Inside Texas Instruments: Last Quarter's Progress

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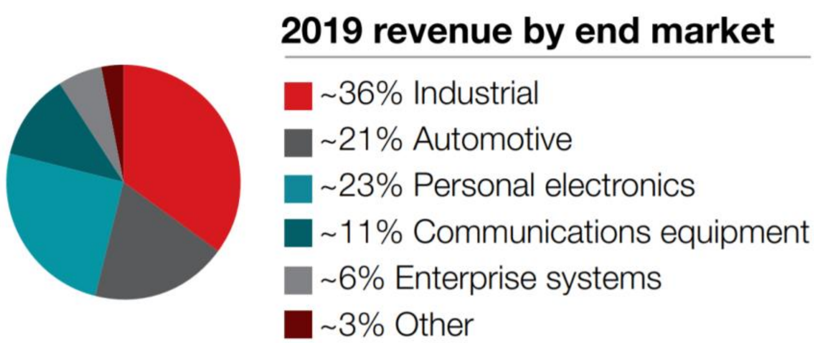
- Revenue dropped 12% from a year ago, mostly due to the automobile sector.
- Other sectors showed unexpectedly high demand.
- Texas Instruments' strategy of holding more inventory to meet all possible market scenarios is paying off.

Texas Instruments' strategy for getting through COVID is to essentially keep business as usual: maintain spending on research and development and capital expenditures, since that helps the business grow in the 2-5 year timeframe, and maintain high levels of inventory of its products to meet customers' demands with no delay in shipping. This strategy proved successful during the second quarter, where the demand for TI's products remained higher than expected for almost every product category except for automobiles. Because of car factory shut downs throughout the first half of the quarter, auto revenue dropped a whopping 40%. This was the main reason for TI's drop in revenue this quarter (down 12% from a year ago) – without the auto sector, revenue would have been up 8%. The auto sector is TI's second largest sector by revenue, so the COVID implications on the auto industry will continue to affect revenues, but the big picture for Texas Instruments is a lot better than a "12% decline" looks on the surface.



Management keeps stressing through today's current crisis that it remains committed to its driving principles: to act like owners, to adapt and succeed in an ever changing world, and to be proud of the company they have created. The first principle, acting like owners, shows up in how it uses its cash. By not delaying construction on its new factory in Texas and by not cutting spending on research and development, management is not hurting future growth to preserve today's profit. (It helps that TI has the financial strength to do this.) The company has also continued to return all free cash flow back to shareholders through dividends and repurchases.

One of Texas Instruments' greatest strengths, its product and customer diversity, helps it live up to its second principle: to adapt and succeed in an ever changing world. It has over 100,000 customers and some 80,000 different products. Because it decided to hold higher inventory levels through the quarter, it was able to respond to its customers' increased demand. This product breadth is also one of the advantages TI has over a potential Chinese threat. For years, China has been trying to bring semiconductor manufacturing in house but hasn't had the technology to keep up with Texas Instruments and its peers. Given today's political climate, the question of "what will happen if China does eventually succeed?" is once again on most analysts' minds. Texas Instruments' answer: "it's mighty hard to replicate a business that has 80,000 products", especially since the products typically sell for less than $1.

It is nice to see the strategy TI laid out three months ago paying off so soon. There is no doubt that it has been negatively affected by COVID due to the auto industry, and the rest of the year is still very uncertain, but TI has the financial strength to get through this time period while still rewarding shareholders. Historically, it is during tough market conditions like these that strong companies can gain market share, and we expect TI to do just that in the coming quarters.