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PRESENTATION

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Great. Well, good morning, everyone. My name is Craig Hettenbach. I'm with Morgan Stanley semiconductor team. Very pleased to have with us Texas Instruments this morning, CFO, Rafael Lizardi; and Investor Relations, Dave Paul. So welcome, guys.

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

Good morning, hello. Great to be here.

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

Good morning, craig. Thanks for having us.

QUESTIONS AND ANSWERS

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Great. I'm just going to read a disclosure for investors. The Morgan Stanley research disclosure website can be found at www.morganstanley.com/researchdisclosures. So with that, I think we can just kick off, starting with the supply chain tightness and how that's impacting your business kind of today, but probably more importantly, from a strategic sense, just how it plays into kind of TI's manufacturing strategy and what your strengths are?

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

Yes, sure. So let me start with that. And I'll start on the strategic angle that you just gave. As you know, we have 4 competitive advantages. One is, owning our own manufacturing and technology, particularly a 300-millimeter wafer fabs. And the value of that strategy was proving once again in this environment by owning those factories, controlling them, has put it in a really good position to do very well in this pandemic. The other angle that I would give you is our approach, our business model of focusing on catalog parts, in the analog and embedded space and from an end market in industrial automotive, with very long product life cycles. So that strategy has enabled us to build inventory that last years, if not decades.

So then we don't worry about obsolescence of that inventory very much. There's very little risk of that. So that's why we generally have inventory levels that are higher than our competitors, and we think there's -- it's a good investment. And again, the pandemic, what we went through and still going through has proven that.

On the more tactical level, leak tons remain generally stable and short, but there are pockets of tighteners. There's no question about that. Automotive is maybe the area that I would highlight. Everybody has read about that in the papers and some of what's going on there. So we're -- after 9 months of strong demand at some point, it gets to a point where that becomes a little tight. But generally speaking, we are withstanding that and doing much better than competitors on that front.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And then you mentioned automotive, which it feels like most pronounced in terms of the snapback that we've seen in that market. Any other markets that feel on the tight side as you see it today?

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

Probably the only 1 that I would highlight. Yes.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Okay. And how -- in terms of customer engagements and maybe even longer-term agreements or visibility, are you seeing any behavior in terms of how customers are responding to how tight things are? And I know it's a more recent phenomenon, but just what is it doing in terms of some of the customer engagements you have in running the business?

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

Yes. What I would tell you is our focus, as I said earlier, is on catalog parts. So again, catalog defined as parts that are sell to 10 customers, sometimes 15, sometimes even 30 different customers. So we can -- and primarily in the industrial automotive market, but not only in those markets. Of course, we sell into personal electronics and communications and others. But that puts us in a position where we can build inventory, have very good availability, very, very short lead time. So then we're not in a position then to be -- for our customers to be worried about supply, to having to order ahead of time or to place long-term agreements of any of that sort. If anything, we're moving the opposite way on that, just having more and more availability.

Just to comment on capital management. About a month ago, we talked about how we are -- we're so confident on that strategy and feel so good about it. We're increasing our target for inventory days to 130 to 190. That's a guideline. That's not a hard number, but it just gives you the confidence that we have in the strategy because it's such a good asymmetric bet to have that inventory invested a capital, invested inventory so that when customers need it, they know they can count on us to provide the short lead time part.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And Rafael, can we touch on just U.S. manufacturing? I mean, there's a lot in the press recently about U.S. policy and things as they kind of look to address some of these, which arguably are much longer-term issue in terms of being able to respond to it and maybe in that some change. But as 1 of the larger U.S. semi manufacturers, are there any types of benefits that TI can see through some potential changes in policy?

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

Yes. So our position when it comes to policy is threefold: one, low taxes; two, a free trade; and then skilled talent. And when it comes to taxes, for example, 3 or 4 years ago when tax reform was passed, that finally put the United States in a more level playing field compared to what other countries around the world do for technology companies, specifically semiconductor. So our encouragement would be to maintain or improve that level playing field.

And there are various things going to congress and the people are talking about in that regard. There's also a lot of talk about increasing the tax rate, right? So we'll see what the net effect of all that will be. But at the end of the day, it would be important for the United States to have that level playing field for semiconductor companies.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And then any updates on 300-millimeter view in terms of just time line of the next fab? Just kind of where things stand? And then from a longer-term perspective, what that means in terms of incremental revenue that you can grow into longer term?

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

Yes. So no change. So I'll just tell you what we talked about at the last capital management meeting, which is we're building the third 300-millimeter factory, is going to be here in Texas in Richardson. Either it should be ready to have output potential in the second half of next year. Once it's built and then once it's fully equipped, which will happen over time, that factory will have the potential of $5 billion of annual revenue, okay?

So that will increment our existing footprint, particularly on 300-millimeter, as we have talked about, that just gives us a tremendous advantage, not just only in our own manufacturing, but having the best cost structure in the industry.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And as you referenced the recent capital management update. There are a couple of small tweaks that you made. You increased the dividend payout as a percent of free cash flow, also raised that the inventory kind of band a target that you look at. Can you just talk about both those things? And it does feed into -- there's a question over the webcast around buybacks and just again, if it's a subtle kind of shift, a little bit more towards dividends, how you're thinking about the cash return aspect of it?

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

Yes. Yes. No, happy to. So on inventory, I pretty much addressed that already, but just to reiterate, we're confident in our inventory strategy because it all starts with the business model and our competitive advantages and how that works. And that enables us to then have -- carry higher levels of inventory and feel really good about the trade-off there between tying up some cash on the balance sheet for inventory, but the potential benefits that come with that to have really good availability, short lead times for our customers.

On the dividend, and let me first step back. Our commitment has been and continues to be to return all free cash flow to the owners of the company. If you look at our history for 15-plus years that's what we have done, and we have done that through dividends and buybacks. If you look back 10, 15 years ago, dividend was a relatively smaller portion of that versus buybacks.

Over the last 15 years, that has even out more with buybacks, about 50-50. And it varies, obviously, buybacks are more discretionary. But at the last capital management update, we tweaked the dividend metric. It was 40% to 60% of free cash flow. We took that to 40% to 80%. That's just to convey that we would be confident in the sustainability, affordability and growth of that dividend anywhere in that range, whether it's 40% or 80%, anywhere in that range, we'd be comfortable with that.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And also as part of the capital management update, you talked about kind of R&D. Certainly, auto and industrial have been focused markets, but you're also investing in other markets like personal electronics. And so how does the company go about prioritizing where to spend, what markets make the most sense?

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

Yes. I'll start on that. And then, Rafael, if you want to add.

I'd say that when we look across the markets, we find good opportunities in all of the markets. And so though -- a good opportunity is a product that we've got a level of differentiation, a product that can sell to multiple customers, across multiple end equipments, ideally across multiple sectors and markets. And when you find opportunities like that, they tend to live a long time.

So those are the types of opportunities that we're looking towards. And you just find more of those types of opportunities in the industrial and automotive markets. So that will continue to be a priority for us, but we'll continue to follow and find good opportunities in our markets.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And maybe just to follow that. Can you talk about scale? Because I think sometimes, that's something that comes up in discussions around just how much you spend on an absolute basis versus as a percent of sales? And how important is that scale that you have in terms of leveraging the investments that you're making? And like you said, having these products go into multiple different markets?

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

Yes. I think I'll bring it to 1 of our competitive advantages, which is the breadth of our portfolio. So if you look at the breadth of our portfolio, it isn't so much scale, but it's -- we've got products in a lot of the subsegments of analog as well in embedded. That just gives us the opportunity to participate in more projects of customers, more sockets per project and just sell more content in each of those projects. So to the ability for each of our investments, it just allows us to find more homes for each of those investments. So that's what that scale, if you will, scale by itself isn't the advantage. It's necessary, but not sufficient, probably a good way to describe it.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Good. And maybe we could shift gears towards the distribution strategy, and you've been taking the business more direct in recent years. And I think that's mostly run its course. But just -- if you can just reiterate kind of what are some of the key highlights of this and advantages for Texas versus perhaps some of the competitors who are still relying more heavily on distribution?

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

Yes. I think if you look at the shift that we had this year, I just describe it as substantial.

And we've been working towards it for thrilled with increased direct relationship with our customers and the early results that we're seeing there. So we started the year with about 1/3 of our revenue coming direct to TI. We left the year with 2/3 of the revenue coming direct.

And that number may continue to increase a little bit, but probably not substantially higher. And again, we're already seeing that -- the benefits of it.

And we'll get benefits of higher growth, just really through more access to customers' projects, the sockets per project and really just insight into what our customers are doing. And we really believe that, that will be an advantage that just will be difficult for many of our competitors to replicate.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And if you think about just as the strategy has unfolded, are there any differences by geography in terms of maybe with direct -- you take all that and it makes sense versus distribution still has a role. And if it's still a 30 of business, I know some of that is just fulfillment. But just how do you think about geography? And does that influence in parts where you still are using distribution. Does that play an important role?

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

No. I wouldn't say it's based on geography. I think that the operating side of the houses for our customers have many needs, but a couple of those needs is availability and pricing or cost of our products.

And by having a direct relationship, certainly, we'll have the best availability because we own and control the inventory of our products and going direct with us will have the best pricing available. And there may be a need for customers to have services from a distributor. And that's -- there is no problem with that, and customers find great value in it. So regardless of what region that they're in, should they find that value, they'll negotiate and discuss with the distributor, what that value is and what services they'll provide. So we'll see that continue really into the future because of the services that they provide.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. Maybe we can just talk about industry consolidation across semis and specifically in analog and micro controllers and just curious, as we've seen this consolidation, are there anything that you're seeing kind of change at the margin in terms of competitive dynamics?

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

Yes. What I would tell you, if you step back over the last 20 years, we've had a few periods in our history where we -- acquisitions have made sense for us, where we have found opportunities to strengthen our competitive advantages. As we mentioned earlier, scale is a component of that, but it's not suffice -- it's not the only thing.

But it did help us broaden the portfolio, get some scale in the manufacturing front. And the last one in 2011 with the National acquisition. And since then, our focus has been and will continue to be organic growth, is to then continue to strengthen and then leverage those competitive advantages. And just in our sense that's a much better, efficient, effective strategy just -- and again, given where we are in today, not to mention the valuations in the industry have been such that even if we wanted to it would be difficult to justify some of those acquisitions.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Understood. And then for the analog industry, what's your guide and sense in terms of just longer-term growth and whether that's relative to GDP or kind of the mix of your business? But how do you think about that on a longer-term basis, the growth potential in the business?

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

Yes. As we have talked about it in previous years, I don't think our view has changed much on that. It's sub point or 2 as an industry hired than GDP because semiconductor content continues to grow. And and we are -- on top of that, we're gaining share. We have gained share pretty consistently. And we're in the best markets, industrial automotive, where the content growth is growing even faster than in other places. So we end up -- you can think of our target as being a few points ahead of GDP.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And then maybe switching gears to the embedded market. There's been some more change for TI there in recent years and the company has talked about where it wants to prioritize investments and has shifted some investments. But can you maybe just talk about really the decision process behind that in terms of how you're trying to optimize that business and where you play?

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

Yes. I would say that if you look at that business overall, our first objective with that business was to get the business stabilized. And I would say that we're pleased with the progress that we've seen there. And we're investing in that business And really, what we need to do at this point is to prove that we can grow that business sustainably over the long term. That will take some time to prove out.

And we want to have products that will reach a broad set of customers that play to our competitive advantages. And we're focused and working very hard to do that. And again, we're making those investments because we believe that, that business will contribute to free cash flow growth over the long term.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And Dave, in the business that remains in terms of that you're optimizing around, is it similar in terms of growth prospects relative to GDP? Are there any puts and takes of how you think about embedded versus analog longer term?

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

Yes. We think both analog and embedded businesses are big enough pieces of the semiconductor market that they'll both grow about the same rate from a market standpoint. And if we're executing well, we will continue to gain share in both of those markets. So they both have the same growth potential.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. Okay. Wanted to dig in for just some of the end markets in growth. And the company has certainly seen a pretty substantial change in mix over the years towards auto and industrial. And I know both of these markets are really broad-based in terms of the applications that you play. But one area that's gotten increased attention in the last year is the inflection in EVs. And we would love to talk about just kind of what that means for TI, kind of where you think you're positioned? And are there certain kind of technologies there that are best suited for you to capitalize on?

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

Yes. Our strategy in automotive has been very intentionally to have a broad-based footprint. So we could measure that in a couple of different directions. One is by looking at the sectors. So electric vehicles would sit in a sector we call powertrain systems. So that would also pick up hybrids. But we've got 4 other sectors we're investing, which include infotainment and cluster displays, ADAS systems, safety systems and then body electronics and lighting.

So we often joke about getting design wins and tail lights. There's lots of semiconductor content today. And turn signals and tail lights and nobody writes articles about it. It's not very exciting. But we like that kind of content. And if you look at our product portfolio, we've got 65 different product lines at the company. 45 of those product lines ship products into the automotive industry. And then if you look at a customer standpoint, we've got probably close to 1,000 different automotive OEMs and of course, the revenue will be weighted towards the Tier 1s. But if you take any Tier 1, we'll have 1,000 to a couple of thousand different products that will ship to any Tier 1.

So again, trying to build on that breadth of products. And the competitive advantage, which is diversity and long-lived positions. So I think automotive is just a great example of that competitive advantage.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And similar to how we talked about just overall more broadly kind of growth, a point or 2 above GDP. Is there a way, Dave, that you kind of think about automotive relative to production in terms of what some of the growth prospects there?

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

Yes. I think that both automotive and industrial are both the markets where you've got content that's being expanding, right? And if you just look backwards, as a frame of reference, over the last 10 or even 15 years, you've had auto SAAR growing somewhere between 1% and 3%. And where the semiconductor market or TAM in that market has probably grown somewhere in the upper single digits. So -- and people pick different numbers inside of that.

That's an easier number to get to and to identify because any semiconductor company knows when you're shipping into automotive because there are certain standards and things that you need to do with products, and we can count the number of cars that are being shipped per year. Industrial is -- has the same type of content expansion that's going on. But in that market, we've got 13 different sectors and hundreds, if not thousands, of end equipments that we're shipping to.

So you can't quite dimensionalize it so easily. But really the same type of opportunity, but just a lot more diversified. And hence, why we really like the opportunity there.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And maybe just following up on that industrial. And I appreciate kind of the 5 buckets in autos that you kind of look to drive growth. I know there's even more of that within the industrial segment, but any of those that you would highlight within industrial from an application perspective that offers strong growth?

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

Yes. That's -- it's the beauty of industrial. And I often get teased that I bore people when I talk about all 13 of the different sectors that we're investing in.

And as we define industrial, every semiconductor company may define it slightly different, unlike automotive, where it's pretty clean cut. But our definition will include things that the financial community would obviously identify as industrial like factory automation or building automation, grid infrastructure, industrial transport, but we'll also include medical, aerospace, appliances, those types of things because they have the same market dynamics and behavior as those others. So and you can drill down into any one of those sectors and take medical, as an example, or literally hundreds, maybe even thousands of different end equipments inside of medical. You could think of a medical imaging system that may sell for millions of dollars down to blood glucose meter as an example that may sell for less than $100 and everything in between.

So just great opportunity, and customers in any of those sectors are trying to make their products more efficient, lighter, more precise, more capable, more connected in any of those vectors, you need semiconductors to be able to do that.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. And then, Dave, how about on the personal electronics? I mean, autos and industrial certainly have -- I think people have identified with those growth drivers on a multiyear basis. Personal electronics last 12 months has been very strong, and there's some influence of pandemic happened. But how do you think about that kind of last 12 months versus as you look on a longer-term basis, some of those things, some of the key drivers in personal electronics?

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

Yes. I think, certainly, when you look at personal electronics, you can even see some of those content drivers happening, maybe not to the same degree. But I know, personally, in the last year, we upgraded our TV and some speakers inside of the house. Those TVs had WiFi and connectivity inside of them. They also -- the speakers were connected and smart speakers that we had in the house.

And 10 years ago, those would have been just a paper diaphragm with a magnet attached to them. So even inside of personal electronics, there's more content being shipped per system that will benefit a portfolio that we have. So -- and again, the strength that we saw as we exited the year was very, very broad-based across the portfolio, reflective of some of those trends.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

Got it. All right. I think we're coming up on the 30 minutes time. So really appreciate then the time with you both, Rafael and Dave, and thanks, everyone else, for joining as well.

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

Thank you, Craig.

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

Thank you. Have a good day.

Craig Matthew Hettenbach ***Morgan Stanley, Research Division - VP***

All right. Take care.
