

TI Manages Cash, Diodes Reiterates, SanDisk Sues

Texas Instruments (TXN, \$44.99 -1.44, Hold, Target \$38.50, FY14: \$2.17 on \$12.8B, FY15: \$2.57 on \$13.9B)

Capital Management Call: The two take-a-ways from yesterday's conference call: 1) TXN raised its free cash flow target from 20-25% of revenue to 20-30% of revenue, and 2) It raised its cash return to investors to include proceeds from employee stock option exercises, or cash return = 100% FCF minus debt plus option exercises. This is clearly good news for shareholders as an increase of confidence by management in the company's business.

Good news, but those headlines fail to recognize the thoughtful and comprehensive business strategy and organizational raison d'être articulated within capital management. Maximizing the return of free cash flow to shareholders over the long run is why TXN exists. It has chosen to sell analog and embedded products because they have long lifecycles of differentiated offerings to diverse markets and customers. It doesn't minimize its tax rate, but rather seeks to repatriate cash at the lowest possible tax rate to invest in the business or benefit shareholders. It maintains a strong balance sheet and credit rating to leverage debt when the economics are favorable. It adds manufacturing capacity when it can cost-effectively—not at whatever price it has too when it needs it—to lower the capital intensity and depreciation in order to maximize cash flow. It doesn't run manufacturing to maximize near-term capacity utilization, but rather to maximize long-term free cash flow. Dividends are calculated as 50% of trailing four year average free cash flow, with the balance of cash returned to shareholders via share repurchases.

I love this company: management, strategy, execution, track record, products, markets and financial structure and operation. While it is clearly angling for the lofty valuations of LLTC, MXIM and ADI peers, I am not yet convinced it will be successful given inferior gross and operating margins. I also remain ambivalent on the shares with respect to valuation, although I do regret not participating in the last few dollars of upside that were well justified from its capital management strategy alone, in my opinion.

Diodes (DIOD, \$24.59 -0.26, Rated Not Compelling/Hold on my latest Semiconductor Investment Ideas)

Reiterates IQ Guidance: 1Q revenue still expected to be -3% to +1% sequentially. DIOD regularly updates around this time mid-quarter via press release, and usually reiterates. Its technology lacks sex appeal, but I really like its business. The shares typically trade at lower valuation levels due to its gross margin profile, and are slightly under historical levels. I am waiting for share price weakness and/or business conditions to improve before I get bullish.

SanDisk (SNDK, \$73.63 -1.38, Rated Not Compelling/Hold on my latest Semiconductor Investment Ideas)

Sues Hynix for Trade Theft: SanDisk is suing NAND competitor Hynix for trade secret theft in California related to an engineer in Japan that left SanDisk for Hynix in 2008. It is also pursuing criminal charges in Japan where the engineer is in custody. The engineer used to work at a SanDisk/Toshiba joint-venture manufacturing facility in Japan, and SanDisk is seeking damages and an injunction against Hynix. While this is great industry gossip and will be interesting to follow as the episode unfolds, I think it will ultimately prove to be more of a headache for Hynix than much of any potential benefit to SanDisk. Obviously, at this point SanDisk has only upside to gain.

In the meantime, I am bullish on SanDisk from a NAND sector and company business perspective, although more ambivalent on the shares that are trading near 52-week highs from a valuation perspective. Similar to Diodes above, I am waiting for share price weakness and/or business conditions to improve before I get bullish.

—Dan K. Scovel
Semiconductor Analyst

Tokeneke Research LLC

Rowayton, CT 06853

dscovel@tokenekeresearch.com

www.tokenekeresearch.com

203-554-4621

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