makes sense, we do use debt in the capital structure. It certainly made sense for us to go ahead and take on debt. We previously had no debt, by the way.

When we acquired National Semiconductor, we took on a significant level of debt, for exactly that reason and that is to incrementally accelerate our rate of free cash flow generation. To that end, as we look forward, when we find opportunities that will allow us to continue to accelerate free cash flow generation, we will certainly entertain the idea of including additional debt on the balance sheet in support of that objective.

Dave Pahl - Texas Instruments Inc - Head of IR

Follow-on, Will?

William Stein - SunTrust - Analyst

Sure. Actually, I'd like to ask about end markets. I know it's not the topic of today's call, but I believe you have meaningful exposure to wireless infrastructure. Can you remind us approximately what that exposure is and whether you see that as a growth market this year for the company?

Dave Pahl - Texas Instruments Inc - Head of IR

Our communications equipment end market was 17% of our revenue. That would be inclusive of things like wireless infrastructure, which is the largest inside of there, but also telecom infrastructure, enterprise switching and residential gateway.

We saw strong growth in that market this past year and we benefited from that. I'll also make the comment that we've actually got a very broad exposure of types of products that we sell into that market. In fact, we actually sell more Analog product into that market than we do Embedded Processing.



I think what we have heard from others in the market that there's a reason to believe that, that growth could continue into this year. I think, then, when we look at it, certainly it has always been a very choppy market and they don't tell us ahead of time when things will roll over. I think we will stay optimistic and just react when we see things that change.

Thanks, Will, and we will go to the next caller please.

Operator

Ambrish Srivastava, BMO Capital Markets.

Ambrish Srivastava - BMO Capital Markets - Analyst

Pretty cogent presentation, guys. I just had a couple of questions. Number one, on the gross margin incremental fall through, if memory serves me correct, it used to be 75%. What is the right way to think about that fall-through rate now as 300 begins to ramp?

Kevin March - Texas Instruments Inc - CFO

Ambrish, we've gone back and checked that recently and it really hasn't changed that much. That is still probably a pretty good model over multi-colored of periods, you can be thinking about.

Ambrish Srivastava - BMO Capital Markets - Analyst

Okay. On the share gains side in Analog, all the data is out and you guys gained share again, albeit small. On the Embedded side, Dave, do you have a read on where shares stand for you versus the collective market?

Dave Pahl - Texas Instruments Inc - Head of IR

Yes, Ambrish, we actually gained share in both Analog and Embedded Processing for the year. I think that we gained about 40 to 50 basis points in Analog, probably a little bit stronger than that in Embedded. Our share is about 15% in the Embedded market and just a little bit over 18% inside of Analog.

Maybe I'll just also just point out that those share gains have been consistent over a period of time, and we really believe that those share gains are driven from the broad portfolio that we have got, the differentiated technology that we can build on our manufacturing assets that give us a cost advantage through our broad sales channel. I think all those things are working together to continue to drive share gains and collectively, those are very hard for our competition to replicate. Thanks, Ambrish, we will go to the next caller, please.

Operator

C.J. Muse, Evercore ISI.

C.J. Muse - Evercore ISI - Analyst

Thanks for taking my question and hosting this call. I think we all understand the sustainable, or multi-yield delta, between DNA and CapEx. What I'm try to understand is how we should think about, as gross margins move higher, what are the implications to free cash flow? I guess put another way, how should we think about incremental free cash flow margins as you start removing some of these underutilization charges, et cetera?

Kevin March - Texas Instruments Inc - CFO



I wouldn't -- remember, under utilization charges are really just an accounting charge so I wouldn't go there. I'd kind of to go back to the thought process that Dave talked about, which is, DMOS6 is now coming into play for us for 300 mm Analog revenue growth.

As I mentioned in my prepared remarks, we expect to have -- qualified by the end of this year, with products coming out of that factory. And as Dave commented, that is pretty much a fully depreciated factory.

That equipment was first put in there beginning in 2001 and we depreciate pretty much on a straight line 5-year schedule. As you can imagine, there is no -- not much depreciation cost that is going to be hurting GPM, so that is what GPM margins will go up.

Because we have already got almost all of the equipment we need, there is relatively little CapEx, and therefore free cash flow generation will be extremely robust coming off of that. So rather than go through thinking about a free cash flow fall through, so to speak, I think it's more important to think about the free cash flow journey that we are on, working our way from the most recent 27% for 2014 to get into a sustained 30% as we move and grow revenue in the next couple of years.

C.J. Muse - Evercore ISI - Analyst

That's helpful. As a quick follow-up there, clearly there is still some cyclicity left in semis, I think, and so 30% in good markets, how do think about free cash flow margin throughout a cycle? Is it still that 20%/30% range? Is it now 25%/30%? How should we the thinking about that?

Kevin March - Texas Instruments Inc - CFO

Is going to really come down to what you want to characterize as a cycle. If you go back to 2009, that was a pretty hard down cycle and I think we slipped into the upper teens back then. A little bit below 20%. I'm certainly hoping we don't ever see one of those cycles again.

But I would expect that we can operate inside the 20% to 30% range that we been talking about and as we get more and more 300 mm, that we begin to move that bar generally in an upward direction. So even as the cycle may want to repeat itself, we should be able to sustainably generate higher levels of free cash flow versus what we might have done in prior cycles, just given the economics of the portfolio and the shift to 300 mm Analog, our CapEx strategy, the fact that could use this equipment for many years, all of those things just provide us tailwind on free cash flow generation.

Dave Pahl - Texas Instruments Inc - Head of IR

I would just add, too, the robustness of the business model, I think in fourth quarter of 2008, during the darkest days of that economic downturn, I think we still generated around \$1 billion of free cash flow. Most of that coming out of working capital, but I think it's just a good highlight of how robust the business model is, even in very difficult times like that.

Thank you, CJ, and we will go to the next caller, please.

Operator

Blayne Curtis, Barclays.

Blayne Curtis - Barclays Capital - Analyst

Thanks for holding this call. I just wanted to ask, in the scenario you have the 50% mix in some time frame in the future obviously shows revenue growth. What are the opportunities, let's just say, in a more modest growth environment? How much of the 200 mm product you have today could actually be switched over to 300 mm in a more modest growth scenario?

Dave Pahl - Texas Instruments Inc - Head of IR



Blayne, our plans really aren't too shift it from 200 mm to 300 mm. It is really there for growth purposes. Again, when you look at our portfolio, and just the tens of thousands of products that we have and the diversity of our customer base, it just takes a lot of time and energy to move those products.

The second thing I will point out is, is when we release new products today, we usually multi-source them, so we will release them perhaps into a 300 mm fab as well as a 200 mm fab and that just gives us flexibility for loading and ensuring that we can meet demand as it comes in. Again, the objective is to support growth.

You have a follow-on?

Blayne Curtis - Barclays Capital - Analyst

I did. When you look, you are way ahead of the competition in terms of the 300 mm, the cost savings that you are showing, the 68% gross margin. I know in the core Analog market it is probably hard to win on price when you look at some of the markets that you've historically backed away from, maybe more price sensitive.

Given this advantage, how do you look at the markets and maximizing actually just cash flow dollars versus, it looks like the target, you're zeroing in on is a 30% margin, how do look at some of these markets now with the advantage? Could you gain some share in the more volume market?

Dave Pahl - Texas Instruments Inc - Head of IR

Blayne, I'd say that -- and we have been asked the question, the same question, which is a very good one, in a lot of different ways. But essentially, our business model isn't changed because we have got the cost advantage. We really want to look and find places where we can find sustainable revenue growth where we have got a differentiated position.

If we don't have that and don't believe that we can do that over time, we will shift our R&D dollars to places where we believe that we can. It goes back to the saying of, you're going to work really hard in good markets and bad markets, so choose good markets to operate in and that is what -- that is where our focus has been.

Thank you and we will go to the next caller, please.

Operator

Christopher Rowland, FBR Capital Markets.

Christopher Rowland - FBR Capital Markets - Analyst

Thanks for the question. I think you guys have always said that you had \$18 billion of revenue footprint and I'm assuming this DMOS number was already in there, so it is still at \$18 billion? Or is it \$21 billion now? And now that you guys have so much 300 mm capacity, are there opportunities to revisit your footprint and perhaps find some fabs to restructure some of the older facilities and help accelerate gross margins?

Dave Pahl - Texas Instruments Inc - Head of IR

Chris, the DMOS6 was in those numbers and essentially that -- the \$18 billion number really hasn't changed that much over the last few years. What was the second part of your question?

Christopher Rowland - FBR Capital Markets - Analyst

Now that you have so much 300 mm capacity, are there more opportunities to revisit your footprint and perhaps look at some older facilities that you guys have to transfer some of this stuff over?

Dave Pahl - Texas Instruments Inc - Head of IR



I've got you. Again, we have got a fairly robust footprint of 200 mm factories. They are very cost efficient. They produce a lot of free cash flow.

We actually did close a couple of factories a couple of years ago and just note that I think one was around 35 years old; the other one was older than 40 years old. So when we look at these assets, they really can be employed for decades and produce a lot of cash and that is really how we look at it versus really chasing the last profit dollar that we can out of the machine.

Kevin March - Texas Instruments Inc - CFO

Let me just add to what Dave was saying. The illustration of how old those factories were is a good point. That means those products that were built in there were sold from those factories for a very long time, because once you qualify these Analog parts into a factory, it really doesn't pay to move them to another factory.

But eventually demand for old, old, old parts will go away and loadings will drop to the point where maybe a factory doesn't generate the kind of free cash flow that we think we should be pursuing. That is more what leads us to looking at our footprint as opposed to just trying to consolidate for the sake of consolidation.

Christopher Rowland - FBR Capital Markets - Analyst

Great. Also, on the inventory side, you guys talked about being perhaps over your days' target there. How much, if you could remind us, how much more disty conversion do you have left to consignment?

Where might days top out? When might we get back into the range?

Kevin March - Texas Instruments Inc - CFO

Chris, I believe we had about 60% of our revenue now is going through distribution and about 60% of that is now on what we call consignment inventory. If that consignment inventory, that is shifting the ownership of that inventory from where it was previously on the distributors' books to where it is now on our books, and that is leading us to push up to the upper end of our model range of inventory days.

As we talked about on the earnings release call, as this shift continues, and we expect it to continue over the next few years, meaning a bigger percentage of revenue going through distribution and a larger portion of our inventory being on consignment arrangements, that is causing us to take a look at what is an ideal model for inventory days. We will review that over the next year as we watch this transition and will probably refresh it at a later date. Right now we're not going to be too hung up on that as we watch what is actually happening with customer behavior and the preference to move towards consignment inventory.

Operator

Tore Svanberg, Stifel.

Tore Svanberg - Stifel Nicolaus - Analyst

The first question, so let me see if I get this right. Assume there is no recession, we should estimate that TI's free cash flow per share growth will be at least 13% and then it is up to us to determine the growth above and beyond that.

Kevin March - Texas Instruments Inc - CFO

I don't think you heard us give a forecast on free cash flow per share growth, Tore. What you did here us say is that for the last 10 years, our shareholders have been able to enjoy what has been a 13% CAGR without the benefit of top-line growth. There has been a lot of other changes going on inside that portfolio, as you know, as you have followed us for a long time.



Clearly going forward, we will have the benefit of top-line growth, continued margin expansion as 300 mm becomes a bigger portion of our overall revenue generation capability and, to the extent the economics continue to make sense, share buybacks. Those combined give us confidence that we will continue to have meaningful free cash flow growth as we go into the future.

I won't try to characterize exactly what the percent might work out to. I'm sure your model can help us get there, too.

Tore Svanberg - Stifel Nicolaus - Analyst

Very good. As a follow-up, you mentioned 25% of Analog at RFAB and I think you said that all four product lines are now at RFAB. Is that distribution fairly even or are some -- do some of the product lines have higher percentage than others? The reason I'm asking is because obviously there is a gross margin differential between let's say between HPA and high-volume analog.

Dave Pahl - Texas Instruments Inc - Head of IR

Tory, I don't actually have the percentage of each of the businesses. It really just will depend on the products that we put in there and the decision on that is primarily driven by the process technologies that can be supported. Obviously, if we can build a 300 mm wafer versus a 200 mm wafer, we will do that because of the cost advantage that we will see.

I will also just add that we have, it's not just determined on high-volume products going into RFAB. We have some people that get confused, because you can run high volumes, that, that's the only thing that we put in there. In fact, we can run wafer lots with multiple products inside of them because of the automation of 300 mm, so it makes it very efficient for even very small lot sizes.

We have a good diversity of products that run through there. We can support quite a few different types of products. With that, I think we have time for one more caller.

Operator

Steve Smigie, Raymond James.

Steve Smigie - Raymond James & Associates, Inc. - Analyst

Thanks a lot, gentlemen. Kevin, I was hoping you could address the tax strategy a little bit. Your tax rate is somewhere in the 20% s.

Other folks have it much lower, but you have much more on-shore cash. So in terms of figuring out what tax you want to go after in terms of tax holiday versus not tax holiday and having cash on-shore, what are the decisions that you are making there in terms of those issues?

Kevin March - Texas Instruments Inc - CFO

Steve, the decision really is pretty straightforward and that is, we believe that, again, at the risk of sounding like a broken record, the free cash flow per share is the best way to increase the value of the company and that, that free cash flow is only useful if you return it either to the business for investment or to your shareholders. To that end, our thinking starts right from how do we make sure we have access to it to invest and, to the extent we have surplus cash, give it to our shareholders.

That then informs us as to what our tax strategy should be. In this case, what it means that we wind up repatriating a sizable amount of our total earnings offshore.

As you model us going forward, because we have a strong preference to actually return surplus cash to our shareholders, you should model our future changes in profitability assuming it is good to be brought back to the US and taxed at 35% marginal tax rate. So take our current tax rate, we've offered guidance for 2014 of our effective tax rate being about 30%.

So as you grow our profit in 2016 and beyond in your models, you should incrementally tax that profit at 35% and you will get a new weighted average effective tax rate as you pass through time. That is the best way to think about us from a tax standpoint.



Dave Pahl - Texas Instruments Inc - Head of IR

I will point out that anyone that modeled that in the transition from 2014 to 2015 got right on top of that number and there was no surprises there. Steve, you got a follow-on question?

Steve Smigie - Raymond James & Associates, Inc. - Analyst

Yes, just real quick. On the stock buyback, I think you indicated that the way to determine to do that is when you feel the, I think the market cap falls below the intrinsic value is just, for the determination of intrinsic value is that kind of a cash flow model or how do you go about figuring out which you consider to be your intrinsic value?

Kevin March - Texas Instruments Inc - CFO

Steve, it is a discounted cash flow model to keep it real simple and when we do that there is a sizable gap which has kept us in the market buying back shares on behalf of our shareholders.

Dave Pahl - Texas Instruments Inc - Head of IR

Thank you for joining us today. Before we go, I just wanted to highlight something that we've prepared for those of you who have not attended our previous capital management calls.

On our website, we will have, posted later today, a comprehensive summary of our capital management strategy. It will include the materials that we've covered today as well as materials that we've covered in our previous calls, such as the summary of our business model, our tax strategy that we just touched on here, as well as multiple balance-sheet items.

Thank you again. A replay of this call and the slides that we have shown today will be available on our website. Good day.

Operator

This does conclude today's program. Thank you for your participation. You may disconnect at any time.

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.

© 2015 Thomson Reuters. All Rights Reserved.

