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ST - Q1 2015 Sensata Technologies Holding NV Earnings Call

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PRESENTATION

Operator

Good morning and welcome to the Sensata Technologies Holding NV first quarter 2015 earnings conference call. At this time I would like to inform you this conference call is being recorded.

(Operator instructions)

For opening remarks and introductions I will turn the call over to Jacob Sayer, Vice President of Treasury and Investor Relations. Mr. Sayer you may begin.

Jacob Sayer *- Sensata Technologies Holding NV - VP of Treasury & IR*

Thank you, Steve and good morning, everyone. Earlier today, Sensata issued a press release describing our financial performance for the first quarter of 2015. If you did not receive a copy you may obtain it from the investor relations section of our website at Sensata.com. This call is being webcast live and a replay will be available in the investors relations section of our website.

Today's discussion will contain forward-looking statements based on the business environment as we currently see it and as such does include certain risks and uncertainties. Please refer to our press release and our 10-Q and 10-K filings for more information on the specific risk factors that could cause our actual results to differ materially from the projections described in today's discussion.

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In addition to US GAAP reporting, we report certain financial measures that do not conform to generally accepted accounting principles. We believe these non-GAAP measures enhance the understanding of our performance. Reconciliations between these GAAP and non-GAAP measures are included in the tables found in today's press release as well as in the investor relations section of our website under financial reports. Comments made during today's call will primarily refer to our non-GAAP financial results.

On the call with me today are Martha Sullivan, our President and Chief Executive Officer; and Paul Vasington our Chief Financial Officer.

(Caller instructions).

I will now turn the call over to Martha to review highlights from the quarter and trends in the end markets we see. Martha?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Thank you, Jacob. Thank you all for joining our first quarter 2015 conference call. Sensata's off to a good start in 2015.

Financial highlights for the first quarter include record net revenues of $751 million, an increase of over 36% from the first quarter of 2014. Adjusted net income for the first quarter of $111 million or $0.65 per diluted share. The acquisitions we concluded last year are all on track with our expectations for performance and integration.

The long-term value creation opportunity at Sensata continues to build. During the quarter, we saw progress on the regulatory front that will benefit Sensata. The upgrades required by the Euro 6 emissions regulations are on track and our European automotive revenues are up 10% on a constant currency basis as a result.

In China, performance enhancing revenue is growing faster than the end market due to content growth. New business loans remain strong signaling good future revenue growth.

We are driving margin benefits from best delivered costs and other continuous cost improvement programs and we continue to optimize our capital structure to minimize interest expense. However, coming into the first quarter we knew that we would see volatility in the markets we serve. This gave us time to prepare and to manage the business to a solid outcome.

Currency exchange rates fluctuated. In particular, the euro to US dollar. A robust currency hedging program ensured that the impact to earnings in the quarter was minimal.

In the heavy vehicle off-road market, production of agricultural, mining and construction equipment shrank dramatically as compared to last year. In Korea and Japan, auto production continues to shrink and is down an estimated 6% in the first quarter from the prior year.

In heating, ventilation and air-conditioning, this shift in Sears standards at the end of 2014 caused the demand dislocation for the first half of 2015. And as a sign of weakness there, China's manufacturing PMI remains below 50. However, Sensata's content growth enabled us to manage through these headwinds and for the business to perform in line with expectations.

We achieved the financial results we expected in the first quarter and the business continues to perform well in each of our largest end markets. Our revenue from the European automotive end market grew 51% in the first quarter, as compared to the year ago quarter, primarily as a result of the impact of the Schrader acquisition as well as content and market growth offset somewhat by the impact of foreign currency exchange rate movements. On a constant currency basis and excluding the impact of acquisitions, our revenue from the European automotive end market grew 10% in the first quarter as compared to the prior year, primarily due to content growth including the impact of the Euro 6 emissions regulations.

Third-party data shows European new passenger car registrations were up over 8% in the first quarter as compared to the prior year. Accordingly, while third-party market forecasts are currently calling for European auto production to be flat this year, we included in our guide and continue to believe that we will see some modest unit growth there in 2015.

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Our revenue from North American auto grew 67% in the first quarter year-on-year reflecting the impact of acquisitions, production growth and Sensata content growth in the region. We also continue to perform well in the Asian automotive markets with revenue up 17% from the year ago quarter. This increase is driven primarily by the impact of the acquisitions and faster than market growth in China offset somewhat by declining markets in Japan and Korea.

Our revenue from the heavy vehicle off-road market grew again this quarter, up 54% from a year ago, reflecting primarily the acquisition of DeltaTech Controls offset somewhat by weakness in the off-road and Chinese commercial vehicle market.

We also served HVAC and industrial end markets with both sensors and electrical protection products. The shift in Sears standards that occurred at the end of 2014 drove OEM to build ahead of the standard change creating excess inventory in the channel which is now being worked down. Consequently, our revenue in the appliance and HVAC end market was down 6% in the first quarter including the unfavorable impact of currency exchange rate.

For Sensata, the most important driver of organic revenue growth is designing new sensors into automotive, heavy vehicle, HVAC and industrial systems. These sensors have long shipment cycles and represents sticky revenue driving our organic revenue growth even in years like this one where we do not expect to see much unit growth in the markets we serve. We collaborate closely with OEM customers to identify new applications driven by energy efficiency, safety and emissions requirements at early stages of development and then design mission critical custom sensors that help enable these applications.

Often those systems are designed and adopted to help an OEM meet regulatory requirements. One such regulatory framework is the Euro 6 emissions requirement that becomes mandatory for all light vehicles in Europe starting this September.

Auto OEMs are increasing the percentage of vehicles made that are compliant with these regulations and we have seen good content growth in the European automotive end market as a result. We estimate that roughly 50% to 60% of the light vehicles being produced in Europe today are compliant with the Euro 6 emissions requirement.

Another beneficial regulation is the adoption of tire pressure monitoring in China. Recently, China's Automotive Technology and Research Center released final specifications for a TPMS legislative mandate. After a period of review, this sets the stage for the Ministry of Industry and Information Technology to issue the final mandate which could happen by the end of this year for adoption in 2018 or 2019.

Design wins are not always driven by regulation. Sensata, as a result of its acquisitions of DeltaTech Controls, recently won a significant design in with a leading global off-road vehicle OEM to design new operator controls for a new line of equipment starting in 2017.

This field is three times larger than any prior design win at DeltaTech. Sensata's industry leadership, global presence and a history of high quality assure this OEM that the combined company was the right partner for them.

The standing on M&A, the integration of each of last year's acquisitions is on track. We are currently in the process of centralizing Wabash's manufacturing activities in Mexico and bringing products into our Oracle ERP system.

The back-office activities at both DeltaTech and Schrader are in the process of being integrated with Sensata. Schrader is also growing very rapidly, up significantly in the first quarter from the same period last year. Given the ramps that serve European growth last year, Schrader's growth will of course, moderate as we move through 2015.

Looking ahead, the M&A pipeline remains robust and we continue to pursue proprietary discussions with potential partners. M&A remains a top priority use for our free cash flow.

I'd now like to turn the call over to Paul to review our first-quarter results in more detail and to provide second quarter financial guidance. Paul?

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Paul Vasington - *Sensata Technologies Holding NV - CFO*

Thank you, Martha. First quarter 2015 net revenue of $750.7 million increased 36.1% compared to the first quarter of 2014. Of this, acquisitions contributed 36.8% and organic revenue growth contributed 1.8% fueled by 3.1% organic growth in performance sensing which continues to see accelerating content growth.

Changes in foreign currency exchange rates, primarily euro, represented a net revenue headwind of 2.5%. The impact to adjusted net income from changes to foreign currency exchange rates was minimal in the quarter due to our robust currency hedging program.

First quarter adjusted net income was $110.9 million, while 14.8% of net revenue. Adjusted EBITDA for the first quarter was $173.3 million or 23.1% of net revenue.

When compared to the prior year, profitability indices are lower primarily due to the impact of acquisitions which included integration costs of $3.6 million and annual price downs which predominantly go into effect at the start of the year. Productivity gains, raw material savings, volume and operating efficiencies offset investments in research development engineering which are critical to the development and execution of our expanding pipeline of new business wins and opportunities.

The integration of our acquisitions is proceeding well and including the impact of financing and integration costs, were in total accretive to Sensata's adjusted net income per diluted share. Schrader, our largest acquisition to date, performed in line with expectations. Consistent with previous guidance, we expect Schrader to deliver $0.18 to $0.21 of adjusted earnings per share accretion in 2015 growing to $0.50 to $0.55 of adjusted earnings per share accretion after full integration and debt paydown.

Cash taxes in the first quarter were approximately $9 million or 5.9% of adjusted EBIT consistent with our overall target. We expect cash taxes for the full-year 2015 to be in the range of 5% to 6% of adjusted EBIT.

Sensata operates on a dollar functional basis globally. However, a portion of our revenues and expenses are denominated in currencies other than US dollar. Produced earnings and capital volatility from the remeasurement of these transactions into US dollars, we hedge a significant portion of our net earnings exposure to each currency.

Currently, we hedge out up to 24 months with the intent to hedge approximately 80% to 90% of the net earnings exposure prior to the beginning of each year. As a result, the impact on earnings represents a weighted average impact of prior movements in exchange rates.

In the first quarter, changes in foreign currency exchange rates had an unfavorable impact of approximately 2.5% to net revenue and $0.01 to adjusted net income per share. Foreign currency exchange rates remain volatile and are now more unfavorable than when we reported results for the fourth quarter of 2014.

As a result, we expect a slightly greater impact from foreign currency exchange rates for the full-year of 2015 or 2% to 3% decline in net revenues and a 3% to 5% unfavorable impact to adjusted net income per diluted share. Notwithstanding this change, we are maintaining our full-year financial guidance.

Longer-term, we continue to be proactive in our efforts to minimize earnings volatilities from movements in foreign exchange rates. For example, we are accelerating expansion of our manufacturing presence within the Euro zone to improve on delivered cost and we are renegotiating local supply agreements to further enhance our cost position. Both having the added benefit of naturally reducing our net foreign currency exposure over time.

First quarter 2015 non-GAAP results including an adjustment of $5.4 million to differ the impact of financial hedge losses related to euro denominated raw material purchases. This non-GAAP adjustment aligns the timing of income statement recognition of lower euro denominated raw material costs and the intended offsetting impact of our euro financial hedges. This adjustment is necessary since under GAAP our current risk management program to hedge net euro earnings does not allow for the deferral of hedge losses the way at the euro denominated inventory purchases.

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The loss deferral recorded in this quarter will be realized in our non-GAAP results once we underline acquired raw materials are converted to finished goods and subsequently delivered in future sales transactions. This adjustment, which is consistent in purpose with our non-GAAP adjusted to defer the recognition of gains or losses on commodity hedges is appropriate given the significant movement in the euro to US dollar exchange rate during the first quarter of 2015.

As intended, during the first quarter, we took advantage of the attractive capital market environment to further optimize our capital structure by refinancing our outstanding 6.5% 2019 senior notes in an economically positive transaction. To fund the purchase of the 6.5% notes, we issued $700 million in new notes at an interest rate of 5% saving over $10 million annually in interest expense.

Financing and other transaction costs of $19.8 million relating primarily to the refinancing were added back to our non-GAAP results. $79 million of the 2019 notes that were not tendered last month have been called and will be mandatorily redeemed tomorrow.

For the first quarter, free cash flow was $65 million. The refinancing of our 6.5% notes pulled forward interest payments that would otherwise have been made in the second quarter impacting free cash flow unfavorably by $15 million.

We invested $38 million in capital expenditures during the quarter and working capital consumed cash as receivables expanded in line with higher revenues. Inventory management improved significantly during the first quarter and days on hand declined to 62 as we worked down buffer inventory that was brought on last year to support customers during our ERP system upgrades.

Cash at March 31, 2015 was $196 million and we continue to expect free cash flow to be between $400 million and $450 million during 2015. Our net leverage ratio at the end of March stood at 4.1 times.

Capital allocation is a strategic imperative for Sensata and M&A remains a top priority for the use of free cash flow. In the absence of near-term M&A, we will look to repay debt in order to bring the net leverage ratio to within our long-term target range of 2 to 3 times.

Now, I'd like to comment on the performance of our two business segments. Performance sensing net revenue was $591 million for the first quarter, up 50% from the year ago quarter as a result of acquired revenue and new robust program launches that continue to gain momentum.

Probably offset by the impact of changes in foreign currency exchange rates and the impact of product obsolescence. Organic volume growth, which excludes the impact of price downs, grew 5.6% in the first quarter from the same period in 2014.

Performance sensing profit from operations was $143.9 million, up 32% for the year ago quarter as a result of acquired revenue and organic volume. Probably offset by annual price downs which predominantly take effect at the start of the year.

Productivity gains offset investments in research development engineering which are critical to developing and executing on our expanding pipeline of new business wins and opportunities. Home and sensing prop from operations index 24.3% was lower than the first quarter of 2014 primarily due to the impact of acquisitions and annual price downs.

Sensing solutions net revenue was $159 million for the first quarter, up 1.6% for the year ago quarter due primarily to acquired revenues offset somewhat by lower volumes in the appliance and HVAC end market, a broadly weaker China and the unfavorable impact of changes in foreign currency exchange rates. Sensing solutions profit from operations was $49.2 million, an increase of 2.5% for the same quarter last year. Sensing solutions profit from operations index of 30.9% was higher than the first quarter of 2014 primarily due to the impact of productivity enhancements offset somewhat by higher investments in research development engineering to support growth efforts in industrial sensing.

Corporate and other costs not included segment operating income was $44.2 in the first quarter. Guidance for the full-year 2015 have not changed. Financial guidance for the second quarter of 2015 includes net revenue of $755 million to $795 million which at the midpoint is an increase of approximately 35% from the second quarter of 2014.

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Key revenue assumptions for the second quarter include largely flat markets with weaker HDOR in China demands offsetting minimal growth in automotive, expanding content, especially in Europe, and continued strong acquired revenue growth offset somewhat by unfavorable impact on foreign currency exchange rates. Our current fuel rate stands at approximately 84% of the midpoint of this guidance.

Adjusted EBITDA of $180 million to $192 million, adjusted net income of $119 million to $129 million, adjusted net income per diluted share of $0.69 to $0.75 reflecting a fully diluted share count of 171.5 million shares. Key profitability assumptions for the second quarter include increasing productivity gains driven by higher volumes, accelerating material savings and improved operations offset somewhat by higher M&A integration costs and increased operating expenses.

In summary, we are pleased to report record revenue and earnings for Sensata for the first quarter of 2015. Sensata continues to deliver on its promise of strong double-digit revenue and earnings growth partly enabled by superior capital deployment for high returning repeatable acquisitions.

We would be happy to take questions that listeners may have. Operator, please introduce the first question.

QUESTIONS AND ANSWERS

Operator

Thank you, Mr. Vasington.

(Operator Instructions)

Scott Davis, Barclays.

Scott Davis - *Barclays Capital - Analyst*

Good morning. Everything sounds pretty good, but I'm trying to reconcile the 1.8% core growth rate with the pickup in Euro 6 and just the strength that I think you said Europe plus 10%. Maybe I didn't hear it right.

Is there a way to parse out the core growth a little bit and think in terms of the legacy Sensata businesses versus maybe Schrader and DeltaTech and such, and really understand is there something in this quarter -- I think last quarter was something a little bit higher, maybe 2.5%. Should we expect acceleration from here, or is there something that is just impacting that? I'm just opening up to some additional comments is my question.

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Sure, Scott. Just to be really straightforward with you, the 1.8% is not including acquisitions. So there is no organic growth in terms of DeltaTech or Schrader in that number. And to give you a sense of it, we are seeing now installation of Euro 6. But that is going to accelerate as we move to the second half of the year. So the outcome here is not unexpected.

I think the way to think about that is stronger organic growth in Europe, some end markets that are challenges for us. The off-road part of HVOR is down significantly. And so in areas like in China, down 30%; above 20% in the Americas and elsewhere. And that has been a pretty strong growth driver for us -- again, not unexpected. We did not expect to get a lot of end market help this year.

We've talked about the fact that our content growth is going to be stronger in the second half and the first half, and there are two major drivers on that. One, as you point out, is Euro 6. So right now we're seeing that in our backlog for second quarter, but that does accelerate into the second half of the year.

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The other driver is the tail now on this program that has been driving obsolescence. We've talked about our occupant weight sensing program. And we see the last of that revenue as we exited 2014. But when you look on a quarter-over-quarter comparison, it's still a 1.5% headwind for us in the first half of the year.

So those are some of that puts and takes. Yes, a little organic growth quarter for Sensata -- not unexpected. We've talked about how we expect the organic growth to play out down over the year.

Scott Davis - *Barclays Capital - Analyst*

Okay, that's very fair.

And just a quick follow-up. You mentioned the release fee, 7.7% R&D to sales. When the acquisitions are fully integrated, is that the right level to think about? Or is there some scale you can get on the larger revenues, where maybe you don't have to spend quite as much as a percent of sales just because sales are so much higher?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

I think over time that index can come down somewhat, but that's not primarily where we're getting our leverage. I think the other way you've got to think about that is in places like Schrader, where we grow episodically, we're going to go through periods where R&D is probably a little more volatile than we've had inside of overall Sensata. So I think that we will see some leverage; but we've talked about staying inside our 5% to 7% over time, and I think that's about what we expect this to run.

Scott Davis - *Barclays Capital - Analyst*

Okay, I'll pass it on. Good luck the rest of the year.

Operator

Shawn Harrison, Longbow Research.

Shawn Harrison - *Longbow Research - Analyst*

Good morning. I guess I'd like to drill more just on where you're thinking in global auto production. Particularly within China and then within Europe, knowing that European registrations were strong and production is expected at essentially, at least HIS and others, to be flattish. And then in China, TE connectivity said they saw a little bit of softening in the market. What are you seeing within China auto production?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, we're seeing end vehicles softer in China. Let's put it this way. We've seen the growth not as robust as it has been in the past. Having said that, we are still growing about 9% in China -- well above the overall production rate.

Let me just give you a couple of things to think about on that front. On overall China market, I think at this point we are calling production -- is it about the 7% run rate? So this is a third party. Were not taking a different view than third party. I'll look on that. Typically, that's been 8% to 9%. And as I pointed out, we're growing at the 9% range; and again, that's content growth that drives it.

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In terms of Europe, yes, it's true. Registrations have been growing nicely in Europe and pretty consistently. Production calls are still for flat. Our view is that production will be stronger than flat this year -- not way stronger, probably in the 1% to 2%.

One of the reasons you see the disconnect between increasing registration and then sort of flattish production is that vehicle inventories has been coming down over the past year in Europe. So that's something we've been taking a look at to understand how production will play out. And production is what drives our growth.

Shawn Harrison - *Longbow Research - Analyst*

Very helpful.

And then as a follow-up I guess, the currency impact. How much of that falls into the second quarter, Paul? And then as we look at 2016, how much of a year-over-year impact right now would currency be, assuming you hedged all of 2016 out at 1.08 euro to the dollar or something like that?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

Good question.

The first one, you saw the $0.01 impact in Q1. It's a little bit larger in Q2. So we did got the higher revenue that we're seeing, and then with the ramp-up of the euro. So we got a little bit more exposure there. And then in Q3 and Q4, it moderates down a bit. But all in all, we're talking about $0.03 to $0.05, with a little heavier impact in Q2.

If you talk about 2016, let's just step back. Let's think about where Sensata is in terms of its hedging program. We hedge out about 24 months. We hedge every month. We do it on a systematic basis. We have net revenues or net earnings in various currencies and net expenses. They offset each other. So our net annual exposure is about $250 million to $300 million of exposure.

Based on where we are hedged today, the rates were today, we think there'd be about a four times impact to the impact that we're seeing in 2015, if you take that $0.03 to $0.05 range multiplied by four times. That's about the impact that we would expect assuming no changes in rates, no changes in exposures, and no changes to our cost model that we're continuing to work continuously in the organization.

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, I think that final piece is really important to understand. Our cost structure is not fixed. And so we broke new ground on an additional manufacturing facility in Bulgaria. That building is almost up and running.

We'll be increasing our production rates in Bulgaria. And that gives us a better overall alignment between euro cost and euro revenue. And as Paul mentioned earlier, we continue to look at our overall procurement strategy and find ways to make sure that our cost structure is moving; it's actually not static.

Shawn Harrison - *Longbow Research - Analyst*

Very helpful. Thanks, Martha.

Operator

William Stein, SunTrust.

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William Stein - *SunTrust Robinson Humphrey - Analyst*

Great. Thank you for taking my question. First, I wanted to delve into the TPMS business in China. At the Analyst Day, I think there was some discussion about some orders flowing despite the regulations not being adopted yet. I think that was small or perhaps more forward-looking. But if you can talk to what you see for demand trends there.

And then also in your prepared remarks, you talked about TPMS in China potentially being mandated this year. I think that's about two years ahead of expectations. And we would love to hear about what you think the sizing of that opportunity could be.

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Sure, this quarter we actually saw development on the regulation; and that was an important development. So mentioned that there is this Chinese Automotive Research and Technology Group, and they are the rule making body for this type of regulation. So they took a step to tighten --I would say to further define that regulation this quarter, made that announcement. So you can actually Google that and take a look at what they're proposing. That was a really important development.

Having said that, there are things that have to happen around further defining the actual thrust threshold for sensing. That's some of the very specific requirements. There'll be deliberations around that, and then there needs to be an enforcement policy over time. So we think that regulation is still very much on track with our investment basis. And that's when we expected to see revenue tied to the regulation play out in the 2018/late 2019 time horizon. That's an important growth trajectory for Sensata and for Schrader. And it really allows us to continue to stay on this high single-digit organic growth rate all in over time.

In terms of what we see happening in China, again, in tire pressure monitoring right now. We have seen some customers actually be interested in putting this into vehicles as a consumer feature. That tends to be your high-end vehicles, so not terribly important from a revenue perspective. I would say more importantly, given the continuous movement of regulations, we are engaged with many more players now as they develop a response and prepare to meet the regulation over time.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Thanks, that's helpful.

And if I can follow up with a 2015 question. You may have said this; I apologize if I missed it. The full-year revenue growth now, can you review what that assumes from an organic growth versus a content growth and FX and M&A?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

We're really not guiding on all of those components. We've given you the impact that you can expect to see from the foreign currency exchange rate.

I will tell you this particular quarter was one that was sort of very, very strong on the acquisitions and a little lighter on the organic. We would expect to see that move a bit as we move through the year. So improving on organic, probably a little less help from acquisitions. So directionally, we can give you a sense for that. But we'll let you know as we move through the quarter how those play out.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Thank you, Martha.

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Client Id: 77

Operator

Mark Delaney, Goldman Sachs.

Mark Delaney - *Goldman Sachs - Analyst*

Yes, good morning and thanks very much for taking the questions.

First question is on the potential Euro 6 impact as we move through the year. And I wanted to check if $75 million to $100 million is still the right annualized benefit that the Company expects to realize, especially given some of the positive trends we've been seeing in the new car registration in the last couple months out of Europe?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, we've definitely separated out end market from the overall impact of Euro 6. But just for the benefit of everybody on the call, the way we had scaled this opportunity was, if we were moving from zero Euro 6 content in our revenue to full implementation, we expected that would deliver $75 million to $100 million annualized increase revenue. So we had a little bit of that content late in 2014, a little bit more as we moved through the first quarter.

When we look at the run rate as we exit the year, that run rate translates now to -- I can probably narrow that for you -- more like $80 million to $85 million on an annualized basis. So very much in line with how we guided.

Mark Delaney - *Goldman Sachs - Analyst*

That helpful. Thanks, Martha.

For a follow-up question, has there been any change in the competitive environment on pricing, given that two of your big competitors are in Europe and Japan and should be benefiting from currency tailwinds?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

We have not seen a change in behavior on that front. And keep in mind that the nature of competition in these markets and with these mission-critical sensors, is that when we're competing it's for programs that are three to four and even five years out. So currency fluctuation over time has just been a fact of life.

I think we have got rational competitors, and we certainly consider ourselves prudent. And so you think about your economics over the long run, and I would be surprised to see them become extremely aggressive in the short-term.

Mark Delaney - *Goldman Sachs - Analyst*

Thanks very much.

Operator

Craig Hettenbach, Morgan Stanley.

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Craig Hettenbach - *Morgan Stanley - Analyst*

Yes, thank you.

Appreciate the color on the controls side and what you outline on the inventory correction. Can you discuss where you are on that? And if you're able to put that aside from an underlying demand perspective, how you see controls into Q2 and Q3?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, that's one we've been spending some time on, Craig, just given the impact on this (technical difficulty). So we are now, when we look at the backlog development into Q2 here, we're seeing a rebound of that demand -- so feeling confident that was a one-time dislocation.

As we look ahead, in terms of our Solutions business, we look ahead to the balance of the year, the remaining headwind there is going to be just PMI-oriented demand in China. When you look at the PMI index now in China at below 50, that's going to continue to be a challenge for the business. We expect organic growth is going to rebound in sensing Solutions, but still probably at the low single digits.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it.

And then as my follow up, a lot of focus on FX translational impact. Are you seeing anything in terms of customer demand or forecasting because of the volatility in the FX markets?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Keep in mind, given that we're dollar functional, there's not a lot of translation impact. So mostly we're dealing with transactions. No, we're not seeing a lot of change in customer behavior. In Europe, we're largely euro-denominated in our contracts are ready.

Craig Hettenbach - *Morgan Stanley - Analyst*

Okay, thank you.

Operator

Ambrish Srivastava, BMO Capital Markets.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Thank you.

Martha, I apologize if I missed it. Just two. First one is on the US production assumption for the year, did you give that number out?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

IHS has the production for North America for the full year at 2.7% growth.

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Ambrish Srivastava - *BMO Capital Markets - Analyst*

Okay, great. Thank you.

And then, there has been a lot of change in the business. Could you please just highlight what we should be expecting for normal seasonality for each quarter? Thank you.

Paul Vasington - *Sensata Technologies Holding NV - CFO*

I can take that.

So we guided to $775 million at this point for Q2. As we look to the second half, we see fairly flat revenue in Q3 and Q4. We will see the seasonal decline in our Sensing Solutions business. However, we've got some great growth opportunities in industrial sensing that will mitigate some of that. We see decent production and really globally for auto in Q3 and Q4. And we will see a little bit of a weakness in Schrader as their after market business gets a bit lighter in the fourth quarter. So varied puts and takes; but basically, it creates more of a balanced Q3 and Q4 revenue profile.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Okay, great. Thank you.

Operator

Amit Daryanani, RBC Capital Markets.

Amit Daryanani - *RBC Capital Markets - Analyst*

Thank you.

Good morning. I have two questions as well.

Paul, just on the FX, I want to make sure I understand this properly. Last quarter, the take was a $0.03 to $0.04 impact; and now it's at incremental $0.03 to $0.05. So really it's a $0.06 to $0.09 impact for 2015?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

It's a $0.03 to $0.05 impact for 2015. It's about $0.01 a quarter, and we widened the range a bit because of the lower exchange rates we're seeing than when we guided back in February.

Amit Daryanani - *RBC Capital Markets - Analyst*

Got it.

Paul Vasington - *Sensata Technologies Holding NV - CFO*

We just expanded the range on the outer end by $0.01.

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Client Id: 77

Amit Daryanani - *RBC Capital Markets - Analyst*

Fair enough, and then it's 4 times is the potential impact next year if currency stays this way and nothing happens?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

Assuming a static environment today and no changes in our cost structure, which we're working very aggressively to drive down costs and moving our production to the Euro zone and looking at all of our supply contracts to improve our costs from being excluded. Assuming that doesn't happen, everything as is today, we think it's about a 4 times multiplier from where our current FX impact is on EPS of $0.03 to $0.05.

Amit Daryanani - *RBC Capital Markets - Analyst*

Got it. That's helpful.

And then, just on the Euro 6, Martha, I think I heard you right. You said 50% to 60% uptick grade already with Euro 6. How did that number stack up with your own initial expectations? I thought it's a little higher than probably I would have thought it would be. But I'm curious, how does that stuck up for you versus what you are thinking? And does that potentially put some pressure on organic growth if this was a little more front half heavy than initially expected?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, I think it's coming into this current quarter a little bit earlier than when we would have expected. So marginally, it's slightly higher in the first, not way higher. So one of the things I think that helped with some of the downside that we saw in the off-road and in this inventory dislocation issue. I've found the margins coming in slightly earlier, but not way off the overall expectations.

Amit Daryanani - *RBC Capital Markets - Analyst*

Got it.

And then Martha, just finally, in terms of leverage ratios, do you feel comfortable where we are today, slightly above 4%, to start looking at buybacks and M&A as you get to the back of the year? Or would that be more 2016 focus?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, we're comfortable. We're certainly comfortable where we're operating. For those of you that know the history of Sensata, you've seen us operate with much more leverage. We don't think we need to do that to take advantage of the M&A pipeline that we have in place.

We had really strong cash performance. If you look at the fact that we used $15 million of that to actually further optimize the capital structure. Just given the overall cash characteristics of the business and of the acquisition, we think we're in good shape with the dry powder that we need and where we're operating from a leverage perspective.

Amit Daryanani - *RBC Capital Markets - Analyst*

Perfect. Thank you very much for your time.

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Operator

Wamsi Mohan, Bank of America.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Yes, thank you.

Martha, sorry if I missed this, but could you just go back to sort of what the pressure was on the organic growth in the quarter? I think you said OWS is a headwind of 1.5 for the first half. I'm wondering if it's higher than that in Q1? And also, how much of a negative impact, the inventory correction was in the quarter?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

OWS is about that same rate in the first quarter, so don't want to overstate that. When we look at our overall Solutions business, the major impact there was this inventory dislocation. And we saw on an organic basis, so foods is actually down year over year. So not insignificant, but also not a sustaining issue for us. So those are the two sort of big takes in the first quarter.

The other thing I would mention is the off-road piece of our HVOR. While we continue to grow in overall HVOR, we're growing much more slowly. And that's an end-market dynamic that continues to be a headwind for us.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Okay, thanks.

And, Paul, the integration charges in the quarter with $3.6 million, how should we expect that to trend through the course of the year? Any color you can share there?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

They're going to increase. So as we are implementing and integrating those businesses and bringing them on Oracle, the cost to do that will increase over the quarter. So I expect them to ramp up in Q2, and then sort of stay at that level for the rest of the year. That may come down at the end of year. But it's going to be about $1 million or so higher than what your -- it's $1.5 million higher than what you saw in Q1.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Okay, great. Thanks a lot.

Operator

Rich Kwas, Wells Fargo Securities.

Rich Kwas - *Wells Fargo Securities, LLC - Analyst*

Good morning, everyone. I wanted to just revisit organic growth.

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Client Id: 77

Martha, on the outlook for the year and better than the revenue guide. When you gave your guide in February, it was 6% organic growth. That assumed some market growth offset by pricing. Is that still intact here for the year?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, we don't see a change to our overall expectations on what market's going to do and where pricing lands. And given what we're seeing on Euro 6 play out and our other wins, we do expect we're going to see the content growth we were relying on.

Rich Kwas - *Wells Fargo Securities, LLC - Analyst*

Okay. So going from 2% and then ramping up over the course of the year, getting to 6%, is still a viable rep?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Absolutely, that's why we're making the point that we've expected -- I think we've been deliberate about expecting that the first half is going to be lower than the second half for OWS, for Euro 6 impact, which is still stronger in the second half even though we're seeing some of that come into the second quarter now.

Rich Kwas - *Wells Fargo Securities, LLC - Analyst*

And then, when we look at the guide here. So you maintain the guide, which understandable. But what gets you to the top end? What are the moving pieces that would drive you upside to the top end of the guidance or near the top half? How do you think about that?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, a lot more moving parts in our business right now. So if you think about some of the acquired businesses, we have the dynamic of a pretty aggressive ramp that is underway with customers now in Europe. Not unusual for just from getting time to market, having those things come in earlier. Then you get a longer run rate on that business in the current year.

When we look at just the impact of things, like regulation, that will have some of your early adopters moving more quickly to put content into vehicles ahead of regulation. A little bit of that potentially on the tire pressure front. Some of that on what we call Euro 6 C, which is now bringing in new content in place as well.

I think having said all that, those tend to be longer cycle decisions. And so the biggest things that will probably move us to the upside or down are most likely going to be end market oriented.

Rich Kwas - *Wells Fargo Securities, LLC - Analyst*

And that's assumed to be flat for the year still?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

That's ahead of our overall assumption, yes.

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Rich Kwas - *Wells Fargo Securities, LLC - Analyst*

And then last one for me on China. The 9% comment, was that auto revenue or was that overall Sensata China revenue? Because versus the 7% auto production, I would think that you would have more content growth above 2% versus underlying production. So I don't know if there was some HVAC stuff in there and what not?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, that was in our performance sensing business, and so that is a combination of commercial truck and auto. Commercial truck is down about 32% from an end-market standpoint in China. So you're right; our auto content growth is growing much more strongly than the 9%.

Rich Kwas - *Wells Fargo Securities, LLC - Analyst*

Okay, and just last one. What's your China commercial truck exposure?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

I don't have that for you off the top of my head. I think in performance sensing, it's about 25% or 30% of the overall business. Let us fact check that for you.

Operator

Jim Suva, Citi.

Jim Suva - *Citigroup - Analyst*

Thank you very much, and congratulations to you and your team at Sensata.

Martha, you made a comment about 2016 FX being $0.03 to $0.05 actually for this year, but then four times that for next year. But you said that assumes everything remains stable, status quo. And then later on you made some comments about also opening up a plant in Bulgaria and some things like that. When we think about that, it seems like that Bulgaria plant could offset some of that given its natural placement of where it is.

Could it offset like half of that? Or should we also be thinking of there's going to be some ramping costs as you ramp that plant and some duplication costs, and that will probably come in this year or next year? Because four times $0.03 to $0.05 is a pretty big number. And so, I assume you're not going to stand still. So I'm just trying to gravitate about what that really implies about what you are doing to that headwind.

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Sure, let me give you a little more insight on that. We're not actually moving into Bulgaria for the first time. So we have an existing production facility there today that supports about 20% of the overall revenues that we ship into Europe. And so we're actually expanding an existing site, which is much less investment intensive and takes less time than going to a new location for the very first time. And in fact, that production begins at the end of this year.

So, yes, we think it could be a significant offset to the overall headwind on currency. At the same time, we look at what we call our best-cost sourcing programs. And we see opportunity to take advantage of currency on that front as well. So not in a position to say exactly what that offset is going to be, but we think it will be important. And as we get closer to 2016, we'll give you a better sense of that.

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Client Id: 77

The other thing to keep in mind is, Paul made the comment that if you freeze everything today -- and that was just to give you a sense for what it looks like all things frozen. So beyond the fact that our cost structure isn't frozen, we're in multiple currencies; we're in multiple cross-currencies all around the world. So a big portion of what we ship into Europe actually comes out of Mexico in the peso. So as the dollar strengthens, we see some benefits to what we call our made currencies as well.

So those are the things to keep in mind in terms of the puts and takes. We know its an area of a lot of interest. We'll continue to provide insight as we make progress on the overall cost structure.

Jim Suva - *Citigroup - Analyst*

Great, thank you very much.

Operator

Christopher Glynn, Oppenheimer.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Thanks, good morning.

Just wanted to go a little deeper into your thoughts around balance sheet flexibility and lender tolerances, just given a pretty aggressive description of the pipeline and the imperative of continuing M&A while leverage is a good bit above the target range.

Paul Vasington - *Sensata Technologies Holding NV - CFO*

As Martha said, M&A is our top priority for free cash flow. We continue to generate strong free cash flow. We are using our free cash flow to pay down some of our variable debt, our term loans.

We think there's a great interest in Sensata from a product perspective. When we did the issue of the 5% 700 million notes, it was four times oversubscribed. So we're very good credit from the perspective of credit investors. They like our story.

So I think there's plenty of financial flexibility through the debt markets. And coupled with our strong cash flow, I think, gives us plenty of firepower to continue to pursue value-creating acquisitions.

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Yes, and I think to put some further balance on that, we often get into the -- are you going to lever up and do more acquisitions, or are you going to pay down debt? We think that's a real continuum on that side. Just given the cash flow of the business, we expect it to be back to the two to three leverage ratio by the end of the year. So we're not looking at a scenario where the pipeline tells us we've got to significantly increase our current leverage. And so that's just something to give you a sense of how we think about it.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Yes, that make sense.

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Client Id: 77

And just given the breadth of integration activity you have right now, at what point would it become a challenge in terms of biting off too much at once?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

One of the things that we did --

Christopher Glynn - *Oppenheimer & Company - Analyst*

I mean operationally not financially.

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

I hear you, and so the digestion is an important piece of that. That's something we've been very thoughtful about in terms of the structure of the business. And in some cases, actually hiring ahead of the pipeline to make sure that we've got the bandwidth that we need to get things integrated.

And in the meanwhile, there's plenty of continuous improvement activity that we can drive with those resources. So we're going to be very careful to make sure that we don't bite off more than we can chew. But I'd like you to understand, we're not highly gated at this point digestibility.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Okay, great. And last one is, any impact on EPS from snow removal in the quarter? (Laughter). I'll take that off line.

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

Just really excited about the spring.

Christopher Glynn - *Oppenheimer & Company - Analyst*

Thank you.

Operator

Matt Sheerin, Stifel.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Thanks, good morning.

Just a question regarding the margin expansion. Your guidance implies pretty good margin leverage, operating margin line, through the end of the year. It looks like there was a big step down in OpEx this quarter. Gross margin was lower obviously due to acquisitions.

As we think about how that plays out through the year, what do we expect SG&A to tick up? You talked about integration costs and some other costs. So what should we think about gross margin versus SG&A percentage through the year?

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Client Id: 77

Paul Vasington - *Sensata Technologies Holding NV - CFO*

I think on the gross margin line, you should expect gross margins to improve over the course of the year. The price, as I mentioned in the prepared remarks, is baked in early in the quarter. And so that continues throughout the year.

But our productivity initiatives around material savings and operating efficiencies, that all accelerates over the course of the year. And we start seeing much greater attraction there. And it starts to drive expansion in our gross margins, as well as the volume leverage that we're getting from the higher volumes that we're going to be generating over the remaining nine months of the year.

From a cost perspective, we continue to invest in research development and engineering and support those business opportunities and execute on those new wins. From the SG&A perspective, I mentioned the integration cost rising a bit and as of April, you'll be kicking to a new compensation cycle that drives up SG&A a little bit, but not significantly. I think the cost will stay, aside from the competition increases, pretty range bound for the rest of the year.

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

And so what will (audio break) a fact that it might be helpful just an understanding of our confidence to get to overall A&I margins on Sensata. If you look at our businesses that are not in the integration mode -- and so if you exclude certainly DeltaTech, Schrader and even Wabash, where we're still spending money on the integration -- our adjusted net income index this quarter was 19.2% on those businesses not being integrated. So continuing to perform very well in the overall core business.

Paul Vasington - *Sensata Technologies Holding NV - CFO*

And that will (multiple voices) significantly over the course of the year.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Got you. And that cost down you talked about, is that around the 2% that you normally see?

Martha Sullivan - *Sensata Technologies Holding NV - President & CEO*

On the pricing? Yes, that's about right.

Matt Sheerin - *Stifel Nicolaus - Analyst*

All right. Thanks a lot.

Operator

As there are no more questions, I would like to turn the conference call back over to Mr. Sayer for closing remarks.

Mr. Sayer?

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Jacob Sayer - *Sensata Technologies Holding NV - VP of Treasury & IR*

Thank you, Steve.

I'd like to thank you all for joining our First-Quarter 2015 Financial Results call today. Sensata will be participating in Wells Fargo Industrial Investor Conference in New York on May 6, 2015; Oppenheimer's Investor Conference in New York on May 12, 2015; and Bank of America Merrill Lynch's Technology Investor Conference in San Francisco on June 2, 2015. We'll also be participating in leveraged finance conferences sponsored by Morgan Stanley on June 4, 2015, and Barclays on June 11, 2015.

Each of these events will be Webcast live and available for replay from the Investor section of our website at www.Sensata.com. We appreciate your continued interest in and support of Sensata and look forward to speaking to you on the road and again next quarter.

Thank you and goodbye.

Operator

That concludes the call for today. You may now disconnect.

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