BTN Research

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Texas Instruments (TXN) EQ Update- 9/20 Qtr.

Current EQ Rating*	Previous EQ Rating
5+	5+

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "–" sign indicates deterioration

*For an explanation of the EQ Review Rating scale, please refer to the end of this report

We are maintaining our rating of TXN at 5+ following the company's beat by 16-cents.

Within that, the company was helped by amortization of intangibles becoming a smaller figure as they near full amortization. The drop from $79 million to $51 million was a 2-cent EPS tailwind. We still believe amortization should decline further y/y going forward as the asset value is only $189 million. TXN also had an 8-cent headwind from the effective tax rate increasing due to discrete items helping in 3Q19 and 2Q20. However, the 15% rate was only 1% above guidance as a 1-cent headwind.

More importantly, the inventory build in 2Q20 when TXN wanted to be ready to deal with a recovery of demand, showed it is returning to normal levels:

Inventory	3Q	2Q	1Q
2020 Inventory	$2,072	$2,136	$2,003
2020 DSI	139	168	147
2019 DSI	142	145	144
y/y Sales chg.	1%	-12%	-7%

As we have noted before, TXN has the liquidity and ability to carry more inventory. It sees this as a way to drive sales by avoiding out-of-stock situations and obsolescence as low-risk. It also allows them to chase larger customers as it can ensure supply plus it can operate at higher utilization rates. A recovery in sales quickly corrected the issue for us. However, we still believe computer screens will red-flag inventory levels.

It continued to invest in R&D and we saw little else of concern. Guidance calls for revenue growth of 2%-10% in 4Q and EPS growth of 7%-25%. It has about 4% already baked in from share repurchases.

Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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