Q3 2021 Earnings Call

Company Participants

- Dave Pahl, Vice President and Head of Investor Relations
- Rafael R. Lizardi, Senior Vice President and Chief Financial Officer, Finance and Operations

Other Participants

- Analyst
- Chris Danely
- Harlan Sur
- John Pitzer
- Joseph Moore
- Ross Seymore
- Stacy Rasgon
- Timothy Arcuri
- Vivek Arya

Presentation

Operator

Good day, and welcome to the Texas Instruments Q3 2021 Earnings Release Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Dave Pahl. Please go ahead.

Dave Pahl {BIO 18870833 <GO>}

Good afternoon, and thank you for joining our third quarter 2021 earnings conference call. For any of you who missed the release, you can find it on our website at ti.com/ir. This call is being broadcast live over the web and can be accessed through our website. A replay will be available through the web.

This call will include forward-looking statements that involve risks and uncertainties that could cause TI's results to differ materially from management's current expectations. We encourage you to review the notice regarding forward-looking statements contained in the earnings release published today, as well as TI's most recent SEC filings for a more complete description.

Our Chief Financial Officer, Rafael Lizardi is with me today, and will provide the following updates. First, I'll start with a quick overview of the quarter. Next, I'll provide insight into third quarter revenue results, with some details of what we're seeing in respect to the customers end markets. And I'll also provide details by end market, including some sequential performance as we have the last few quarters. As sequential data begins to be less insightful, will move back to reporting on the year-over-year per our normal practice. And lastly, Rafael will cover the financial results and update of our capacity expansion plans and our guidance for fourth quarter 2021.

Starting with a quick overview of the quarter. Revenue in the quarter was $4.6 billion, an increase of 1% sequentially and 22% year-over-year driven by demand in industrial, automotive and personal electronics. On a sequential basis, Analog grew 2% and Embedded Processing declined 5%. On a year-over-year basis, Analog revenue grew 24% and Embedded Processing grew 13%. Our other segment grew 19% from the year-ago quarter.

Now let me comment on the current environment to provide some context of what we're seeing with our customers and markets. Overall, the quarter came in generally as we expected across the product segments, end markets, and geographies. Lead times for the majority of our products remain stable, but hotspots continue to exist. However, customers are becoming more selective in their expedite request, focusing on products that complete a matched set rather than expediting products across the board. This behavior is not specific to any product family, end market or geography. Discussions with customers confirm a high-level interest in our commitment to expanding our internal manufacturing capacity road map, including 300 millimeter wafer fabs RFAB2 and Lehi or what we call LFAB and the associated assembly test expansions.

These investments to strengthen our manufacturing and technology competitive advantage will provide lower costs and greater control of our supply chain. And while there is a growing recognition that the near-term supply-demand imbalance will end at some point. The secular growth of semiconductor content per system will continue to grow and this requires a robust manufacturing capacity roadmap for 2025 and beyond.

Moving on, I'll provide some insight into our third quarter revenue by end market. First, the industrial market was down mid-single digits sequentially, and up about 40% from the year ago. The changes both sequentially and from the year ago were generally consistent across the diverse set of sectors. The automotive market again grew sequentially and was up more than 20% from the year ago, when comparing to pre-pandemic levels of Q4 2019, revenue is up almost 30%. Personal electronics grew low double-digit sequentially and was up low double-digits compared to a year ago. The strength sequentially in the year ago was due to mobile phones, PC notebooks and tablets.

Next, communications equipment was down mid-single digits sequentially, and was down upper teens from a year ago. Enterprise systems grew sequentially and from the year ago quarter. Rafael will now review profitability, capital management and our outlook.

Rafael R. Lizardi {BIO 20006334 <GO>}

Thanks, Dave, and good afternoon, everyone. As Dave mentioned, third quarter revenue was $4.6 billion, up 22% from a year ago. Gross profit in the quarter was $3.2 billion or 68% of revenue. From a year ago, gross profit margin increased 360 basis points. Operating expenses in the quarter were $800 million up 1% from a year ago and about as expected. On a trailing 12-month basis, operating expenses were 18% of revenue.

Over the last 12 months, we have invested $1.6 billion in R&D. Acquisition charges and non-cash expense were $47 million in the third quarter and will go to zero beginning in fourth quarter of 2021. Operating profit was $2.3 billion in the quarter or 50% of revenue. Operating profit was up 43% from the year-ago quarter. Net income in the third quarter was $1.9 billion or $2.07 per share.

Let me now comment on our capital management results. Starting with our cash generation, cash flow from operations was $2.4 billion in the quarter. Capital expenditures were $486 million in the quarter. Free cash flow on the trailing 12-month basis was $7.1 billion. In September, we announced we would increase our dividend by 13% effective this month, marking our 18th consecutive year of dividend increases. In the quarter, we paid $942 million in dividends and repurchased $139 million of our stock. In total, we have returned $4.2 billion in the past 12 months.

Over the same period, our dividend represented 53% of free cash flow underscoring its sustainability. Our balance sheet remains strong with $9.8 billion of cash and short-term investments at the end of the third quarter. In the quarter, we've issued $1.5 billion of debt in three tranches of $500 million each. The first as a coupon of 1.125%, which is doing five years. The second at 1.9% due in 10 years and the last 2.7% due in 30 years. This resulted in total debt of $7.8 billion with a weighted average coupon of 2.6%.

Regarding inventory, TI inventory dollars were up $7 million from the prior quarter and days were 112, up one day sequentially, but still below desired levels. For the fourth quarter, we expect TI revenue in the range of $4.22 billion to $4.58 billion, and earnings per share to be in the range of $1.83 to $2.07. The Lehi acquisition closed last Friday, but the costs are not included in our guidance. We will provide those details when we report fourth quarter results. Just as a reminder, the purchase price was about $900 million. And we expect ongoing cost of about $75 million per quarter through 2022.

We continue to expect our annual operating tax rate for 2021 to be about 14% and our effective tax rate to be about 13%. As you are looking at your model for 2022 without any changes to tax law, we would expect our annual operating and effective tax rates to remain about what they are this year, with a similar quarterly profile of discrete tax benefits that are higher in the first quarter compared to the rest of the year.

In closing, we continue to invest to strengthen our competitive advantages and in making our business stronger. Our investments in our long-term roadmap for capacity expansion both in LFAB and RFAB2 are great examples. As a reminder, our CapEx will be higher on an absolute level as well as a percentage of revenue as we strengthen this advantage. We are working through detailed plans of our long-term roadmap, and we'll have specifics of timing and CapEx spending in our capital management call in February. We continue to believe owning and controlling our supply chain will be of growing strategic importance.

With that, let me turn it back to Dave.

Dave Pahl {BIO 18870833 <GO>}

Thanks, Rafael. Operator, you can now open the lines up for questions. (Operator Instructions) Operator?

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions) And we will go first to John Pitzer of Credit Suisse.

Q - John Pitzer {BIO 1541792 <GO>}

Yeah. Good afternoon, guys. Thanks for let me ask question. Dave, I know in this sort of environment seasonality doesn't make a lot of sense. But when you look at the September quarter, I'm just kind of curious that the June quarter came in well above your guidance range. September was well above the midpoint, but still within the guidance range. We're hearing sort of logistical constraints and supply constraints across the economy. I'm kind of curious when you look at sort of the lower level upside in the September quarter versus the June quarter, to what extent might have been supply constraints outside of your control? To what extent do you think its customers just being more selective about what they're pulling from you? Any color there would be helpful.

A - Dave Pahl {BIO 18870833 <GO>}

Sure, John and thanks for the question. Yeah, I really think it depends on the customers' bill of material. I think that there are supply constraints that are widely reported across different components. And as we mentioned in our prepared remarks, the behavior that we're seeing is different. Our customers are showing up and requesting we have meetings with them rather than showing up with long list of devices. They're asking us to expedite. They really just short list. So they're looking for particular parts that complete those match sets so that they can complete those builds for them. So it is a different behavior that we're seeing this quarter versus the prior quarters. So, do you have follow on?

Q - John Pitzer {BIO 1541792 <GO>}

Yeah. Just as a follow on. I know you're going to give us more color about LFAB expenses and RFAB expenses as we get into next year. But I'm wondering if you could just help us set the stage a little bit, next year is obviously going to be kind of a capacity build out year for you. And I guess all else being equal, how should we think about the gross margin impact on calendar year '22 as you layer in these investments?

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. I'll take that one. First, as you know, you notice for a long time we don't manage the business to gross margins. We manage for a long-term growth of free cash flow per share, and that starts with driving the top line and that's why we're making this investments right to support revenue growth and as we do that is extending our low-cost manufacturing advantage that gives us the great structural costs advantage with 300 millimeter. And in addition to that, we're controlling the supply chain.

And specifically on your question, RFAB2 all-in that's about a $6 billion expense, about $1 billion of that is the building which depreciates over 30 years or so. The balance of the rest is equipment and we're going to be putting that equipment starting next year and over the coming years. With LFAB, obviously a $900 million purchase price and that -- some of that is building, some of that is equipment and then on top of that we'll put about $3 billion of CapEx over a number of years as we ramp that up. So we'll give you additional details on that and the bigger longer term picture of how we're going to support the longer term growth will give you those details in February at the Capital Management call.

Q - John Pitzer {BIO 1541792 <GO>}

Okay. Thank you.

A - Dave Pahl {BIO 18870833 <GO>}

Thank you, John. And we'll go to the next caller, please.

Operator

And we'll go next to Timothy Arcuri of UBS.

Q - Timothy Arcuri {BIO 3824613 <GO>}

Hi. Thanks. Rafael, I was wondering if you can talk about pricing. Obviously you're seeing some increases in your input costs. Can you talk about whether you're passing those on to customers and sort of how ubiquitous any price increases on your side might be?

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. What I would tell you, our strategy on pricing has not changed, we regularly monitor that. And our goal is to be competitive and it's really frankly dependent of the input costs to the large -- to the largest degree. But our goal is to be competitive, and if prices move higher, we're just over time and we have been adjusting those over time.

A - Dave Pahl {BIO 18870833 <GO>}

Do you have follow-on Tim?

Q - Timothy Arcuri {BIO 3824613 <GO>}

I did. Thanks. And I guess I'll ask the same question that I've asked last I think three calls about share repo. It was pretty low again. I guess is there sort of, can you help us think through maybe what the triggers might be for you to start to buyback more stock, is there a target cash level where maybe you've said that the balance sheet is getting a little bit over capitalized and you'd start to buyback more stock. I'm just kind of obviously you're not buying back much, but I'm just kind of wondering if you can talk us through what triggers you might be looking for to start that back again. Thanks.

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. Stepping back and just to remind everybody how we think about returns, our objective is to return all free cash flow to the owners of the company over the long-term and we do that through dividends and buybacks. You look at our 18-year history on that and it's really consistent, in fact, we've -- many years -- most years, we've averaged well over 100% of return. During that time, we have, I would remind you, we have increased the proportion of the return that comes into dividend, so that also plays into that.

But as long as we think the buybacks are accretive to our long-term owners. We're going to have some buybacks. And as you have seen that you pointed out the last three quarters we have, in fact that I don't think there's been a single quarter in the last 18 years or so that we have not purchased return cash to the owners through buybacks in one form or another.

A - Dave Pahl {BIO 18870833 <GO>}

Okay. Thank you, Tim. And we'll go to the next caller, please.

Operator

We'll go next to Harlan Sur of JP Morgan.

Q - Harlan Sur {BIO 6539622 <GO>}

Good afternoon. Thanks for taking my question. On finished goods inventory, most of which I assume is sitting at customer consignment hubs. This is come down faster than overall inventories, right, finished goods dropped 8% sequentially in Q3, dropped 9% in Q2, they're down 25% from the beginning of this year and down 33% pre-COVID '19. I assume due to the strong demand profile from your direct customers. So how far below normal our consignment inventories relative to your customers target levels? And is part of the muted Q4 outlook to replenish these very low inventories or does the demand profile backlog and forecast actually reflect the sequential decline here in the fourth quarter?

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. So I'll start and Dave if you want to chime in after that. But I think where you're going with that, let me maybe step back. Yeah, obviously inventory levels are below these higher levels, right? We're at a 112 days our target is a 130 to 190 days. So clearly we're well below where we want to be. And inside of that, as you pointed out finished goods, all finished goods whether it's in consignment or, or at our product distribution centers are the ones that are decreasing most. In fact, even though inventory -- total inventory level stayed above flat slightly up second to third quarter finished goods decreased and then with raw materials increased a little bit to offset that.

So our goal as soon as capacity increases, there's an adjustment in demand, we will build those inventory levels back up to be at a more healthy levels and given our business model is just a great bet, just given the low obsolescence of our inventory, the diversity of positions, diversity of products that we can afford, not only we can afford, it makes sense for us to build that inventory, have it ready for the secular growth that we're confident will happen beyond that. And I think maybe tactically where you are going on consignment inventory, frankly those tend to be pretty lean to begin with, that's how that process that process is designed to just keep a couple weeks. So, I wouldn't expect that by itself to build significantly, purely consignment, where I would expect the bill to happen if more of our product distribution centers and that gives us more flexibility to then shift where the demand is most needed. Dave?

A - Dave Pahl {BIO 18870833 <GO>}

Yes, I think that's well said and I think it's just tactically where we -- whether we keep it in our hubs, where we would prefer it or if we push it out to a consignment center that will just be reflective of our expectation that a customer will pull it. So, that's just a tactical decision. I'd also point out that, as you said Rafael, we do plan to bring on more capacity incrementally as we have each quarter through this year and through the middle of next year and in the back half of 2022 RFAB2 will come online and then that will be followed by LFAB Spence's Rafael pointed out. We did close on that factory on Friday of last week. And so that is on target to come online in early 2023 to support growth in the future. So did you have follow-on Harlan?

Q - Harlan Sur {BIO 6539622 <GO>}

Yeah. Thanks. I appreciate the insightful answer. So, exiting last year, the direct business which includes consignment that was about 65% of revenues. Where does that makes roughly sit today? And did the team drive a positive book-to-bill ratio in Q3, if you could maybe quantify?

A - Rafael R. Lizardi {BIO 20006334 <GO>}

So on the book-to-bill, we don't think that's relevant frankly materially haven't disclosed that in a while and we were not disclosing that anymore. On your first question, on percent, I think you asked percent of our revenue from consignment, is that right?

Q - Harlan Sur {BIO 6539622 <GO>}

Yeah. I think quite --

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah, that's the first part. Yeah, could you just repeat it Harlan. So we got -- make sure we got it, right, that you're asking the first question.

A - Dave Pahl {BIO 18870833 <GO>}

Harlan, are you there?

Q - Harlan Sur {BIO 6539622 <GO>}

Yeah. This percent is the overall direct business?

A - Dave Pahl {BIO 18870833 <GO>}

Direct business, yeah. So we left last year with about two-thirds of our revenues direct. So, we expected that percentage will increase over time. We'll provide an update of what we've done with that this year in our February call, Cap management call in February of actually what that looks like. But just to say over time that we do expected that will move up slightly over time.

So, and just the other color with Rafael talking about book to bill, as we've got a lot of our revenue on consignment, we've got ti.com, the actual backlog isn't quite as meaningful as what it used to be. So, he said it's just about a number that we look at or measure or we've talked about in some time. So it isn't quite as helpful as what it used to be. So, thank you Harlan, and we'll go to the next caller, please.

Operator

And we'll go next to Stacy Rasgon of Bernstein Research.

Q - Stacy Rasgon {BIO 16423886 <GO>}

Hi guys. Thanks for taking my question. For the first one, I wanted to ask you about the near-term Micron and I know you said $75 million in cost impact in the model next year. But that costs don't go away, right? That's $75 million a quarter is people, correct? And doesn't include depreciation or anything else as it is people, how do you think about that like what that incremental cost long-term?

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Very good, Stacy, good direct question. So yes, that $75 million is mainly people and direct costs, not depreciation, depreciation will not start until about first quarter '23, when we start production, just the way the rules work on that front. And that $75 million there might -- we're still working through the details, but we currently believe that the most likely scenario is that most of that cost will go through the restructuring charges/other line, until we start production, right. And at that point the majority of the cost would go to the COR line.

Now, the cost actually do increase over time as we increase production, right, but I think where you're going is that as that happens and those costs are then absorbed by revenue, right. Now how quickly those are absorbed beyond under utilization, et cetera.

They just depends how quickly we run that factory, right. Clearly at the beginning there won't be 100% absorption and we'll get to that at some point. But we'll -- we're not going to -- that's in 2023, so we'll get to that at some point to give you some details. And in February at the Capital Management call, I think we'll frame it kind of a bigger picture of that along with our other CapEx investments and you get a better sense of how that's going to play out.

A - Dave Pahl {BIO 18870833 <GO>}

Do you have follow-on Stacy?

Operator

And it looks like Stacy has disconnected.

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Okay.

A - Dave Pahl {BIO 18870833 <GO>}

Okay. If you have a follow-on, let us know Stacey. We'll go to the next caller, please.

Operator

And we'll go next to Ross Seymore of Deutsche Bank.

Q - Ross Seymore {BIO 20902787 <GO>}

Hey guys. Thanks letting me ask a question. Dave and Rafael, I want to talk about the quarterly report and get into some of the supply demand dynamics. It was the smallest beat to your original revenue guidance (Technical Difficulty) you guys have had in a year and I realized that it's been exceedingly volatile in the last year. But I wondered, was that's the demand for the demand profile changing from those investors that selectivity changing that you're talking about or did supply play a role in that where you just couldn't meet up to the demand. Just trying to get what really changed versus whatever level of conservatism you had built into the prior quarters when you beat by bigger deltas.

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. I think you said demand from investors, I think you might want to say demand from customers, right or wrong?

Q - Ross Seymore {BIO 20902787 <GO>}

Yes. Sorry about that.

A - Dave Pahl {BIO 18870833 <GO>}

Yes. No, that's okay. Certainly, if any investors want to buy semi conductors from us, we will be happy to sell them, but yeah. So I'd just say that overall, the quarter came in as we expected it to right? And that's the statement as we said in the prepared remarks and we looked across geographies and products and product groups End markets those types of cuts. So there wasn't like one area that was underperformed or outperformed what we were expecting.

But again, the main thing of what was different this quarter versus last quarter was really where customers are coming in and requesting expedites and upsides from us and those upsides were much, much more narrow and focus just on few products. So that was really what the difference was. If you're looking for -- what was different this quarter versus last quarter and those types of things that's what I would point to, to say what's changed in the last 90 days.

Q - Ross Seymore {BIO 20902787 <GO>}

Thanks for the help on that. And I guess as my follow-up, a similarly toned question. You mentioned that lead times remain extended, but are stable and then you talked about that whole selectivity dynamic. What would you imagine it would change the lead times? Is it going to be your supply incrementally rising or more so with Lehi or is the selectivity something as you guys look back in our students of cycles, is the demand side in that selectivity side more likely to impact the lead times going forward?

A - Dave Pahl {BIO 18870833 <GO>}

Well, as you know, you've been through many cycles with us, right. It's always a combination of both. And we will and continue to add incremental capacity as we have planned for some time and certainly as we go out in time as we get the bigger tranches of capacity coming on with our FAB2 and then LFAB. We'll be able to make more progress on that front. And at some point, we know that things will change from a demand standpoint. And so we don't spend time trying to predict that, but we'll be ready for it. We know what we want to do, as Rafael talked about, one of the top things are as will want to rebuild inventory to prepare for the next time as the demand strengthens. So we have a long list of things that we're doing to invest in the company to make it stronger. So, we won't control the timing of that, but we'll be ready for sure.

A - Rafael R. Lizardi {BIO 20006334 <GO>}

And just to emphasize that point. When that adjustment happens whenever that is we will continue investing in R&D, focus on the areas of auto and industrial for the secular long-term growth, we'll continue to invest on CapEx in to set up the company for the next 10 to 15 years. We've a great long-term roadmap and we will build inventory that's as David mentioned.

Range is 130 and 190 days, frankly will probably end up being at the higher end of that range just because we're still so good about the business model and how good that inventory will be and how it sets us up for the next up turn on the other side given the long-lived nature of that inventory.

A - Dave Pahl {BIO 18870833 <GO>}

That's right. Yeah. Okay. Thank you, Ross. And we'll go to the next caller, please.

Operator

We'll go next to Vivek Arya of Bank of America.

Q - Vivek Arya {BIO 6781604 <GO>}

Thanks for taking my question. I just want to get the supply side, right. Our customers not ordering as much from you because they don't have enough from you on the component side, or they don't have enough from others that they need to complete the bill of materials.

A - Dave Pahl {BIO 18870833 <GO>}

It's both of that. There are instances of both of those and sometimes it's not even semiconductors, right. It's maybe other components that they may be missing. So yes, it's a combination of those things. Supply chains are complex depends on the bill of materials and the systems that they're building, so it depends.

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. And Vivek, the new ones changes, 90 days ago, 180 days ago they were expiring everything almost regardless of matched set position, now they're more selective in what they're expediting right?

A - Dave Pahl {BIO 18870833 <GO>}

Do you have follow-on to that?

Q - Vivek Arya {BIO 6781604 <GO>}

Yes. Thank you. Could you talk specifically to the automotive market, this year it's clear the production has not been that strong. But auto semiconductor sales have been pretty strong. So as it applies to TI, what do you think has been kind of the interplay between content and mix? Or do you think that there is perhaps inventory stuck in the automotive supply chain somewhere that we should watch out for?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. I'll comment on automotive, I think I'll even extend it into industrial. And those are two markets that we have long talked about that we believe that there is content growth in those markets, content per system. It's easy to see in cars and well reported on. I know, Vivek, in your reports that you've reported on that content growth you can see it in automotive. It's happening in industrial across 13 different sectors, so harder to see. And we invest in all the markets, but we have a strategic focus on automotive and industrial. So you're beginning to see some of the benefits of those that strategic bias that we have. Our channel advantages, the breadth of our products advantageous in those markets as well. So there's components of that.

But that said, any time that we have supply shortages in the industry, customer behavior is always very consistent and that behavior is that they will want to build inventory to protect themselves. So whether they've already begun that or have already done that they certainly will want to do that and at some point they'll have too much product and that's what creates the cycles in our industry. So it won't surprise us if the cycle comes to an end at some point we'll be prepared for that and we'll know what we want to do with that at that point. So thank you for those questions and we'll go to the next caller, please.

Operator

We'll go to Joe Moore of Morgan Stanley.

Q - Joseph Moore {BIO 17644779 <GO>}

Great. Thank you. I wonder if you could talk to the hot spots. Is there any particular pattern that's driving which products you have in short supply? It seems like we see it most in areas like enterprise and some of the person electronics, higher volume stuff. Is that something that you guys would agree with? And do you think is it -- is there more foundry versus internal fabs, like is there anything that particular driving those hotspots?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. I wouldn't put it down on any one thing, Joe. Certainly, there's the reports of the tightness across foundry. So obviously we see that as well. So there's tightness in some lead frames. So, we see that as well. Other input raw materials most compounds, we have testers, in some cases some process technologies, some particular products themselves that have a large number of customers.

So in those hotspots move around is our operations teams will sometimes move capacity from one area to the other. So they're not always consistent or persistent. Sometimes they are, but sometimes they're not and there's things that we can do to mitigate those or actually completely alleviate them. So and that's why as we describe them. It's not just one particular product area or one particular product set that even one particular market or even I'd say even one particular customer that would be impacted by that you may see.

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. And just to highlight something for maybe new listeners, Dave mentioned the foundries only about 20% of our wafers are come from foundries, the vast majority 80% and growing with our investments in 300 millimeter our internal wafers and that it just gives us a much better control of our destiny and for all the reasons Dave mentioned and then the low cost structure or low cost that we get with 300 millimeter.

A - Dave Pahl {BIO 18870833 <GO>}

Yes, I think that makes it especially clear why we believe that continues to be a strategic advantage for sometimes like this. So, do you have follow-on Joe?

Q - Joseph Moore {BIO 17644779 <GO>}

Yeah. I wonder also with the hotspots, as a situation where you can't respond on to upside in demand and that's why it's tight or are there actual areas where, I know there's a little bit of this but on a broad scale where you're not meeting kind of commitments that you would made because of some of those things that are upstream from you.

A - Dave Pahl {BIO 18870833 <GO>}

I think there's probably both of those that exists.

A - Rafael R. Lizardi {BIO 20006334 <GO>}

I mean, at a 112 days of inventory, it is harder to respond to what size and if we were a 150, 160 190 days of course.

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. For sure. So okay. Well, thank you, Joe. We'll go to the next caller please.

Operator

And the next question comes from Chris Danely of Citi.

Q - Chris Danely {BIO 3509857 <GO>}

Hey, thanks guys. So Dave and Rapfael, you mentioned that the lead times haven't really changed, but expedites are getting better or less bad. Why do you think that is? Do you think that your competitors are reducing lead times? Do you think that the supply chain has had a little bit of a chance to build some buffer inventory? Why do you think the situation is getting, I guess either better or less bad?

A - Dave Pahl {BIO 18870833 <GO>}

Yeah. Chris, I think that's a great question. I don't know that we know the answer specifically to that question. So I think we're trying to stick to the facts of we can observe that behavior change. I think you're offering some good theories of why that behavior may be changing. But what we're trying to do is to speak to the fact of what's going on. There's multiple reasons why it might be changing and would rather not venture into guessing or predicting or calling, what's that was driving that behavior. So, do you have follow-on?

Q - Chris Danely {BIO 3509857 <GO>}

Yeah. I guess you can leave the guessing and predicting up to sell siders. On the -- since you guys talk about gross margin, but you do, talk about free cash flow margin. I think you hit an all-time high in free cash flow margin in Q3. And it looks like there's some headwinds coming down the pie in the I guess near to medium term. Is there any reason for us to believe that you've seen your all-time Beacon free cash flow margin, or eventually could have get back above where it was in the most recent quarter?

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Sure. I'll take that, Chris. And Chris you know us very well, you follow us for a long time, you know we do not manage to free cash flow margin percent, right. That is not what drives our long-term value for the owners, is the long-term growth of free cash flow dollars, right?

And to your point there, there are some headwinds on that with the CapEx that we're talking about to set up the company well for the future. But of course, we're only doing that because we think that is going to drive even faster growth of the long-term trend of free cash flow dollar. So we'll continue to focus on that because we think that is what drives value for the long-term owners.

A - Dave Pahl {BIO 18870833 <GO>}

Okay. Thank you, Chris. And we've got time for one more call.

Operator

And we'll go to (inaudible).

Q - Analyst

Yes, thank you for squeezing me in. As far as the question on controlling the supply chain, you talked about 80% outsourced now, I believe that's kind of the more advanced nodes. But should we assume that that 80% is just going to grow and that you're going to rely less and less on foundries going forward?

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. So you said 80 outsourced, is 80 in-sourced, just to make sure 80% --

Q - Analyst

Sorry, Rafael.

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. So, 80% our own wafers. Yeah that should grow over time as we continue to add this wafer fabs that we're talking about all in 300 millimeter which the efficiency of 300 millimeters is huge, right, because 300 millimeter wafer accounts for almost 2.3 times of 200 millimeter wafer. And these are pretty large wafers for efficiency purposes. In fact RFAB2 is going to be bigger than RFAB1. So yeah it's reasonable to deduce that percent will increase over time.

Q - Analyst

Very good. And as a follow-up and I don't want to steal your thunder from February. But in the past you've talked about capacity of $22 billion, obviously, you're going to go through capacity expansion here for the next 12 to 18 months. Would you share any new numbers with those? I don't know 25, 28 anything at all?

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Yeah. No, it's a great question, thanks for the setup for February. We will talk about that in February. So until then, what I would tell you is you've heard us talk about DMOS6 and RFAB1, roughly that's potential of about $8 billion of annual revenue on 300 millimeter, then RFAB2 and this is all depending, highly dependent on mix, right. So these are not exact numbers. But RFAB2 with that caveat, RFAB2 should add another $5 billion of annual revenue again when it's fully equipped, right, so obviously not on day one. And Lehi should add $3 billion to $4 billion of annual revenue. So we're thinking in terms of that and we're thinking even beyond that, right, because as we look at the company's potential for growth into the next 10 and 15 years, then we were not stopping just thinking in the next four or five years, we're thinking 10, 15 years, I would talk about that in February in more detail.

A - Dave Pahl {BIO 18870833 <GO>}

That's great. And I think we can go ahead and wrap up Rafael.

A - Rafael R. Lizardi {BIO 20006334 <GO>}

Okay. So let me wrap up by reiterating what we have said previously. At our core, we are engineers and technology is the foundation of our company, but ultimately, our objective and the best metric to measure progress and generate long-term value for owners is the growth of free cash flow per share.

While we strive to achieve our objective, we will continue to pursue our three ambitions. We will act like owners who will own the company for decades. We will adapt and succeed in a world that's ever changing. And we will be a company that we're personally proud to be a part of and would want as our neighbor. When we're successful, our employees, customers, communities and owners all benefit. Thank you and have a good evening.

Operator

And so this concludes today's call. Thank you for your participation. You may now disconnect.