TEXAS INSTRUMENTS INC
Form 10-Q
May 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2015

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________ to ___________

Commission File Number 001-03761

TEXAS INSTRUMENTS INCORPORATED

(Exact Name of Registrant as Specified in Its Charter)

Delaware	75-0289970
(State of Incorporation)	(I.R.S. Employer Identification No.)

12500 TI Boulevard, Dallas, Texas	75243
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code 214-479-3773

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x		Accelerated filer	¨
Non-accelerated filer	¨	(Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No x

1,040,363,377

Number of shares of Registrant’s common stock outstanding as of

April 29, 2015

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements.

Consolidated Statements of Income

(Millions of dollars, except share and per-share amounts)

	For Three Months Ended March 31,	
	2015	2014
Revenue	$ 3,150	$ 2,983
Cost of revenue (COR)	1,334	1,376
Gross profit	1,816	1,607
Research and development (R&D)	338	366
Selling, general and administrative (SG&A)	439	479
Acquisition charges	83	83
Restructuring charges/other	(2)	(11)
Operating profit	958	690
Other income (expense), net (OI&E)	4	6
Interest and debt expense	22	25
Income before income taxes	940	671
Provision for income taxes	284	184
Net income	$ 656	$ 487
Earnings per common share (EPS):		
Basic	$ .62	$ .44
Diluted	$ .61	$ .44
Average shares outstanding (millions):		
Basic	1,046	1,081
Diluted	1,061	1,096
Cash dividends declared per common share	$ .34	$ .30

As a result of accounting rule ASC 260, which requires a portion of Net income to be allocated to unvested restricted stock units (RSUs) on which we pay dividend equivalents, diluted EPS is calculated using the following:

Net income	$ 656	$ 487
Income allocated to RSUs	(9)	(7)

Income allocated to common stock for diluted EPS	$ 647	$ 480

See accompanying notes.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(Millions of dollars)

	For Three Months Ended March 31,	
	2015	2014
Net income	$ 656	$ 487
Other comprehensive income (loss), net of taxes:		
Net actuarial gains (losses) of defined benefit plans:		
Adjustments	(10)	(2)
Recognized within Net income	10	10
Prior service cost of defined benefit plans:		
Recognized within Net income	1	—
Other comprehensive income (loss)	1	8
Total comprehensive income	$ 657	$ 495

See accompanying notes.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Consolidated Balance Sheets

(Millions of dollars, except share amounts)

	March 31, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 1,242	$ 1,199
Short-term investments	2,062	2,342
Accounts receivable, net of allowances of ($12) and ($12)	1,394	1,246
Raw materials	107	101
Work in process	906	896
Finished goods	831	787
Inventories	1,844	1,784
Deferred income taxes	340	347
Prepaid expenses and other current assets	810	850
Total current assets	7,692	7,768
Property, plant and equipment at cost	6,177	6,266
Accumulated depreciation	(3,419)	(3,426)
Property, plant and equipment, net	2,758	2,840
Long-term investments	232	224
Goodwill, net	4,362	4,362
Acquisition-related intangibles, net	1,822	1,902
Deferred income taxes	174	172
Capitalized software licenses, net	73	83
Overfunded retirement plans	128	127
Other assets	105	244
Total assets	$ 17,346	$ 17,722
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt	$ 1,000	$ 1,001
Accounts payable	432	437
Accrued compensation	349	651
Income taxes payable	75	71
Deferred income taxes	4	4
Accrued expenses and other liabilities	426	498
Total current liabilities	2,286	2,662
Long-term debt	3,638	3,641
Underfunded retirement plans	253	225
Deferred income taxes	403	399
Deferred credits and other liabilities	397	405
Total liabilities	6,977	7,332

Stockholders’ equity:		
Preferred stock, $25 par value. Authorized – 10,000,000 shares.		
Participating cumulative preferred. None issued.	—	—
Common stock, $1 par value. Authorized – 2,400,000,000 shares.		
Shares issued – 1,740,815,939	1,741	1,741
Paid-in capital	1,410	1,368
Retained earnings	29,948	29,653
Treasury common stock at cost.		
Shares: March 31, 2015 – 696,401,920; December 31, 2014 – 694,189,127	(22,199)	(21,840)
Accumulated other comprehensive income (loss), net of taxes (AOCI)	(531)	(532)
Total stockholders’ equity	10,369	10,390
Total liabilities and stockholders’ equity	$ 17,346	$ 17,722

See accompanying notes.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Millions of dollars)

	For Three Months Ended March 31, 2015	2014
Cash flows from operating activities		
Net income	$ 656	$ 487
Adjustments to Net income:		
Depreciation	203	213
Amortization of acquisition-related intangibles	80	81
Amortization of capitalized software	13	16
Stock-based compensation	78	78
Gains on sales of assets	(1)	(37)
Deferred income taxes	1	—
Increase (decrease) from changes in:		
Accounts receivable	(154)	(149)
Inventories	(60)	17
Prepaid expenses and other current assets	54	(29)
Accounts payable and accrued expenses	(108)	(117)
Accrued compensation	(294)	(189)
Income taxes payable	147	80
Changes in funded status of retirement plans	19	22
Other	(25)	(11)
Cash flows from operating activities	609	462
Cash flows from investing activities		
Capital expenditures	(123)	(77)
Proceeds from asset sales	1	37
Purchases of short-term investments	(335)	(1,051)
Proceeds from short-term investments	615	785
Other	—	1
Cash flows from investing activities	158	(305)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	—	498
Dividends paid	(356)	(325)
Stock repurchases	(670)	(720)
Proceeds from common stock transactions	246	283
Excess tax benefit from share-based payments	56	49
Other	—	(4)
Cash flows from financing activities	(724)	(219)

Net change in Cash and cash equivalents	43	(62)
Cash and cash equivalents at beginning of period	1,199	1,627
Cash and cash equivalents at end of period	$ 1,242	$ 1,565

See accompanying notes.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Notes to financial statements

1. Description of business, including segment information

We design, make and sell semiconductors to electronics designers and manufacturers all over the world. We have two reportable segments, which are established along major categories of products as follows:

- Analog – consists of the following product lines: High Volume Analog & Logic; Power Management; High Performance Analog; and Silicon Valley Analog, which consists primarily of products that we acquired through our purchase of National Semiconductor Corporation (National) in 2011.
- Embedded Processing – consists of the following product lines: Processor, Microcontrollers and Connectivity.

We report the results of our remaining business activities in Other.

Segment information

	For Three Months Ended March 31, 2015	2014
Revenue:		
Analog	$ 2,035	$ 1,837
Embedded Processing	672	656
Other	443	490
Total revenue	$ 3,150	$ 2,983
Operating profit:		
Analog	$ 721	$ 498
Embedded Processing	123	52
Other	114	140
Total operating profit	$ 958	$ 690

We use centralized manufacturing and support organizations, such as facilities, procurement and logistics, to provide support to our operating segments. Costs incurred by these organizations, including depreciation, are charged to the segments on a per-unit basis. Consequently, depreciation expense is not an independently identifiable component within the segments' results and, therefore, is not provided.

2. Basis of presentation and significant accounting policies and practices

Basis of presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) and on the same basis as the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2014. The Consolidated Statements of Income, Comprehensive Income and Cash Flows for the periods ended March 31, 2015 and 2014, and the Consolidated Balance Sheet as of March 31, 2015, are not audited but reflect all adjustments that are of a normal recurring nature and are necessary for a fair statement of the results of the periods shown. Certain information and note disclosures normally included in annual consolidated financial statements have been omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. Because the consolidated interim financial statements do not include all of the information and notes required by GAAP for a complete set of financial statements, they should be read in conjunction with the audited consolidated financial statements and notes included in our annual report on Form 10-K for the year ended December 31, 2014. The results for the three-month periods are not necessarily indicative of a full year's results.

The consolidated financial statements include the accounts of all subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. All dollar amounts in the financial statements and tables in these notes, except per-share amounts, are stated in millions of U.S. dollars unless otherwise indicated.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Significant accounting policies and practices

Earnings per share (EPS)

Unvested share-based payment awards that contain non-forfeitable rights to receive dividends or dividend equivalents, such as our restricted stock units (RSUs), are considered to be participating securities and the two-class method is used for purposes of calculating EPS. Under the two-class method, a portion of Net income is allocated to these participating securities and, therefore, is excluded from the calculation of EPS allocated to common stock, as shown in the table below.

Computation and reconciliation of earnings per common share are as follows (shares in millions):

	For Three Months Ended March 31,					
	2015			2014		
	Net Income	Shares	EPS	Net Income	Shares	EPS
Basic EPS:						
Net income	$ 656			$ 487		
Income allocated to RSUs	(9)			(7)		
Income allocated to common stock for basic EPS calculation	$ 647	1,046	$ .62	$ 480	1,081	$ .44
Adjustment for dilutive shares:						
Stock-based compensation plans		15			15	
Diluted EPS:						
Net income	$ 656			$ 487		
Income allocated to RSUs	(9)			(7)		
Income allocated to common stock for diluted EPS calculation	$ 647	1,061	$ .61	$ 480	1,096	$ .44

Potentially dilutive securities representing 12 million and 10 million shares of common stock that were outstanding during the first quarters of 2015 and 2014, respectively, were excluded from the computation of diluted earnings per common share for these periods because their effect would have been anti-dilutive.

Derivatives and hedging

We use derivative financial instruments to manage exposure to foreign currency exchange risk. These instruments are primarily forward foreign currency exchange contracts, which are used as economic hedges to reduce the earnings impact that exchange rate fluctuations may have on our non-U.S. dollar net balance sheet exposures. Gains and losses from changes in the fair value of these forward foreign currency exchange contracts are credited or charged to OI&E. We do not apply hedge accounting to our foreign currency derivative instruments.

In connection with the issuance of long-term debt, we use financial derivatives such as treasury rate lock agreements that are recognized in AOCI and amortized over the life of the related debt. The results of these derivative transactions have not been material.

We do not use derivatives for speculative or trading purposes.

Fair values of financial instruments

The fair values of our derivative financial instruments were not significant as of March 31, 2015. Our investments in cash equivalents, short-term investments and certain long-term investments, as well as our deferred compensation liabilities, are carried at fair value and are discussed in Note 6. The carrying values for other current financial assets and liabilities, such as accounts receivable and accounts payable, approximate fair value due to the short maturity of such instruments. The carrying value of our long-term debt approximates its fair value as measured using broker-dealer quotes, which are based on Level 2 inputs. See Note 6 for the definition of Level 2 inputs.

Changes in accounting standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). This standard provides a single set of guidelines for revenue recognition to be used across all industries and requires additional disclosures. On April 1, 2015, the FASB proposed deferring the effective date by one year to December 15, 2017, for annual and interim reporting periods beginning after that date. The FASB also proposed permitting early adoption of the standard, but not before the original effective date of December 15, 2016. We are currently evaluating the potential impact of this standard on our financial position and results of operations.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810) – Amendments to the Consolidation Analysis, which changes the way reporting entities evaluate certain investment holdings for possible consolidation and also includes possible changes in disclosures resulting from that evaluation. This standard is effective for annual and interim reporting periods beginning as of January 1, 2016. We are currently evaluating the potential impact of this standard and expect it will have no material impact on our financial position and results of operations.

3. Acquisition charges

We incurred various costs as a result of the 2011 acquisition of National that are included in Other for segment reporting purposes, consistent with how management measures the performance of its segments. For the three months ended March 31, 2015 and 2014, Acquisition charges were primarily from the ongoing amortization of intangible assets resulting from the National acquisition. See Note 7 for more information.

4. Restructuring charges/other

Restructuring charges/other is comprised of the following components, all of which are recognized in Other for segment reporting purposes:

	For Three Months Ended March 31,	
	2015	2014
Restructuring charges by action		
2013 actions:		
Severance and benefits cost (a)	$ (1)	$ 27
Other exit costs	—	5
Restructuring charges for 2013 actions	(1)	32

Prior actions:		
Severance and benefits cost (a)	—	(6)
Accelerated depreciation	—	1
Other exit costs (a)	—	(1)
Restructuring charges for prior actions	—	(6)
Total restructuring charges	(1)	26
Other		
Gains on sales of assets	—	(37)
Other	(1)	—
Restructuring charges/other	$ (2)	$ (11)

(a) Includes changes in estimates.

2013 actions

We announced in January 2014 cost-saving actions in Embedded Processing and in Japan to reduce expenses and focus our investments on markets with greater potential for sustainable growth and strong long-term returns. We expect the actions to be completed by mid-2015. Cost reductions include the elimination of about 1,100 jobs worldwide. Through March 31, 2015, we have recognized $74 million in cumulative restructuring charges, with no further material charges expected. As of March 31, 2015, $48 million has been paid to terminated employees for severance and benefits.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Prior actions

Prior to 2013, we announced a restructuring of our former Wireless business and the closures of manufacturing facilities in Houston, Texas and Hiji, Japan. These actions were completed in 2013, and as of March 31, 2015, $356 million has been paid to terminated employees for severance and benefits.

The table below reflects the changes in accrued restructuring balances associated with these actions:

	2013 Actions Severance and Benefits	2013 Actions Other Charges	Prior Actions Severance and Benefits	Total
Accrual as of December 31, 2014	$ 22	$ 9	$ 26	$ 57
Restructuring charges (a)	(1)	—	—	(1)
Payments	(5)	(1)	(6)	(12)
Remaining accrual as of March 31, 2015	$ 16	$ 8	$ 20	$ 44

(a) Includes changes in estimates.

The accrual balances above are primarily reported as a component of either Accrued expenses and other liabilities or Deferred credits and other liabilities on our Consolidated Balance Sheets, depending on the expected timing of payment.

Other

Gains on sales of assets

During the first quarter of 2014, we recognized $37 million of gains on sales of assets. This consisted of $30 million associated with the sale of our site in Nice, France, and $7 million of asset sales associated primarily with the closure of our Houston, Texas, and Hiji, Japan, manufacturing facilities.

5. Income taxes

Federal income taxes for the interim periods presented have been included in the accompanying financial statements on the basis of an estimated annual effective tax rate. The rate is based on current tax law and for 2015 does not assume reinstatement of the federal research tax credit, which expired at the end of 2014. As of March 31, 2015, the estimated annual effective tax rate for 2015 is about 30 percent, which differs from the 35 percent statutory corporate tax rate due to lower statutory tax rates applicable to our operations in many of the jurisdictions in which we operate and from U.S. tax benefits.

6. Valuation of debt and equity investments and certain liabilities

Debt and equity investments

We classify our investments as available for sale, trading, equity method or cost method. Most of our investments are classified as available for sale.

Available-for-sale and trading securities are stated at fair value, which is generally based on market prices or broker quotes. See fair-value discussion below. Unrealized gains and losses on available-for-sale securities are recorded as an increase or decrease, net of taxes, in AOCI on our Consolidated Balance Sheets. We record other-than-temporary impairments on available-for-sale securities in OI&E in our Consolidated Statements of Income.

We classify certain mutual funds as trading securities. These mutual funds hold a variety of debt and equity investments intended to generate returns that offset changes in certain deferred compensation liabilities. We record changes in the fair value of these mutual funds and the related deferred compensation liabilities in SG&A.

Our other investments are not measured at fair value but are accounted for using either the equity method or cost method. These investments consist of interests in venture capital funds and other non-marketable equity securities. Gains and losses from equity-method investments are reflected in OI&E based on our ownership share of the investee’s financial results. Gains and losses on cost-method investments are recorded in OI&E when realized or when an impairment of the investment’s value is warranted based on our assessment of the recoverability of each investment.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Details of our investments are as follows:

	March 31, 2015			December 31, 2014		
	Cash and Cash Equivalents	Short-Term Investments	Long-Term Investments	Cash and Cash Equivalents	Short-Term Investments	Long-Term Investments
Measured at fair value:						
Available-for-sale securities:						
Money market funds	$ 442	$ —	$ —	$ 522	$ —	$ —
Corporate obligations	160	365	—	97	390	—
U.S. Government agency and Treasury securities	390	1,697	—	365	1,952	—
Trading securities:						
Mutual funds	—	—	193	—	—	185
Total	992	2,062	193	984	2,342	185
Other measurement basis:						
Equity-method investments	—	—	27	—	—	27
Cost-method investments	—	—	12	—	—	12
Cash on hand	250	—	—	215	—	—
Total	$ 1,242	$ 2,062	$ 232	$ 1,199	$ 2,342	$ 224

As of March 31, 2015, and December 31, 2014, we had no significant unrealized gains or losses associated with our available-for-sale investments. We did not recognize any credit losses related to available-for-sale investments for the three months ended March 31, 2015 and 2014.

For the three months ended March 31, 2015 and 2014, the proceeds from sales, redemptions and maturities of short-term available-for-sale investments were $615 million and $785 million, respectively. Gross realized gains and losses from these sales were not significant.

The following table presents the aggregate maturities of investments in debt securities classified as available for sale as of March 31, 2015:

Due	Fair Value
One year or less	$ 2,919
One to two years	135

Gross realized gains and losses from sales of long-term investments were not significant for the three months ended March 31, 2015 and 2014. Other-than-temporary declines and impairments in the values of these investments recognized in OI&E also were not significant for the three months ended March 31, 2015 and 2014.

Fair-value considerations

We measure and report certain financial assets and liabilities at fair value on a recurring basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The three-level hierarchy discussed below indicates the extent and level of judgment used to estimate fair-value measurements.

- Level 1 – Uses unadjusted quoted prices that are available in active markets for identical assets or liabilities as of the reporting date.
- Level 2 – Uses inputs other than Level 1 that are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data. We utilize a third-party data service to provide Level 2 valuations. We verify these valuations for reasonableness relative to unadjusted quotes obtained from brokers or dealers based on observable prices for similar assets in active markets.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

- Level 3 – Uses inputs that are unobservable, supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models that utilize management estimates of market participant assumptions. As of March 31, 2015, and December 31, 2014, we had no Level 3 assets or liabilities, other than certain assets held by our postretirement plans.

The following are our assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2015, and December 31, 2014. These tables do not include cash on hand, assets held by our postretirement plans, or assets and liabilities that are measured at historical cost or any basis other than fair value.

	Fair Value March 31, 2015	Level 1	Level 2
Assets:			
Money market funds	$ 442	$ 442	$ —
Corporate obligations	525	—	525
U.S. Government agency and Treasury securities	2,087	1,632	455
Mutual funds	193	193	—
Total assets	$ 3,247	$ 2,267	$ 980
Liabilities:			
Deferred compensation	$ 203	$ 203	$ —
Total liabilities	$ 203	$ 203	$ —

	Fair Value December 31, 2014	Level 1	Level 2
Assets:			
Money market funds	$ 522	$ 522	$ —
Corporate obligations	487	—	487
U.S. Government agency and Treasury securities	2,317	1,762	555
Mutual funds	185	185	—
Total assets	$ 3,511	$ 2,469	$ 1,042
Liabilities:			
Deferred compensation	$ 202	$ 202	$ —
Total liabilities	$ 202	$ 202	$ —

7. Goodwill and acquisition-related intangibles

Goodwill was $4.36 billion net of accumulated impairment of $90 million as of March 31, 2015, and December 31, 2014. There was no impairment of goodwill during the three months ended March 31, 2015 and 2014.

Components of acquisition-related intangible assets are as follows:

	Amortization	March 31, 2015			December 31, 2014		
	Period (Years)	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Developed technology	5 - 10	$ 2,132	$ 766	$ 1,366	$ 2,135	$ 714	$ 1,421
Customer relationships	8						