Bird's Eye View of Texas Instruments, Focusing on Capital Allocation

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Dave: All right folks. Welcome to Investing for Beginners podcast. Today we are gonna do a Bird's Eye View. We're gonna take a look at the company, Texas Instruments and their Capital Allocation, and we're gonna use this as a case study of something that you would want to use to understand the basics of capital allocation and a template for other companies that you may wanna look for.

To replicate when you're trying to find great investments. So, great, great company. For those of you not familiar with Texas Instruments, um, I guess a very brief, like a 32nd idea of what they are. They focus on analog semiconductor chips, and so it's not as sexy or fancy as something like Intel, AMD, NVIDIA, and TMSC, but it is a very integral part of.

A lot of industries, in particular the car industry, and they also have been around for a very, very long time. And most of us are probably familiar with Texas instruments from their lovely computers that we all used to use in the higher math that we all hated in high school. So , that's probably a good introduction to Texas Instruments.

So I guess let's talk a little bit about capital allocation and what exactly that means. So would you like to fill our good listeners in? When we're, when I, when I say capital allocation, what does that mean to you? It's basically

Andrew: what does a management do with its profits? So there's, I kind of think of it like three different categories of capital allocation and then there's like subsets within those three categories.

Um, but let's think about. They can reinvest it back in the business, grow the business, they can give the money back to shareholders, or they can basically buy another business. And whether that helps the current business or that's a completely new business. Companies do both. So those are kind of the three buckets that I think of for capital allocation.

And in the case of Texas instrument. They do a lot of number one and number two, which means they reinvest in the business through a lot of, um, working capital, which we can cover in a little bit. And they also.

Give a bunch of cash back to shareholders through very generous dividends and buybacks. Um, I will wanna put a disclosure in the beginning.

I own Texas Instruments. It's something I've recommended in the past. Dave, you owned some too. Mm-hmm. . So we might not be completely unbiased on this, but, um, the facts of the facts of the numbers are the numbers and they are definitely one of the better capital allocators. Out of all companies. Not even just in the

Dave: semiconductor industry.

Yeah, exactly. And I think one of the things that, that I like about the company, and one of the things that I think that is kind of interesting is if you look across the sphere of, of businesses out there, when you think of great out capital allocators or clean balance sheets or Queen financials, Texas Instruments is always one of the companies.

Across investors, it kind of always rises to the top. As a great example, when you talk about these kinds of ideas, because their financials aren't super complicated, there's not lots of moving parts, if you will, and generally it's easy to understand. They aren't. They aren't playing with a lot of different, different parts, which can make, sometimes it can be very, very difficult.

And basically they do what they do and they do it really well. And they make a lot of money, and then they, they allocate those, those funds really, really well. So I guess let's talk about, I guess the, the, the core of what Texas instrument does, kind of around the idea of, of free cash flow and kind of how much of a mantra that is for them.

Andrew: Yeah, go ahead. I mean, I know it's a theme that they pound the table on pretty much with every, every time they

Dave: open their mouth. Yep. Pretty much. So I, I noticed, uh, when I was doing research on the company, I noticed that at the beginning, at the end of every earnings call, they have this little. I guess talking points regarding free cash flow and how important that is to the company.

So they start all the calls with those, they end it with the same thing. If you read their financial reports, whether it's the 10 K or the 10 Q, the annual or the quarterly reports, they do the same thing. They have the same kind of structure in there, and the first. Part of the of Every 10 K has a little section about the importance of free cash flow to the company and how important it is for them to generate.

A certain level and more so that they can return money back to us, the shareholders. And that's really the whole mantra of the company. And it's their, it, it's, it's their working premise and that's what they really try to focus on. It's even in their proxy when I, when I read their, their proxy, which talks about voting rights and pay for the management.

And the, the board of, of executives free cash flow is, is littered throughout that as well. So it, it's. A very, very important part of what they do. And maybe you could, maybe you could kind of explain briefly what free cashflow is when we, we throw that term around. What does that mean?

Andrew: Yeah. Basically the cashflow that's available to investors.

Um, so it's a little bit different from profits, but that's a similar kind of idea where profits will tell you like, Let's say we started the business and it's the year 2023, and we made this, we, we brought in this much cash and we paid out this much in expenses. So for the year, we have a profit and loss.

But if we're talking about running a business for 10 years, then there's some stuff that takes longer than a year. So like if we were having to build a, a big semiconductor, Fab like Texas Instruments has, then there's gonna be cash flow changes that go along with that, which are bigger than just one year.

So that's why the difference between cash flow and profits is cash flow is taking more of a long-term approach and really looking at what's the actual cash going in and out and not necessarily what's on what's on our profit and loss every year. And that's, I. All the greats talk about it, right? Uh, Warren Buffet talks a lot about free cash.

Even Jeff Bezos, he e ever since ipo, I, Amazon IPOed, he was beating the drum about how they were focused on free cash flow. So it's, it's not necessarily this new under the sun concept, it's something that's as old as time, but it kind of shocks me that so few companies seem to focus on it and focus on other.

Kind of more glamorous metrics than something that's so practical, which is the free cash flow that's flowing through the

Dave: business. Right, exactly. And I, the thing that I love about that example with, with Jeff Bezos, if you look at Amazon's financial statements, typically the normal order, if you will, on the 10 K, are the annual report goes like this income statement balance.

Free cash flow state or cash flow statement, that's usually the order that they go in. Sometimes the companies will flip 'em around a little bit, but Amazon, because free cash flow is such a big part of theirs, they list the cash flows, the statement of cash flows first before they list anything else. So that's the first thing that you look at when you read the financial numbers of Amazon.

And so he did that way back when because to him that was their focus and he wanted, that's, that I guess, is a subliminal way of. Showcasing that this is what's really important to us and what and what should be important to investors when you're analyzing a company like Amazon. And likewise a company like Texas Instruments.

And the thing that I find fascinating about the whole idea about cashflow is, It really underlines the profitability of a company and the business that they're operating in, because if they don't do it profitably and make money on the things that they do, whether it's selling an iPhone or whether it's a Netflix subscription, easy for me to say.

Uh, Either one of those, if they don't generate a profit, a company can't have cashflow and cashflow. The way I've always thought of it is like, it's the, the cashflow statement is really the, the, the checking account for the business. That's the money that they actually use to buy and sell things that they need to do to operate the business, whether it's paying employees or whether it's buying.

Inventory to sell at Walmart? It, it's, it, it's, that is all contained within the cash flow statement and because. Cashflow is such a big part of what Texas Instrument does and why they focus on it so much. It also indicates how profitable the company is doing what they do and that kind of allows them to use that money to, to allocate to in to shareholders.

And so I guess maybe we can talk a little bit, can we kind of segue into, from the, the cashflow. So now we've talked about that and we think, okay, hey, they make a lot of money, so now. What now it comes down to what do the people in charge do with all that money?

Andrew: Right? And I would maybe start with the idea, why does that matter?

Mm-hmm. . Because I think there's a lot of focus on income statements and like what's your profit and loss? So if I were to come to you as a beginner investor, Dave, how would you describe, why does that even matter? What you do with the cash flow?

Dave: What it matters with the cash flow, it really determines. A, what the company is going to do from today going forward, and how are they going to reward shareholders for giving them their hard earned money to invest?

And the more cashflow that a company generates, the more options they have to either grow the business. Give money back to the shareholders or do all the above. So the three categories that you mentioned earlier, whether it's reinvesting, whether it's giving money back to the shareholders, or whether it's buying other businesses, those are all parts of, those are all components of a company growing or returning.

Investment to shareholders, which encourages shareholders to give more to the business and also attract more investors over time so that they have a liquidity so they can keep doing what they want to do. And so it's just kind of this reinforcing circle, I guess, if you will. And that's why cash flow is such an important concept and what is such an important idea, and that's why guys like Buffet have been, you know, banging their drum about cash flow.

And keep in mind, he's been banging the drum about this before there was even a cash flow statement. So the cash flow statement as far as a function of being able to read is a newer idea. Uh, don't hold my feet to the fire, but I think it came around in the eighties or nineties, so it's not, it's not a, it's not an old time thing.

So like in 1957 when Buffet started, his, his partnership, they didn't have such a thing and so, but he's been talking about it since then. So it's, it's, it's a concept that's been around in finance for a long time, even though the gap accounting or the accountants didn't recognize it separately as its own statement.

So I think that just kind of illustrates again how important this idea really is.

Andrew: It really, really is, and it does. The cash flow statement does fill in a lot of the gaps of things that just the income statement and the balance sheet won't always show. And a lot of that comes down to capital allocation.

I mean, just as a last example, and then we'll move on to the next point. A business can grow. Really, really fast if it's raising capital. So, you know, we like to talk about diluting, right? Which would be the opposite of giving capital back to shareholders. Now you're taking it in. So I could make my business look so much better than somebody else's, cuz I can grow at 30% per year.

But does that, does that, my business. A good investment for other people. Well, if I'm giving away the whole business to the rest of the world for peanuts to, to get, to get a bunch of cash to grow the business, well that's fine. But if there's nothing left for you because the, the person's always raising capital, then that's like an example of capitalization that doesn't do well.

So that's why it's important because growth is great, but growth at all cost is not great. Mm-hmm. and it. It won't. Over the long run, it won't result in great returns for investors if a, if a company's not managing their cash flow well and being good capital

Dave: allocators. Yep, exactly. And I think that's one of the things that sets, like guys like Warren Buffett apart from other investors, is his capital allocation skills.

Everybody focuses on his ability to find these great companies. But the blunt factor of the matter is, is that if Berkshire wasn't producing a lot of cash and a lot of free cash flow, he wouldn't have the resources to go out and buy those things that he's done. And it's, and it's not just in, everybody focuses on the stock.

Picking portfolio. But if you think about him buying companies like Geico and buying companies like National Indemnity, the insurance company, and buying companies like, you know, um, I'm gonna blank on some of 'em now. Of course. These candies. Yeah. Seize candies. Perfect example. All these companies throw off a ton of cashflow.

Were great investments for the business, which in turn became great investments for investors in Berkshire because it gave Warren a lot of extra dry ammunition or, or firepower to go out and do all these things with his capital allocation, which in turn drives more returns for the investors. So let's, I guess let's talk about, I guess, Texas instruments and maybe their capital allocation and what, what maybe sets them apart from some of their competitors or some of their.

Andrew: I mean, do we talk about a numbers perspective or a bigger picture? Um, it's hard to explain maybe without like getting too into the weeds. Mm-hmm. , but I'll try to give like a good example. So when we think of how Texas Instruments makes their money, Dave mentioned at the beginning how. They're an analog semiconductor, so they're making a lot of these chips which form the brain of a lot of different electronics that go into anything and everything from appliances to cars, to obviously phones.

Yeah, thank you and, uh, and electronics. Um, on the analog side, it's a lot of the more simpler things like cars. Where Texas instrument sets themself apart from a lot of their competitors is they build those own, those factories that make the semiconductors, they're called fabs, so they own and build a lot of those, rather than outsourcing that to a different company, some of their competitors don't have nearly as many fabs as Texas instrument stuff does.

And so if a business like Texas Instruments can do that well and it can give them a competitive advantage, then that becomes a good form of capital allocation. Because in general it's a lot, you don't need much capital to, to have somebody else do it. Mm-hmm. . But if you can do it yourself, you can pocket more of the profits and you have more control over the product.

So something they've done lately is they've, They've, and again, I don't wanna get too technical, but they changed their wafer. They upgraded their wafer to a bigger, it went from 200 to 300 millimeter. And so basically they're able to pack more product. in each wafer that goes out. And that's important because to make a wafer is very, very expensive.

I mean millions of dollars and, and these very expensive control rooms and machines and it's a very expensive process, so it's hard to be efficient in it. Mm-hmm. . But they were able to do that and that helps give them an advantage over their competitors, cuz now they can produce more at a lower price.

and that's just more profit for the company. And if you can do that, um, sustainably, and you don't have to spend hundreds of billions on these fab. , you get good returns on the fabs and it's a good competitive advantage and good capital allocation, which is something that Texas Instruments has done really well.

Dave: Yeah, really, really well. And that would, would that fall under the, I guess, the reinvestment part of, of the capital allocation? So they've chosen to, to improve their, I guess, efficiency of what they're producing and giving them a leg up on their competitors and that you would find. You would find the money that they're using to do that on the cashflow statement under the CapEx, correct?

Yes. Like that. That or capita allocation or? Expenditures. Thank you. That's the right word. looking for the word. All right. So that's one, I guess leg of what Texas Instruments does. They also have two other legs that they kind of use, and this is, I guess, would fall under giving back to us. So what would those two legs be?

Andrew: Yeah, I mean, I love both of those. I love when companies give me back. , um, it's dividends and buybacks. Mm-hmm. , and I think we know what dividends are. Those are those checks that come to us every quarter. Part of the profits and buybacks are great when they're done at the right price because they basically give us a bigger ownership stake in the business.

Um, so what, what part of that's your favorite? Cuz I mean, they do both really

Dave: well. , I think it's, I, I don't know that I could, could. I don't know that I could differentiate between the two. I think the strength really of what they're doing is, is the combination of both at the same time, and because each kind of feeds on each other and the as they continue to grow revenues and then they return.

More money back in, in share buybacks that just gives us a bigger piece of the pie of what they're earning. And it also gives us a bigger piece of the pie of the dividend that, that they're earning too, because they're reducing the share count, which means that I own more of the company every time they do that, which means that the dividend that they give me is, is, is, is a bigger piece of the pie.

And I'm gonna, uh, I'm gonna throw three numbers at you. So these are coming from. The investor relations page of Texas Instruments. So this is something that we haven't talked about before, but something that's really cool is each company has an investor relations page. So you can just type in Texas instruments, uh, investor relations into Google and you'll go directly to their page.

And whether it's Microsoft, apple, Texas Instruments, whoever, they all have this, and that's a great resource to go find investor. Presentations, uh, quarterly earnings, financial reports, the 10 k, the proxy, you name it, and some of. Better run companies, shall we say. I'll say that nicely. They have a little more, I guess, information that is you don't have to go hunting for.

And Texas Instruments is one of those. So they have three metrics that they share on their investor relations page. One is free cashflow per share, which we just spent a little bit of time about. So talking about over the last 18 years, they've grown that free cashflow per share at 11% a. Annually, so, which is a huge number, dividend growth.

They've had 19 consecutive years of dividend increases and a 25% kg from 2004 to 2022 and the share count reduction, they've had a 47% reduction in shares since 2004, which is huge. So they've, they've reduced their outstanding shares by almost half in the last 18 years. And

Andrew: that doubles. Sorry to interrupt.

Mm-hmm. , that doubles your investment. . If even the business doesn't grow, they cut shares in half. You've just doubled your investment because now you have twice as much of a slice of a pie of the company.

Dave: Right? Right. Exactly. And so I think those three numbers, when you look at that on their investment relation page, Really tells the story about what kind of capital allocators this company is and how important it is to them.

Because one thing that you'll find out very quickly about investing is no company is gonna publicize or make, uh, a big deal about that's not in the benefit of the company or the shareholder. And so they're not gonna highlight something that's a wart. They're only gonna highlight things that are positives for the company.

And this is definitely a very, very big positive. And it's a big positive for shareholders too, because they. They put it so much front and center that you know that that's important to them and they're gonna execute on that. And I guess the last thing that I'll kind of share about all this is that every company has, every quarter they have earnings calls that they'll do where the, the c e o and other, other management will come and talk to analysts and sometimes individual investors about the performance of the company for the last three months.

Texas Instruments also does a separate Capital Investment Day, where they have the C F O who's in charge of the company, of the finances for the company. He come and he comes and does a separate presentation about the capital allocation of Texas Instruments. And they actually did their, their call today, so I haven't been able to listen to it.

But they have their, their presentation slides already up and so you can see what the company is projecting for the year, what they did for last year, and they grade the. And so they have goals that they set in black and white of what they're trying to do. So, you know, as an investor, this is what Texas Instruments goals are for the year.

And if they follow and execute on their goals and their plans, this is what we can expect as an investor in Texas Instruments. And it's all right there in black and white. So there's not a lot of ambiguity and there's not a, like, I don't know how well the company's gonna do this year. They're telling you, Hey, this is what we think we're gonna do and this is what we think.

Coming in the future. And the C F O for Texas Instruments I think has been there for about 18 to 20 years. So he's a smart cookie and he is got a lot of experience and he knows what to expect. And so this is another indication to me that these, these people that are leading the company are, are. Are fanatical about capital allocation and it's very, very important to them.

And so these are all great things to help as investors. And when you're looking at other companies, you, you hope you find things like this. You won't always, unfortunately, I'm not gonna, not to cover cover up the truth, but, uh, this is, I guess, a great indication of the company. So, All that to say ? Um, I, I like both of them in combination.

I probably like the, the, the cap, the, the share buybacks a little bit more than the dividends. And I, I know that's, you know, probably gonna rock some people's worlds, but, The way that I, the way that I look at it is when they do share buybacks, that to me indicates that they believe that the company is undervalued.

That's especially a company like Texas Instruments, they're telling me that they think that the company is undervalued because they're spending three to $5 billion a year of buying back their own shares when they could use it to invest in something else. And so when they do that, they're, they're, they're telling me that, Hey, my company's undervalued.

and you're getting a lot of value by me doing this because they're giving me more pieces of the pie, a bigger piece of the pie when they do that. Dividends once. Dividends are awesome and I love dividends because they also can help in that whole compounding idea that we've talked about many, many times.

But the one, I guess, Drawback to dividends is, it's a chain around your ankle is once a company starts to issue a dividend, they have to keep doing it because once they do stop, for whatever reason, let's say the Texas had a horrible year and they decided to cut the dividend, that would be. Really bad.

Wall Street does not like when companies cut dividends. And so I'm not saying it's a negative, but it's just, it's something to, to kind of keep in the back of your mind. And the, the whole reason I bring that up is until a company that I own is got a huge anchor around the, their ankle right now with, with the dividend and the company is, is hemorrhaging money.

And there's a lot of pressure to cut the dividend, but if they do that, the stock price will fall even farther than. already, so it can, dividends are awesome. And when companies are doing great, that's I guess my only drawback, if you will, to dividends. So Andrew, I know you wanna counter with something on that.

I can

Andrew: see. No, I just wanna ask, is it a shackle or is it a responsibility? Uh,

Dave: Really, you know, with a company like Texas Instruments, I would say it's a responsibility with, with a tell right now. It's a shackle, , it's, it's an anchor dragging 'em down because they, they need the money to, to keep doing what they're trying, you know, trying to turn the company around.

And when they have that shackle or ankle around their, their, their neck, they can't really do it. So it's, it could be, it can be a problem when a company's in trouble, but Texas Instruments is way on the other side of that.

Andrew: What would you say is a drawback of buybacks? Because I think it's easy. I'm not like the biggest fan of buybacks, obviously, and dividends.

Um, but you know, we have to be careful as investors because one company's buybacks might not be as good as another company's buybacks. So what's a drawback or a reason why a company shouldn't do a buyback? Or what's like an example of a company doing a buyback not in a good.

Dave: Um, I, I, well, I think the easiest, the easiest way to, to think about that if, from, I guess my vantage point is when you see management just buying back shares because that's what's in vogue and everybody else is doing it.

And in, in some cases, if a company is in Uber growth mode, and then they're also buying back shares, i e. Why are they doing that? You know, they're, they're hemorrhaging money and they're not cash full positive. They're hemorrhaging money, but then they're announcing that they're gonna buy back shares. That makes zero sense.

And it's, it, to me it's a, it's a really poor allocation of money that they have, cuz they have a lot of cash on their balance sheet from when they IPOed a few years ago. But instead of using that, Buttress what they're doing on the income statement or the operations. They're trying to give money back to shareholders to offset the fact that their share prices is hemorrhaging so badly.

And that to me is a poor allocation of, of capital. And there's other companies in the market like that that, that are huge growth mode, or their stock prices, you know, gone up 145% over the last year and a half and they're buying back shares. You know, is that really the best time to do that When the price is trading at it's, you know, five times, it's all time high.

No , that's not, you know, the best time to do sh share buybacks. And this is what Buff has talked about many times, is he's gonna, he's gonna do them judiciously when he thinks that a, he doesn't have any other better use of the capital and. When he thinks his, his, the, the value of his company is selling below what he thinks it's worth.

And so that's why you don't see Berkshire just doing blindly three and a half billion dollars every single quarter. He, it, it, it, it, it ebbs and flows based on what he thinks the company is worth at, at a particular time. And so I think that's the, the more judicious way to do it than just doing it. And Perfect, perfect, perfect.

Case in point is Texas Instruments right now. is working on building out another foundry, or you know, another production plant for their fabs. And so they're spending more money on CapEx than they have over the last 10 years in the last two or three years because they're trying to expand their capacity.

Therefore, this last quarter, they didn't buy back any shares. And so that indicates to me that, hey, My capital allocation is important. Giving back is important, but I'm gonna do what's best for the company now because I know that that's gonna give me more free cash flow next year that I can give back more to the investors then.

So when, when you see companies just do it blindly, I, that's what I don't like. What about you?

Andrew: Yeah, that's, that's, that's exactly right. Um, and it does go to what kind of stocks you invest in. So if you're, Gonna buy a gross stock, or you're gonna buy an expensive stock, then they should be doing things that growth stocks do, which is reinvesting heavily in their business, not giving that money back.

So I think that's a, that's a greater distinction. And I mean, You asked, um, what do I not like? I don't like when they buy back stock and it doesn't do anything. And what I mean is when they buy back stock, your slice of the pie is supposed to be shrinking. And there are times when companies do that and they actually don't shrink the pie very much.

And that's because sometimes companies will. only buy back stock to offset the stock options they gave to their employees.

Dave: Meta , .

Andrew: Not to throw any companies under the bus

Dave: meta, uh, .

Andrew: Or if, if, if it's just done like Dave was saying, at a super expensive price, then the amount of shares that you're gonna see get reduced are not very much because the company's just buying these shares at such a high price.

So how I like to look. I don't look at like, did this company buy 30 billion in buybacks? I like to look at what's the share count and how is that, how is that changing every year? So Texas Instruments, great example again. Um, they've done it by a little over 2% a year over the last nine years. If you take the compounded number and it has abdin flowed like you were saying.

or you could just take the number from their investor relations, page two, they reduced it by 49% over that time period. So both of those numbers are really, really good and that shows that they're actually making progress on their buybacks, which is what you wanna see as well.

Dave: Anything else that you'd like to add, sir? Nope. Okay. I think that's probably a good place to,

Andrew: okay. Alright, .

Dave: All right. Okay. I'll go ahead and count out. I have a one and two and three. All right, folks. Well, with that, we will go ahead and wrap up our conversation on a bird's eye view of Texas Instruments and their capital allocation.

I hope you guys enjoyed our give and take and our analysis of a company like Texas Instruments, and I think it's a great example of a company that does capital allocation really, really well. And has a nice clean balance sheet for you to look at so you can examine all the things that we're talking about as well as our cash flow statement.

If you have any questions about anything that we talked about today, capital allocation share, buybacks, dividends, any of those kinds of terms and terminology, please check out our website, reinvesting for beginners.com. We have a huge search bar at the top with all kinds of resources hidden within that search bar to help you learn more about this terminology that we talked about.

Sometimes investing can be a little overwhelming. And there can be a lot of jargony stuff, and we try our best to eliminate those or explain the terms, but sometimes people come away with things that they may not quite understand, and that's a great resource to help you get a better understanding of that and many, many other topics with over 1200 blog posts there for you to peruse at your leisure.

So without any further ado, I'll go ahead and sign us off. You guys go out there and invest with a margin of safety, emphasis on the safety. Have a great week and we'll talk to y'all next week.