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PRESENTATION

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

(technical difficulty) JPMorgan's 48th annual Technology, Media and Communications conference. My name is Harlan Sur. I'm the semiconductor capital equipment analyst here for the firm. Very pleased to have the team from Texas Instruments. We've got Rafael Lizardi, Chief Financial Officer; and Dave Pahl, Head of Investor Relations. What I've asked Rafael to do is start us off with a summary of how the team is approaching the COVID-19-driven macro downturn, the historical framework they're using as a guide to drive operational decisions, guide spending plans, and investment and capital return strategy. Then we'll go ahead and kick off the Q&A. Remember, you guys have any questions, use the Q&A button at the bottom of the screen.

And with that, Rafael, a, thank you for joining us today, and let me turn it over to you.

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

Thank you, Harlan. Good morning, and good morning, everyone. Thanks for having us at the conference. Yes. So let me -- to answer that question. As we said at the earnings call, we're looking at the 2008 financial crisis as a model to inform our decisions. If you recall back then, the entire industry, the revenues dropped very quickly and then they recover also very quickly. And then the industry had a hard time meeting customer expectations and demand and keeping lead times short for probably a couple of years until we've fully caught up. So we're using that framework to inform our decisions. That's not meant to say that we're predicting the same type of recovery. It's just as a framework to follow. So we are keeping our factories running at about the same level as they were in first quarter. What that means, with the range that we put out and on our revenue, is that we will likely grow inventory, but that will allow us to keep availability high, lead time short in an environment where our customers will have very little visibility themselves.

At some point, we're in the middle of a recession, at some point, they will have a lower demand and they'll have lower visibility. So this running the factories this way will give us that optionality so that we can respond to the customers well.

Now the key reason why we can do this is our business model and how we run the company. So as you know, our focus is on auto and industrial, with catalog parts that sell to many, many customers with product life cycles in the last years or sometimes decades. So what that does is that we have this inventory, and we can sell it for many years. So the risk of obsolescence is very, very low. To ramp up the answer on investments, R&D, that's a very long-term view for R&D, particularly with industrial automotive so we're not changing the investments there. On SG&A, we generally keep that. We always keep that really tight. So we'll continue to do that. Whatever we can cut discretionary spending we have, and we will. But of course, even in that area, we also have some critical investments like such as ti.com. And then on CapEx, we'll continue our road map investments with the -- primarily -- almost entirely with 300-millimeter investments and some of the back end related to that. And we've already broken ground on the new 300-millimeter factory here in Texas.

QUESTIONS AND ANSWERS

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

Great. (inaudible) framework. (inaudible) assume the '08, '09 financial crisis as sort of a framework for how to think about this current macro downturn? I think it's prudent, number one, but -- and I should also point out that the team drove strong free cash flow through that period of time. So -- but that's also a period of time '08, '09 where gross margins and operating margins for the team were 10 percentage points lower versus where they are today, and you still had smartphones at 28% of your overall business. Your auto and industrial was only 20% of the mix versus high 50% of the mix today. So the team has structurally better margins and mix. How do you anticipate the financial and mix profile helping to limit the downside, either revenues, up margins, free cash flow margins, relative to an '08 and '09 recession like scenario?

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

Yes. So as you point out, we are a different company than 12 years ago. And the mix of our revenue is very different. As you said, we're almost at the 60% mark for industrial and automotive. And our profitability is at a much higher point. So it's a better place to be. You have more cushion, so to speak, to drop. Revenues come in and out, and they're going to hit your margin, right? They're going to hit your profitability. But it's much better, obviously, to start from that -- from the higher point. Strategically, the best -- or the one thing I would mention is, as I said earlier, by having that preponderance of parts that are catalog and that sell to industrial and automotive that last a long, long time, it puts us in a position that we can do the things that I just described, right? We can build through this period, we can be ready with that optionality to help our customers. Because frankly, if 90% of our revenue was Personal Electronics, that turns over -- the investments there turn over very quickly. So I could build on one during the downturn. But then on the other side of it, 1/3 or half of my inventory would be bad. So it would do me no good to build under those conditions. But the way we're set up, it makes sense to do that.

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

On the -- appreciate the insights there. On the supply chain side, you have factories in the U.S., China, Japan, Malaysia, Philippines, amongst other geographies. Many of your peers have been struggling, especially with their factories in Malaysia and Philippines, and supply chain doesn't be having as much of an impact on TI. How has the team mitigated many of these issues? And is this just a good example of the team's inventory strategy, i.e., sort of carrying healthy levels of inventory to be able to respond to customers either in periods of operational supply disruptions, like maybe we are in today or in periods where the cycle is strong, and you just see strong surges in demand?

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

Yes. No, very good question. Yes. So first, as you said, is the inventory strategy. And we have followed this for a number of years now, at least, what, 5 or 6 years in different versions. And it served us very well. And like I said before, it is very low risk, and it has been. Our scrap has been and continues to be very low. That's the first thing. The second thing is that we have business continuity programs and have had, certainly since the 2011 earthquake, but even before them. But since then, we have strengthened those and some of that is the inventory piece, but a lot of it is second sourcing our suppliers, but also internally, where we have our parts that generally build -- can be built in multiple fabs and multiple APs. So that gives us a lot of flexibility.

And the last component, maybe most important, at the end of the day, is our competitive advantage of owning our own manufacturing technology. And we're maybe a bit of an outlier on that, in the grand scheme of things because, especially in Analog, we run the vast majority of our revenue to our own factories. And then specifically, 300-millimeter, right, where we have 2 300-millimeter factories today, and we're building a third one. So the combination of those things, inventory, BCP programs and owning our own manufacturing gives us the ability to go through this type of disruptions, relatively unscathed, at least compared to our competitors.

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

I do have a question from one of the investors in the audience. Is the team considering pushing out any capital spending? Or are you just going to continue the roadmap as planned?

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

Yes. We're going to continue the roadmap as planned on 300-millimeter. And that's a factory, that's a building comment because the building uses optionality too. Once we have that building, it's a onetime kind of discrete expense, it will be over a couple of years, probably 24 months or so 18 to 24 months. And once we have that building, then after that, the purchases are incremental and more tactical aligned with domain, right? So when it comes to the building, though, we want to have that out of the way. Of course, on other things, anything that like equipment, we're still buying some equipment for ATS and even some of the factories wherever makes sense to bow that down a little bit, we have. So that's -- yes, there's no question there. But on the big spending, which is to build in that one, we're moving forward with.

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

On the strong move to the consignment model, which is about 70% to 75% of your business today, you have a much more real-time read on your customers' demand profile as they'll need full products, right, when they need them. They do provide you with a forecast in order for you to maintain adequate levels of inventory. So it would seem that you have a better read on real-time demand trends and forward visibility. Is this what's giving the team a sense that off of a strong March and first half of April that demand trends going forward here in Q2 will probably continue to abate? But then on the flip side, would you anticipate seeing a strong -- would you anticipate seeing a positive inflection in demand earlier given the consignment model?

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

Yes. So first, I would tell you that the reason we think that demand will abate, as we said in the earnings call, March and April were strong, early April, at least. The reason we think that's going to abate is that we're in the middle of a recession. So with people around the world, staying at home, working from home, demand consumption is just not what it used to be and the thing at this point is a forgone conclusion and pretty much any economies would tell you that worldwide GDP is contracting, both in margin expected for second quarter. So that's where we think demand is going to be. The consignment fees don't necessarily reflect that because customers are kind of driving blind, frankly.

Now I'm going to stay away from the argument of whether it's early indicator or late indicator. I mean, people have different theories on that. We obviously like it. Otherwise, we wouldn't have it. And in fact, we continue to grow our -- whenever we can, we continue to grow our consignment engagements. We do think it's valuable. The demand signal comes in, in times like this of disruption, it's less reliable. But in normal times, those signals tend to be very reliable. It's also a little -- just one more thing that is kind of sticky with the customers once you engage with that. It helps just continue to build a relationship with the customers to support the production (inaudible).

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

Yes. Maybe just to add to that, I think we used the words before, winning and controlling that inventory, we think has strategic value. Because that allows us to keep lead times stable and product availability high. So as customers work their way through this uncertain time, and that demand does firm up, we'll have that product available so as they begin to pull on it, that product will be there for them. And so that -- we believe that, that's really important. There will just be less piles of it around the world. It will be in our control. And as that demand comes, we will be able to start maturing on our factories to feel true demand as it begins to get close. So we really do believe it's a really good model for us to operate under.

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

That's a great point. So just to build on that, not only do we get consignment arrangements, not only do we get their feed for 26 weeks or * weeks, but we also know exactly how much inventory is at their site because it's on our books, okay? So by knowing them, it allows us to manage that very well, much better. So now we know that they're running low on this. They're running too high on this other part. And we can provide that in a more real-time and optimal basis versus if you don't have that information, you're -- you tend to have too much. In some cases, it's not enough of the inventory that the customers need. That's part of the advantage of owning that inventory and controlling.

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

Along those same lines, and this is a question coming in from an investor, but given your business model that allows you to better serve customers in times of stress, given the inventory strategy, do you expect to make additional -- or do you expect to drive additional market share gains as we go through and come out of the crisis, just given some of your peers are struggling with air supply chain and value chains in terms of being able to service their customers. So is this a good -- potentially good opportunity for TI to gain some market share?

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

Yes. I think we've made the comments that it's times like these that you can make the most strategic progress, and as we've commented before and Harlan, as you've watched the industry over the years because of the quality of the markets, it's hard to gain share. It's hard to lose share. And if you look at our market share over three, five, 10, 15 years, 30, 40 basis points of share gained or lost, is hard to do, and it's really reflective of the market and the difficulty it is to gain share. But strengthening our competitive advantages in times like this when other peers can't do that, strengthening the reach of our channels, investing in virtual selling capabilities, the things that we're doing with our distribution channels, investing in 300-millimeter, continuing the investments in product development, all those things give us confidence that we can continue to make the progress that we've made. And over time, that's a huge, huge thing for us that will help us to grow the top line. So it's not one of these things that you come out of it, gaining a 1,000 basis points of share through something like this, but it's just -- it adds to that confidence that over the time, we'll be able to deliver the results that we want to.

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

Absolutely. And speaking of your competitive advantages, you guys have outlined 4 competitive advantage, 2 of them, which revolve around technology and product leadership and breadth, right? Strong #1 position in the analog market, strong #1 position in Power Management, solid position in Embedded Processing. I think you guys roll out about 300, 400 new products every year across 70 different product lines. How has COVID-19 impacted innovation, product development and new product introductions for the team?

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

It really hasn't slowed it down at all. We're able to work virtually from home. Our engineers are able to VPN in, work on designs. Our labs remained open. We've got protocols in place for the product engineers running tests, application engineers to set tests up and then run them remotely, if necessary. Virtual selling is something that we talked about on the earnings call and something that we set up and worked on starting, gosh, 3, 4 years ago, never thought of COVID-19 when we did that, so engagement with customers and helping them continue their design and efforts. So really from beginning to end, so developing products, put them -- getting them designed into customers, all of that work continues in this environment. So -- not that we would want it to continue, but we're really not slowing down because of it.

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

On the product and technology front, focusing on the Analog franchise, it's been gaining share. You're targeting 30 to 40 basis points per share on a go-forward basis. 30% market share, according to the most recent market share stats in Analog. Strong #1 position there, obviously, like I said, strong #1 in Power Management. It looks like you either held your gained share in 2019. However, your embedded processing business, MCUs and processors declined about 17%. That clearly seems to be more severe than the overall market. Any more insights on specific end market exposures? Or dynamics that drove the underperformance in Embedded in 2019?

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

Yes. And just to go back on the Analog and depending on which numbers that you look at, I think most analysts, the most numbers would have us probably closer to the upper teens to maybe into the low 20s from an Analog standpoint. And again, we would aspire to much more than 30 to 40 basis points, so I think just -- of share gains a year just because of the quality of the market and the difficulty of gaining share, in either Analog or Embedded is what [limited to that]. And I think that, that applies -- those comments apply in Embedded as well. So if you took a look at '16, '17 and really 3 quarters of '18, you'd see a significant outperformance in Embedded. In '19, we gave some of that back. You began to see some of that abate as we got into the later quarters of '19. We saw some signs of stabilization. And then certainly in the fourth quarter, that continued. We actually saw some sequential growth. So we've got work to do to have that business continue to perform like we would like it to over the long term. And we're confident that it will be -- it's a great business, and it will grow and contribute to free cash flow over time.

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

Your -- did you have something to add, Rafael?

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

No.

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

Your communications business interestingly has been sort of following the same trends as your embedded products. I don't know if there's any correlation with a more digital-age 3G, 4G legacy products may be falling off as 5G ramps, and that is also being partially augmented by growth in your Analog and RF 5G products, which are growing. Any insights there would be helpful. And after a period of pause, it looks like 5G infrastructure spending is going to start to pick back up starting in China, obviously, with the recent awarding of a whole bunch of tenders maybe starting the second half of this year. Is the team starting to get some visibility on this? And where in the Analog, Power Management, RF side does TI have a particular strength in 5G?

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

Yes. I think that if you looked at our communications market, as we noted on the earnings call, it was down 50% from a year ago. The reason it was down so much was because of a very difficult compare. If you remember, a year ago, it was because of the (inaudible) that new technologies are deployed, and specifically, fewer 5G. It was growing extremely strongly a year ago. So it was a very, very difficult compare. To your point, that there was a pause in 5G spending as well. People put 4G spend on pause, as they began to rationalize and look at their networks and began to think about the conversion over to 5G. There are economic benefits to go into 5G and networks. They get more users for every slice of bandwidth. So I don't think operators are looking at that rationalization. And so you'll have certain things that line up as we go through the balance of this year. One is just math. The compares are going to get easier. And the second thing is, at some point, those operators are going to begin to spend money. And so there is a small chance that we'll come in having a smooth gradual growth rate off of this trough in comms equipment. But if history is a guide, that revenue in comms equipment has always done choppy or lumpy. You can pick your adjective that you like the best. That's typically the way it is. So we won't try to predict when that revenue will come back. But usually when it comes back, it comes back usually pretty strong.

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

Data center has been a bright spot here given the strong pickup on the cloud spending on data center compute, networking and storage infrastructure. Not a surprise given work-from-home, remote workforce, online, everything. It's a part of your enterprise systems business, which was 6% of sales last year. You've always characterized this -- you guys have always characterized this segment as sort of whole selective participation, flattish R&D spending profile. But given the strong outlook for cloud spending beyond COVID-19, and I think the strong results within your enterprise business that has been driving and the strong focus by these customers on Power Management, high-speed connectivity, all kind of core competencies of the TI team? Is the team sort of reconsidering putting more R&D focus here on a go-forward basis?

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

Simple answer is no. I think that -- I think you described it correctly, we're selective. The areas that you talked about are the areas that we are selectively -- continue to spend. Those customers do see value in Power Management, you think the server farms, it's -- you can go from 90% efficiency to 91% efficiency. That doesn't sound like a lot, but that's a 10% improvement in efficiency. If you're spending $1 million a year in the energy costs, that's a 10% improvement. So that brings a lot of value and also high-speed connectivity. So that's where we direct our spend. But if you contrast that, that's essentially one application, and you can count the number of customers that consume those products probably on your fingers. And certainly, if not on your fingers, your fingers and toes. And if you contrast that to the opportunity in industrial, where literally, we've got 13 different sectors that we're selling into, hundreds, if not thousands of end equipments and each of those end equipments are going through content expansion. A lot of them we could describe today and spend some time going through those -- some of them were very obvious. Automotive is the other great example on the ones that's very visceral because we're all drive around in cars. And we can see those types of content expansion very easily in our lives. But that's where we know that there's a decade or 2 decades or 3 decades of roadway ahead of us. So that's why we really believe and are excited about the opportunity inside of Industrial.

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

Investor questions for Rafael. So Rafael, what do you think is the disconnect in the semiconductor, primarily the broad-based Analog and Microcontroller sector. Some companies like TI, and some of your peers are seeing softening demand trends in the near to midterm. Others are more optimistic on a second half recovery seeing minimal cancellations, minimal push out. So what is your view on why this disconnect between yourselves and maybe some of the peers out there?

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

Yes. It's tough for me to comment on how our competitors are dealing things. I know -- anecdotally, I know some of them are calling for a second half rebound. That seems speculative, frankly. And at the end of the day, just given our business model, we don't have to make that call. That's not our expertise, right? Our job is to run the company and be ready to -- for whatever the economy throws at us and not get hung up on the debate of is it going to recover, is it not. And again, as I said earlier, fortunately, and it's not luck, it's really good preparation of how we had shaped the company. We are in the relevant markets and our focus on products is on catalog products. So while it would be nice to know and have an opinion on that. At the end of the day, we're in a position that we can handle, and we can operate to handle whatever the economy throws at us. So if it -- if there is a rebound in the second half of the year, clearly, where we run the operation, we're going to be able to handle that. If there's not a rebound or if there's something worse, then we'll adjust, and we will have minimal to 0 scrap on our inventory. So we -- it would be a relatively low-cost bet that (inaudible).

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

On the -- turning to the financials, the team has driven 6% growth CAGR on your core Analog and Embedded products over the past 5 years, 6% CAGR over the past 10 years. And in line with that, you're driving an 11% growth trend on free cash flow per share. Obviously, the team will continue to drive leverage on its OpEx, given your scale. We can continue to see dollar content growth in your core auto and industrial segments combined with the market share gains. So is this the right framework for thinking about TI kind of longer-term mid- to high single-digits type top line growth and low double-digits free cash flow per share growth over the coming few years?

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

Yes. The way we think about it is very much along those lines, but there are 3 key drivers for free cash flow per share growth which, by the way, as you know, is very well, that's -- we think that is the key metric to drive long-term owner value, free cash flow per share growth -- long-term free cash flow per share growth. So the first driver is top line growth, and that is with auto and industrial, Analog and Embedded, catalog type of products, right, for the reasons that we have talked about. And we think, yes, we could probably grow that over the long term, somewhere in the mid-single digits, kind of GDP-plus range. And that's because semiconductor content keeps growing, and we're gaining market share, and we're in the right spaces. The other one is more 300-millimeter just gives you a structural advantage, a tailwind, if you win -- if you would, on that front to drive more free cash flow. And then the last one is what do you do with the capital that you generate, and we allocate that very efficiently back to the owners of the company. One of the ways we do that is with buybacks, right? And as we -- I think we have bought back shares every single quarter for the past 15 or 16 years. And what that does is that it reduces your denominator, right? It buys out a -- the short-term owners and the long-term owners have a bigger call on the future cash flows of the company and the free cash flow per share then gets additional fuel to grow.

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

On the capital return side, focusing on the dividend, again, a pretty stellar track record here. You've been growing your dividend, whether you look at it 5-year, 10-year CAGR. I mean you -- 5 years, 10 years, you've been growing at a 20% CAGR. Looking out over a longer period of time, should we assume that dividend will -- should approach free cash flow per share growth? Or do you expect that the rate of dividend growth is probably slightly better than free cash flow per share growth? How do investors think about that?

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

Yes. Yes. So I'm quickly going to step back. As I said in the question earlier, our goal is to -- allocating capital is very important. It's one of the most important thing we do. And when it comes to returning the cash to the owners, we -- our goal is to return all that free cash flow to the owners of the company. We do it through dividends and buybacks. And when it comes to dividend, the goal is -- objective is sustainability and growth. So we want to be able to sustain the dividend, and we want to be able to grow it. And as you said, we have been growing at a pretty high clip for the last 5-plus years, really 10, 15 years. But at some point, that growth approaches the growth in free cash flow per share. So yes, so the 20% is bound to come down over then.

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

Given the competitive and financial advantages of the 300-millimeter manufacturing strategy, and maybe for those investors that haven't been keeping as close watch on TI, can you just give us an update on your new plant in Richardson, Texas?

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

Sure. So we broke ground, in fact, this week or last week, broke ground on the building itself. We have spent the last 6 months or so building the parking garage that was needed to make room to build the factory in the parking space that we had before. So now we're -- we [face that garage], it looks really nice. And now we're starting the actual building for the factory. And that's going to take 18 to 24 months to get built, as I said earlier. And once that's built, that will give us optionality to equip it as demand requires, or as our expectation of demand requires. And that's a more incremental CapEx expense.

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

I guess we're running out of time here, but my last question to you would be, if the business environment were to take a big step down from here, how much further can the TI team sort of flex its OpEx lower without major headcount reductions?

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

Yes. So we have -- there's variable costs that we have in our model between profit sharing and bonus. And those adjust somewhat from (inaudible), in some cases, in other -- for the bonuses is driven by the Board's decision on assessment of our performance in an absolute and relative basis. So those things, again, would definitely adjust depending on the magnitude of the drop in revenue and the environment. Beyond that, we run the place pretty tight. So beyond that, what's left is mainly people. And as we have talked about earlier, our view is that these investments are very long term. So their focus on 5 to 10 years from now, and not what happens in a year or 2. So for the moment, we have no plans on making any adjustments -- any structural adjustments to that.

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

Great. Well, with that, we're just about out of time. Rafael, Dave, always appreciate the insights and the longer-term view on the business and on the industry. Thank you very much for joining us this morning.

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

Thank you very much.

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

Thank you, Harlan. Bye-bye.

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

Bye.
