Q4 2017 Earnings Call

Company Participants

- David Pahl, Vice President & Head, Investor Relations
- Rafael R. Lizardi, Senior Vice President, Chief Financial Officer & Chief Accounting Officer, Finance & Operations

Other Participants

- Christopher Brett Danely, Analyst
- David M. Wong, Analyst
- Harlan Sur, Analyst
- John William Pitzer, Analyst
- Ross C. Seymore, Analyst
- Stacy Aaron Rasgon, Analyst
- Toshiya Hari, Analyst
- Vivek Arya, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Texas Instruments fourth quarter 2017 and 2017 year-end earnings release conference call. Today's conference is being recorded.

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

David Pahl {BIO 18870833 <GO>}

Thank you. Good afternoon and thank you for joining our fourth quarter and 2017 earnings conference call. Rafael Lizardi, TI's Chief Financial Officer, is with me today.

For any of you who missed the release, you can find it on our website at ti.com/ir. This call is being broadcast live over the web and can be accessed through our website. A replay will be available through the web. This call will include forward-looking statements that involve risks and uncertainties that could cause TI's results to differ materially from management's current expectations. We encourage you to review the notice regarding forward-looking statements contained in the earnings release published today as well as TI's most recent SEC filings for a more complete description.

First, let me provide some information that's important for your calendars. We plan to hold an update to our capital management strategy on February 6 at 10:00 AM Central

Time. Similar to what we've done in the past, Rafael and I will provide insight into our strategy. You also likely saw that last week we announced that Brian Crutcher will become President and CEO on June 1 and that Rich Templeton will continue as our Chairman. I'm sure you'll join me in congratulating them both.

Before I give you an overview of the fourth quarter results, I want to summarize the impact the December 2017 tax reform act had. We applaud the reform to U.S. corporate law because it enables U.S. headquartered companies like TI to compete more effectively on a global basis. The new law recognizes and rewards companies for exporting and having manufacturing, R&D and intellectual property in the United States.

Regarding the financial implications, there's three important points I'd like to point out. First, investors should assume an ongoing 18% annual operating tax rate starting in 2019. This rate comprehends the 21% statutory corporate rate and the benefit of exports and having manufacturing, R&D, and intellectual property in the U.S. This rate does not include an estimate for stock-based compensation impact, which we provide at the start of each year.

Second, for 2018, investors should assume a 23% annual operating tax rate before stock-based compensation. This 23% rate comprehends the long-term rate of 18% that I just described plus 5 percentage points of transitional tax effect that must be expensed in 2018. These transitional tax effects are mostly non-cash.

To get you to an effective rate by quarter, we're assuming about $55 million of stock-based compensation benefit for 2018, split quarterly with $30 million in the first quarter, $10 million in the second and third quarters and $5 million in the fourth. Therefore, the effective tax rate should be about 21% in the first quarter, 22% in the second and third, and 23% in the fourth quarter of 2018. You'll find this information summarized on our IR website under Financial Summary Data as we've done in the past.

Lastly, in fourth quarter of 2017, our tax expense included approximately $800 million of expense that was primarily related to the recently passed tax reform act. This included about $700 million for the tax on indefinitely reinvested earnings, as well as about $60 million for a reduction in deferred tax assets. The charge on deferred tax asset is non-cash.

The charge associated indefinitely reinvested earnings will impact cash flow and will be paid over eight years. We'll pay about $60 million in the first five years, $100 million in the sixth, $140 million in the seventh, $160 million in the eighth year. This will have impact – there is no impact to cash flow in the fourth quarter of 2017 because of these tax changes. Of course, our initial estimate for the financial impact on the tax reform act could change as we refine our analysis and if any additional guidance on this new law becomes available.

Our long-term investment strategy remains unchanged by tax reform. With more cash available on an ongoing basis, we'll continue to invest to grow our business, to strengthen our competitive advantages and return all free cash flows to our owners. Again, we believe the reform to U.S. corporate tax will enable U.S. headquartered companies, like TI, to compete more effectively on a global basis.

Now I'll start with a quick summary of our financial results. Revenue for the fourth quarter increased 10% from a year ago as demand for our products remained strong in the automotive and industrial markets. Communications equipment declined while personal electronics grew mid-single-digits, but results vary by customer. In our core businesses, Analog revenue grew 11% and Embedded Processing grew 20% compared to the same quarter a year ago. Operating margins increased in both businesses. Earnings per share were $0.34, including $0.75 of tax-related expenses not in our original guidance, primarily due to the recently passed tax reform act that I just discussed.

With that backdrop, I'll now provide details on our performance, which we believe continues to be representative of our ongoing strength of our business model. In the fourth quarter, our cash flow from operations was $1.9 billion. We believe that free cash flow growth, especially on a per-share basis, is most important to maximizing shareholder value in the long term. Free cash flow for the trailing 12-month period was $4.7 billion, up 14% from a year ago. Free cash flow margin for the same period was 31.2% of revenue, up from 30.5% a year ago.

We continue to benefit from an improved product portfolio that's long-lived and diverse and the efficiencies of our manufacturing strategy, the latter of which includes our growing 300-millimeter Analog output. We believe free cash flow will be valued only if it's productively invested in the business or returned to owners. In 2017, we returned $4.7 billion of cash to owners through a combination of dividends and stock repurchases.

I'll now provide some details by segment. From the year-ago quarter, Analog grew 11% due to Power and Signal Chain. High Volume declined. Embedded Processing revenue grew 20% from the year-ago quarter due to growth in both product lines, which are Processors and Connected Microcontrollers. In our Other segment, revenue declined 16% from a year ago, primarily due to custom ASIC and the move of royalties, which began in the first quarter of 2017. For the year in total, Analog and Embedded each grew about 16% on broad-based growth and combined are now 90% of TI's revenue.

Let me describe next our revenue by end market in 2017. Just as a reminder, we provide an estimate of TI's revenue by end market on an annual basis. We break this into six categories: industrial; automotive; personal electronics, and that will include things like mobile phones, PC, tablets and TVs; comms equipment; enterprise systems; and everything else, which is primarily calculators. Notably, every market contributed to growth in 2017.

Specifically, industrial comprised 35% of our revenue, up 2 percentage points from 2016. Automotive was 19%, up 1 point. Personal electronics was 25%, down 1 point. Comms equipment and other were 12% and 3% respectively, down a percentage point, while enterprise systems was about 6% in both years. Also, we did not have a customer who was more than 10% of our revenue in 2017.

We continue to focus on a strategy on industrial and automotive markets, where we've been allocating capital and driving initiatives to strengthen our position. This is based on a belief that industrial and automotive will be the fastest growing semiconductor markets. They have increasing semiconductor content, and these markets provide diversity and longevity. Taken together, this all translates to a high terminal value of our portfolio.

In 2017, industrial and automotive combined made up 54% of TI's revenue, up from 42% just four years ago. We've established momentum in these markets, and we are far from satisfied and continue to make improvements.

Rafael will now review profitability, capital management, and our outlook.

Rafael R. Lizardi {BIO 20006334 <GO>}

Thanks, Dave, and good afternoon, everyone.

Gross profit in the quarter was $2.44 billion or 65.1% of revenue. From a year ago, gross profit increased due to higher revenue and lower manufacturing costs. Gross profit margin increased by 250 basis points.

Operating expenses in the quarter were $795 million. Operating expenses on a trailing 12-month basis were up 3% and were 21.4% of revenue, within our range of expectations. For the year, we have invested $1.51 billion in R&D, an important element of our capital allocation.

Acquisition charges were $79 million, all of which was the ongoing amortization of intangibles, which is a non-cash expense. Acquisition charges will be about $80 million per quarter through the third quarter of 2019 due to amortization of intangibles. It will decline to about $50 million per quarter for two remaining years.

Operating profit was $1.56 billion or 41.7% of revenue. Operating profit was up 17% from a year-ago quarter. Operating margin for Analog was 46.9%, up from 43.2% a year ago. And for Embedded Processing, it was 34.3% up from 28.8% a year ago. Our focused investments on the best sustainable growth opportunities with differentiated positions enabled both businesses to continue to contribute nicely to free cash flow growth.

Other income and expense declined $176 million, as we signed several intellectual property agreements in the year-ago quarter that did not repeat. Net income in the fourth quarter was $344 million or $0.34 per share, which included $0.75 in tax-related expenses not in our prior outlook, as we have discussed.

Let me now comment on our capital management results, starting with our cash generation. Cash flow from operations was $1.93 billion in the quarter, up 39% from a year ago. Capital expenditures were $231 million in the quarter. In the fourth quarter, we paid $611 million in dividends and repurchased $706 million of our stock for a total return of $1.32 billion in the fourth quarter.

Our balance sheet remains strong with $4.47 billion of cash and short-term investments at the end of the quarter. We issued $500 million of debt in 10-year notes during the quarter. This leaves total debt of $4.1 billion with a weighted average coupon rate of 2.05%. Inventory days were 134 up 8 days from a year ago and within our expected range.

Now let's look at some of the results for the year. In 2017, cash flow from operations was $5.36 billion, up 16% from the previous year. Capital expenditures were $695 million or 4.6% of revenue consistent with our long-term expectations. Free cash flow for the past 12 months was $4.67 billion or 31.2% of revenue. Our cash flow reflects the strength of our business model.

As we have said, we believe free cash flow growth, especially on a per share basis is most important to maximizing shareholder value in the long term and will be valued only if it is productively invested in the business or returned to shareholders. We remain committed to return all free cash flow to the owners of the company.

Total cash returned to owners in 2017 was $4.66 billion. These combined returns of dividends and share repurchases demonstrate our confidence in our business model and our commitment to return all free cash flow to our owners. Over the last 12 months, we paid $2.10 billion in dividends or about 45% of free cash flow, evidence of their sustainability. Outstanding share count was reduced by 1.3% over the past 12 months and has been reduced by 43% since the end of 2004 when we initiated a program designed to reduce our share count.

Turning to our outlook for the first quarter, we expect to have revenue in the range of $3.49 billion to $3.79 billion and earnings per share to be in the range of $1.01 to $1.17, which includes an estimated $30 million discrete tax benefit.

In closing, I'll note that the strength of our business model was demonstrated throughout our financial performance, from top line growth and margin expansion to free cash flow generation. We continue to invest in our competitive advantages which are technology and manufacturing, portfolio breadth, market reach and diverse and long-lived products. We will continue to strengthen these advantages through disciplined capital allocation and by focusing on the best products, Analog and Embedded Processing, and the best markets, industrial and automotive, which I believe will enable us to continue to improve and deliver free cash flow per-share growth for a long time to come.

With that, let me turn it back to Dave.

David Pahl {BIO 18870833 <GO>}

Thanks, Rafael. Operator, you can now open the lines up for questions. In order to provide as many of you as possible an opportunity to ask a question, please limit yourself to a single question. After our response, we'll provide you an opportunity for a follow-up. Rene?

Q&A

Operator

Thank you. And our first question comes from Vivek Arya with Bank of America Merrill Lynch.

Q - Vivek Arya {BIO 6781604 <GO>}

Thank you for taking my question. I was wondering if you could give us some more color on what you're seeing in different end markets at the start of the year. When I look at your Q1 sales outlook, it's in line with consensus; seasonally somewhat conservative after seasonally below – or below-seasonal quarter you had in Q4. And Dave, it seems to be in somewhat contrast to the very strong macro environment. So is there something that you're seeing that is keeping you more conservative than usual?

A - David Pahl {BIO 18870833 <GO>}

Yeah, Vivek. I'd first just take a look at the results in total. If you look at the quarter, fourth quarter came in with 10% year-on-year growth. We just took – for the year, the company came in at 12% year-on-year growth. And if you look at the outlook, at the midpoint we're – we'd be at mid or I'd say upper single-digit growth overall.

So I think if you look inside of that, we've continued to see strength in automotive and industrial. The exciting thing about that, of course, is that both of those markets we think will drive our revenue for quite some time. I think inside of the fourth quarter, as we talked about in our prepared remarks, we did see weakness in comms equipment. That's a market that traditionally is choppy. And then in PE, it's really more of a mixed bag there and more dependent or varied by customers overall. But again, with double-digit growth in the quarter and 12% growth for a year, I'd consider that as still strong performance. Do you have a follow on?

Q - Vivek Arya {BIO 6781604 <GO>}

Yeah. Thank you, Dave. So maybe let me ask that same question in a different way. So you grew 10% in Q4. When I look at Q1, it's pointing to a somewhat deceleration to 7%, which is still impressive but a deceleration regardless. So are you seeing anything in the environment that is making you conservative? And a follow-on from that is do you think this is a sustainable growth rate, right? I know you don't give out full year guidance, but do you see the trend sustainable for the rest of the year? Thank you.

A - David Pahl {BIO 18870833 <GO>}

So let me not try to forecast the year. I think as you said, the upper single-digits is still strong growth. I think when we look at the macro environment, it overall seems constructive, continues to seem constructive for us. We did see changes in comms equipment. I wouldn't describe that as something that's necessarily a macro effect. It is just what it is, that continues to be a choppy market for us, but a good market. It's a market that we continue to invest in and can make money there for some time. So overall, I think we're positioned well, and again, I think the overall environment is constructive.

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

Just to add to that, if you take a step back and think about on the sustainability question, the way we think about our market, it starts with global GDP growth of 3% to 4% or so. And then semiconductors should grow on top of that 1% or 2%, particularly the markets that we focus, which are industrial and automotive, and that's because that's where the semiconductor content is happening.

And then on top of that, we've been gaining share in Analog and Embedded on a pretty consistent basis, so you can think of another 1 point or 2 points on top of that for our long-term sustainable growth. Of course, any one quarter, even any one year, that can vary, but over the long haul, this is a great market to be in, particularly industrial and automotive, which is where we're focusing our investments and our effort, because that's where the semiconductor content growth is happening.

A - David Pahl {BIO 18870833 <GO>}

Okay. Thank you, Vivek. And we'll go to our next caller, please.

Operator

Thank you. Our next question comes from Ross Seymore with Deutsche Bank.

Q - Ross C. Seymore {BIO 20902787 <GO>}

Hi, guys. Thanks for letting me ask a question. The 21% roughly growth that you had in your Industrial business, any color you could provide, Dave, on what's going on underneath the covers there? That's a very, very impressive number. And getting at the same sustainability question, any color that you could give looking backwards might be helpful.

A - David Pahl {BIO 18870833 <GO>}

Yeah. You bet, Ross. The numbers that we provide you are rounded percentages, so I would describe Industrial growth overall in the upper teens when you look year over year, and that growth is based on almost all sectors growing, so very, very diverse. That's one of the things that we like about it.

And for those that listen to us regularly, you've heard me talk about the 14 different sectors that we have that make up the industrial segment, and they will include things like factory automation and control, industrial transport, things that you would expect. But it also includes things like medical and healthcare, avionics, appliances, and those types of things that perhaps the financial community wouldn't put inside of industrial but behaves much in the same way, so that's why they're in there. So we're really pleased with that growth. What's encouraging about it again is it's coming from very diverse sources, and it's really about content gains inside of that market.

Do you have a follow-up, Ross?

Q - Ross C. Seymore {BIO 20902787 <GO>}

Yeah, I do. Switching over to the OpEx side for either you or Rafael, in 2017 there's a big delta between what R&D did versus SG&A. and then now also that you have some better profitability with the tax rate being lower, I really just wanted to see what your views are on the OpEx side of the equation overall. Will you spend more now that you have more cash? And how will it be split if any differences between those two buckets?

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

Yeah. Ross, what I would tell you is that first at a high level, OpEx to us is an investment, whether it's R&D or SG&A. In the case of R&D, obviously we're putting out more differentiated products. It's focused on industrial and automotive to strengthen our competitive advantages. In this case, they are the breadth of our portfolio, of course.

In the case of SG&A, there are a lot of things there, but one thing that we've been focusing on is demand creation. And that strengthens another competitive advantage, which is the channel advantages. So we did that in 2017. Our OpEx was up about 3%, and we're going to continue focusing our investments on that.

On the second part of your question on tax reform – and by the way, on that let me step back for a second. As Dave said during the call, that is a great thing. We're very happy with tax reform. It's going to enable companies like TI, a U.S.-based company, to compete more effectively on a global basis. Now we're on an even playing field versus companies outside the United States, so that is great.

But our long-term investment strategy remains unchanged. We're going to continue investing to strengthen our competitive advantages, as we have talked about before. And now with more cash we're going to do that and then we're going to return all free cash flow to the owners of the company, which is our commitment as part of our capital management strategy and that we have been talking about for a number of years.

A - David Pahl {BIO 18870833 <GO>}

Right. Thank you, Ross, and we'll go to our next caller, please.

Operator

Thank you. We move next to Toshiya Hari with Goldman Sachs.

Q - Toshiya Hari {BIO 6770302 <GO>}

Hi, guys. Thanks for taking the question. Dave, you talked a little bit about the communications equipment market and the weakness there. Was that focused around a single region or a couple customers, or was it broad based? And when would you expect that part of the market to inflect to the upside?

A - David Pahl {BIO 18870833 <GO>}

First, I would say that it was different by customer and it impacted our segments differently because of that exposure. And it's really hard to predict what direction that market will take over the long term. The good news is that our position even there is very broad based, so we will be reflective of the overall market. People will continue to buy communications equipment, base stations and things for some time to come.

We continue to invest and position ourselves well for newer technologies as they come out. So that includes trends like carrier aggregation or massive multiple antennas that we'll see in later 4G as well as 5G standards. So we're very confident about those positions, and in the short term, the market will be what the market will be. Do you have a follow-on?

Q - Toshiya Hari {BIO 6770302 <GO>}

Yes, thank you. I had a question on inventory at TI and what you see in the distribution channel and also at your end customers. Specifically, on your own inventory, I was a little bit surprised to see inventory tick up on a sequential basis. I think historically Q4 would be flat to down, if I'm not mistaken. So if you can comment on how you would describe the inventory, that would be great. Thank you.

A - David Pahl {BIO 18870833 <GO>}

Yeah. Toshiya, let me start and then I'll hand it over to Rafael. And I think when you look at inventory, I'll start with inventory in the channel, it remains steady at about four weeks. I'll point out to those that aren't as familiar with us, that's structurally lower than many of our peers will run because of consignment programs. So you'll see that as a half to about a third as what many of our peers will run and we feel very comfortable at those types of levels.

What we see down channel from customers is, will depend on what type of arrangements we've got. If we've got a consignment program with them, we can see very – into their manufacturing plans and their build plans because we own that material until they pull it. But really our visibility ends there, meaning that if they're building inventory or if they're putting inventory down channel, we can't see that, but we see no indications of inventory that's building there, overall. So let me turn it over to Rafael about our inventory.

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

So let me step back and tell you how we think about our inventory overall. We want to maintain high levels of customer service. We want to minimize obsolescence, optimize manufacturing utilization and all these things vary depending on multiple factors, for example, consignment. We have many consignment engagements. In fact, we want to continue increasing consignment engagements because we tend to get a better signal through consignment engagements, so all of that is good stuff.

Also, step back and think about our strategy focusing on diverse customers, focusing on diverse positions, on industrial automotive where we design a part in industrial and that part may sell for 10, 20, even 30 years. So the inventory is good for a long, long time so we don't have to worry about this obsolescence risk that maybe in the past we had with other types of focus that we had.

So in this particular case in fourth quarter, our inventory days ended up at 134, that's within our range and we had a chance to replenish some of our low volume high mix stuff. So we're going to – and we did some of that. In fact, we're going to continue doing that because over the long-haul, as we replenish that, we have inventory available to sell to those industrial and automotive customers and be able to keep those high levels of customer service.

A - David Pahl {BIO 18870833 <GO>}

Great, thank you, Toshiya. We'll go to the next caller, please.

Operator

Thank you. Our next question comes from John Pitzer with Credit Suisse.

Q - John William Pitzer {BIO 1541792 <GO>}

Good afternoon, guys. Thanks for letting me ask a question. Dave, Rafael, maybe just a follow-up on the inventory question, I guess, maybe asked a different way. Were you planning to grow inventory sequentially in the calendar fourth quarter or did it end up growing because some revenue upside did not materialize in the quarter? And I guess importantly, as you look out to calendar first quarter, how do you expect to manage inventory for the calendar first quarter? Will it come down from here? Are you taking any unusual utilization action around inventory to bring it down?

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

What I would tell you is inventory came in about as expected. On the second part of your question, of course we don't get into that level of detail. But I would tell you that, as I mentioned to the earlier caller, we want to have buffers of inventory, particularly when addressing the industrial market, but also the automotive market. It's a good thing to have these buffers. And we have many, many of our products are low-volume, high-mix, so.

And, by the way, those are products that last for – we can keep them for 10 years in our shelves and then we sell them to our customers for 20 or 30 years. So, from a manufacturing standpoint, it makes sense to build them, keep them in storage. And that way you build them in batches, and it's just a lot more efficient that way. So we did that in fourth quarter, and if, depending on the market, if we can build some more in first and second and third, we'll do that again.

A - David Pahl {BIO 18870833 <GO>}

Yeah. And I'll just add kind of a corollary to the point that Rafael made. We do look at risk of obsolescence, so if we have a part that's a custom part or primarily used by one or two customers, we'll tend to keep very low inventory on those parts. So, kind of managing that inventory stack to risk of obsolescence is something that we aggressively do. Do you have a follow-on, John?

Q - John William Pitzer {BIO 1541792 <GO>}

Just to be clear, is this a change in sort of your long-term inventory targets? Or are we just still within those targets, just perhaps maybe migrating to the higher end?

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

The objective is the same. As far as the target, as we do every year, we look at our metrics for the capital management strategy. And, as you know, we have 10 or 12 metrics or so. So we look at those, and if we need to tweak them, we tweak them. So on February 6 we have a call, and we'll go through that. And if we need to tweak some of those metrics including inventory, we will do that at that point.

A - David Pahl {BIO 18870833 <GO>}

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

Operator

Thank you. Our next question comes from Harlan Sur with JPMorgan.

Q - Harlan Sur {BIO 6539622 <GO>}

Hey. Good afternoon, guys, and solid job on the quarterly execution. Can you just give us an idea of the breadth of the demand trends on a year-over-year basis by geography? I think last quarter you guys saw year-over-year growth in most geographies except for Japan, which was flat. Just wondering if the strength continues to be broad-based here.

A - David Pahl {BIO 18870833 <GO>}

Yeah, Harlan. It was broad-based. We had, we saw revenue growth in Europe, in Asia, as well as the U.S. But again, this year Japan was down. So almost very similar, but I would describe that growth as being very broad-based. Do you have a follow-on?

Q - Harlan Sur {BIO 6539622 <GO>}

Yes, I do. Thanks for that. Your Analog revenues grew by about $1.4 billion in 2017, and if my memory serves me correctly, you guys exited 2016 with your 300-millimeter fabs driving about $2.5 billion in revenues on an annualized basis. Is it, therefore, kind of fair to assume that you're driving now close to about $4 billion in revenues through your 200-millimeter Analog fab? So utilization roughly about 48%?

A - David Pahl {BIO 18870833 <GO>}

You're right in the ZIP code, Harlan. And so we ran about 50% of that capacity in our 300-millimeter fabs, which includes the Richardson FAB, but also DMOS6. So, somewhere in the ZIP code of about $4 billion of revenue. And I think, as we look at that and just to take a step back, manufacturing and technology is one of our four competitive advantages.

300-millimeter is probably one of the best examples that we can point to inside of that. And we have, because of 300-millimeter, when you look at the number of dies we produce on that versus 200-millimeter, we just have a structural cost advantage in every wafer that we build and every dollar of revenue we put through there. So, that's a benefit that has, we've accrued over the years and have increased that. But the great news is we continue to have a lot of headway, a lot of runway ahead of us, so.

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

Just to build on that, that is part of what's supporting the free cash flow growth that we're seeing. This year, free cash flow growth was 14%, on a per-share basis, it was 16%. Just illustrate the strength of the business model with the competitive advantages, our focus on auto and industrial and Analog and Embedded.

A - David Pahl {BIO 18870833 <GO>}

Right. Thank you, Harlan. We'll go to the next caller, please.

Operator

Thank you. Our next question comes from Chris Danely with Citigroup.

Q - Christopher Brett Danely {BIO 3509857 <GO>}

Thanks, guys. I guess first question for Rafael. If we look at your sort of cash flow deployment over the last few years, you'll take out, I think, around $500 million in debt and then the rest of it goes to kind of one-third buyback, two-thirds dividend. With the extra cash, can we assume those same ratios? Or would you look to take out a little more debt? Or keep it kind of the same?

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

So, Chris, you have a few things there. Let me maybe take one at a time. First, with the debt, the way we think about debt is we take on debt when the economics make sense. And right now, the economics make sense. We have $4.1 billion of debt, and it's at a 2.05% weighted average coupon rate. And the one we took out recently was 10-year debt at 2.9%. Of course, that's pre-tax. So the economics makes sense, and of course, we do it in a very judicious way. We don't have concentrated maturities and we maintain strategic flexibility.

On the first part of your question, our commitment is to return all free cash flow to the owners of the company. You know us for a long time and you know that we've been doing that. This year, for example, we generated $4.7 billion free cash flow, and we returned, guess what, $4.7 billion. So we're committed to doing that, and we do it through both dividends and buybacks. This year, dividends were $2.1 billion, buybacks $2.6 billion. We have a robust and flexible model to do that. It doesn't have to be necessarily any particular split. Dividends we like to be between 40% and 60% of free cash flow of the current year, and essentially repurchases is everything else. Do you have a follow-up on that?

Q - Christopher Brett Danely {BIO 3509857 <GO>}

Yes, thanks, another, I guess, historical/longer term question. So in Q4, you guys are roughly on a sequential basis seasonal. And if you look at I think the six quarters before that, every quarter was probably 1% to 3% above seasonal. So are you seeing things I guess stabilizing or cooling off or any signs of that in the industry, or am I just looking at the numbers too much and doing a little paralysis by analysis?

A - David Pahl {BIO 18870833 <GO>}

Maybe more of the latter. I'd just say when you look at the numbers, Chris, really from the top line growth down to free cash flow generation, you just see the strength in the business model. We've been investing in Analog and Embedded. They represent 90% of our revenue. They both grew 16% year on year. Industrial and automotive make up 54% of that. So we won't control the short-term demand. It is what it is. But when you look at those numbers overall, I think – at least when we look at them, we think they look pretty solid. So thank you and we'll go to our next caller, please.

Operator

Thank you. Our next question comes from Stacy Rasgon with Bernstein Research.

Q - Stacy Aaron Rasgon {BIO 16423886 <GO>}

Hi, guys. Thanks for taking my questions. Regarding the near-term OpEx trends, the last few quarters OpEx come in light, at least versus Street expectations. I know you guys don't guide short-term OpEx, but I would say this time it came I guess a little higher than at least we had expected. How did OpEx come in versus your own expectations in the quarter? And how should we be thinking about it as we go into Q1? Are there any I guess changes or differences versus what we might ordinarily see in a typical Q1 in terms of your plans?

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

Yeah, Stacy. First, OpEx came in about as expected. That's the short answer to your first question. Then before I go to the second question, let me take a step back. I think I alluded to this earlier, but just to mention it again. We see OpEx as investments, whether it's R&D or SG&A. And those were up 3% for the year, so very reasonable given the growth that we're turning in our key markets in Analog and Embedded and industrial and automotive. So we're getting the results that we want from those investments, and those investments go to strengthen our competitive advantages. And in the case of R&D, maybe the easiest thing to point out is the broad portfolio that continues to grow and strengthen. And in the case of SG&A, the easiest one to point to is demand creation and everything that we're doing there.

Going to the second part of your question on first quarter, as you know, we don't get into specific details there, although I would tell you that it's normal. People are still going to take less vacation in first quarter than they do in fourth because of Christmas and Thanksgiving and other things, and we still have pay and benefit increases in February. So we expect about the same as we usually expect in that transition.

A - David Pahl {BIO 18870833 <GO>}

Do you have a follow-on, Stacy?

Q - Stacy Aaron Rasgon {BIO 16423886 <GO>}

I do, thank you. Around the inventory buffers that you were talking about putting in place, are you actually seeing shortages or lead times for those specific products actually beginning to extend to drive that buffer addition, or are you just being proactive about getting it in place now? And how much of the I guess total inventory as it stands today out of the $1.96 billion would correspond to some of these buffer areas?

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

Let me start, and then Dave will chime in on the rest of your question. But the buffers, this is nothing new. We've had it – wow, four, five, six years or so, and obviously depending on strength of demand, it fluctuates if we're able to build or if we're draining the buffers. That's what they're for. At times we drain them. And frankly, off the top of my head I couldn't tell you how much of the $1.9 billion and change is for the buffers, but the bigger point is why we have the buffers.

We're focusing on end markets. Industrial is the best example where you have a lot of small customers across the world, in the middle of the U.S., in Shenzhen, in the middle of Germany, small customers focus on 14 sectors, hundreds of end equipment. You couldn't possibly build to order that stuff, right? Because there's any one customer may order a few thousand pieces.

So what you do is you build in bigger batches, you store it and then you sell it over time. And because the parts just in our inventory last 10 years, then it's very affordable. It makes a lot of sense to do that, and we do that with very low levels of scrap in any one quarter and any one year, so.

A - David Pahl {BIO 18870833 <GO>}

And I'll just add, I think when you look, we're doing that, Stacy, so that our lead times can remain stable, and then probably coupled with that is we focus on making sure that we've got very high customer service metrics. So when we say we're going to ship something that we actually ship it on that date to customers.

And those two things combined are what gives customers confidence that they can get the products that they need from us. So we spend a lot of time, and maybe just to highlight that, that's one of the initiatives that we've had at our company as we looked at having more Analog, more Embedded products, more industrial and automotive. We knew we needed to ensure that we put in place the capabilities to be able to service customers of any size and have those types of metrics.

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

Yeah. And just to add a little bit to that, back on the way we look at inventory, think about the improving manufacturing asset utilization. If you can improve that and run the factories not completely level, because you can never do that exactly like that, but fairly level, that goes a long way to improving your manufacturing processes, your yields, your cycle times. And that just translates into lower cost which, guess what, translates into more free cash flow, and that goes to the strength of our business model, how we generate all that free cash flow that we have been growing consistently for now 13-14 years.

A - David Pahl {BIO 18870833 <GO>}

Yeah. Right. Okay. Operator, I think we have time for one more caller, please.

Operator

Thank you. Our next caller is David Wong with Wells Fargo.

Q - David M. Wong {BIO 6109216 <GO>}

Thanks very much. To follow on from Vivek's question earlier, so you're seeing a slight deceleration in your overall blended growth, but in the December quarter you had really strong growth in Analog and Embedded. Would we expect in the March quarter sort of roughly equal deceleration in both Analog and Embedded? Or is it one more than the other?

A - David Pahl {BIO 18870833 <GO>}

Yeah. David, we provide guidance at the top level for revenue, and we try not to get into the corners by markets or by products. So now if there's something unusual going on, either if it was by market or specific customer or in one of those business units, we would call that out, and there's nothing for us to highlight inside of there. Do you have a follow-on?

Q - David M. Wong {BIO 6109216 <GO>}

No. That's good. Thank you very much.

A - David Pahl {BIO 18870833 <GO>}

Okay. With that, I'll turn it over to Rafael.

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

Sure. Let me just finish with a few comments on some key items that I want everybody to remember. First, the strength of our business model is demonstrated throughout our financial performance, with strong growth in both Analog and Embedded, which are the best products, and industrial automotive, which are the best markets. That's where the semiconductor content growth is happening, and we're confident that's where it will continue to happen for many, many years to come.

Second, as I said before, we're very excited about the tax reform. It's made TI just more competitive on a global scale, so we're excited about what we can do with that.

And finally, we continue to be disciplined in executing our capital management strategy. We remain committed to returning all free cash flow to the owners of the company.

Dave?

A - David Pahl {BIO 18870833 <GO>}

Thank you all for joining us. Again, please plan to join us for our Capital Management call on February 6 at 10:00 AM Central Time. A replay of this call is available on our website. Good evening.

Operator

Thank you. This does conclude today's presentation. We thank you for your participation.