

FOCUS



value
growth
stability

FINANCIAL HIGHLIGHTS

Financial Summary	1996	1995
Net revenues (<i>millions</i>)	\$ 9,940	\$ 11,409
Profit (loss) from operations (<i>millions</i>)	\$ (26)	\$ 1,439
Earnings (loss) per share:		
Continuing operations	\$ (.24)	\$ 5.15
Net income	\$.33	\$ 5.63
Average common and common equivalent shares (<i>millions</i>)	192.1	193.6
Research and development expense (<i>millions</i>)	\$ 1,181	\$ 842
Capital expenditures (<i>millions</i>)	\$ 2,063	\$ 1,351
Other Highlights		
Stockholders' equity (<i>millions</i>)	\$ 4,097	\$ 4,095
Debt-to-total-capital ratio33	.17
Number of employees	59,927	59,574

Employees include persons employed in the company's Defense Systems and Electronics business.

Earnings per share in 1996 from continuing operations were \$1.46 and PFO from continuing operations was \$374 million, excluding special charges in the third and fourth quarters.

Texas Instruments creates the digital solutions that are shaping the networked society. As the market leader in digital signal processing solutions – powerful semiconductor devices – we help connect you to the networked society through countless personal electronic products. Headquartered in Dallas, Texas, but with sales and manufacturing operations in more than 30 countries, TI offers products and services including semiconductors, instructional calculators, electrical controls, metallurgical materials and software productivity tools.

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At Texas Instruments,
our focus
is on

value + growth + stability.

The future. A future shaped by technology into a different world than the one we live in today. We call it a networked society – a society where personal electronics are commonplace and connected – all sharing and communicating digital information.

We envision a world where every bit that's processed – every message that's communicated – every image that's projected – are all touched by TI technology. Every connection in the networked society will be made through a digital signal processor or DSP – an exceptionally fast and smart semiconductor device. DSPs are the engines that drive the network in the networked society, and Texas Instruments is the market leader in digital signal processors.

We are committed to building on our world leadership position in DSP Solutions, and we'll do that by focusing on three things – value, growth and improved financial stability. We believe that by sharpening this focus year after year TI will be a premier electronics company, one that sets the pace for the networked society.

At Texas Instruments, 1996 was a year of challenge.

Net revenues from continuing operations were \$9.9 billion in 1996, down from \$11.4 billion in 1995. PFO from continuing operations, excluding special charges for cost reduction actions and in-process R&D, was \$374 million, down from \$1439 million in 1995. As a result of the announced sale of TI's defense business to Raytheon Company, financial figures throughout this report have been adjusted to reflect defense as a discontinued business. We have also announced the sale of our mobile computing business to The Acer Group.

In TI's continuing operations, most of the decrease in revenues was due to a precipitous drop in dynamic random access memory (DRAM) prices. From the fourth quarter of 1995 to the fourth quarter of 1996, DRAM prices dropped about 80 percent. In our differentiated semiconductor business, however, revenues for digital signal processing solutions (DSPS), comprised of digital signal processors plus mixed-signal/analog products, continued to establish new records. Revenues for all differentiated semiconductor products were nearly two-thirds of the company's total semiconductor revenues in fourth-quarter 1996.

As an extended family, Texas Instruments faced its greatest challenge of the year in the sudden death of our leader and our friend, Jerry Junkins. A tribute to Jerry immediately follows this letter.

Our vision. In last year's annual report, we introduced a new vision for Texas Instruments. That vision is World Leadership in Digital Solutions for the Networked Society. There are three very significant global trends shaping the networked society.

Number one is the continuing personalization of electronics across computing, communication and entertainment. The second trend is digitalization. While unknown to most users, this digitalization trend means that for the first time all personal electronics will be speaking a common digital language. The third trend is connectivity, brought on primarily by computer networking and the recent emergence of the Internet in the public domain, and by the growing wireless networks of the world.

Personalized electronics for computing, communication and entertainment – all speaking a common language – all connected together. These trends will create a networked society, with its profound impact on the way we live, learn, work and play. The networked society is still more talk than reality right now. At TI, we will be a leader in creating the digital solutions that shape the networked society. It's the companies who get out in front today that will lead that society forward. TI will be one of those companies.

Our strategic direction. 1996 was a year of strategy development at TI, providing a company direction that will help us realize our vision. It has three elements – value, growth and improved financial stability.

Value. First, we will deliver high-quality, value-added solutions to our customers and to end-users – solutions that provide sustainable differentiation. Technology and market understanding are at the core of a value-added solution. At TI, we want to have architectural leadership in every major market where we compete. Then



The Office of the Chairman and the Chief Executive includes from left to right:

Thomas J. Engibous
President and
Chief Executive Officer

William P. Weber
Vice Chairman

James R. Adams
Chairman of the Board

we have to push beyond that and deliver fully integrated solutions around our leading architectures. That means providing the software and systems expertise, the tools and customer support to make the TI solution a superior solution.

Growth. The next element is growth. We will focus on high-growth markets. Growth means opportunities for all of us – our stockholders, our employees, our customers, our suppliers and our communities.

Financial stability. The third and final element is improved financial stability. Consistency in financial performance is important to our stockholders and our employees. It's a key element in achieving the kind of stock valuation appropriate for a premier electronics company.

By focusing on value, growth and improved financial stability, we can realize our vision for TI and create powerful points of difference between us and our competitors that will ensure TI a winning position today and in the future.

In the pages that follow, you will see examples of TI providing value-added solutions, creating and capturing market growth and working to improve financial stability.

1997 – The time to FOCUS. With our strategic direction in place, 1997 is the year for implementation. To do that, we must focus: on the businesses, products and technologies where we have strong leadership positions that are based on sustainable competitive advantage; on the businesses and markets with strong growth potential; and on those areas and programs that can improve financial stability.

Change. Our defense business has been an important contributor to TI. It has performed consistently and positively throughout the ups and downs of the defense industry. In addition, it has been a role model inside and outside TI – winning the Malcolm Baldrige National Quality Award in 1992 and the U.S. Navy Best Manufacturing Practices Award in 1995.

However, increasing consolidation in the defense industry continued to put this business at a disadvantage in winning new programs versus integrated defense suppliers. So, in January 1997, we reached agreement to sell TI's Defense Systems and Electronics business to Raytheon. The sale is expected to close in second-quarter 1997. We believe this best positions this business and its employees to compete and win over the long term.

This cash sale for \$2.95 billion also will allow TI to focus management attention and funding in high-growth businesses where we have built or can build a leadership position.

In January 1997, we also announced the sale of our mobile computing business to The Acer Group for cash. The agreement includes the purchase by Acer of our award-winning TravelMate™ and Extensa™ product lines and the associated assets of the business. The sale is expected to close in the first quarter of 1997.

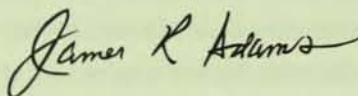
As we move forward, we will continue to review all of our businesses. We will focus on those where we can deliver value, growth and improved financial stability in ways our competitors cannot. While we are making progress in implementing our strategy, we still have work to do, and 1997 will be a year of transition. It will be a year of change for TI, but change that is grounded in our past and in our view of the future.

People and community. We believe the people of Texas Instruments are the best and the brightest in the business. Without their dedication, TI could never realize its vision. Also important is the support of the communities in which we work. One way we help build strong communities is by supporting minority-owned and women-owned suppliers – from whom we purchased five percent of our domestic goods and services in 1996. Our commitment to people and community is detailed in this year's annual report. It has been and will continue to be an important area of emphasis for TI.

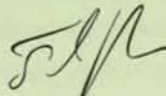
In 1996, Bill Lee, former chairman and CEO of Duke Power and a longtime director and friend, passed away. His many contributions to Texas Instruments will have a lasting impact on our company.

Finally, it is with mixed emotions that we say good-bye and good luck to TI Vice Chairman Bill Mitchell, who retired at the end of 1996. Bill's 35 years with TI represent a lifetime of accomplishment. We thank Bill for his many contributions and wish him well.

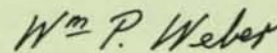
Summary and outlook. 1997 will be an exciting year for TI – one of increased focus. We see tremendous opportunity in our major markets. Focused on these opportunities, we are in an excellent position to create strong, sustainable competitive advantage. We will compete and win on these advantages – our unique points of difference. And our stockholders, our employees, our customers, our suppliers and our communities will win with us.



James R. Adams
Chairman of the Board



Thomas J. Engibous
*President and
Chief Executive Officer*



William P. Weber
Vice Chairman

He had the **vision to lead**...and the **humility to listen**.

"He **encouraged communications** and was a **great listener**. This brought out the best in everyone."

LEWIS McMAHAN
Texas Instruments employee

"Our state and nation have lost one of our finest business leaders... Jerry Junkins' **integrity and foresight are unparalleled** in modern American business."

KAY BAILEY HUTCHISON
U.S. Senator

"People will always remember Jerry because of the way he was able to **integrate** the different factors of **the community**...he did more for minority business owners than everyone else combined."

ALBERT BLACK
On-Target Supplies & Logistics

"Jerry was a **tireless advocate for American jobs and trade**. Because of Jerry's leadership, more Americans have and will realize the economic benefits of the global marketplace."

ROBERT E. RUBIN
Secretary of the Treasury

"I always wanted to say thank you to Mr. Junkins for truly expanding my mind through **leadership and dedication** to education."

ELIZABETH JANG
Gunter High School student

On May 29, 1996, **Jerry R. Junkins** died while on a business trip in Germany. In his 11 years as president and CEO and eight years as chairman, he inspired and led the most profound cultural, organizational and business change in the history of Texas Instruments.

He initiated a process to engage the entire company in a search for an enduring vision that would serve Texas Instruments well into the 21st century. He saw strength in diversity – both in our businesses and our people – and sought to bring them together to motivate TIers and drive the corporation to new levels of growth and profitability. Inspired by the Baldrige quality challenge, he instituted a completely new system of management based on teams and the sharing of best practices. His sense of humility and respect for others drove a new emphasis on the customer. He pioneered an era of business alliances that has given TI a global reach and access to leading-edge capacity unparalleled in the industry.

Jerry will especially be remembered inside the company for his personal relationships with employees. He cared deeply about people. He was as comfortable talking with a machinist on the shop floor as he was in arguing for free trade on Capitol Hill.

Outside the company, Jerry's selfless integrity and sense of commitment – to the cause of education and to a forceful confrontation with the social and economic challenges facing our communities – steadily led him to a remarkable position of leadership in the Dallas-Fort Worth Metroplex, in the State of Texas and on the national and international stage. He became a counselor of mayors, governors, presidents and prime ministers with his intelligence, his vision and his disarmingly effective common sense.

In sharing those talents, Jerry won respect and admiration for Texas Instruments throughout the nation and the world, all while keeping sight of his first priority – his family. His example will remain an inspiration for all of us whose lives he touched.



This photograph, taken from last year's report, is just one example of Jerry Junkins' commitment to education, as he listens to students from Gunter High School describe their first-place winning entry in 1995's Texas BEST (Boosting Engineering, Science and Technology) competition.

We build solutions. Digital solutions that place technology at your fingertips. That make technology work for you. Our differentiated solutions are a strategic part of our customers' products and services.

A strategic part **that delivers added**

value.

The value starts with architectural leadership and market understanding. As technology markets evolve, each aspect of processing – data processing in computers or signal processing in phones, modems and computers, to name just a few – will be dependent on a small number of system architectures. Companies that provide architectural leadership drive change in their markets.

At TI, we're sharpening our focus and building architectural leadership. We are the market leader for digital signal processors. Our DSP architecture is found in digital solutions for wireless communications, modems, set-top boxes and hard disk drives. We're building on that leadership position with investments in new technologies like our 0.18-micron TImeline process technology. And in February 1997, we introduced the industry's most powerful DSP, the 'C6x. It cuts design cycle times in half, while providing unmatched levels of performance.

Architectural leadership is essential, but it's not enough. To deliver strategic value in a differentiated solution, companies have to integrate around that leading architecture. And that means combining advanced technology with software and systems expertise and with tools for customer use and support. It means leveraging TI's strong position in mixed-signal chips – devices that translate the outside "analog" world of signals into the "zeros and ones" of the digital world. In fact TI became the number two supplier of analog chips worldwide in 1996.

The result? We're creating highly integrated, high-quality solutions for our customers that get them to market first with the latest innovations. We're delivering the modem chipset platform for U.S. Robotics' x2™ technology – up to 56 kilobits per second, the new standard for on-line speed. We developed a one-chip solution – replacing a seven-chip solution – for Seagate Technology, improving the performance and reducing the cost of their hard disk drives.

We will continue to focus on our market-leading position in digital signal processors. That focus gives our customers a powerful advantage. It lets them move faster. It reinforces our architectural leadership. It helps us develop integrated solutions. And it ensures that we're building differentiated solutions that deliver strategic value to our customers.

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"Commu-ti-cating"

Commuting and communicating at the same time. In Japan, people often spend several hours a day commuting to and from work. They use that time to communicate. And the best way to do that is with a mobile phone. In Japan, cellular phones must be very small, very thin and very light on power consumption. Mitsubishi designs its advanced phones for the Japanese cellular market with a TI DSP. Using the global design and manufacturing resources of both companies and focusing them on the specific needs of Japanese customers are what created a winning solution for Mitsubishi and TI.



Leading companies create value.

We introduced the 'C6x – the industry's most powerful digital signal processor – with 10 times the performance of any DSP on the market today.

10x



We drive change. Our leading technologies drive change in end-equipment markets. And that change creates growth. We participate in some of the fastest growing markets in the world. But the goal isn't to participate. The goal is to accelerate **and capture market**

growth.

Our goal is to be the first to deliver the next level of performance – in power, connectivity, flexibility and speed – to our customers. We're already aggressively pursuing that goal in three markets – wireless, networking and mass storage – with more to come.

Wireless. In 1996, our wireless-optimized DSP solutions were incorporated into 23 million digital cellular phones worldwide. That's more than half the digital cellular phones made last year. Our DSPs for wireless are focused on high-speed number crunching and are exceptionally efficient at voice coding, channel coding, error correction, demodulation and encryption. All of that means clear connections for cellular users. TI provides the most complete set of digital solutions for wireless communications in the semiconductor industry.

Networking. In 1996, we introduced the industry's first complete Ethernet switch on a chip called ThunderSwitch™ – a family of products that is revolutionizing the way local area network switches are built. Our ThunderLan™ products provide a seamless connection between the personal computer and the network, positioning TI silicon at both ends of the wire in office data communications. We've also invested millions of dollars in our Networking Technology Center. Its capabilities are unmatched in the industry. Its sole purpose is to get better networking products to market faster. It has paid off in one of the broadest portfolios of semiconductor networking solutions.

Mass storage. Our acquisition of Silicon Systems, Inc. (SSi) in the third quarter of 1996 firmly established TI as the leading semiconductor supplier to the mass storage market. We have substantial engagements with all major hard disk drive manufacturers as well as key designs in emerging areas like digital video disks (DVD) and removable storage. As a market leader, we intend to provide the higher levels of density, integration and performance that will drive the mass storage market.

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Zip It

Gotta lot of stuff? Zip it in an Iomega® Zip™ drive. Iomega brings inexpensive storage technology to computer users and makes their lives easier. If you've ever had your hard drive crash, you'll appreciate the comfort of having an external Zip drive on your desk. TI's mixed-signal portfolio – enhanced by the recent acquisition of SSI – helps Iomega bring that inexpensive technology to you. With the information age upon us, we're all going to have more stuff. Iomega and TI can help you zip it up.



Leading companies generate growth.

In the fast-growing digital cellular phone market that is projected to grow more than 40 percent a year*, we provide the most complete set of digital solutions of any semiconductor company.

>40%

A yellow line graph with four square markers showing an upward trend, set against a background of several mobile phones. The phones are arranged in a diagonal line from the bottom left to the top right, with some in focus and others blurred. The background is a dark green gradient.

Our strategy is to deliver more consistency in our results. We are pursuing many ideas – some innovative, some basic. Ideas focused on generating business results with **improved financial**

stability.

One basic approach has been to broaden our differentiated product portfolio. By building our business in digital signal processors, mixed-signal chips and other differentiated devices, we've shifted our semiconductor revenue base from less than 30 percent differentiated about 10 years ago to nearly two-thirds by year-end 1996. This shift in revenues has dramatically improved the consistency of our semiconductor operating results.

Nowhere is stability harder to achieve than in the DRAM market where the overall market in dollars decreased significantly during 1996. Our shared investment strategy was specifically designed to address market volatility. While these arrangements were unable to fully comprehend the 1996 market, the approach of sharing in the risks and rewards of the DRAM market did help cushion the impact of lower memory prices. We will continue to look for opportunities to reduce volatility in our DRAM business.

Another way we have added financial stability is through the negotiation of 10-year cross-license patent agreements with a number of companies, replacing five-year agreements that had expired.

Strong customer relationships are the ultimate in stability builders. We want to work side by side with our customers during the design process to build a foundation of long-term strategic relationships. We are building these types of relationships every day with customers like Ericsson, Nokia, Seagate, Sony and U.S. Robotics. What we call "design-ins" are often the result of strong customer relationships. We will continue to look for opportunities to get TI solutions designed into our customers' next-generation products. That's how we build and retain market-leading positions.

Another approach to improve financial stability has been to diversify our revenue base geographically. Over the last decade, we've moved from a heavy concentration in the U.S. and European markets to a geographically balanced mix, well aligned with the total market. To reach that level of diversity, we significantly strengthened our share of the market in Asia and Japan. We now have the world's best geographic coverage in the semiconductor industry.

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Hit the Brakes

But don't worry about skidding, thanks to antilock brake systems or ABS. ITT Automotive leads the fast-growing worldwide market for antilock brake systems in passenger cars. In 1996, TI delivered customized 8-bit and 16-bit microcontroller solutions for ITT Automotive. TI engineers in France and ITT engineers in Germany are laying the groundwork for third-generation ABS products that will further reduce cost and increase performance. Strong, close customer relationships such as the one we have with ITT Automotive help add financial stability to our business.



Leading companies produce stable financial returns.

TI revenues from higher margin, more stable differentiated products have grown steadily over the last 10 years, reaching nearly two-thirds of semiconductor revenues by year-end 1996.

~65%



In each of the businesses of Texas Instruments,
you can find the unique ways
we're focusing on

value + gro

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Blistering Speed

U.S. Robotics is breaking barriers for on-line speed – **x2 technology**. It brings up to 56 kilobits per second of information to your computer over traditional phone lines, nearly twice the rate of yesterday's modems. Whether you're downloading from the Internet, telecommuting into your office or simply sending an e-mail, you can do it at blistering speed. And that'll make the market for Internet access, for modems and for modem chipsets grow faster than ever before. TI's programmable modem chipsets – a DSP Solution – were the first to market with this breakthrough technology. With it, modem product designers and U.S. Robotics customers can easily upgrade equipment to x2 technology by reprogramming software, rather than changing the hardware. TI's leading DSP technology adds the flexibility that is key to getting x2 technology to market quickly.



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The Incredible Shrinking Chip

With TI's 0.18-micron process technology, Timeline, 125 million transistors can be packed onto a single chip. Why should you care? Because 125 million transistors is roughly the number of transistors found in a personal computer including the CPU, motherboard chips, modem, sound card, hard disk drive and memory. Because with 125 million transistors, the traffic of today's Internet could be routed by a switch the size of a soft drink can. With 125 million transistors, picture-phones and wrist computers could be as common as digital watches. **Timeline Technology** will drive new applications we can't even begin to imagine. It'll turn science fiction into science fact.

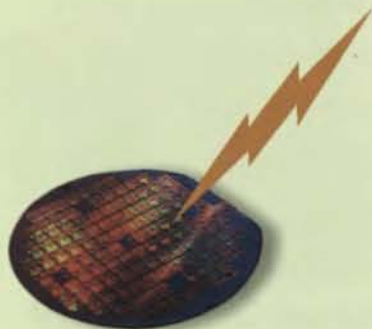
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The Beauty of Digital Light

A digital window on the world. That's the idea behind our **Digital Light Processing™ (DLP™)** system. It creates clear, bright and vivid images using digital information and more than 500,000 microscopic mirrors. In the future, it may change the way you experience personal computing and television. For now, it's changing the way you can present your thoughts and ideas. As the December 1996 issue of *PC Magazine* said when it announced DLP technology as the winner of its Technical Excellence award: "In the near future, we expect DLP technology to have a major impact on all sorts of displays. For now, we can make glowing presentations without having to turn off the lights." As the May 13, 1996, issue of *NewMedia Magazine* said: "Digital Light Processing knocks the pixels off traditional LCD and CRT technology."



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Digital Insurance?

Zurich Insurance Group UK has responded to competitive business conditions by bringing new financial products and services to market faster using **Composer™** from TI. Composer software is used to reengineer business systems by using a component-based development approach. By standardizing on many of these systems globally, Zurich Insurance Group is able to reduce costs while providing greater choice and satisfaction to their customers worldwide.



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The Battle for Bandwidth

Chances are your computer is hooked into some kind of network. If you battle for bandwidth every day – bandwidth to send data or video or an e-mail message – you may need a **ThunderSwitch** in your network. ThunderSwitch is the first Ethernet switch on a chip, and TI has it. It's the industry's only system on a chip – replacing more than 20 discrete devices with a single piece of silicon. That lowers costs, shrinks the size of network management hardware and simplifies designs. By making the advantages of a switched network more available and more affordable, we're driving a major trend in the networking industry. When you add ThunderSwitch to our broad line of networking products, you can see why TI is uniquely qualified to help you win the battle for bandwidth.



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Get Your Motor Running

Head out on the highway. The ride has never been smoother than it is now with our **transmission range sensors**. Ford Motor Company was looking for an electronic sensor to provide digital input to their transmission control module – input that supports smoother shifting and a more enjoyable ride. You can't see our sensor at work, but with every smooth shift your Ford vehicle makes, you'll know it's working.



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This Calculator Rules!

Some kids like cars, some like rap music, and some like the **TI-92**. The TI-92 was announced in 1995, and since then some amazing things have happened. TI-92 Web sites have sprung up all over the Internet – all of them created by TI-92 users. Two Tennessee high school students thought the TI-92 so indispensable to their learning, they presented a proposal to their school administrators asking the school to purchase 60 TI-92s for student use. We knew the TI-92 was a great tool – with the intelligence of a desktop computer and the portability of a handheld calculator. We knew it would take technology out of the computer lab and put it in kids' hands. What we didn't know and couldn't even begin to imagine were all the amazing places those kids would go with their TI-92s.

Without the support of our employees and the communities

in which we work, we could never realize our vision. As we sharpen our focus,

we renew our commitment to

people

The people of Texas Instruments bring our company's future into focus every day, in everything they do. Whether they operate a multimillion dollar stepper in one of our wafer fabrication facilities, run the test equipment in an assembly-test operation or develop the next-generation process technology in our new Research and Development Center, TI employees hold the company's future in their hands. Their determination to delight their customers, to deliver products with unmatched performance and superior quality and to constantly challenge the status quo is what puts Texas Instruments on the leading edge. As we move toward our vision of world leadership in digital solutions for the networked society, the opportunities and challenges for our employees will be great. We know the people of TI will capture those opportunities and meet the challenges head on. And we're not the only ones who think so. For example, in the fourth quarter of 1996, *U.S. Black Engineer and Information Technology* magazine recognized the outstanding achievements of two TI engineers – Zephra Freeman and Dixie Garr – by awarding each of them the Black Engineer of the Year Award. Also, in 1996, we were honored to win the Catalyst Award, recognizing our initiatives to advance the careers of women at TI.



community.



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Environment

There's money in eliminating waste. By following an aggressive program to design out waste and to recycle, we've reduced our total cost. Our goal is to reach zero wasted resources. It makes sense for TI, for our employees and for our communities. And our efforts haven't gone unnoticed. In November, our Freising, Germany, site was certified both by the International Standards Organization (ISO 14001) and by the European Union Environmental Management and Audit Scheme. These are two of the toughest standards for environmental management in the world. TI Germany is the first semiconductor operation in the world to be certified by both organizations. Our Taiwan operation is one of about 25 companies there to be ISO 14001 certified.

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Education

TI and the TI Foundation are taking an innovative approach to supporting education at all levels in all of our communities. As illustrated below, for children of every age, science and technology come alive at the TI Founders' IMAX Theater at the Science Place in Dallas. The new theater opened in June 1996 and provides a powerful learning experience and a financial boost for South Dallas. At the university level, we have long partnered with premier colleges and universities on high-potential research. Much of the work on digital signal processing was developed and published by Rice University faculty working with TI engineers. In 1996, we announced a \$7 million cash grant to Rice University to continue that partnership. In Europe, we launched the Schools Network Internet Programme, a pan-European initiative linking selected local schools and TI Europe sites via the Internet to help develop their knowledge and understanding of the Internet and the networked society.



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Work/Life

We recognize that work/life programs are about committed employees producing exceptional business results. We want TI to be a "family friendly" environment. We're providing our employees with several resources to help them keep a healthy balance between work and family. Nate and Faye Rainey, TI employees, are pictured here with their two children at Texins Kids Room, a child-care service provided at one of TI's fitness and activity centers. Our LifeWorks resource program, our WorkingSmart training classes and our parents' on-line network are all part of our work/life program at TI. In 1996, we were honored to be named as one of the "100 Best Companies for Working Mothers" by *Working Mother* magazine, which recognizes companies making progress in work/life programs and in advancing women in the workplace.

With this focus, we will realize our vision of world leadership in digital solutions for the networked society. At the heart of this vision are **digital signal processing**

solutions.

DSP. The engine of the networked society. A DSP is an incredibly powerful processor – 10 times as fast as the most powerful general-purpose micro-processor. It handles information real-time – no waiting. When you combine a DSP with other semiconductor devices, you get a DSP Solution. These **DSP Solutions** take signals from the real world – such as light, sound, heat and pressure. They translate those signals into the digital language of zeros and ones. Then the speed and power of the DSP take over. The digital information is processed and people **connect**. Every connection in the networked society is made by a DSP Solution. **You** connect with DSPs every day. DSPs are your connection **to the digital world**. The everyday appliances of the future have

not yet been invented. No one knows what they are. But we do know that DSPs will be the enabling engine of that future and the networked society.

Your World Today

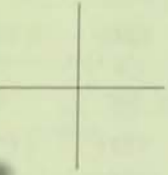
Your voice is clearly transmitted over a cellular phone. You exchange e-mail – real-time – with a friend over the Internet. Or you watch your favorite team play via direct satellite television. These connections are made through a DSP Solution.



the



...your television becomes a window on the world – pulling in digital movies, games, videoconferences and news. It keeps you connected, informed and entertained.



...your personal computer recognizes your speech as well as a wink and a nod. Welcome to the world of hands-free computing.



...a scanner verifies your bank balance and debits your account as you carry your merchandise out of the store. It eliminates check-out lines and paper checks.



...a personal, intelligent phone knows your preferences and schedule. It books your flight, dinner reservations and tickets for a show in London.

future — dsp

CONSOLIDATED FINANCIAL STATEMENTS

(In millions of dollars, except per-share amounts)

Income	<i>For the years ended December 31</i>		
	1996	1995	1994
Net revenues	\$ 9,940	\$11,409	\$ 8,608
Operating costs and expenses:			
Cost of revenues	7,146	7,401	5,725
Research and development	1,181	842	578
Marketing, general and administrative	1,639	1,727	1,379
Total	9,966	9,970	7,682
Profit (loss) from operations	(26)	1,439	926
Other income (expense) net	76	79	6
Interest on loans	73	48	45
Income (loss) before provision for income taxes	(23)	1,470	887
Provision for income taxes	23	474	295
Income (loss) from continuing operations	(46)	996	592
Income from discontinued operations	109	92	99
Net income	\$ 63	\$ 1,088	\$ 691
Earnings (loss) per common and common equivalent share:			
Continuing operations	\$ (.24)	\$ 5.15	\$ 3.12
Discontinued operations57	.48	.51
Net income	\$.33	\$ 5.63	\$ 3.63

See accompanying notes.

December 31

Balance Sheet**1996** **1995**

Assets

Current assets:

Cash and cash equivalents	\$ 964	\$1,364
Short-term investments	14	189
Accounts receivable, less allowance for losses of \$90 million in 1996 and \$45 million in 1995	1,799	2,079
Inventories	703	978
Prepaid expenses	50	57
Deferred income taxes	395	357
Net assets of discontinued operations	529	421
Total current assets	4,454	5,445

Property, plant and equipment at cost	6,712	4,880
Less accumulated depreciation	(2,550)	(1,986)
Property, plant and equipment (net)	4,162	2,894
Deferred income taxes	192	175
Other assets	552	234
Total assets	\$9,360	\$8,748

Liabilities and Stockholders' Equity

Current liabilities:

Loans payable and current portion long-term debt	\$ 314	\$ 27
Accounts payable and accrued expenses	1,940	2,313
Income taxes payable	163	170
Accrued retirement and profit sharing contributions	69	369
Total current liabilities	2,486	2,879

Long-term debt	1,697	804
Accrued retirement costs	719	643
Deferred credits and other liabilities	361	327

Stockholders' equity:

Preferred stock, \$25 par value. Authorized—10,000,000 shares. Participating cumulative preferred. None issued	—	—
Common stock, \$1 par value. Authorized—500,000,000 shares. Shares issued: 1996—190,396,797; 1995—189,526,939	190	190
Paid-in capital	1,116	1,081
Retained earnings	2,814	2,881
Less treasury common stock at cost. Shares: 1996—143,525; 1995—138,129	(12)	(12)
Other	(11)	(45)
Total stockholders' equity	4,097	4,095

Total liabilities and stockholders' equity	\$9,360	\$8,748
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See accompanying notes.

CONSOLIDATED FINANCIAL STATEMENTS

(In millions of dollars, except per-share amounts)

Cash Flows	For the years ended December 31		
	1996	1995	1994
Continuing operations:			
Cash flows from operating activities:			
Income (loss) from continuing operations	\$ (46)	\$ 996	\$ 592
Depreciation	904	681	580
Deferred income taxes	(51)	(54)	(32)
Net currency exchange losses	7	6	3
(Increase) decrease in working capital (excluding cash and cash equivalents, short-term investments, deferred income taxes, and loans payable and current portion long-term debt):			
Accounts receivable	250	(795)	(227)
Inventories	245	(221)	(74)
Prepaid expenses	9	9	(11)
Accounts payable and accrued expenses	(404)	691	331
Income taxes payable	(3)	112	(67)
Accrued retirement and profit sharing contributions	(283)	155	106
Increase (decrease) in noncurrent accrued retirement costs	79	48	(3)
Other	91	65	82
Net cash provided by operating activities	798	1,693	1,280
Cash flows from investing activities:			
Additions to property, plant and equipment	(2,063)	(1,351)	(1,020)
Purchases of short-term investments	(27)	(733)	(779)
Sales and maturities of short-term investments	202	1,076	732
Acquisition of business, net of cash acquired	(313)	—	—
Proceeds from sale of businesses	150	—	—
Net cash used in investing activities	(2,051)	(1,008)	(1,067)
Cash flows from financing activities:			
Additions to loans payable	288	12	40
Payments on loans payable	(2)	—	(41)
Additions to long-term debt	871	24	1
Payments on long-term debt	(199)	(12)	(88)
Dividends paid on common stock	(129)	(111)	(79)
Sales and other common stock transactions	35	111	110
Other	(1)	(1)	(2)
Net cash provided by (used in) financing activities	863	23	(59)
Effect of exchange rate changes on cash	(16)	10	6
Cash provided by (used in) continuing operations	(406)	718	160
Discontinued operations:			
Operating activities	86	(26)	252
Investing activities	(80)	(88)	(56)
Financing activities	—	—	—
Cash provided by (used in) discontinued operations	6	(114)	196
Net increase (decrease) in cash and cash equivalents	(400)	604	356
Cash and cash equivalents at beginning of year	1,364	760	404
Cash and cash equivalents at end of year	\$ 964	\$ 1,364	\$ 760

See accompanying notes.

Stockholders' Equity	Common Stock	Paid-In Capital	Retained Earnings	Treasury Common Stock	Other
Balance, December 31, 1993	\$ 91	\$ 932	\$ 1,307	\$ (5)	\$ (10)
1994					
Net income			691		
Dividends declared on common stock (\$.47 per share)			(86)		
Common stock issued:					
To profit sharing trusts		31			
On exercise of stock options	2	60		3	
Other stock transactions, net		18		(4)	
Pension liability adjustment					10
Cash investments adjustment					(1)
Balance, December 31, 1994	93	1,041	1,912	(6)	(1)
1995					
Net income			1,088		
Dividends declared on common stock (\$.64 per share)			(119)		
Two-for-one common stock split	94	(94)			
Common stock issued:					
On exercise of stock options	3	81		6	
On conversion of debentures		20			
Other stock transactions, net		33		(12)	
Pension liability adjustment					(45)
Cash investments adjustment					1
Balance, December 31, 1995	190	1,081	2,881	(12)	(45)
1996					
Net income			63		
Dividends declared on common stock (\$.68 per share)			(130)		
Common stock issued on exercise of stock options		28			
Other stock transactions, net		7			
Pension liability adjustment					6
Equity and cash investments adjustment					28
Balance, December 31, 1996	\$ 190	\$ 1,116	\$ 2,814	\$ (12)	\$ (11)

See accompanying notes.

Accounting Policies and Practices

The consolidated financial statements include the accounts of all subsidiaries. The preparation of financial statements requires the use of estimates from which final results may vary. Intercompany balances and transactions have been eliminated. The U.S. dollar is the functional currency for financial reporting. With regard to accounts recorded in currencies other than U.S. dollars, current assets (except inventories), deferred income taxes, other assets, current liabilities and long-term liabilities are remeasured at exchange rates in effect at year end. Inventories, property, plant and equipment and depreciation thereon are remeasured at historic exchange rates. Revenue and expense accounts other than depreciation for each month are remeasured at the appropriate month-end rate of exchange. Net currency exchange gains and losses from remeasurement and forward currency exchange contracts to hedge net balance sheet exposures are charged or credited on a current basis to other income (expense) net. Gains and losses from forward currency exchange contracts and interest rate swaps to hedge specific transactions are included in the measurement of the related transactions.

As discussed in the Discontinued Operations footnote, the consolidated financial statements have been restated to classify TI's Defense Systems and Electronics business as discontinued operations. Also, beginning in 1996, the company has made reclassifications to its statement of income to conform with current industry practices. Research and development expense, which was previously included in cost of revenues, is now presented separately. Also, employees' retirement and profit sharing plans expense, previously separately reported, is now allocated throughout operating costs and expenses, consistent with other employee benefit costs. Prior year amounts have been reclassified to conform with the 1996 presentation.

Inventories are stated at the lower of cost, current replacement cost or estimated realizable value. Cost is generally computed on a currently adjusted standard (which approximates current average costs) or average basis.

Revenues are generally recognized as products are shipped or services are rendered. Royalty revenue is recognized by the company upon fulfillment of its contractual obligations and determination of a fixed royalty amount, or, in the case of ongoing royalties, upon sale by the licensee of royalty-bearing products, as estimated by the company.

Substantially all depreciation is computed by either the declining-balance method (primarily 150 percent declining method) or the sum-of-the-years-digits method. Fully depreciated assets are written off against accumulated depreciation.

Advertising costs are expensed as incurred. Advertising expense was \$124 million in 1996, \$131 million in 1995 and \$87 million in 1994.

Earnings per common and common equivalent share are based on average common and common equivalent shares outstanding (192,117,119 shares, 193,630,826 shares and 190,854,565 shares for 1996, 1995 and 1994). Shares issuable upon exercise of dilutive stock options and upon conversion of dilutive convertible debentures are included in average common and common equivalent shares outstanding. In computing per-share earnings, net income is increased

by \$2 million in both 1995 and 1994 for interest (net of tax and profit sharing effect) on the convertible debentures considered dilutive common stock equivalents.

Discontinued Operations

On January 6, 1997, TI and Raytheon Company announced that their boards of directors had approved a definitive agreement dated as of January 4, 1997, for Raytheon to purchase TI's Defense Systems and Electronics business (DSE) for \$2.95 billion in cash. The transaction is subject to Hart-Scott-Rodino antitrust review and is expected to close in the second quarter of 1997. The consolidated financial statements of TI have been restated to present the DSE operations, assets and liabilities as discontinued operations.

The assets and liabilities of DSE have been classified on the balance sheet as net assets of discontinued operations and consist of the following:

	<i>Millions of Dollars</i>	
	1996	1995
Accounts receivable	\$ 278	\$ 240
Inventories (net of progress billings)	221	157
Prepaid expenses	1	—
Current deferred income taxes	91	96
Property, plant and equipment (net)	296	293
Noncurrent deferred income taxes	62	54
Other assets	40	47
Total assets of DSE	989	887
Accounts payable and accrued expenses	234	259
Accrued retirement costs	226	207
Total liabilities of DSE	460	466
Net assets of discontinued operations	\$ 529	\$ 421

The net income from operations of DSE has been classified on the statement of income as income from discontinued operations. Summarized results of discontinued operations are as follows:

	<i>Millions of Dollars</i>		
	1996	1995	1994
Net revenues	\$1,773	\$1,720	\$1,707
Income before provision for income taxes	175	149	155
Provision for income taxes	66	57	56
Income from discontinued operations	109	92	99

The Defense Systems and Electronics business includes products such as radar systems, navigation systems, infrared surveillance and fire control systems, defense suppression missiles, missile guidance and control systems, and electronic warfare systems, which are sold to the U.S. government (either directly or through prime contractors) and to international customers approved by the U.S. government. TI has provided various ongoing services to DSE including, but not limited to, facilities management, data processing, security, payroll and employee benefits administration, insurance administration, duplicating and telecommunications services. Their inclusion in discontinued operations is based upon TI's intercorporate allocation procedures for such services. The allocation basis of these

expenses and all other central operating costs is first on the basis of direct usage when identifiable, with the remainder allocated among DSE and other TI businesses on the basis of their respective revenues, headcount or other measures. These expenses allocated to DSE totaled \$163 million in 1996, \$167 million in 1995 and \$161 million in 1994. It is expected that TI will reach agreements for payments from Raytheon to continue to provide certain of these services on an ongoing basis and others on a transition basis to DSE following Raytheon's acquisition.

Income from discontinued operations for 1996 includes the effect of a fourth quarter pretax charge of \$32 million for voluntary and involuntary severance actions in the United States. These actions were essentially completed by year-end 1996 and affected approximately 700 DSE employees.

Cash Equivalents and Investments

Debt securities with original maturities within three months are considered cash equivalents. Debt securities with original maturities beyond three months have remaining maturities within 13 months and are considered short-term investments. These cash equivalent and short-term investment debt securities are available for sale and stated at fair value, which approximates their specific amortized cost. As of December 31, 1996, these debt securities consisted primarily of the following types: U.S. government (\$9 million), corporate (\$413 million), and asset-backed commercial paper (\$300 million). At December 31, 1995, these debt securities consisted primarily of the following types: U.S. government (\$205 million), corporate (\$667 million), and asset-backed commercial paper (\$405 million). Gross realized and unrealized gains and losses for each of these security types were immaterial in 1996, 1995 and 1994. Proceeds from sales of these cash equivalent and short-term investment debt securities in 1996, 1995 and 1994 were \$10 million, \$190 million and \$75 million.

Adjustments to fair value of cash equivalent and short-term investments as well as noncurrent publicly traded equity investments are recorded as an increase or decrease in stockholders' equity. At December 31, 1996, this adjustment, net of a deferred tax effect of \$15 million, was an increase of \$28 million (zero for cash equivalent and short-term investments and \$28 million for noncurrent equity investments). At year-end 1995 and 1994, this adjustment was zero and a decrease of \$1 million. Gross realized and unrealized holding gains and losses and proceeds from sales of equity investments were immaterial in 1996, 1995 and 1994. The aggregate fair value of these noncurrent equity investments at December 31, 1996 was \$63 million compared to their original cost of \$20 million. Similar amounts for 1995 were immaterial.

Inventories

	Millions of Dollars	
	1996	1995
Raw materials and purchased parts	\$ 111	\$ 209
Work in process	361	341
Finished goods	231	428
Inventories	\$ 703	\$ 978

To secure access to additional semiconductor plant capacity, TI participates in several joint ventures formed to construct and operate DRAM semiconductor manufacturing facilities. Upon formation of the ventures TI contributed technology and cash to acquire minority interests and entered into long-term inventory purchase commitments with each joint venture. Under the agreements, TI purchases the output of the ventures at prices based upon percentage discounts from TI's average selling prices. This pricing method is designed to help reduce the effect of market volatility on TI, although it may not be able to fully comprehend a sharp decline in average unit prices. Certain co-venturers have the right to buy a portion of the output from TI. Under the ventures' financing arrangements, the venturers have provided certain debt and other guarantees. At December 31, 1996 and 1995, TI was contingently liable for an aggregate of \$25 million and \$40 million of such guarantees. Inventory purchases from the ventures aggregated \$1176 million in 1996, \$1779 million in 1995 and \$908 million in 1994. Receivables from and payables to the ventures were \$43 million and \$66 million at December 31, 1996, and \$25 million and \$223 million at December 31, 1995.

The purpose of the joint ventures is to provide semiconductor output for TI and other co-venturers. As a result, TI expects to recover its cost of the ventures through sale of the semiconductor output, and is amortizing its cost of the ventures over the expected initial output period of 3 to 5 years, and recognizing its share of any cumulative venture net losses in excess of amortization. The related expense charged to operations was \$33 million in 1996, \$15 million in 1995 and \$15 million in 1994.

Property, Plant and Equipment at Cost

	Depreciable Lives	Millions of Dollars	
		1996	1995
Land		\$ 89	\$ 71
Buildings and improvements	5-40 years	2,372	1,711
Machinery and equipment	3-10 years	4,251	3,098
Total		\$6,712	\$4,880

Authorizations for property, plant and equipment expenditures in future years were approximately \$795 million at December 31, 1996 and \$1620 million at December 31, 1995.

Accounts Payable and Accrued Expenses

	Millions of Dollars	
	1996	1995
Accounts payable	\$ 775	\$1,044
Advance payments	84	144
Accrued salaries, wages, severance and vacation pay	309	368
Other accrued expenses and liabilities	772	757
Total	\$1,940	\$2,313

NOTES TO FINANCIAL STATEMENTS

(continued)

Debt and Lines of Credit

Long-Term Debt	Millions of Dollars	
	1996	1995
9.0% notes due 1999	\$ —	\$ 150
6.75% notes due 1999	200	—
6.875% notes due 2000	200	—
9.0% notes due 2001	150	150
6.65% notes, due in installments through 2001	200	—
9.25% notes due 2003	150	150
6.125% notes due 2006	300	—
8.75% notes due 2007	150	150
3.98% to 6.10% Italian lira mortgage notes (17% swapped for 1.60% U.S. dollar obligation)	200	104
2.75% convertible subordinated debentures due 2002	103	103
Other	59	10
	1,712	817
Less current portion long-term debt	15	13
Total	\$1,697	\$ 804

In the first quarter of 1996, the company issued \$300 million of 6.125% notes due 2006 and, in the third quarter, redeemed, at par, \$150 million of 9.0% notes due 1999. In July 1996, the company acquired Silicon Systems, Inc., via a stock purchase agreement for \$340 million in cash plus the assumption of \$235 million 4.0% long-term notes (\$217 million, as imputed to the then prevailing market interest rate of 6.65%) to TDK Corp. of Japan. The cash payment, initially financed by a draw down on TI's existing line of bank credit, was permanently financed through the company's issuance on July 26 of \$400 million of notes due 1999 and 2000.

The convertible subordinated debentures may be redeemed at the company's option at specified prices. The debentures are convertible at the holder's option into an aggregate 2,493,031 shares of TI common stock at a common stock conversion price of \$41.4375 per share.

A portion of the coupon rates for the notes due 2001 and 2007 (in 1995, notes due 1999, 2001, 2003 and 2007) have been swapped for commercial-paper-based or LIBOR-based variable rates through March 1997, resulting in a combination of fixed plus short-term variable rates for an effective interest rate of approximately 9.1% and 9.5% as of December 31, 1996 and 1995. The Italian lira mortgage notes, and related swaps, are due in installments through 2005. The mortgage notes are collateralized by real estate and building equipment.

Interest incurred on loans in 1996, 1995 and 1994 was \$108 million, \$69 million and \$58 million. Of these amounts, \$35 million in 1996, \$21 million in 1995 and \$13 million in 1994 were capitalized as a component of capital asset construction costs. Interest paid on loans (net of amounts capitalized) was \$54 million in 1996, \$48 million in 1995 and \$53 million in 1994.

Aggregate maturities of long-term debt due during the four years subsequent to December 31, 1997, are as follows:

	Millions of Dollars
1998	\$ 60
1999	267
2000	314
2001	229

The company maintains lines of credit to support commercial paper borrowings and to provide additional liquidity. These lines of credit totaled \$696 million at December 31, 1996 and \$538 million at December 31, 1995. Of these amounts, at December 31, 1996 and 1995, \$600 million and \$440 million exist to support outstanding and future commercial paper borrowings or short-term bank loans. At December 31, 1996, outstanding commercial paper borrowings of \$299 million with a weighted-average interest rate of 5.49% are included in current loans payable.

Financial Instruments and Risk Concentration

Financial instruments: In addition to the swaps discussed in the preceding note, as of December 31, 1996, the company had forward currency exchange contracts outstanding of \$333 million to hedge net balance sheet exposures (including \$82 million to buy deutsche mark, \$48 million to sell yen, and \$36 million to sell French francs). At December 31, 1995, the company had forward currency exchange contracts outstanding of \$303 million to hedge net balance sheet exposures (including \$78 million to buy deutsche mark, \$40 million to buy Singapore dollars, and \$36 million to buy yen). As of December 31, 1996 and 1995, the carrying amounts and current market settlement values of these swaps and forward contracts were not significant.

The company uses forward currency exchange contracts, including the lira note swaps, to minimize the adverse impacts from the effect of exchange rate fluctuations on the company's underlying non-U.S. net balance sheet exposures. The interest rate swaps for the company's notes due 2001 and 2007 (in 1995, notes due 1999, 2001, 2003 and 2007) are used to change the characteristics of the interest rate stream on the debt from fixed rates to a combination of fixed plus short-term variable rates in order to achieve a mix of interest rates which, over time, is expected to moderate financing costs. The effect of these interest rate swaps was to increase interest expense by \$2 million and \$6 million in 1996 and 1995 and reduce interest expense by \$8 million in 1994. These interest rate swaps are sensitive to interest rate changes. If short-term interest rates increase (decrease) by one percentage point from year-end 1996 rates, annual interest expense would increase (decrease) by \$3 million.

In order to minimize its exposure to credit risk, the company limits its counterparties on the forward currency exchange contracts and interest rate swaps to investment-grade rated financial institutions.

As of December 31, 1996, and 1995, the fair value of long-term debt, based on current interest rates, was approximately \$1759 million and \$902 million, compared with the carrying amount of \$1712 million and \$817 million.

Risk concentration: Financial instruments which potentially subject the company to concentrations of credit risk are primarily cash investments and accounts receivable. The company places its cash investments in investment-grade, short-term debt securities and limits the amount of credit exposure to any one commercial issuer. Concentrations of credit risk with respect to the receivables are limited due to the large number of customers in the company's

customer base, and their dispersion across different industries and geographic areas. The company maintains an allowance for losses based upon the expected collectibility of accounts receivable.

Stockholders' Equity

The company is authorized to issue 10,000,000 shares of preferred stock. None are currently outstanding.

Each outstanding share of the company's common stock carries half a stock purchase right. Under certain circumstances, each right may be exercised to purchase one one-hundredth of a share of the company's participating cumulative preferred stock for \$200. Under certain circumstances following the acquisition of 20% or more of the company's outstanding common stock by an acquiring person (as defined in the rights agreement), each right (other than rights held by an acquiring person) may be exercised to purchase common stock of the company or a successor company with a market value of twice the \$200 exercise price. The rights, which are redeemable by the company at 1 cent per right, expire in June 1998.

Research and Development Expense

Research and development expense, which totaled \$1181 million in 1996, \$842 million in 1995 and \$578 million in 1994, included a one-time charge in 1996 of \$192 million for the value of acquired in-process research and development as a result of the acquisition of Silicon Systems, Inc., a semiconductor enterprise. There was no tax offset associated with this one-time charge.

Other Income (Expense) Net

	Millions of Dollars		
	1996	1995	1994
Interest income	\$ 62	\$ 87	\$ 51
Other income (expense) net	14	(8)	(45)
Total	\$ 76	\$ 79	\$ 6

Stock Options

The company has stock options outstanding to participants under the Texas Instruments 1996 Long-Term Incentive Plan, approved by stockholders on April 18, 1996. Options are also outstanding under the 1984 and 1988 Stock Option Plans and the Texas Instruments Long-Term Incentive Plan; however, no further options may be granted under these plans. Under all these stockholder-approved plans, the exercise price per share may not be less than 100 percent of the fair market value on the date of the grant. Substantially all the options have a 10-year term and do not become exercisable until after eight years, although exercisability may be accelerated to the extent that earnings per share goals are achieved.

Under the 1996 Long-Term Incentive Plan, the company may grant stock options, including incentive stock options; restricted stock and restricted stock units; performance units; and other stock-based awards, including stock appreciation rights. The plan provides for the issuance of 18,500,000 shares of the company's common stock; in addition, if any award under the 1984 or 1988 Stock Option Plans or

the Long-Term Incentive Plan terminates, then any unissued shares subject to the terminated award become available for granting awards under the 1996 Long-Term Incentive Plan. No more than 2,000,000 shares of common stock may be awarded as restricted stock, restricted stock units or other stock-based awards under the plan. In 1996, 55,014 shares of restricted stock units, which vest over 1 to 5 years, were granted (weighted-average award-date value of \$45.31 per share). In addition, 34,906 previously unissued shares were issued as Annual Incentive Plan stock awards in 1996 (weighted-average award-date value of \$46.56 per share). Compensation expense for restricted stock units and annual stock awards totaled \$1.6 million in 1996.

The company also has stock options outstanding under an Employees Stock Option Purchase Plan approved by stockholders in 1988. The plan provides for options to be offered to all eligible employees in amounts based on a percentage of the employee's prior year's compensation. If the optionee authorizes and does not cancel payroll deductions which, with interest, will be equal to or greater than the purchase price, options granted become exercisable 14 months, and expire not more than 27 months, from date of grant.

Stock option transactions during 1996, 1995 and 1994 were as follows:

	Long-Term Incentive and Stock Option Plans	Weighted- Average Exercise Price	Employees Stock Option Purchase Plan	Weighted- Average Exercise Price
Balance, Dec. 31, 1993 ..	8,904,496	\$20.51	1,036,612	\$29.94
Granted	1,719,500	35.21	685,124 *	41.07
Forfeited	(99,202)	26.51	(141,958)	35.27
Expired	—	—	—	—
Exercised**	(2,365,240)	19.28	(630,996)	28.16
Balance, Dec. 31, 1994 ..	8,159,554	23.91	948,782	38.37
Granted	2,911,760	35.68	982,948 *	59.32
Forfeited	(118,364)	33.68	(110,485)	48.45
Expired	—	—	—	—
Exercised**	(3,070,378)	20.97	(687,536)	37.41
Balance, Dec. 31, 1995 ..	7,882,572	29.24	1,133,709	56.13
Granted	2,663,375	45.84	848,546 *	56.25
Forfeited	(198,739)	26.16	(399,909)	58.43
Expired	—	—	—	—
Exercised**	(434,660)	25.80	(386,162)	50.36
Balance, Dec. 31, 1996 ..	9,912,548	\$33.91	1,196,184	\$57.31

* Excludes options offered but not accepted.

** Includes previously unissued shares and treasury shares of 820,822 and zero; 3,656,872 and 101,042; and 2,938,686 and 57,550 for 1996, 1995 and 1994.

In accordance with the terms of APB No. 25, the company records no compensation expense for its stock option awards. As required by SFAS No. 123, the company provides the following disclosure of hypothetical values for these awards. The weighted-average grant-date value of options granted during 1996 was estimated to be \$18.47 under the Long-Term Incentive Plans (Long-Term Plans) and \$12.10 under the Employees Stock Option Purchase Plan (Employees Plan). These values were estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions: expected

NOTES TO FINANCIAL STATEMENTS

(continued)

dividend yield of 1.48% (Long-Term Plans) and 1.21% (Employees Plan), expected volatility of 39%, risk-free interest rates of 5.42% (Long-Term Plans) and 6.15% (Employees Plan); and expected lives of 6 years (Long-Term Plans) and 1.5 years (Employees Plan). Had compensation expense been recorded based on these hypothetical values, the company's 1996 net income would have been \$40 million, or \$0.21 per share. A similar computation for 1995 would have resulted in net income of \$1078 million, or \$5.57 per share. Because options vest over several years and additional option grants are expected, the effects of these hypothetical calculations are not likely to be representative of similar future calculations.

Summarized information about stock options outstanding under the Long-Term Plans and Stock Option Plans at December 31, 1996, is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at Dec. 31, 1996	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at Dec. 31, 1996	Weighted-Average Exercise Price
\$16.41 to 27.38	3,263,288	4.5 years	\$21.63	3,263,288	\$21.63
35.10 to 49.50	6,553,410	8.2	39.55	2,245,578	35.51
51.13 to 81.19	95,850	8.9	66.93	35,500	72.31
\$16.41 to 81.19	9,912,548	7.0	\$33.91	5,544,366	\$27.58

At December 31, 1996, the stock options outstanding under the Employees Plan have exercise prices of \$56.25 or \$59.32, depending on the year of grant, and a weighted-average remaining contractual life of 1.3 years. Of the total outstanding options, 412,022 are exercisable at year-end 1996.

In connection with the purchase of DSE by Raytheon Company, vested TI options held by DSE employees under the Long-Term Plans and stock option plans will be modified by TI to retain their full contractual life instead of expiring within three months of the DSE transaction. As a result, an expense charge to discontinued operations will be recorded at the time of the transaction closing. Unvested Long-Term Plan options will be canceled and replaced by Raytheon Company with Raytheon options. Vested Employees Plan options will expire three months after closing. Unvested Employees Plan options will be canceled and payroll deductions, with interest, will be refunded. At December 31, 1996, options held by DSE employees were as follows:

	Long-Term and Stock Options Plans	Employee Plan
Vested	489,337	113,868
Unvested	279,363	214,806

At year-end 1996, 18,415,865 shares were available for future grants under the 1996 Long-Term Incentive Plan and 2,237,858 shares under the Employees Stock Option Purchase Plan. As of year-end 1996, 28,765,675 shares were reserved for issuance under the company's stock option and incentive plans and 3,434,042 shares were reserved for issuance under the Employees Stock Option Purchase Plan.

The company acquires its common stock from time to time for use

in connection with exercise of stock options and other stock transactions. Treasury shares acquired in 1996, 1995 and 1994 were 7,730 shares, 135,001 shares and 59,198 shares. Previously unissued common shares issued under the Long-Term Incentive Plan and the Annual Incentive Plan in 1996, 1995 and 1994 were 49,036 shares, 16,386 shares and 46,330 shares. Treasury shares issued under the Texas Instruments Restricted Stock Unit Plan for Directors in 1996 were 2,334 shares.

Profit Sharing and Retirement Plans

The company provides various incentive plans for employees, including general profit sharing and savings programs as well as an Annual Incentive Plan for key employees. The company also provides pension and retiree health care benefit plans in the U.S. and pension plans in certain non-U.S. locations.

Profit sharing: There was no profit sharing expense in 1996. Profit sharing expense was \$257 million in 1995 and \$133 million in 1994. Under the plans, unless otherwise provided by local law, the company and certain of its subsidiaries contribute a portion of their net profits equal to 25% of the amount by which consolidated income (as defined) before profit sharing and income taxes exceeds 8% of the company's consolidated average assets for the year. Effective 1995, the majority of the profit sharing plans worldwide provide that, depending on the individual plan, from 50% to 100% of the profit sharing earned by employees is paid in cash to the eligible participants with the balance contributed to a deferred plan. For non-U.S. employees, contributions to a deferred plan generally are invested in TI common stock. For U.S. employees, several investment options, including TI common stock, are available.

Except in the event of company contributions in stock, investments in TI common stock are made by the trustees through purchases of outstanding shares or through purchases of shares offered from time to time by the company. The board of directors has authorized the issuance of previously unissued shares for purposes of the plans; 4,616,918 of such shares were available for future issuance at December 31, 1996.

The trustees of the profit sharing plans purchased 3,123,905 outstanding shares of TI common stock in 1996 (4,762,460 shares in 1995 and 1,881,815 shares in 1994) and no previously unissued shares in 1996 and 1995 (403,945 shares in 1994) for use in the profit sharing plans and savings program.

Savings program: The company provides a matched savings program whereby U.S. employees' contributions of up to 4% of their salary are matched by the company at the rate of 50 cents per dollar. Contributions are subject to statutory limitations. The contributions may be invested in several investment funds including TI common stock. The company's expense under this program was \$17 million in 1996, \$14 million in 1995 and \$13 million in 1994.

U.S. pension plan: The company has a defined benefit plan covering most U.S. employees with benefits based on years of service and employee's compensation. The plan is a career-average-pay plan which has been amended periodically in the past to produce approximately the same results as a final-pay type plan. The board of directors of the company has expressed an intent to make such

amendments in the future, circumstances permitting, and the expected effects of such amendments have been considered in calculating U.S. pension expense. The company's funding policy is to contribute to the plan at least the minimum amount required by ERISA. Plan assets consist primarily of common stock, U.S. government obligations, commercial paper and real estate.

As noted in the Discontinued Operations footnote, accrued retirement costs of \$226 million at year-end 1996 and \$207 million at year-end 1995, consisting primarily of the U.S. pension plan and the retiree health care benefit plan obligations and assets related to DSE employees, is included in discontinued operations. The following information on pension and retiree health care benefit plans excludes discontinued operations amounts.

Pension expense of the U.S. plan includes the following components:

	<i>Millions of Dollars</i>		
	1996	1995	1994
Service cost — benefits earned			
during the period	\$ 40	\$ 31	\$ 35
Interest cost on projected benefit obligation	51	44	42
Return on plan assets:			
Actual return	(123)	(95)	10
Deferral	82	57	(47)
Net amortization	(2)	(5)	(4)
U.S. pension expense	\$ 48	\$ 32	\$ 36

The funded status of the U.S. plan was as follows:

	<i>Millions of Dollars</i>	
	1996	1995
Actuarial present value at Dec. 31 of:		
Vested benefit obligation	\$ (540)	\$(434)
Accumulated benefit obligation	\$ (595)	\$(493)
Projected benefit obligation	\$ (819)	\$(750)
Plan assets at fair value	611	546
Projected benefit obligation in excess of plan assets	(208)	(204)
Unrecognized net asset from initial application of SFAS 87	(20)	(42)
Unrecognized net loss	8	60
Unrecognized prior service cost	18	23
Accrued pension at Dec. 31	(202)	(163)
Less current portion	45	43
Accrued U.S. pension costs	\$ (157)	\$(120)

The projected benefit obligations for 1996 and 1995 were determined using assumed discount rates of 7.25% and 7.0% and an assumed average long-term pay progression rate of 4.25%. The assumed long-term rate of return on plan assets was 9.0%.

Non-U.S. pension plans: Retirement coverage for non-U.S. employees of the company is provided, to the extent deemed appropriate, through separate plans. Retirement benefits are based on years of service and employee's compensation, generally during a fixed number of years immediately prior to retirement. Funding policies are based on local statutes. Plan assets consist primarily of common stock, government obligations and corporate bonds.

Pension expense of the non-U.S. plans includes the following components:

	<i>Millions of Dollars</i>		
	1996	1995	1994
Service cost — benefits earned			
during the period	\$ 64	\$ 59	\$ 56
Interest cost on projected benefit obligations	34	38	32
Return on plan assets:			
Actual return	(49)	(32)	(15)
Deferral	14	(3)	(15)
Net amortization	13	10	11
Non-U.S. pension expense	\$ 76	\$ 72	\$ 69

The funded status of the non-U.S. plans was as follows:

	<i>Millions of Dollars</i>	
	1996	1995
Actuarial present value at Sept. 30 of:		
Vested benefit obligations	\$ (535)	\$(523)
Accumulated benefit obligations	\$ (696)	\$(619)
Projected benefit obligations	\$ (940)	\$(873)
Plan assets at fair value	500	448
Projected benefit obligations in excess of plan assets	(440)	(425)
Unrecognized net liabilities from initial application of SFAS 87	18	21
Unrecognized net loss	236	253
Unrecognized prior service cost	12	5
Accrued non-U.S. pension at Sept. 30	(174)	(146)
Additional minimum liability	(48)	(56)
Adjustments from Sept. 30 to Dec. 31	(3)	(5)
Less prepaid pension costs at Dec. 31	13	12
Accrued pension at Dec. 31	(238)	(219)
Less current portion	4	12
Accrued non-U.S. pension costs	\$ (234)	\$(207)

The range of assumptions used for the non-U.S. plans reflects the different economic environments within the various countries. The projected benefit obligations were determined using a range of assumed discount rates of 3.25% to 8.0% in 1996 and 1995 and a range of assumed average long-term pay progression rates of 3.0% to 6.0% in 1996 and 3.5% to 6.0% in 1995. The range of assumed long-term rates of return on plan assets was 7.0% to 9.0%. Accrued pension at December 31 includes approximately \$111 million in 1996 and \$101 million in 1995 for two non-U.S. plans that are not funded.

Pension accounting rules require recognition in the balance sheet of an additional minimum pension liability equal to the excess of the accumulated benefit obligation over the fair value of the plan assets. A corresponding amount is recognized as an intangible asset, not to exceed the amount of unrecognized prior service cost, with the balance recorded as a reduction of stockholders' equity. As of December 31, 1996 and 1995, the company has recorded an additional non-U.S. minimum pension liability of \$48 million and \$56 million and an equity reduction of \$39 million and \$45 million.

Retiree health care benefit plan: The company's U.S. employees are currently eligible to receive, during retirement, specified company-paid medical benefits. The plan is contributory and premiums

NOTES TO FINANCIAL STATEMENTS

(continued)

are adjusted annually. For employees retiring on or after January 5, 1993, the company has specified a maximum annual amount per retiree, based on years of service, that it will pay toward retiree medical premiums. For employees who retired prior to that date, the company maintains a consistent level of cost sharing between the company and the retiree. Any funding of the plan obligation will be at amounts determined at the discretion of management.

Expense of the retiree health care benefit plan includes the following components:

	<i>Millions of Dollars</i>		
	1996	1995	1994
Service cost – benefits earned during the period	\$ 4	\$ 4	\$ 3
Interest cost on accumulated postretirement benefit obligation	22	23	24
Retiree health care benefit expense	<u>\$ 26</u>	<u>\$ 27</u>	<u>\$ 27</u>

The funded status of the plan was as follows:

	<i>Millions of Dollars</i>	
	1996	1995
Actuarial present value at Dec. 31 of accumulated postretirement benefit obligation:		
Retirees	\$ (239)	\$ (235)
Fully eligible employees	(11)	(16)
Other employees	(62)	(76)
Accumulated postretirement benefit obligation	(312)	(327)
Unrecognized net (gain) loss	(23)	6
Unrecognized prior service cost	(7)	(7)
Accrued at Dec. 31	(342)	(328)
Less current portion	14	12
Accrued retiree health care benefit costs	<u>\$ (328)</u>	<u>\$ (316)</u>

Retiree health care benefit amounts were determined using health care cost trend rates of 7.3% for 1997 decreasing to 5.0% by 2000, and assumed discount rates of 7.25% for 1996 and 7.0% for 1995. Increasing the health care cost trend rates by 1% would have increased the accumulated postretirement benefit obligation at December 31, 1996, by \$16 million and 1996 plan expense by \$2 million.

Special actions: In the fourth quarter of 1996, the company took a pretax charge of \$208 million, of which \$91 million was for severance for cost reduction actions consisting of a voluntary retirement program in the United States and selected involuntary employment reductions worldwide. These actions, which primarily involved the components and digital products segments were essentially completed by year-end 1996 and affected approximately 2,600 employees. The balance of the charge, \$117 million, was for asset write-downs on several product lines, primarily the mobile computing business. In 1994, the company took a pretax charge of \$126 million for restructuring of its European operations and divestiture of certain non-strategic product lines. These actions were essentially completed by year-end 1995.

Industry Segment and Geographic Area Operations

The company is engaged in the development, manufacture and sale of a variety of products in the commercial electronics and electrical industry primarily for industrial and consumer markets. These products and their markets consist of the following: components (semiconductors, such as integrated circuits, discrete devices and sub-assemblies, and electrical and electronic control devices) which are sold primarily to original equipment manufacturers principally through the company's own marketing organizations and to a lesser extent through distributors; digital products (such as electronic calculators, software productivity tools, mobile computing products and other electronic systems) which are marketed through various channels, including system suppliers, business equipment dealers, distributors, retailers, and direct sales to end-users and original equipment manufacturers. In 1996, the company sold substantially all of its custom manufacturing services business and its printer business, which were part of the digital products segment. Subsequent to year-end 1996, the company entered into an agreement to sell its mobile computing business. The company also produces metallurgical materials (including clad metals, precision-engineered parts and electronic connectors) which are primarily sold directly to original equipment manufacturers.

The company's business is based principally on its broad semiconductor technology and application of this technology to digital solutions for the networked society.

Industry segment and geographic area profit (loss) is not equivalent to income (loss) before provision for income taxes due to exclusion of general corporate expenses, net interest, currency exchange gains and losses, and other items along with elimination of unrealized profit in assets. Profit sharing expense is allocated to segment results based on payroll costs. Beginning the fourth quarter of 1995, for geographic area purposes responsibility for certain interarea product transfers was changed consistent with the company's pan-European operations approach. The effect of this change on 1995 geographic area results was to increase Europe profits and decrease U.S. profits by approximately \$70 million. Additionally, prior to 1995, for geographic area purposes U.S. interarea product transfers for further processing were recorded as cost credits. In 1995, such transfers are recorded as interarea revenues. The effect of this change was to increase 1995 U.S. interarea revenues by approximately \$960 million. Royalty revenue from patent license agreements is included in the U.S. geographic net revenues and (except for royalty revenue from microcomputer system patent license agreements, which is included in the digital products segment) is principally included in the components segment.

Identifiable assets are those associated with segment or geographic area operations, excluding unallocated cash and short-term investments, internal company receivables and deferred income taxes. Generally, revenues between industry segments and between geographic areas are based on prevailing market prices or an approximation thereof.

Industry Segment Net Revenues

	<i>Millions of Dollars</i>		
	1996	1995	1994
Components			
Trade	\$8,008	\$ 9,419	\$ 6,787
Intersegment	63	60	56
	8,071	9,479	6,843
Digital Products			
Trade	1,717	1,829	1,661
Intersegment	7	23	1
	1,724	1,852	1,662
Metallurgical Materials			
Trade	172	160	152
Intersegment	12	23	25
	184	183	177
Eliminations and other	(39)	(105)	(74)
Total	\$9,940	\$11,409	\$ 8,608

Industry Segment Profit (Loss)

	<i>Millions of Dollars</i>		
	1996	1995	1994
Components	\$ 559	\$ 1,840	\$ 1,107
Digital Products	(207)	(55)	62
Metallurgical Materials	17	2	(8)
Eliminations and corporate items	(392)	(317)	(274)
Income (loss) before provision for income taxes	\$ (23)	\$ 1,470	\$ 887

Industry Segment Identifiable Assets

	<i>Millions of Dollars</i>		
	1996	1995	1994
Components	\$6,287	\$ 5,192	\$ 3,650
Digital Products	642	930	756
Metallurgical Materials	76	88	76
Eliminations and corporate items	1,826	2,117	1,764
Net assets of discontinued operations	529	421	222
Total	\$9,360	\$ 8,748	\$ 6,468

Industry Segment Property, Plant and Equipment

	<i>Millions of Dollars</i>		
	1996	1995	1994
Depreciation			
Components	\$ 851	\$ 612	\$ 514
Digital Products	20	23	24
Metallurgical Materials	9	11	10
Eliminations and corporate items	24	35	32
Total	\$ 904	\$ 681	\$ 580

	<i>Millions of Dollars</i>		
	1996	1995	1994
Additions			
Components	\$1,898	\$ 1,207	\$ 888
Digital Products	17	32	42
Metallurgical Materials	7	14	9
Eliminations and corporate items	141	98	81
Total	\$2,063	\$ 1,351	\$ 1,020

The following geographic area data include revenues, costs and expenses generated by and assets employed in operations located in each area:

Geographic Area Net Revenues

	<i>Millions of Dollars</i>		
	1996	1995	1994
United States			
Trade	\$4,489	\$ 5,055	\$ 4,253
Interarea	1,605	1,467	457
	6,094	6,522	4,710
Europe			
Trade	2,091	2,165	1,557
Interarea	462	389	253
	2,553	2,554	1,810
East Asia			
Trade	3,280	4,122	2,729
Interarea	2,171	1,822	1,525
	5,451	5,944	4,254
Other Areas			
Trade	80	67	69
Interarea	80	59	50
	160	126	119
Eliminations	(4,318)	(3,737)	(2,285)
Total	\$9,940	\$11,409	\$ 8,608

Geographic Area Profit (Loss)

	<i>Millions of Dollars</i>		
	1996	1995	1994
United States	\$ (350)	\$ 1,082	\$ 879
Europe	159	203	(28)
East Asia	335	287	219
Other Areas	4	(2)	5
Eliminations and corporate items	(171)	(100)	(188)
Income (loss) before provision for income taxes	\$ (23)	\$ 1,470	\$ 887

Geographic Area Identifiable Assets

	<i>Millions of Dollars</i>		
	1996	1995	1994
United States	\$4,392	\$ 3,071	\$ 2,222
Europe	1,238	1,299	889
East Asia	1,896	2,163	1,616
Other Areas	49	46	43
Eliminations and corporate items	1,256	1,748	1,476
Net assets of discontinued operations	529	421	222
Total	\$9,360	\$ 8,748	\$ 6,468

NOTES TO FINANCIAL STATEMENTS

(continued)

Income Taxes

Income (Loss) before Provision for Income Taxes

	Millions of Dollars			
	Geographic area profit (loss)		Elims. & corp. items	Total
	U.S.	Non-U.S.		
1996	\$ (350)	\$ 498	\$ (171)	\$ (23)
1995	1,082	488	(100)	1,470
1994	879	196	(188)	887

With the exception of interarea elimination of unrealized profit in assets, which increased \$3 million in 1996, increased \$5 million in 1995 and increased \$18 million in 1994, the remaining corporate items consist primarily of general corporate expenses which are applicable to both U.S. and non-U.S. operations. These expenses are generally deductible for tax purposes in the U.S.

Provision (Credit) for Income Taxes

	Millions of Dollars			
	U.S. Federal	Non-U.S.	U.S. State	Total
1996				
Current	\$ (125)	\$ 202	\$ (3)	\$ 74
Deferred	(44)	(6)	(1)	(51)
Total	\$ (169)	\$ 196	\$ (4)	\$ 23
1995				
Current	\$ 319	\$ 182	\$ 27	\$ 528
Deferred	(36)	(19)	1	(54)
Total	\$ 283	\$ 163	\$ 28	\$ 474
1994				
Current	\$ 217	\$ 94	\$ 16	\$ 327
Deferred	(16)	(18)	2	(32)
Total	\$ 201	\$ 76	\$ 18	\$ 295

Principal reconciling items from income tax computed at the statutory federal rate follow.

	Millions of Dollars		
	1996	1995	1994
Computed tax at statutory rate	\$ (8)	\$ 515	\$ 310
Effect of acquired in-process R&D	67	-	-
Effect of non-U.S. rates	(3)	(89)	(43)
Research and experimentation tax credits	(11)	(5)	(2)
Effect of U.S. state income taxes	(3)	17	12
Other	(19)	36	18
Total provision for income taxes	\$ 23	\$ 474	\$ 295

Included in the effect of non-U.S. rates for 1996, 1995 and 1994 is a \$4 million, a \$93 million and a \$69 million benefit from tax loss carry-forward utilization reduced by certain non-U.S. taxes and losses for which no benefit was recognized. Provision has been made for deferred taxes on undistributed earnings of non-U.S. subsidiaries to the extent that dividend payments from such companies are expected to result in additional tax liability. The remaining undistributed earnings (approximately \$760 million at December 31, 1996) have been indefinitely reinvested; therefore, no provision has been made for taxes due upon remittance of these earnings. Determination of the amount of unrecognized deferred tax liability on these unremitted earnings is not practicable.

The primary components of deferred income tax assets and liabilities at December 31 were as follows:

	Millions of Dollars	
	1996	1995
Deferred income tax assets:		
Accrued retirement costs (pension and retiree health care)	\$ 220	\$ 201
Inventories and related reserves	193	228
Accrued expenses	186	197
Loss carryforwards	44	46
Other	197	170
	840	842
Less valuation allowance	(134)	(192)
	706	650
Deferred income tax liabilities:		
Property, plant and equipment	(96)	(123)
Other	(155)	(89)
	(251)	(212)
Net deferred income tax asset	\$ 455	\$ 438

As of December 31, 1996 and 1995, the net deferred income tax asset of \$455 million and \$438 million was presented in the balance sheet, based on tax jurisdiction, as deferred income tax assets of \$587 million and \$532 million and deferred income tax liabilities of \$132 million and \$94 million. The valuation allowance shown above reflects the company's ongoing assessment regarding the realizability of certain non-U.S. deferred income tax assets. The balance of the deferred income tax assets is considered realizable based on carry-back potential, existing taxable temporary differences, and expectation of future income levels comparable to recent results. Such future income levels are not assured because of the nature of the company's businesses, which are generally characterized by rapidly changing technology and intense competition.

The company has aggregate non-U.S. tax loss carryforwards of approximately \$95 million. Of this amount, \$38 million expires through the year 2006 and \$57 million has no expiration.

Income taxes paid were \$240 million, \$384 million and \$399 million for 1996, 1995 and 1994.

Rental Expense and Lease Commitments

Rental and lease expense was \$175 million in 1996, \$151 million in 1995 and \$143 million in 1994. The company conducts certain operations in leased facilities and also leases a portion of its data processing and other equipment. The lease agreements frequently include purchase and renewal provisions and require the company to pay taxes, insurance and maintenance costs.

At December 31, 1996, the company was committed under non-cancelable leases with minimum rentals in succeeding years as follows:

Non-Cancelable Leases

	Millions of Dollars
1997	\$ 113
1998	79
1999	52
2000	38
2001	24
Later years	158

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors

Texas Instruments Incorporated

We have audited the accompanying consolidated balance sheets of Texas Instruments Incorporated and subsidiaries (the Company) at December 31, 1996 and 1995, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Texas Instruments Incorporated and subsidiaries at December 31, 1996 and 1995, and the results of its operations and cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Dallas, Texas

January 22, 1997

SUMMARY OF SELECTED FINANCIAL DATA

Years ended December 31	1996	1995	1994	1993	1992
<i>Millions of Dollars</i>					
Net revenues	\$ 9,940	\$ 11,409	\$ 8,608	\$ 6,687	\$ 5,456
Operating costs and expenses	9,966	9,970	7,682	6,157	5,233
Profit (loss) from operations	(26)	1,439	926	530	223
Other income (expense) net	76	79	6	19	6
Interest on loans	73	48	45	47	51
Income (loss) before provision for income taxes	(23)	1,470	887	502	178
Provision for income taxes	23	474	295	147	51
Income (loss) from continuing operations before cumulative effect of accounting changes	\$ (46)	\$ 996	\$ 592	\$ 355	\$ 127
<hr/>					
Earnings (loss) per common and common equivalent share from continuing operations before cumulative effect of accounting changes	\$ (.24)	\$ 5.15	\$ 3.12	\$ 1.89	\$.55
<hr/>					
Dividends declared per common share	\$.68	\$.64	\$.47	\$.36	\$.36
<hr/>					
Average common and common equivalent shares outstanding during year, in thousands	192,117	193,631	190,855	187,211	170,621

As of December 31	1996	1995	1994	1993	1992
<i>Millions of Dollars</i>					
Working capital	\$ 1,968	\$ 2,566	\$ 1,965	\$ 1,499	\$ 1,219
Property, plant and equipment (net)	4,162	2,894	2,277	1,870	1,804
Total assets	9,360	8,748	6,468	5,471	4,847
Long-term debt	1,697	804	808	694	909
Stockholders' equity	4,097	4,095	3,039	2,315	1,947
<hr/>					
Employees	59,927	59,574	56,333	59,048	60,577
Stockholders of record	32,804	30,034	28,740	29,129	31,479

Employees include persons employed in the company's Defense Systems and Electronics business.

See Notes to Financial Statements and Management Discussion and Analysis of Financial Condition and Results of Operations.

Management Discussion and Analysis of Financial Condition and Results of Operations

The management discussion and analysis of the company's financial condition and results of operations consists of the first two paragraphs of the letter to stockholders set forth on page 2 of this report and the following additional information:

Segment	Change in orders, 1996 vs. 1995	Change in net revenues, 1996 vs. 1995
Components	Down 27%	Down 15%
Digital Products	Down 13%	Down 7%
Total	Down 23%	Down 13%

Segment	Change in orders, 4Q96 vs. 4Q95	Change in net revenues, 4Q96 vs. 4Q95
Components	Down 17%	Down 18%
Digital Products	Down 45%	Down 47%
Total	Down 20%	Down 22%

1996 Results of Operations Compared with 1995

TI's orders for continuing operations for 1996 were \$9.3 billion, down 23 percent from \$12.1 billion in 1995. Significantly reduced DRAM prices in the components segment were the primary contributor to the change.

TI's net revenues for continuing operations for 1996 were \$9.9 billion, down 13 percent from \$11.4 billion in 1995. The decrease in the components segment was due to significantly lower DRAM prices and reduced royalties. Digital signal processors and mixed-signal/analog products grew strongly in 1996. In the digital products segment, the sale of substantially all the Custom Manufacturing Services (CMS) business in the first quarter and the sale of the printer business in the third quarter accounted for most of the decrease.

PFO from continuing operations for 1996, excluding the special charges, was \$374 million, down from \$1439 million in 1995 primarily because of significantly lower DRAM prices and reduced royalties. Including the special charges, loss from operations was \$26 million.

The special charges for continuing operations during 1996 include \$192 million for in-process R&D associated with the purchase of Silicon Systems, Inc. (SSI) in the third quarter, and \$91 million in the fourth quarter for severance costs related to voluntary retirement and involuntary actions, as well as \$117 million for asset write-downs on certain product lines, principally mobile computing.

Net loss from continuing operations including special charges in 1996 was \$46 million, and loss per share was \$0.24. Net income for the year from continuing operations, excluding the special charges, was \$281 million, compared with \$996 million in 1995. Earnings per share from continuing operations, excluding the special charges, were \$1.46, compared with \$5.15 in 1995.

Results from continuing operations for 1995 included \$257 million of profit sharing. There was no profit sharing in 1996.

Net income including discontinued operations for the year was \$63 million, and earnings per share were \$0.33.

Royalty revenues were \$300 million lower in 1996 than the record royalties received in 1995. The decrease is primarily due to a reduction in royalty rates in exchange for longer-term agreements, expired licenses that have not yet been renewed, and licensees' lower DRAM revenues. Also, first-quarter 1995 royalty revenues included a favorable adjustment of \$36 million related to higher-than-estimated licensee shipments in the second half of 1994.

Payments that licensees will make over the next five years under the recently negotiated ten-year agreements with Samsung Electronics Co., Ltd., Fujitsu Limited, Oki Ltd. and Matsushita Electric Industrial Co., Ltd. are expected to exceed payments made under the expired five-year licenses. Negotiations continue with NEC Corporation and several smaller firms, including firms not previously licensed. TI continues to expect a significant ongoing stream of royalty revenue into the next century.

The Tokyo High Court has not yet decided TI's appeal of a ruling that Fujitsu's production of certain memory products does not infringe TI's Kilby patent. The decision should not have any significant effect on existing licenses.

For 1997, the estimated effective tax rate for continuing operations is about 35 percent.

TI's backlog of unfilled orders for continuing operations as of December 31, 1996, was \$1623 million, down \$671 million from the end of 1995, due primarily to decreases in semiconductors and the CMS sale.

R&D for continuing operations was \$1181 million for 1996, compared with \$842 million for 1995. The 1996 R&D includes the \$192 million charge associated with the SSI acquisition.

Capital expenditures for continuing operations were \$2063 million in 1996, compared with \$1351 million in 1995.

Depreciation for continuing operations for 1996 was \$904 million, compared with \$681 million in 1995. Depreciation in 1997 is expected to be about \$1.2 billion.

Components Segment: For 1996, orders in the components segment were down 27 percent, and revenues were down 15 percent from 1995, primarily because of the precipitous drop in DRAM prices and lower royalties. TI's semiconductor orders for the fourth quarter were up solidly from the third quarter of 1996. Fourth quarter orders for DSPS, comprised of digital signal processors plus mixed-signal/analog products, grew more than 30 percent over the fourth quarter of 1995, with particular strength in wireless communications and mass storage applications. TI's semiconductor revenues for the fourth quarter of 1996 were up sequentially from the prior quarter. DSPS revenues in 1996 increased strongly from 1995 and exceeded 40 percent of the company's total semiconductor revenues during the fourth quarter.

Components segment profits for 1996 were down from 1995 because of sharply lower DRAM prices and lower royalties. Results for the components segment include a charge of \$192 million in the third quarter of 1996 related to the SSI acquisition and a charge of \$61 million in the fourth quarter of 1996 for cost reduction actions. Excluding charges, semiconductor operating profit in the fourth quarter of 1996 was up significantly from the third quarter as all product groups showed improvement. Memory, while improved,

SUPPLEMENTAL FINANCIAL INFORMATION

(continued)

operated at a loss in the fourth quarter due to continued lower prices and the high level of fixed investment.

TI's plans for 1997 are based on a moderate recovery in the world semiconductor market, with sustainable growth in electronic end equipment. Customer inventories of semiconductors are at historically low levels. DRAM prices remain volatile and the near-term memory market environment is expected to be difficult, although the bit growth rate remains strong.

Digital Products Segment: Orders in TI's digital products segment were down 13 percent in 1996, and revenues were down seven percent, compared with 1995. Excluding the CMS and printer businesses, which were sold during the year, revenues were up 37 percent. The segment operated at a loss during the year, due to the high level of marketing expense and intense price competition in mobile computing, as well as continued investments and new product development in the software business and in communications and electronics systems. Fourth quarter operations include the impact of sharply lower mobile computing revenues, compared with the third quarter of 1996, which negatively impacted fourth quarter earnings per share by about \$0.08 per share from the running rate of the prior quarter. Results for the digital products segment include a charge of \$125 million in the fourth quarter for cost reduction actions and asset write-downs. As expected, calculators operated at break-even in the fourth quarter after achieving substantial seasonal profits in the second and third quarters.

In addition to the charge for asset write-downs taken in the fourth quarter, TI expects to take a charge in the first quarter of 1997 for severance and other costs associated with the sale of the mobile computing business. As a result of the sale agreement, TI will not reflect operating results of the mobile computing business subsequent to 1996.

Emerging Opportunities: TI's digital imaging products continue to make steady progress in the transition from R&D to initial production, targeted at the very competitive commercial projection display market. The major long-term challenge continues to be cost reduction to levels that will permit participation in several markets. The company remains positive about the opportunity to build a high-growth business and expects to continue significant investments in 1997.

Discontinued Operations: For discontinued operations, a special pretax charge of \$32 million was taken for voluntary and involuntary severance actions during the fourth quarter of 1996.

Financial Condition: TI's financial condition remains sound. During the year, cash and cash equivalents plus short-term investments decreased by \$575 million to \$978 million. Net cash provided by operating activities was negatively impacted by the payout of 1995 profit sharing in the first quarter. Investments in property, plant and equipment were \$2063 million for the year, and the sale of TI's CMS business generated \$132 million of cash in the first half of 1996.

In the third quarter, TI acquired Silicon Systems, Inc. via a stock purchase agreement for \$340 million in cash plus the assumption of

a \$235 million long-term note to TDK Corp. of Japan. The cash payment, initially financed by a draw down on TI's existing line of bank credit, was permanently financed through the company's issuance on July 26 of \$400 million of three- and four-year notes.

On January 6, 1997, TI and Raytheon Company announced that their boards of directors had approved a definitive agreement for Raytheon to purchase the assets of TI's defense operations for \$2.95 billion in cash. The transaction is subject to Hart-Scott-Rodino antitrust review and is expected to close in the second quarter of 1997. TI plans to use the net proceeds from the sale to strengthen its focus on digital solutions for the networked society.

The outstanding balance of commercial paper was \$299 million at the end of the year, up from zero at the end of 1995. Other financing activities included the first quarter issuance of \$300 million of 6.125% notes due in 2006, the balance increase of Italian lira mortgage notes of \$102 million in the second quarter, and the August 28 redemption, at par, of \$150 million of 9.0% notes due in 1999. At year-end, the debt-to-total-capital ratio was .33, up from .17 at the end of 1995.

Unused authorizations for future capital expenditures were \$795 million at December 31, 1996. Capital expenditures are planned to be about \$1.1 billion in 1997, compared with \$2.1 billion in 1996. Excluding the one-time charge associated with the SSI acquisition, R&D will be increased to about \$1.1 billion in 1997, up from \$1.0 billion in 1996, primarily to support digital signal processing solutions and other advanced semiconductor technology.

The company maintains lines of credit to support commercial paper borrowings and to provide additional liquidity. These lines of credit totaled \$696 million at December 31, 1996. Of this amount, \$600 million exists to support outstanding and future commercial paper borrowings or short-term bank loans.

The company believes that its financial condition provides the foundation for continued support of the programs essential to TI's future.

1995 Results of Operations Compared with 1994

TI's orders for 1995 were \$12.1 billion, up 39 percent from \$8.7 billion in 1994. Significantly higher semiconductor orders in the components segment were the primary contributor to the change.

TI's net revenues for 1995 were \$11.4 billion, up 33 percent from \$8.6 billion in 1994. The increase was due primarily to higher semiconductor revenues in the components segment, resulting from increased shipments and new products. Demand was particularly strong for digital signal processors, mixed-signal products and memory. Profit from operations was \$1439 million, up 55 percent from \$926 million in 1994. Higher semiconductor operating profits accounted for much of the increase; higher royalties also contributed. Results for 1995 included a profit sharing accrual of \$257 million compared with \$133 million accrued in 1994. Results for 1994 included \$126 million in pretax restructuring and divestiture charges taken in the first quarter.

Net income from continuing operations for 1995 was \$996 million, compared with \$592 million in 1994, an increase of 68 percent. Earnings per share from continuing operations

were \$5.15, versus \$3.12 for 1994. Consistent with its goal of increasing shareholder value, TI posted a return on invested capital (ROIC) of 24.8 percent, up from 19.5 percent in 1994 (including the effect of discontinued operations).

Results for 1995 included significantly higher royalty revenues.

TI's backlog of unfilled orders as of December 31, 1995, was \$2294 million, up \$678 million from the end of 1994, due to an increase in semiconductor backlog.

TI R&D was \$842 million for 1995 compared with \$578 million in 1994. Capital expenditures were \$1351 million in 1995, compared with \$1020 million in 1994.

Depreciation for 1995 was \$681 million, compared with \$580 million in 1994.

Components Segment: Orders in the components segment were up 45 percent for 1995, and revenues up 39 percent from 1994, with particular strength in semiconductors, which grew faster than the segment. Components segment profits were up 66 percent, primarily due to improved semiconductor manufacturing productivity and higher royalties.

Semiconductor revenues reached record levels in 1995, primarily due to growth in memory and application specific products. Profits, up substantially in 1995 over 1994, also reached record levels. Semiconductor operating margins improved in 1995, primarily due to increased manufacturing productivity.

Digital Products Segment: Orders in TI's digital products segment were up 14 percent in 1995, and revenues up 11 percent, compared with 1994. The segment operated at a loss during 1995, due to increased marketing expenses and intense price competition in notebook computers, as well as continued investments and new

product development in communications and electronic systems, and in the software business.

TI significantly increased marketing investments in the notebook computer business to increase brand awareness and aggressively communicate a strategic shift that emphasized mobility and connectivity in the networked society. These investments, coupled with intense price competition, caused the business to operate at a loss for 1995. TI software also operated at a loss for 1995.

Common Stock Prices and Dividends

TI common stock is listed on the New York Stock Exchange and traded principally in that market. In addition, TI common stock is listed on the London, Tokyo and Swiss stock exchanges. The table below shows the high and low prices of TI common stock on the composite tape as reported by *The Wall Street Journal* and the dividends paid per common share for each quarter during the past two years, adjusted for the two-for-one stock split in 1995.

	Quarter			
	1st	2nd	3rd	4th
Stock prices:				
1996 High	\$55.75	\$59.63	\$59.25	\$68.38
Low	42.75	48.63	40.50	47.50
1995 High	49.00	72.00	83.75	81.25
Low	34.38	43.38	66.50	46.00
Dividends paid:				
1996	\$.17	\$.17	\$.17	\$.17
1995	\$.125	\$.125	\$.17	\$.17

Quarterly Financial Data

Millions of Dollars, Except Per-Share Amounts

	1995				1996			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
Net revenues	\$ 2,450	\$ 2,807	\$ 3,005	\$ 3,147	\$2,675	\$ 2,399	\$2,407	\$2,459
Gross profit	875	1,003	1,014	1,116	786	677	664	667
Profit (loss) from operations	303	364	401	371	146	40	(177)	(35)
Income (loss) before provision for income taxes	308	372	398	392	190	37	(185)	(65)
Income (loss) from continuing operations	205	255	268	268	132	41	(179)	(40)
Income from discontinued operations	25	23	21	23	31	35	32	11
Earnings (loss) per common and common equivalent share:								
Continuing operations	\$ 1.08	\$ 1.32	\$ 1.38	\$ 1.38	\$.68	\$.21	\$ (.95)	\$ (.21)
Discontinued operations13	.12	.10	.12	.16	.18	.17	.06
Net income (loss)	\$ 1.21	\$ 1.44	\$ 1.48	\$ 1.50	\$.84	\$.39	\$ (.78)	\$ (.15)

As a result of the 1996 acquisition of Silicon Systems, Inc., the company took a one-time charge of \$192 million in the third quarter for the value of acquired in-process research and development. In the fourth quarter of 1996, the company accrued \$105 million for catch-up royalty revenues due under the new cross-license agreement with Samsung Electronics Co., Ltd. Also in the fourth quarter, the company took a pre-tax charge of \$208 million for cost reduction actions.

Earnings (loss) per common and common equivalent share are based on average common and common equivalent shares outstanding (190,076,427 shares and 194,676,703 shares for the fourth quarters of 1996 and 1995).

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- James B. Busey IV**
Retired Admiral, U. S. Navy
- X **Thomas J. Engibous**
President and
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- Gerald W. Fronterhouse**
Investments
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Treasurer and
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New TI Fellows

A TI Fellow is a scientist or technologist who is recognized by his or her peers and TI management for outstanding performance. Fellows are elected based on patents, publications and, most important, contributions to the success of TI projects.

TI Fellows elected in 1996 were:

Ih-Chin Chen
Joseph C. Fuller
Thomas C. Holloway
Roger D. Norwood
Paul Saunier
Tadashi Tachibana
Vishu Viswanathan

SEC Form 10-K

Stockholders may obtain a copy of the company's annual report to the Securities and Exchange Commission on Form 10-K without charge (except for exhibits) by writing to:

Manager of Investor Relations,
P.O. Box 655474, MS 413,
Dallas, TX 75265

Stock Exchange Listings

The common stock of Texas Instruments Incorporated is listed on the New York Stock Exchange, the London, Tokyo and Swiss stock exchanges. Ticker symbol: **TXN**

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(312) 461-7763

For dividend reinvestment information:

Harris Trust and Savings Bank
Dividend Reinvestment Service
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Safe Harbor Statement

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995: With the exception of historical information, the matters discussed in this annual report are forward-looking statements that involve risks and uncertainties including, but not limited to, economic conditions, product demand and industry capacity, competitive products and pricing, manufacturing efficiencies, new product development, timely completion of announced asset sales, ability to enforce patents, availability of raw materials and critical manufacturing equipment, new plant startups, the regulatory and trade environment, and other risks indicated in filings with the Securities and Exchange Commission.

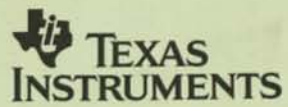
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