

REFINITIV STREETEVENTS

EDITED TRANSCRIPT

TXN.OQ - Q4 2024 Texas Instruments Inc Earnings Call

EVENT DATE/TIME: JANUARY 23, 2025 / 9:30PM GMT

OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Dave Pahl *Texas Instruments Inc - Vice President & Head, Investor Relations*

Haviv Ilan *Texas Instruments Inc - President & Chief Executive Officer*

Rafael Lizardi *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

CONFERENCE CALL PARTICIPANTS

Toshiya Hari *Goldman Sachs Group Inc - Analyst*

Chris Caso *Wolfe Research LLC - Analyst*

Ross Seymore *Deutsche Bank AG - Analyst*

Chris Danely *Citigroup Inc - Analyst*

Harlan Sur *JPMorgan Chase & Co - Analyst*

CJ Muse *Cantor Fitzgerald LP - Analyst*

Joshua Buchalter *Cowen Inc - Analyst*

Thomas O'Malley *Barclays - Analyst*

PRESENTATION

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Welcome to the Texas Instruments fourth quarter 2024 earnings conference call. I'm Dave Pahl, head of Investor Relations, and I'm joined by our Chief Executive Officer Haviv Ilan and our Chief Financial Officer Rafael Lizardi.

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. In addition, today's call is being recorded and will be available via replay on our website.

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.

I would like to provide some information that's important to your calendars. On Tuesday, February 4, at 10 a.m. Central time, we will have our capital management call. Similar to what we've done in the past, Haviv, Rafael, and I will share our approach to capital allocation and summarize our progress as we prepare for the opportunity ahead.

Moving on, today we'll provide the following updates. First, Haviv will start with a quick overview of the quarter. Next, he'll provide insight into fourth quarter revenue results, with some details of what we're seeing with respect to our end markets. Haviv will then provide the annual summary of revenue breakout by end market. And lastly, Rafael will cover the financial results and our guidance for the first quarter of 2025.

With that, let me turn it over to Haviv.

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Thanks, Dave. Let me start with a quick overview of the fourth quarter. Revenue was \$4 billion, a decrease of 3% sequentially and 2% from the same quarter a year ago. Analog revenue grew 2% year over year, after eight quarters of decline. Embedded processing declined 18% and our "Other" segment grew from the year-ago quarter.

Now, I'll provide some insight into our fourth quarter revenue by end market. Our overall results reflect the performance from our two largest markets, industrial and automotive, with some modest sequential declines.

Similar to last quarter, I'll focus on sequential performance as it is more informative at this time.

First, the industrial market was down low-single digits. The automotive market was down mid-single digits. Personal electronics grew mid-single digits. Next, enterprise systems declined low-single digits. And lastly, communication equipment grew upper-single digits.

In addition, as we do at the end of each calendar year, I'll describe our revenue by end market. As a percentage of revenue for 2024, industrial was 34%; automotive, 35%; personal electronics, 20%; enterprise systems, 5%; communication equipment, 4%; and other was 2%.

In 2024, industrial and automotive combined made up about 70% of TI's revenue, up from 42% in 2013. We see good opportunities in all of our markets, but we place additional strategic emphasis on industrial and automotive. Our customers across all regions are increasingly turning to analog and embedded technology to make their end products more reliable, more affordable, and lower in power. This drives growing cheap content per application, or secular content growth, which will likely continue to drive faster growth in industrial and automotive.

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

Rafael Lizardi - Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations

Thanks, Haviv, and good afternoon, everyone.

As Haviv mentioned, fourth quarter revenue was \$4 billion.

Gross profit in the quarter was \$2.3 billion, or 58% of revenue. Sequentially, gross profit decreased primarily due to lower revenue, higher depreciation and reduced factory loadings. Gross profit margin decreased 190 basis points.

Operating expenses in the quarter were \$937 million, up 4% from a year ago and about as expected. On a trailing 12-month basis, operating expenses were \$3.8 billion, or 24% of revenue.

Operating profit was \$1.4 billion in the quarter, or 34% of revenue. And profit was down 10% from a year-ago quarter.

Net income in the fourth quarter was \$1.2 billion, or \$1.30 per share. Earnings per share included a 2-cent benefit for items that were not in our original guidance.

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

Cash flow from operations was \$2 billion in the quarter. Capital expenditures were \$1.2 billion in the quarter.

In the quarter, we paid \$1.2 billion in dividends and repurchased \$537 million of our stock. We also increased our dividend per share by 5% in the fourth quarter, marking our 21st consecutive year of dividend increases. In total, we have returned \$5.7 billion in the past 12 months to owners.

Our balance sheet remains strong with \$7.6 billion of cash and short-term investments at the end of the fourth quarter. Total debt outstanding was \$13.7 billion with a weighted average coupon of 3.79%.

Inventory at the end of the quarter was \$4.5 billion, up \$231 million from the prior quarter, and days were 241, up 10 days sequentially.

Now, let's look at some of these results for the year.

In 2024, cash flow from operations was \$6.3 billion, and capital expenditures were \$4.8 billion, as expected. We're nearly 70% through a six-year elevated CapEx cycle that, once complete, will uniquely position TI to deliver dependable, low-cost, 300mm capacity at scale to meet customer demand.

Free cash flow for 2024 was \$1.5 billion, or 10% of revenue. Our free cash flow reflects the strength of our business model as well as our decisions to invest in 300mm manufacturing assets and inventory to support our overall objective to maximize long-term free cash flow per share, which we believe is the primary driver of long-term value.

Turning to our outlook for the first quarter, we expect TI revenue in the range of \$3.74 billion to \$4.06 billion and earnings per share to be in the range of \$0.94 to \$1.16.

Based on current tax law, we now expect our effective tax rate for 2025 to be about 12%.

In closing, we will stay focused in the areas that add value in the long term. We continue to invest in our competitive advantages, which are manufacturing and technology, a broad product portfolio, reach of our channels, and diverse and long-lived positions. We will continue to strengthen these advantages through disciplined capital allocation and by focusing on the best opportunities, which we believe will enable us to continue to deliver free cash flow per share growth over the long term.

With that, let me turn it back to Dave.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

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

Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Toshiya Hari, Goldman Sachs.

Toshiya Hari - *Goldman Sachs Group Inc - Analyst*

Hi, good afternoon, and thank you so much for taking the question. First one for Haviv. You're guiding Q1 revenue down, I think, 2% to 3% sequentially. I was hoping you could maybe provide some color by end market, what you're seeing on a sequential basis?

You guys were quite helpful last quarter, diving deep into automotive, what you're seeing in China, et cetera, et cetera. So any color, any standouts to the upside or downside relative to what's typical seasonality would be very helpful. Thank you.

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Okay. Thanks, Toshiya. So again, for Q1, as you said, about 3%, I think, sequential, which is -- I would describe it as a seasonal decline for Q1. I will say that typically, in Q1, what we do see is the personal electronics market would usually show quite a significant decline, just seasonality. And we did have a pretty decent Q4 for PE. So I think that's what we expect there.

And typically, also, if you look at the markets like automotive, industrial, the decline should be less pronounced there. So that's kind of my expectation. Nothing specific that I would add on markets.

I will provide a little bit more color on Q4, especially in our two main markets, industrial and automotive. I think, again, they behaved similarly like the overall company in Q4 and also similar to what we've seen in Q3, but maybe with some -- a little bit -- small changes.

So if I start with the industrial market, as I described I think during the last call, most of the sectors that are kind of hovering at the bottom, maybe found the bottom. And then there are a couple of sectors that are still showing larger declines, especially industrial automation and the energy infrastructure market that has still not found its, I believe -- uh the bottom. We'll have to see what the first half of '25 has planned for that.

And on the automotive market, similar to Q3, we did see kind of a pretty significant weakness, maybe with the -- maybe outside of China. So it declined about mid-single digit, about 5% sequentially. But China did grow, but not enough to offset the declines in Europe, the U.S., and Japan, which is very -- it was kind of similar to what we've seen in Q3, but maybe the growth in China was less pronounced and the decline outside of China was more pronounced. That would be my high-level summary for Q4 and a little bit for Q1.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Do you have a follow-up, Toshiya?

Toshiya Hari - *Goldman Sachs Group Inc - Analyst*

I do, Dave. Thanks so much. The earnings outlook for Q1, Haviv, there's a pretty significant drop off on a sequential basis for a 2% to 3% decline in revenue. I was hoping you could kind of provide some context there. Is it primarily gross margin? And behind that, is it continued underloadings, increase in depreciation, some of the same dynamics we saw over the past 12 months? Or is it higher OpEx? Anything below the line? Any sort of additional color on sort of the drop-off in EPS for Q4 to Q1, that would be helpful.

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Sure. I think I covered revenue; Rafael, maybe you cover the other part there.

Rafael Lizardi - *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

Yeah, happy to. Okay. So maybe let me start with GPM, and then I'll go to OpEx, and then I'll go to the other income line, which is relevant this time.

So on gross margins, keep in mind that depreciation is increasing, first of all. Second, well, revenue is decreasing. That has an impact. Then depreciation is increasing. And then we are -- in order to manage inventory, we are reducing factory loadings. We've reduced some of that in fourth quarter, but we're going to reduce those further in first quarter. So I do expect GPM percent to decrease probably a few hundred basis points fourth quarter to first quarter.

Then let me comment on OpEx. OpEx will increase 3% to 5% fourth to first, and that's kind of normal seasonal increases that happen in first quarter on OpEx in addition to the overall increases in investments that we're making. Beyond that, this time it's relevant that interest income is decreasing by about \$50 million. The reason that is happening is short-term interest rates are decreasing, and that's where we invest our cash. And our cash on the balance sheet, cash levels, are also decreasing. So a combination of lower interest rates and lower cash gives you a significant drop in other income. So that's, in this case, about \$50 million less going to first quarter.

Operator

Chris Caso, Wolfe Research.

Chris Caso - Wolfe Research LLC - Analyst

Yeah, thank you. I guess first question would be with regard to the Embedded business. And we're seeing a sharp divergence there between those two businesses, particularly on the margin side. Can you give some explanation of what's going on between the Analog and the Embedded businesses, and is the reason for the decline the Embedded margins?

Haviv Ilan - Texas Instruments Inc - President & Chief Executive Officer

Chris, let me just say a few words on the revenue side, and I'll let Rafael talk about the margins over there. So again, Embedded and Analog a little bit are -- like many of the phenomena we see regarding markets, geographies, we are seeing asynchronous behavior between these two markets.

As you remember, Embedded -- our Embedded business -- grew in 2023, while our Analog business in '23 declined double digits. So we saw a later peak -- about a year later on Embedded; that's the reason we see a sharper decline in Embedded right now, while Analog in Q4 actually grew. So I think Analog is about a year maybe ahead on Embedded in terms of the cyclical behavior.

Regarding profitability, Rafael, I'm sure it's related to LFAB, but you go.

Rafael Lizardi - Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations

That's absolutely right. Yes. So the profitability, Embedded first, is revenue. As revenue drops, that clearly has an impact on profitability. But the second part that is different than Analog is that Embedded is taking a disproportionate impact due to LFAB, the Lehi factory in Utah. Because that factory, while it's going to serve both Embedded and is serving both Embedded and Analog, but it disproportionately serves Embedded. And since it's underutilized right now, it takes that hit from that underutilization, and factory loading affects Embedded disproportionately.

Dave Pahl - Texas Instruments Inc - Vice President & Head, Investor Relations

Do you have a follow-on, Chris?

Chris Caso - Wolfe Research LLC - Analyst

Yes. Got it. That's helpful. I guess the follow-up question would be some update on what's going on in China right now. You had spoken about, I guess, the auto business, again, is stronger there.

Perhaps you could talk about the rest of the business that you're seeing in China, in the industrial business, for example. And we know that you've been taking some actions to kind of take back some of the share that you may have lost when your lead times were longer. Could you give us an update on that and how that may be affecting some of the numbers in the near term?

Haviv Ilan - Texas Instruments Inc - President & Chief Executive Officer

Sure. So first, high level, our China business in Q4 did grow both sequentially, but also year over year. I think it was mid-teens or in that area for the entire China business.

I think the automotive strength, we talked about it last quarter. We're seeing the same phenomenon, meaning customers are continuing to do well. And there is a bigger share for the EV vehicle type in China, which has higher content. So secular growth is helping us in China on the automotive side.

But you also see -- and I think we mentioned it also in the previous calls -- that we had some supply limitations during the upcycle in China. And the personal electronics market was one of the main markets that suffered when we were short. We are seeing this market growing in China. It grew sequentially again nicely in Q3, but also year over year, that market grew significantly in China and also in the U.S. These are the main markets that we have our personal electronics businesses.

So overall, again, overall business in China right now is healthy.

You asked about industrial, we haven't seen yet the start of the cyclical growth again in industrial across all of our geographies. So China here is not an outlier. The strength is coming mainly from, I would say, automotive and from personal electronics.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Yeah. And let me just add a little color. U.S., China and really rest of Asia is really more flat, to describe it sequentially. Europe and Japan were down low-double digits. As Haviv mentioned, if you look year on year, you see the U.S. and China up kind of 12%, 14% in that range. And that growth was offset overall by declines in the other regions.

Great. Okay. Thank you, Chris, and we'll go to the next caller, please.

Operator

Ross Seymore, Deutsche Bank.

Ross Seymore - *Deutsche Bank AG - Analyst*

Hi, guys. Thanks for having a question. I want to ask about the pricing environment in general. You didn't mention that, Rafael or Haviv, in any of your discussions about gross margin or the competitive environment or any of the sequential weakness. But just wondered if that has changed in any meaningful way, either Analog versus Embedded or in certain geographies? Just any update on that front would be helpful.

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Yeah. In high level, the pricing environment is not -- we've not seen any change in Q4 versus what we've seen in 2024. I think we've expected -- I think we said in the beginning of '24 that pricing will go back to previous behavior, pre-COVID, where pricing will decline low-single digits like-for-like parts per year. And that's more or less what it did in 2024 as the year ended.

Of course I think I did provide some color on revenue by market. The mix has changed, right? So the selling price, if you will, has changed, because industrial in '23 was 40% of revenue. It declined to 34% in '24, and the PE market grew from 15% in '23 to 20% in '24. And that is a big change of mix, if you will.

And that's what we have seen. But the like-for-like parts has behaved as expected. And I'm not expecting that to be different in 2025, and that's a comment to go across all geographies.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Yes. Do you have follow-on, Ross?

Ross Seymore - *Deutsche Bank AG - Analyst*

Yeah, I do. A little bit of a longer-term question maybe for Haviv. Historically, the company has talked about share gains and losses in your markets being measured in basis points. I think, 15, 20, 25 basis points a year. Given the fragmented nature of it, it was kind of what you would aspire to.

It can, of course, go down or up, I guess, for kind of idio reasons -- supply shocks, those sorts of things. But now that you have supply, it seems like the world has plenty of supply, is there any reason that, that historical share gain pace would be different going forward?

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Again, when we talk about share down or up, I think the only way to really measure it is over the long term. That's always been our approach. That's the way we run the company. That's the way we behave, right?

So TI, yes, there was a lot of, I would say, a shock wave almost during COVID. It was not only supply/demand mismatch, but behavior of customers and almost anxiety of needing parts. So I think inventory was built. And I think it's still playing out. I wouldn't say that this asynchronous behavior across markets is done. We see it still across sectors in industrial. We see it differently between geographies. We even see it internally between our Embedded business and Analog business. So it's one of these things -- and I kind of hate to say it, but time will tell where we are.

I am excited about the fact that now we have the right inventory level, the right supply to support growth. I'm encouraged about our progress in the analog market. As I mentioned in our prepared remarks, we did grow the Analog business on a year-over-year perspective in Q4. It was a couple of points of growth, but after about eight quarters of decline. And I think we -- I look forward to continue to grow that business, especially when you think about the longer term. And most importantly, the secular growth in the market that we've mentioned, industrial and automotive, I'm convinced that it's there. I'm convinced that our product portfolio is improving and strengthening. And we will have the right level of capacity and inventory to support our customers. So obviously, expectation, that I have for the team, is TI will continue to compete for market share and grow it.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Thank you, Ross. Can we go to next caller, please.

Operator

Chris Danely, Citi.

Chris Danely - *Citigroup Inc - Analyst*

Haviv, I guess, just a little bit of a drill down on the end markets. How would you expect things to sort of play out this year? Maybe talk about where you would expect relative strength or not strength by the end markets? And have you seen -- would you say you've seen any change in business conditions over the last three months, like better, worse or not really?

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Yeah. Chris, as I think I told you last time we met, we call it when we see it. Meaning, I can tell you what happened; it's very hard for us tell you exactly what will happen, even for this quarter, I think I mentioned even during the last call, lead times are short. Customers are coming real time for demand. And our turn business, or what we call age in, is running high right now simply because customers are almost waiting for the last second before they make the order. And we fulfill it, because we do have the right level of inventory and of course capacity to support further growth.

I will say that I think that some of the markets -- and we've seen it through 2024 -- they are already on the cyclical upturn. I.e., we saw it in PE, then enterprise, really driven by data center joined, and we are seeing nice growth over there. And even the communications business, I would say that I think it found the bottom. We saw it somewhere, I think, in Q1 of '24 and grew sequentially since then and even returned to year-over-year growth in Q4. So these three markets, I think they are on the upturn. And I don't think that -- I expect at least that, if nothing major changes, to continue into 2025.

The big question for us is also 75% of our business -- or 70% of our business in 2024 is industrial and automotive. And here, we haven't seen the bottom yet. Let's be very clear about that. We're seeing points of strength. I've given China as an example, but we'll have to see how the year play out. I do believe at least on the industrial side that there is kind of, as I said last time, kind of this hovering at a low level. It's a great position to grow from. But we'll just have to wait and see when it wants to do it, Chris. And of course, when we see it, we'll say it.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

A follow-on, Chris?

Chris Danelly - *Citigroup Inc - Analyst*

Sure. Just quickly on Embedded. So it looks like you guys have the lowest margins there in I think over a decade or something like that. Does something need to be changed or restructured there to get Embedded back to an adequate level of margins? Or maybe talk about what needs to be done to get it to some sort of an appreciable level of margin?

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Yeah. Let me take a quick high-level answer, Chris, and Rafael will give a little bit more what's going on there. I think you're seeing a business in transition, Chris. I'm growing more excited about Embedded every quarter. I think our portfolio is strengthening, and we are winning business.

We are going through a transition, especially on the manufacturing side. And that puts pressure on the margins. But we are convinced that strategically Embedded is going to be a great contributor to free cash flow per share. And so the short answer to your question about restructuring or anything. The answer is no.

Rafael, maybe you can provide some more color on what's going on there.

Rafael Lizardi - *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

Yeah. No. I'll just add, similar to what I said in a few calls -- a few questions ago. One is the revenue is the main factor. As Haviv talked about earlier in the call, Embedded has seen a sharp decline because it took longer to get into the downturn than Analog did. But if you look at peak-to-trough, they're about the same place, Analog and Embedded.

And then the other reason is LFAB, right? So Embedded is taking a disproportionate amount of the impact from having LFAB underutilized. But let me stress, just like that takes away, it gives it to you on the other end. So when we ramp -- as we ramp LFAB, and as we move from external to internal, you're really going to like the fall-through both to GPM, but even better to free cash flow -- as we do that.

So Embedded is, as Haviv said, it's in transition. And when we're on the other side, we're going to like the results.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Thank you, Chris. And onto the next caller, please.

Operator

Harlan Sur, JPMorgan.

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Good afternoon. Thanks for taking my question. One of the metrics we look at to gauge the health of the cycle is the number of customer pushouts, cancellations, rescheduling of the backlog relative to prior quarters or maybe big changes, right, on customer forecast inside of the quarter. Has this level of activity remained at kind of normalized levels? And then maybe on another metric we look at is turns orders. And I know, Haviv, you said it's at high levels, but -- is that coming in about as expected as well?

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Yeah. Let me start with the second part of the question. I'll let Dave comment about the first part. So look, we came in Q4 at the higher side of the range, close to the top of the range. That all came from what we call the turns business. So we didn't see that clog in the beginning of the quarter, and it came in real time. So we need to see that, that continues into the beginning of this year. Of course, there is Chinese New Year right now. And we just have to see that it's not -- that it's a trend rather than anything that is a one-quarter phenomenon, but the turns business looks very, very good in Q4.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Yeah. And Harlan, when you look at those other indicators, like you brought up cancellations, we had seen those drop several quarters ago, and they continue to be at very low levels. If you look at things like revenue linearity, revenue increase through the quarter, that's very typical for us to see that. And Haviv mentioned earlier, lead times are -- remain short.

We have availability of essentially all of our products that we sell via the web available for immediate shipment. So customers can behave and have that confidence that they can get the product that we've got.

Do you have a follow-on?

Harlan Sur - *JPMorgan Chase & Co - Analyst*

Yeah. Thank you. So right before the capital management update back in August, I remember you had just received your preliminary CHIPS Act grant allocation, \$1.6 billion. That number was solidified, I think, in December, and this was not contemplated in your free cash flow per share calculation. In the CHIPS Act press release, you guys articulated some of the milestones attached to those grant dollars. And it looks like actually, many of those milestones are going to be executed in or before 2026. And that's \$1.6 billion in grant dollars. That drives an incremental \$1.75 of

free cash flow per share versus sort of what you potentially laid out in your 2026 scenario analysis. So have you mapped out that \$1.6 billion in CHIPS Act grants over 2025, 2026, and maybe have an updated view on the potential better free cash flow per share profile for Texas Instruments?

Rafael Lizardi - *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

So let me try to answer that question. First, kind of bigger picture, as you alluded to, the Department of Commerce awarded us up to \$1.6 billion in CHIPS Act funding. This will help support three of our new 300mm wafer fabs under construction in Texas and Utah. This direct funding, coupled with the ITC, will help us provide a geopolitically dependable supply of analog and embedded processing chips for years to come.

Over the life of the -- maybe the most important point is, over the life of the program between the ITC and the direct funding, we expect to receive \$7.5 billion to \$9.5 billion in total. We've received some of that already in 2024 and expect 2025 and beyond to continue. We don't have any specific details to share at this point on the cash payments related to the direct funding, but as those happens, we will share those.

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

I will just add that the math is not incorrect, but the timing is the problem, right? So I think, as you said, there is -- and we talked about free cash flow, so it also depends on when we get the cash -- we just don't have that visibility.

The milestones are related, as we I think mentioned, to cleanroom construction and tool installations in Sherman 1, which we are -- we started installing tools in the summer of '24, and that moved well. And the construction of SM2, the shell, which is not done yet, but it's moving well. The other part is more in Utah. It's LFAB2. This is where we talk about cleanroom construction and tool installations for LFAB2. But we are now only now starting the groundwork over there, right? So there is still quite a bit of execution in LFAB2. And we will see how that timing works as we continue to move forward on that execution.

Rafael Lizardi - *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

Let me add one more thing. Just given that we have been officially awarded at \$1.6 billion, we already booked that on our balance sheet. So we have a \$1.6 billion receivable. You can see that on the balance sheet. The other side of that, \$1 billion of that, decreased our net PP&E. And because that's related to a factory that's already built. \$0.6 billion of that is actually deferred liability because it's related to a factory that's not built. But the bottom line, where I'm going, is that this is already going to decrease our expected depreciation.

So with that, let me give you an update to depreciation. Depreciation for 2025, now you should expect \$1.8 billion to \$2 billion. That's slightly down from the previous expectation. And for 2026, we're keeping the range the same, \$2.3 billion to \$2.7 billion, but I'll tell you that we expect to be on the lower half of that range. That's a 2026 depreciation expectation, \$2.3 billion to \$2.7 billion to be at the lower end of that range.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

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

Operator

CJ Muse, Cantor Fitzgerald.

CJ Muse - *Cantor Fitzgerald LP - Analyst*

Hey, good afternoon. Thank you for taking the question. I know you guys are loath to talk beyond the quarter, but I was hoping you could give us a framework for thinking about gross margins beyond the March quarter.

You just gave us the depreciation. That's very helpful. Would love to hear kind of your thoughts on what's optimal inventory and therefore planned utilization beyond March? And is the March quarter kind of low for gross margin and we should start tracking higher? Any thoughts there would be very helpful.

Rafael Lizardi - *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

Yeah. No, happy to do that. It's going to be very similar to what I've said before, but it all starts with revenue. So revenue is the number one driver of gross margin, both dollars and percent going forward. You model your revenue, then you fall that through at 75% to 85%.

And then after you do that, then you have to adjust for depreciation increases. And I already gave you the depreciation numbers, so you can model that in the future. This works much better if you do full years and do it over the long term, rather than any given quarter.

And on that, the other factor that you have is the factory loadings or underutilization. Right now, as I mentioned, we expect a hit from that in first quarter, but that -- just as it's a hit sometimes, is a benefit when you go the other way. But that depends on revenue expectations. So if revenue materializes in the future, and we expect that to continue, then we ramp up the factories and that helps with the loadings, and that tends to take the 75% to 85% towards the high end of that range. If that doesn't happen, then you're looking at the lower end of that range.

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

And the last note, and I think you touched it before Rafael, is related to our execution. So of course, revenue, we want to grow it. And definitely, we want to do it faster than the market. That's always our objective.

But on the other hand, is that LFAB execution, right? We are executing our transition from our foundry business into Lehi. I expect that to have a step forward in 2025. Especially in our automotive business, we have a bunch of parts what we call -- there's a safety spec that usually the qual is a little bit more complex. It just takes a little bit longer. But we are moving well on that execution. And again, my expectation from the team is to meet our commitment to our customers and get these parts out of Lehi, as they prefer that dependable capacity. And for us, it's a way lower cost and, of course, helps as a byproduct on the margins as well.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Do you have a follow-on, CJ?

CJ Muse - *Cantor Fitzgerald LP - Analyst*

Yeah. Yes, just a quick one, Dave. Rafael, just to go back to kind of the loading question. If we do assume normal seasonal pattern for your top line into Q2, Q3, should we assume that loadings would move higher in Q2?

Rafael Lizardi - *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

Yeah, we forecast one quarter at a time, so I'm going to stick with that. But I'll also say, maybe as you're alluding to, the more revenue we have, then -- let me put it this way. We're not planning -- \$4.5 billion of inventory is a healthy level of inventory. And we would not want to be draining those levels at this point. So maybe that gives you enough to think about.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

We'll go to the next caller please.

Operator

Joshua Buchalter, TD Cowen.

Joshua Buchalter - *Cowen Inc - Analyst*

Hey, guys. Thank you for taking my question. I guess I wanted to follow up on the previous one you mentioned, not necessarily wanting to drain the inventory levels below the \$4.5 billion levels. As we think about how you're thinking about 1Q, though, is this the level you're comfortable with and you're going to manage to the \$4.5 billion? And I guess to ask more acutely, is there a near-to-medium-term inventory target on a days basis that we should be thinking about? Because I know that's obviously evolved through the last several years. I'd be curious how you're thinking about it now as we sort of are chipping closer to end demand?

Rafael Lizardi - *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

Yeah. First, let me give you a big picture, and I will give you some specifics. But big picture, inventory, the goal here, the objective is to maintain high levels of customer service while we minimize the obsolescence of inventory. We have target levels at the finished goods, at the chip level, for the 80,000 parts that we sell in different end markets. And that is done in a very rigorous and disciplined way on a part-by-part basis. So that's how we look at it. And the risk of obsolescence on this part is very, very low. These parts last for a long time. They sell to many, many customers for many, many years in very long life cycles.

Now to the specific that you asked, given how we're running the factories right now, I would expect a further increase of inventory levels going into first quarter, but probably in the \$100 million, \$100 million plus level and then potentially stabilize at that point around that level.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Do you have a follow-on, Josh?

Joshua Buchalter - *Cowen Inc - Analyst*

Yeah. Thank you for the color, Rafael. Yes, to follow up, I want to about -- there were some earlier questions about competition, specifically in pricing. I guess I wanted to ask bigger picture, not necessarily pricing related. But as some of your peers have sort of gotten through and lapped and are no longer shipping to NCRs or LTSAs, have you noticed a change in the competitive backdrop on the number of sockets that are open for competition? I'd be curious to hear about if there's any big change in competitively over the last couple of quarters. Thank you.

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

I haven't seen a significant change. It feels the same to me, kind of stable. I mean it's -- we are in a downcycle. And I remember throughout my career at TI, every time there is a downcycle, the market gets more competitive, and it's still the same now. And that's again across all markets, all geographies, but I haven't seen any significant change in the last couple of quarters, to your direct question.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Thank you, Josh, and we'll -- we've got time for one last caller, please.

Operator

Thomas O'Malley, Barclays.

Thomas O'Malley - *Barclays - Analyst*

Hi, guys. Thanks for letting me ask a question. This is for Haviv or Rafael. Just at the capital management day, you guys highlighted different CapEx ranges depending on kind of different revenue CAGRs. And I know the intention there wasn't to guide revenue. But you just updated us on depreciation in response to just the ITC and some of the grants as well. Is the depreciation being at the lower end entirely a function -- or the updated guide that you're giving today entirely a function of those tax credits and grants? Or is that a function of potentially lower CapEx as well?

Rafael Lizardi - *Texas Instruments Inc - Senior Vice President & Chief Financial Officer, Finance and Operations*

It is not a function of lower CapEx. We continue to expect CapEx for 2025 to be \$5 billion. And in 2026, as we said at the last call, between \$2 billion to \$5 billion, depending on further expectations. And we'll have more clarity on that in the second half of the year.

Haviv Ilan - *Texas Instruments Inc - President & Chief Executive Officer*

Yeah. And again, I will add, this is not -- I mean, as we said in August, our plan is still -- we like the plan. We're going to be very disciplined in executing it. We always look at the environment and what's going on. But based on what I see right now, you shouldn't expect a plan to change in terms of our Phase 1, Phase 2.

As I described, Phase 1 is serving us very well. This is as we move revenue from external foundries into our LFAB factory in Utah. And also on the analog side, we want most of our part planning on 300 rather than, for example, 6-inch fab that we are shutting down. And that's going well.

The Phase 2 is very important for our future. So we are going to complete the qualification line in Sherman 1. We are going to set the shell or build a shell in Sherman 2, and also build a shell in Lehi, so it can give us this flexible capacity phase that we are so excited about, and so are the customers.

Once they engage with us, they fully understand that not only they will have enough cleanroom capacity to grow into, but also the qualification is going to be behind them. So their parts are already running, for example, in Sherman or in Lehi. And that gives them a very, very easy path to grow their business with us without having to go through a requal and new fabs or new suppliers.

So I think that plan serves our customers well, and we are continuing to execute to it. And as you said, the slide in August, and I will probably see a very similar story in a couple of weeks, is that we want to say that we have a plan, but we do always have flexibility into the plan, especially in 2026 and 2027.

Dave Pahl - *Texas Instruments Inc - Vice President & Head, Investor Relations*

Right. Tom, you got a follow-up?

Thomas O'Malley - Barclays - Analyst

I do. Thanks for all the detail there. Last one of the call, so broader and hate to end it on this, but I just want to give you a chance to respond. So articles out on a China statement talking about dumping product in that market. I think there's an ongoing debate just around the sustainability of China longer term. I guess part of this question is can you just address what you've seen in the public there?

And then kind of the derivative of that, you're obviously growing year over year in China. You're seeing strength in China auto. You highlighted that. But outside of that, are you seeing any change in the dynamic there in terms of your ability to ship product, competition, just addressing the whole debate.

Haviv Ilan - Texas Instruments Inc - President & Chief Executive Officer

Yeah. And again, I'll probably not settle the debate; I'll just tell you what we see. And I'll start with a high level in China. It's an important market. China represents 20% more or less of world GDP, and you want to play in that market. By the way, our business in 2024 in China was at about 20%.

So we are kind of not over or underpenetrated in China, it's kind of just right at 20%.

And our commitment is to our customers. Our customers in China, they rely on our parts. They want to have the best products. They want to have the highest quality. They want to get best service. And TI is a good supplier. And on top of it, their ambition is to be global players, right? So maybe they are part of the headquarters in China, but they want to sell their end equipment to any geography. And in that sense, TI is a great supplier because we are a global player. We have a diverse footprint of manufacturing and support structure. And that's a great fit for their needs.

Now as you know, and I think this is not news, the China end market has always been competitive, and it's continuing to be. We know that they are very capable, motivated, fast-moving competition.

But I think the competitive advantages of TI allows us to compete, whether it's our broad portfolio, the reach of the channel and also our position in industrial and automotive, customers value that and want to continue to do business with TI. And we want to compete, and that's really the fact that we own our manufacturing, own our technology. I think we have the right cost structure to compete across our entire portfolio, whether it's low AUP general-purpose parts or very integrated sophisticated ASSPs that are tailored for a specific application. We don't need to sub select. We want to compete across our portfolio, and our customers there appreciate that. And I continue to see that. Specifically to your question, at this time, we haven't been notified about an investigation, and it's kind of business as usual between us and our customers in China.

Dave Pahl - Texas Instruments Inc - Vice President & Head, Investor Relations

Great. Thank you. Thank you for asking that question, Tom. And thank you, everyone else, for joining us tonight. We look forward to sharing our capital management call on Tuesday, February 4, at 10 a.m. Central time. A replay of this call will be available shortly on our website. Good evening.

Operator

Thank you. And this concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.

DISCLAIMER

Refinitiv 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 REFINITIV 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.

©2025, Refinitiv. All Rights Reserved.