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EDITED TRANSCRIPT

ST - Q3 2015 Sensata Technologies Holding NV Earnings Call

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CORPORATE PARTICIPANTS

Jacob Sayer *Sensata Technologies Holding N.V. - VP of Treasury and IR*

Martha Sullivan *Sensata Technologies Holding N.V. - President and CEO*

Paul Vasington *Sensata Technologies Holding N.V. - CFO*

CONFERENCE CALL PARTICIPANTS

Wamsi Mohan *BofA Merrill Lynch - Analyst*

Scott Davis *Barclays Capital - Analyst*

Sumit Chatterjee *JPMorgan - Analyst*

Craig Hettenbach *Morgan Stanley - Analyst*

Matt Sheerin *Stifel Nicolaus - Analyst*

Rich Kwas *Wells Fargo Securities, LLC - Analyst*

Mark Delaney *Goldman Sachs - Analyst*

Shawn Harrison *Longbow Research - Analyst*

Ambrish Srivastava *BMO Capital Markets - Analyst*

Amit Daryanani *RBC Capital Markets - Analyst*

William Stein *SunTrust Robinson Humphrey - Analyst*

Jim Suva *Citigroup - Analyst*

Jeremy Capron *CLSA - Analyst*

PRESENTATION

Operator

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

(Operator Instructions)

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

Jacob Sayer *- Sensata Technologies Holding N.V. - VP of Treasury and IR*

Thank you, Keith. And good morning, everyone. Earlier today Sensata issued a press release describing its financial performance for the third quarter of 2015. You may obtain a copy from the Investor Relations section of our website at Sensata.com. As a reminder, this call is being webcast live and a replay will be available in the Investor 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, 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, Sensata's President and Chief Executive Officer, and Paul Vasington, Sensata's 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 that we serve. Martha?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Thank you, Jacob. And thank you all for joining our third-quarter 2015 conference call. Our strategic goal to win in sensing and drive long-term secular growth at Sensata remains intact, and we continue to deliver on promised double-digit revenue and earnings growth for shareholders.

Key highlights for the third quarter include net revenue of $727 million, an increase of 26% from the third quarter of 2014. Net revenue in performance sensing grew 40% in the quarter from the prior year, driven primarily by acquired revenue from Schrader and DeltaTech. Organic growth of 2% was depressed due to weak China vehicle and heavy vehicle off-road production. However, revenue in our European automotive end market grew 19% organically, driven by strong sensor content growth, and new sensor program launches remain on schedule.

Net revenue in sensing solutions shrank by 9% in the quarter compared to the prior year and by 8% organically, due primarily to weakening markets in China, as indicated by seven consecutive months of week manufacturing PMI data and continued inventory destocking, weakening semiconductor manufacturing and communication markets, and continued HVAC inventory rationalization from the SCR changeover in the US. Adjusted net income was $123 million, an increase of 14.5% from the third quarter of 2014 or $0.72 or diluted share, in line with our expectations. And adjusted net income margin in the core business, which excludes Schrader and DeltaTech, was 19.7% which reflects continued progress towards our target margin range of 20% to 23%.

When we updated full-year financial guidance in July, we expected a quick inventory adjustment affecting Chinese vehicle production in Q3, a stabilization of the downward trend in off-road vehicles and end to destocking in the industrial HVAC and appliance markets. Given where we stand today, end markets look worse than our prior assumptions. Consequently, we have taken further action to improve our cost position in order to align our costs with weaker demand, a portion of which will provide sustainable savings into next year.

We are executing on our strategy to win in sensing with a growing pipeline of new business wins and the successful execution of our M&A strategy. Despite weakness in our end markets, sensor content growth remained on track to deliver 5% to 6% growth this year, driven by high single-digit content growth in our core performance sensing business. We are prospering in a fast-growing sensing market that is driven by safety, efficiency and a clean environment.

We have a leading position providing differentiated value to our customers by designing and manufacturing innovative custom sensors for mission-critical hard to do applications. We work closely with our customers to design and deliver innovative sensing products that drive secular growth for Sensata, fueling organic revenue growth even in years like this one where markets are a headwind to revenue. Regulation and its enforcement is a critical catalyst for long-term sustainable sensor growth.

We believe a move toward real-world emissions testing is more likely given recent revelations of diesel emissions irregularities. This would lead to an acceleration of emissions control development pipeline at OEM. For example, we will see more widespread adoption of systems such as selective catalytic reduction systems that include pressure and high temperature sensors enabling those systems. In the normal course, heavy vehicle emissions regulations in the US and Europe next year in Q3 and Euro 6 C light vehicle emissions regulations in 2017 and 2018 will help to drive future sensor growth.

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Inorganic growth through acquisition enabled by our strong free cash flow and a highly efficient capital deployment strategy is a key pillar to delivering long-term double-digit revenue growth and a core part of our value creation strategy. This year acquisitions will deliver over 25% revenue growth for Sensata. Acquisitions also open up new avenues for technological and adjacent market growth as well as cross-selling opportunities.

The integration of each of our prior acquisitions is proceeding well and Schrader continues to exceed profit expectations. During the diligence phase for Schrader, we identified certain product lines that are not aligned to our long-term strategy and were unprofitable, such as Schrader's Brazilian operation. In light of the current market backdrop we are accelerating plans to reduce or exit these product lines. This will reduce net revenues but will improve earnings.

During the quarter we announced an agreement to acquire the sensing portfolio of Custom Sensors and Technologies, or CST. This acquisition is highly profitable with EBITDA margins in Sensata's core range. They're highly cash generative and we expect the acquisition to be accretive after the first year.

The product portfolio is highly complementary and expands Sensata into attractive applications in aerospace, industrial, machinery and medical end markets. The regulatory review is proceeding in line with expectations, and the parties are currently working towards the goal to close the acquisition on the first of December.

Organic growth this year has trailed our long-term expectations for single-digit revenue growth. End market performance has had a negative impact, with the number of cars, trucks, appliances and industrial end equipment manufactured this year in decline. Vehicle production in China, which has been an engine for growth for a number of years, declined in the third quarter.

We believe automotive and light commercial truck production in China fell by 10% to 15%, as declining retail sales triggered OEM to slow production to improve inventory positions. While content growth remains strong in China, and production is improving sequentially into the fourth quarter, we currently expect to see a similar production decline year on year in China in the fourth quarter. Long-term we believe that Chinese automotive market will be robust and will provide a continued runway for market growth.

Regulatory enforcement of emissions and fuel economy is improving and OEMs are responding by producing cleaner and more fuel-efficient vehicles. These new vehicles include numerous new designs that drive significant sensor content growth. Consequently, once we get through expected near-term market volatility, we expect China to again be a long-term driver of revenue growth for Sensata.

Our European automotive business continues to perform extremely well, with revenue up 59% in the third quarter as compared to the year-ago quarter, primarily as a result of the impact of the acquisition of Schrader, as well as from content end market growth, offset somewhat by the impact of foreign currency, all in line with our expectations. On a constant currency basis, our revenue in the European automotive market grew 19% organically in the third quarter as compared to the prior year, primarily due to content growth, including the benefit of the Euro 6 emissions regulations.

In line with our expectations, third-party forecasts continue to call for modest automotive production unit growth in Europe in 2015. We expect to see continued low single-digit production growth next year as the European economy improves.

In North America our automotive revenue grew 79% in the third quarter as compared to the prior year, reflecting the impact of the acquisition of Schrader and underlying production growth in the region. While vehicle production is running at high levels in North America, we foresee low single-digit growth in light vehicle production rates over the next year. Our revenue from the heavy vehicle off-road market grew 2% this quarter from a year ago reflecting, primarily the acquisition of DeltaTech, offset by poor conditions in the off-road vehicle market, especially for agricultural and construction equipment which appears to have contracted at a 15% to 20% great.

We expect the HVOR market to continue to contract in the fourth quarter, principally in the off-road agricultural and construction segments. For the next year we expect HVOR revenue to be up slightly as increases in content growth offset an overall weaker end market.

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Within sensing solutions, a small but growing industrial sensor unit serves OEMs in the HVAC and industrial markets. Despite market headwinds, industrial sensing revenue grew organically in the quarter, including low double-digit content growth. Next year we expect industrial sensing to grow greater than 10% on continued content growth.

In addition, the acquisition of CST will add substantially to our industrial sensing product base revenue and end market access. However, the appliance and HVAC industrial and other end markets are primarily served with electrical protection products from our sensing solutions business that do not benefit from content growth drivers. As result of broadly weaker China, we saw continued weakness in these end markets and further destocking by customers. We also saw continued HVAC inventory rationalization from the SCR changeover in the US and weakness in the semiconductor, manufacturing and communication markets.

I would now like to turn call over to Paul to review our third-quarter results in more detail to provide financial guidance for the fourth quarter and to discuss our initial take on 2016. Paul?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

Thank you, Martha. Third-quarter 2015 net revenue of $727.4 million increased 26% compared to the third quarter of 2014. Of this, acquisitions contributed 30.1%. Organic revenue was down 70 basis points and changes in foreign currency exchange rates, primarily the euro, represented a net revenue headwind of 3.3%.

Third-quarter adjusted EBITDA was $181.3 million, or 24.9% of net revenue. Adjusted net income for the third quarter was $123.3 million, or 17% of net revenue. When compared to the prior year, profitability indices are lower in the third quarter, primarily due to the impact of acquisitions, which included integration cost of $4.1 million. Core adjusted net income margin, which excludes Schrader and DeltaTech, continued to move in the right direction and was 19.7% in the third quarter, up from the prior year.

Structuring and special charges of $8.5 million recorded in the third quarter were added back to adjusted net income. This amount includes a $6 million charge reflecting an oral agreement to settle fee acquisition IP litigation between Bridgestone and Schrader. This amount also includes activities management is undertaking to respond to weaker end markets including the right-sizing of business operations. These charges appear in the cost of revenue, selling, general and administrative, and restructuring and special charges line in the GAAP income statement.

Financing and other transaction costs added back to adjusted net income include $3.7 million of costs associated with the acquisition of CST. Cash taxes in the third quarter were approximately $8.7 million or 5.4% of adjusted earnings before interest and tax. We expect cash taxes for the full-year 2015 to be in the range of 5% to 6% of adjusted earnings before interest and tax.

Sensata hedges a significant portion of its net earnings exposure to foreign currencies. As a result, the impact of exchange rates on earnings represents a weighted average impact of prior movements. In the third quarter changes in foreign currency exchange rates had an unfavorable impact of approximately 3.3% to net revenue and $0.02 to adjusted net income per share.

Pretax flow for the third quarter was $108 million. We invested $43 million in capital expenditures during the quarter and working capital to provide cash as receivables declined in line with lower revenue. Inventory expanded in the quarter due to weaker shipments to optimize inventory levels and manufacturing capacity related to future demand. For the full-year our current expectation is for free cash flow of $325 million to $350 million.

During the fourth quarter we are working towards that goal of closing the CST acquisition on December 1. We intend to fund the acquisition through the issuance of senior unsecured notes and cash on hand from our revolving credit facility. While this financing will temporarily inflate our leverage ratios, our goal is to operate in a 2 to 3 times net leverage range.

Now I would like to comment on the performance of our two business segments. Performance sensing net revenue was $576 million for the third quarter, up 40% from the year-ago quarter as a result of acquired revenue and new program launches, partly offset by the impact of changes in foreign currency exchange rates and weakness in certain end markets, most notably the Chinese vehicle and HVOR agricultural and construction markets. Organic volume growth, which excludes the impact of price downs, grew 4.7% in the third quarter.

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Performance sensing profit from operations was $151 million, up 36% from the year-ago quarter, primarily as a result of acquired revenue, partly offset by investments in research development engineering which are critical to developing and executing on our expanding pipeline of new business wins and opportunities. Performance sensing profit from operations index of 26.2% was lower than the third quarter of 2014, primarily due to the impact of growth investments and acquisitions.

Sensing solutions net revenue was $151 million for the third quarter, down 9% from the year-ago quarter due primarily to a broadly weaker China resulting in lower volumes, including the impact of continued inventory destocking in the industrial and appliance and HVAC end markets; weakness in semiconductor manufacturing; and the unfavorable impact of changes in foreign currency exchange rates. WIth the exception of industrial sensing, sensing solutions electrical production products do not benefit from content growth drivers. As a consequence, changes in revenue are highly influenced by the rise and fall of its end markets.

Sensing solutions profit from operations was $50 million, a decline of 4% from the same quarter last year, primarily due to lower volumes. Despite revenue headwinds, sensing solutions profit from operations index of 33% was higher than the third quarter of 2014, primarily due to the impact of cost controls and productivity improvements.

Corporate and other costs not included in segment operating income were $47 million in the third quarter. These costs are higher than the third quarter of 2014 due to the addition of corporate cost from acquisitions, restructuring and special charges, and M&A deal costs related to the acquisition of CST. Previous guidance provides for the full-year 2015 contemplated more normal demand in revenue levels for the fourth quarter predicated on stabilization in China and to inventory destocking that significantly depressed demand for many of our sensing solutions products and HVOR market decline stabilizing. As of now it does not appear that this will occur. Coupled with further weakness in the semiconductor and communications segments, we are now guiding net revenue and adjusted net income lower in the fourth quarter.

Details of our financial guidance for the fourth quarter of 2015, which assumes a December 1 close for the acquisition of CST, are as follows. Net revenue of $700 million to $740 million, which at the mid point is an increase of approximately 2% from the fourth quarter of 2014. Our current fill rate stands at approximately 86% of the mid point of this guidance.

Key revenue growth assumptions impacting the quarter include; acquired revenue growth of 5% to 6%, including CST as of December 1; performance sensing organic revenue growth in the low single digits, reflecting high percent organic growth in the core automotive business despite lower vehicle production in China; flat to higher pressure sensor revenue; continuing weak demand for off-road, agricultural and construction equipment; sensing solutions organic revenue to decline at a high single-digit rate due to continued weak demand in the industrial and appliance HVAC semiconductor and communication markets; and changes in foreign currency exchange rates to be a 2% to 3% headwind for the total Company. Further, we expected adjusted EBITDA of $176 million to $188 million, reflecting a small unfavorable impact from CST due to initial integration changes, and adjusted net income of $106 million to $118 million, reflecting increased operating efficiencies, higher sourcing savings, cost control, and the benefit of improved mix as we exit unprofitable product lines; and one month of operating results from CST, including integration charges and interest expense on the new debt raised to fund the acquisition; adjusted net income per diluted share of $0.62 to $0.69, which includes $0.05 to $0.06 of dilution related to one month of results related to the acquisition of CST; and a fully diluted share count of 171.7 million shares.

While we give comprehensive of financial guidance for 2016 during our fourth-quarter results call in early February, we feel investors would benefit from our current thinking regarding expected revenue growth for next year. We believe core automotive performance sensing organic revenue growth will be 5% to 6%, reflecting high single-digit sensor content growth and low single-digit global production, which includes a recovery in China; higher pressure sensor organic revenue to move in line with markets, as 2016 is not year with new tire pressure regulations.

HVOR should grow organically low single digits due to sensor growth in a slightly weaker overall market. In the long run we expect HVOR to be a strong growth driver for the Company. Sensing Solutions organic revenue growth to grow low single digits, driven by the strength in industrial sensing and modest growth in market served with electrical protection products which do not benefit from content growth drivers. We expect a 1% to 2% unfavorable impact to net revenue as a result of changes in foreign currency exchange rates, as CST should drive approximately 10 percentage points inorganic net revenue growth next year.

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In summary, despite weak end markets, Sensata delivered 26% net revenue growth and adjusted net income in line with our expectations for the third quarter. Sensata continues to deliver on its promises of strong double-digit revenue and earnings growth, partly enabled by superior capital deployment from high returning repeatable acquisitions.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Wamsi Mohan, Bank of America Merrill Lynch.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Yes, thank you. Good morning.

Martha, given the changes in demand, can you update us on your thoughts around how that CST portfolio is looking, especially given the weakness in industrial as you are heading into 2016? And are you expecting still break even to EPS in 2016 or does that now start to look accretive given the timing of the close? And I have a follow-up.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Sure. When we look into the end markets for CST we're still really excited just given what it will allow us to intercept on content growth over the long run.

Some of those end markets that are beleaguered in CST, we saw during diligence, for example, there's a small exposure to oil and gas that was definitely part of our thinking in the investment case. So, not a lot of surprises on that front. Some exposure to the agricultural aspects of the business that we are experiencing now, but actually less exposure than we have at Sensata. So, all in all feeling good about the end markets.

We do expect to be a least break even on CST, probably slightly accretive in 2016. Paul, I don't know if you want to comment further on that.

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

That's right. The charges that were taken this quarter, Wamsi, the $0.05 to $0.06 is impacted by integration charges that were taken this quarter. We'd expect those to be in 2016 since we accelerated those. We will be slightly accretive next year as a result of that.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Okay, great. Thanks.

And as a follow-up, Martha, it sounds like you spoke about increased opportunity from SCR applications given the dislocations in the diesel market. There our clear worries that there might be a longer-term shift away from diesel that could impact you guys. Can you help us think through or frame that a little bit from a longer-term perspective?

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Do you actually anticipate that diesel will become a headwind or do you think it will still continue to be a tailwind, given your comments around the increased opportunity from SCR? Thanks.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Sure. I think in North America, for example, in the US, diesel has never been a big factor in the passenger car market. Unfortunately, it was beginning to build momentum and I think that momentum is off the table. That is not highly material to our business, Wamsi, given how low the diesel penetration rates were.

When we think about diesel more broadly, the market where it is most important, obviously, is in Europe. We don't expect end market increase in installation rates on diesel.

But when you look at the overall regulations in Europe, particularly the need to meet CO2 mandates -- we are talking about 35% to 40% improvement in grams per kilometer of carbon dioxide emissions -- the headwind to meeting that regulation if diesels are off the table makes that nearly impossible. So, we do not expect a major headwind in diesel installation rates in Europe.

Just to remind everybody, when you look at the impact on Sensata, about a 5% movement in diesel penetration or market share is about a $10 million revenue impact for us. Beyond that kind of swing we are not anticipating a headwind as we move into 2016.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Great, thanks a lot.

Operator

Scott Davis, Barclays.

Scott Davis - *Barclays Capital - Analyst*

Hi, good morning guys. The 19% content growth number you quoted in Europe seems like a pretty nice number. Can you just talk to the sustainability of that as you think through 2016?

Euro 6, it is tough for us to get our arms around really what kind of ramp in content you get. It would seem at least the initial impact would be pretty helpful. Can you help put some context around that for us?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Yes, we can. One of the things we've laid out this time around is just to give you a sense for what our core performance sensing organic growth will be. When we talk about the 5% to 6% it really is reflecting strong single-digit sensor content growth. So, let me help you reconcile the 19% we saw in this quarter with the overall longer-term development.

Our content growth tends to be lumpy. It can be accelerated around times of regulation enforcement. We expected that ramp in the second half here in 2015 in Europe due to this Euro 6 regulation that requires really more sensors, particularly on diesel engines in Europe.

There are other ways of regulation that will be coming in 2017 and 2018 in Europe, for example. There's a Euro 6 C component that requires now onboard diagnostics and add sensing content to the overall vehicle fleet. At the same time in the US and in China there our fuel economy mandates. We continue to see the need to meet stringent tailpipe emissions in HVOR, and on and on and on.

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This is just an example of where you can see the impact of Euro 6 regulation and the growth in our content. It is hard evidence that our overall growth thesis is on track.

Scott Davis - *Barclays Capital - Analyst*

That's helpful. It is a tough world out there now, as you guys alluded to, but does this give you an opportunity to pull forward some of the consolidation initiatives and things? I'm just thinking more specifically around Schrader. Pulling forward maybe some of the integration efforts and getting us ahead on the curve on that?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

We think it does, Scott. You saw a little of that on the call for the fourth-quarter guidance, that we have a small amount of revenue on the $5 million to $10 million range actually coming out of Schrader, which we had anticipated in the investment case. These are nonperforming products, they are not sensor products.

And we are able to accelerate, just given some of the softness in overall current demand. And we expect to do that as we enter 2016.

Scott Davis - *Barclays Capital - Analyst*

Great. Okay. Good luck.

I will pass it on. Thanks.

Operator

Sumit Chatterjee from JPMorgan.

Sumit Chatterjee - *JPMorgan - Analyst*

The first question I had -- and thanks for your comments on the diesel installation rates and that you see no major change in that. Maybe if you can help us by talking about the opportunity -- the content opportunity that you have on gasoline and hybrid vehicles, the greater producing vehicles, and what a shift would mean, even a small shift, in terms of content opportunity for Sensata.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Sure. Let's talk first off on gasoline engines.

When you look at the new content coming into gas engines, and you hear about this now even in commercials these days, so, things like gas direct injection, things like dual clutch transmissions that really drag fuel economy, are adding more sensors. We have been very open about the delta between our content in diesel versus gasoline's. And that can be $10 or $15 on a very high-end diesel.

That gap is actually shrinking over time as gas engines have to be more fuel-efficient and as they also have to meet tailpipe emissions. So, we think gas engines are great content driver for us. Things like gas direct injection are still low penetration rates around the world, less than 40% of the overall fleet. So, we're very enthusiastic about the evolution of sensors on gas engines.

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Hybridization is another development that bodes well for Sensata. When you look at the subsystems on a hybrid vehicle they tend to be the most energy efficient that you can find.

For example, your braking system will have regenerative braking. That requires multiple sensors to regenerate at each channel to the wheel versus a single sensor that we provide today in most stability control systems. So, we like hybridization and we like the evolution of gas engines over time for Sensata.

Sumit Chatterjee - *JPMorgan - Analyst*

Great. Thank you for that comment.

Just moving on to China where you stated that you are assuming a roughly similar decline in production in 4Q as in 3Q. I'm just curious if that is based on your customer call-offs or if there's something about your customer mix. Because when I look at IHS production estimates on the latest one, obviously 4Q seems to be a bit better off than 3Q.

So, I'm just wondering if that's something else that's driving that? And maybe on that line if you can give me what your organic growth in auto was in China.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Okay, let's try the first piece of that. As you know, there have been times when we have departed from IHS, and this is one of those. We do not expect to see that 5% production increase that they are calling for. And that is a combination of just shutdowns that we saw during the third quarter, the return production rates that are coming back in that time period.

The one thing I will call out here is there has been a much greater impact in China on vehicles produced by multinational producers versus the local China producers. The latter tends to support the lower-end segments in China.

So, to answer your question about any specific impacts to us, the overall sensor content growth in a vehicle produced by the multinationals -- and you can think of Volkswagen joint ventures, GM joint ventures -- is higher than those produced by the local producers. It is about a 2 to 1 ratio right now.

Over time that's a good thing because it presents a lot of sensor content growth in the smaller end vehicles, and we see that coming. But as the market share shifts given this recent correction, that does have an impact on overall sensor content and does have an impact on our business. Again, we do not expect to see production growth in the fourth quarter.

In terms of overall organic growth in China, between the combination of commercial trucks and automotive, we were down about 15%.

Sumit Chatterjee - *JPMorgan - Analyst*

Okay. Finally, just on the sensing solutions business, I believe organic growth has now been down roughly 8% for the last couple of quarters. And you are guiding to a similar organic decline in 4Q.

What gives you maybe confidence in those? Are you seeing anything on the ground level that you are seeing that would give you more visibility going into 2016?

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Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

One of the things we look at, and we've got backwards-looking data out of IOL that tells us what the actual production rates were. And at the same time we have some visibility customer by customer as to what's in the inventory channel.

I think the thing that drove our guide or drove our difference in thinking here was just the accelerating decline of the PMI in China. The PMI is an important market driver for our sensing solutions electrical protection devices. That's really what's been driving the overall.

It is going to be important that that stabilizes. If not, that probably would have an impact on our overall thinking in 2016.

Sumit Chatterjee - *JPMorgan - Analyst*

Thanks.

Operator

Craig Hettenbach, Morgan Stanley.

Craig Hettenbach - *Morgan Stanley - Analyst*

Yes, thanks. Just following up on the comment on Schrader in terms of exiting some product lines, as you look at the impact on sales, is that something that you can help quantify?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

In the fourth quarter we think that's in the $5 million to $10 million, probably closer to the lower end of that overall range. As we look into the year --.

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

Next year it's going to be around $20 million.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Yes, probably $20 million. And, again factually a positive to earnings. No impact.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. Thanks.

Then just looking at the OpEx, you guys usually do a really good job in terms of aligning to the market. Just curious, Martha, as you look at the slowdown we are seeing now versus we've seen a number of these in recent years, how you'd compare and contrast maybe? And then also how you see visibility coming out of the current downturn.

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Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Sure. I would say this time around it's somewhat surgical in where we are dealing with the issues. China is having most of the impact here certainly in the fourth quarter.

In the past we've seen much broader based overall market weakness. We are not seeing that in the business.

As we look ahead we continue to think it is important to make sure we look at each end market and understand its dynamics. It does have us aligning across the business to make sure that we deliver to shareholders on overall earnings and that is the focus.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. And maybe just one last quick one on CST, as you look to close that deal since you announced it today, and any update in terms on your due diligence in terms of market opportunities and things like that that you are feeling better or worse about.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

We really feel good about the synergies that we expect to drive. We feel good about how the business is positioned, having now cleared or very close to clearance on the antitrust front. We're getting into dialogue about customer plans and that allows us to continue to develop the overall integration plans. Feeling very good about it.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it, thank you.

Operator

Matt Sheerin, Stifel.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Yes, thanks. I just wanted to go back to your assumptions for organic growth next year, which, given the headwinds that you are seeing in Q4, seem to be fairly optimistic at this point, particularly in China. Are you just expecting that inventory correction to play out? And are you seeing any signs that that will start see a resumption in growth in Q1 of next year?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Yes, we are seeing some of that now. We do expect production to improve sequentially -- now, let's talk automotive -- we expect production to improve sequentially in third to fourth quarter. And our order rates are reflecting that. So, we feel confident that the overall vehicle inventory correction, which has been driving the mess on the second half, is going to be behind us.

When we talk about the overall sensing solutions piece of this, as I mentioned previously, we have the ability to look backwards at what actual production rates are doing. And we have line of sight in the overall customer channel on the inventory workdown. Given the PMI deterioration, that drove production down again in another wave of inventory correction.

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Key to 2016 will be the stabilization of PMI in China. At this point we don't view our overall outlook as being optimistic. We are not expecting any more than a 1% to 2% overall improvement or growth in that segment of our business. Again, we think that's aligned with what we're seeing in the marketplace.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Okay, thanks. In terms of Volkswagen and the issues going on there, are you seeing any near-term impact on revenue or any expectation for share shifts among your customers?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

We have about a $2 million to $3 million impact, I believe, in the fourth quarter, all of that in North America just given that they've stopped sales on those vehicles. But, again, very low diesel installation rates in North America, so not huge. When we carry that trend forward into 2016 that's about an $8 million to $10 million overall impact.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Okay. Thanks very much.

Operator

Rich Kwas, Wells Fargo Securities.

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

Hello. Good morning.

I just wanted to follow-up on here in the quarter on performance sensing. Europe, strong organic growth. North America -- what was the organic growth in the quarter for North America? I don't think you gave that.

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

It would have been around flat -- flattish or so.

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

Okay. What was impacting that?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

Year-over-year we still have a good production growth.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

It is primarily timing, Rich, of when the content comes into play. We will see organic growth in the fourth quarter in North America.

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Keep in mind, the launch and the timing of content adds tends to be lumpy. Very strong in Europe this time round, not so strong in North America. But we expect that to rebound in the fourth quarter.

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

Okay. Then in terms of the outlook for next year on the performance sensing side I think it mid singles is the outlook. Does that include price or is that excluding price? Do we take price off of that?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

It includes price. Organic growth includes price.

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

So, it does include price -- okay. And then the same thing for sensing solutions, correct?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

Yes. Sensing solutions has very little price. In fact, prices could be slightly up.

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

Okay. Then within that, in terms of the outlook for performance sensing next year, I know, Martha, you talked about off-road construction, ag, et cetera. That's been weak for some time.

But there's growing concern around on road. And I know that's a substantial piece of your business. It doesn't sound like you've assumed any downturn on the on-road side for next year so could you help us understand your assumptions there.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

We have, Rich. This is where content growth helps to offset. We are aware of what's happening with Class A, and looking carefully even at Class 6 and 7. So, we do expect that to be a headwind next year and, hence, the call for low single digits in that part of the business.

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

Is there any way to quantify that in terms of the thoughts around what you are assuming within the outlook for on road?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

On road, you have a (inaudible) North America and Europe. But for North America we are assuming that the market decline is going to be something in line with what the production estimates are that are out there in the market today.

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

Okay. And then last one on free cash flow, Paul, is your vision again here on free cash flow -- I understand there's lower earnings but anything else moving that number lower, apart from that?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

There's a couple things, Rich. Capital expenditures could be running a little bit higher than what we originally anticipated, which is a good thing as we continue to build manufacturing capability in Bulgaria, as an example.

Working capital is trending a little bit behind from where I would have liked it to have been. Still making lots of improvement there, continue to get better. But some of that may end up realizing in 2016.

And then we have some other one-time things like the deal costs related to CST, transaction costs, this settlement here that we are looking to have with Bridgestone. Those things were additional costs that were not anticipated in the previous guide, along with the earnings decline that you mentioned before.

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

All right. And, Martha, real quick, just on the outlook longer term, what is your confidence level on a high single-digit growth rate organically going forward? This has been a tougher year than you envisioned and next year doesn't look to be a lot better macro-wise. How are you looking about that outlook that you provided back in February at the Investor Day?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

I think the swing on this is going to be end markets. So, when we look at the actual sensor wins that we are having and the launches that we anticipate, we feel better than ever about it. When we look at the access that we're going to get to some adjacent markets that will have sensor content growth, we feel great about it.

I think the swing is going to be some of these end markets that will be bit of a headwind. They won't be a headwind forever. At the same time we are at some very low points in some of these end markets and they will begin to be a tailwind for us.

I think some of the things to recall about overall business model -- we did not anticipate that Schrader would drive organic growth in a meaningful way until we hit the next wave of regulation. That is playing out. When we look at CST we will have work to do to take what has been in business that has been under invested in and return that one and restore that organic growth on that front, which is going to create overall more growth for Sensata.

So, I think in the near term we feel very good about the content wins, are going to continue to watch closely the end markets. But these elements of our business are playing out really in line with our expectations.

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

Okay, thank you.

Operator

Mark Delaney, Goldman Sachs.

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Mark Delaney - *Goldman Sachs - Analyst*

Yes, good morning and thanks very much for taking the questions. The first question was on some of the cost lines as we move into 4Q and for 2016, just given there's some moving parts with the CST coming in and then also the cost reduction actions that the Company's has undertaken, both in the third quarter and then incremental ones in 4Q.

Can you just help us think about how we should think about the SG&A line trending for the next couple quarters? And what integration expenses may be in COGS in the next few quarters?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

SG&A should trend in Q4 similar to what you saw in Q3. Martha continued to work the cost side very hard. We continue to drive efficiencies within the business.

As Martha said, we are restructuring those operations which are not growing. We are optimizing our network, moving manufacturing to areas where we think it is the most effective and drives the best delivered costs. So, being very proactive on the cost side to continue to drive profitability in a lower growth environment.

Mark Delaney - *Goldman Sachs - Analyst*

Okay. Then for a follow-up question on the VW topic around diesel engines, there was a report in Reuters a couple weeks ago quoting a German newspaper that VW is looking to find cost cuts of about EUR3 billion from their supply chain to help deal with some of the diesel regulations that they are going to have to contend with going forward. Are you expecting to see any pricing pressure from your customers as it relates to diesel?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

I think we see pricing pressure from customers every day. Keep in mind that we operate under multi-year contracts that have price reductions built into those, as well. So, we are not seeing any pressure at this point in time.

We think at the end of the day it comes down to what's our ability to hold our competitive position. And we think we are very well-positioned to maintain the share that we have and actually to grow our business over time. So, I don't expect that this is going to be anything out of the usual.

Mark Delaney - *Goldman Sachs - Analyst*

Okay, thanks, I will turn it over.

Operator

Shawn Harrison, Longbow Research.

Shawn Harrison - *Longbow Research - Analyst*

Hi, good morning. I want to talk about Wabash and DeltaTech and the accretion expectation for 2016, knowing that there's been some end market tumult. I think both were expected to maybe deliver about $0.10 of accretion for 2016. If you can just give us an update on what you expect it to contribute next year.

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Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

On the cost side, we are making great progress on both of those acquisitions. Wabash is now just about fully integrated and DeltaTech is a little over a year into its integration journey.

I think what's going to be a bit of a headwind in achieving those numbers is the fact that they both serve markets that are weak. So, to the extent that they are selling into the HVOR end markets they're seeing revenue challenges similar to the rest of our business. And that is going to create some top-line headwinds and also some bottom-line headwinds, as well.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Just one thing to recognize, the 19.7% A&I that we called out on our core business included Wabash. So, you can see now where, post integration, we are able to align these businesses up with our core profitability.

Shawn Harrison - *Longbow Research - Analyst*

And the headwinds being experienced by both Wabash and DeltaTech is similar to what you are seeing across the aggregate business or are they seeing greater or better trends?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

They're consistent. DeltaTech is entirely off-road so it is feeling more of that than Wabash.

Shawn Harrison - *Longbow Research - Analyst*

Okay. And then just on the cost side, is there a way to sum up everything that's being implemented, say, in the back half of the year, what type of aggregate benefit that will be to the P&L in 2016 given the number of moving parts?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

There are a lot of moving parts. I can tell you that the actions that we are taking continue to support A&I margin expansion towards the 20% to 23%. But there will certainly be a lot more to come when we get together again in February.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

And I think more color on that when we provide our guidance, as Paul called out. We do think 2016 is a year where we will absolutely see earnings grow faster than overall revenue. And we are positioning ourselves to make sure that that happens.

Shawn Harrison - *Longbow Research - Analyst*

Just to clarify in the wording, the comment means incremental actions will be announced between now and February, is what I was expected to take from that comment?

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Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

No, it meant that we will provide the impact, what we expect that to contribute, when we provide our guidance in February.

Shawn Harrison - *Longbow Research - Analyst*

All right, perfect. Thank you, Martha.

Operator

Ambrish Srivastava, BMO.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Hi, thank you. Quite a few questions answered.

I just had a few blocking and tackling ones. I don't think I heard, if we look at the fourth-quarter guidance, what is the impact of CST in those numbers that you provided?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

The impact of CST on revenue -- we're saying around $15 million to $20 million of revenue is the range for December. December is typically a lighter month

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Ambrish Srivastava - *BMO Capital Markets - Analyst*

Okay, got it, thank you.

And then two quick ones. And thanks for providing an early look in 2016. What I didn't hear, I don't think I heard was what is the assumption for China auto production.

And then also free cash flow -- is CapEx going to be similar to what we have been running at? And then also free cash flow to sales margin? Thank you.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

For China, we are expecting growth to be slower than it was coming into the downturn, so in the 3% to 4% overall production growth on China. We expect to grow better than that just given content growth.

Operator

Amit Daryanani, RBC Capital Markets.

Amit Daryanani - *RBC Capital Markets - Analyst*

Thanks a lot. A couple question, guys.

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One, Martha, you talked about 2016 seeing EPS growth faster than revenue growth. I'm curious, is that anchor organic revenue growth of 5% or so or is the anchor revenue growth of mid teens with the CST acquisition?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

That was really on the organic basis. So, thanks for the opportunity to clarify that. Appreciate that. We think we will be slightly accretive

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Amit Daryanani - *RBC Capital Markets - Analyst*

Fair enough. And then as I think about the guide for December quarter, how do you guys think gross margin and OpEx plays out on a sequential basis versus September quarter that you guys had?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

Gross margin I would expect to improve in the 80 basis points to 100 basis point range. And I'm looking for operating expenses, our research and development, SG&A, to be about sequentially flat.

Amit Daryanani - *RBC Capital Markets - Analyst*

Fair enough. And then, just finally, I think towards the end of the quarter you guys announced Martin Carter had resigned from his position and Jeff Cote was going to take over, or has taken over. Could you just talk about what led to that transition and change? And what do you think Jeff is going to do differently in that business as you go forward from here?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Listen, this was very much a personal decision by Martin. We are sorry to see him go. He's had a great impact on our overall industrial sensing strategy. So, purely of personal decision.

I think Jeff brings a lot to the role, particularly when we look at the elements of this business that don't enjoy secular growth. And then the opportunity to really align those front to back to continue to contribute earnings growth. And I think Jeff will do that really well.

Amit Daryanani - *RBC Capital Markets - Analyst*

Perfect. Thank you.

Operator

William Stein, SunTrust.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Great, thank you for taking my questions. First, Martha, I'm hoping you can give us an update on Schrader with regard to the Company's progress in manufacturing in China and also expectations for regulation of TPMS, or mandate for TPMS, in China?

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Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Yes, we are making great progress in China. We have launched and are now producing and are actually loading some demand into China that actually would serve, for example, the aftermarket of the tire pressure sensing business, as well. So, very good progress on that front.

On the regulatory front in China, we follow it closely. At this point we are working in the standards committee to develop a unified standard that would then go to rule making in China. And that continues to move well. So, we are on track with our assumption that in late 2018, 2019 we would expect to see regulation in place and impacting demand in China.

Having said that, we continue to work with China OEMs right now on applications for tire pressure sensing. Most OEMs recognize that this is going to be coming and we are starting that work today, so that would allow us and allow them to be compliant as the regulation comes into place.

William Stein - *SunTrust Robinson Humphrey - Analyst*

That's very helpful. And then maybe a follow-up, more on the VW topic, understanding that long-term it sounds like this is more of an opportunity for Sensata but that next quarter you expect a $2 million to $3 million impact from VW cars being held back in the US.

We think we've seen news reports of similar restrictions to VW sales in many other countries, as well. Do we have that wrong or does that somehow have a smaller impact on the business? Or how can I reconcile that?

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Where we've seen that, interestingly, has been on Euro 5 vehicle., So, if you look at the number of those vehicles that are in the marketplace there are not very many. I think there are some isolated cases where small countries have done that across the board.

Interestingly, what that does is it actually takes inventory off the dealer lot and usually into somebody else's hands. So, we've not seen a high-volume impact on that in Europe. We think that that gets served very quickly with other OEMs where we have strong content.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Great, thank you.

Operator

Jim Suva, Citi.

Jim Suva - *Citigroup - Analyst*

Thank you. And thank you so much for your team for all the details. That helps out a lot.

I have one question on the same line, but two parts. First of all, the diesel slowdown and challenges with the emissions by that one OEM, are you seeing any production slowdowns from that OEM in Europe?

And then the second part of that question is, are you building any potential share shifts away from that OEM to others because, yes, you may have similar footprints with other European automakers, but there is the chance -- or maybe I'm misreading it -- that some of them go to, say, some Japanese OEMs that maybe just don't have as much Sensata content? Thank you.

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Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

Sure, Jim. It is a fair point.

To answer the first question, we have not seen any slowdown in production. And got to be a little bit careful here because some of what we get is proprietary information. But we are not seeing that.

When we talk about the $8 million to $10 million in overall headwind on the VW issue for us, it is with the assumption that the rest of the market takes that share at the market mix today. So, we are not assuming that it necessarily goes to, say, a more favorable OEM versus a Toyota, if you will. We use the overall balance of the mix on the marketplace to make those assumptions.

Jim Suva - *Citigroup - Analyst*

That helps out a lot. Thank you so much for your details.

Operator

Jeremy Capron from, CLSA.

Jeremy Capron - *CLSA - Analyst*

Thanks, good morning. I wanted to follow-up on sensing solutions where I think margins looked pretty strong despite the revenue shortfall. And you talked about incremental cost actions taken to protect margins on the way down.

I wonder if you could give us a little more clarity around what these actions are? And I think, Martha, you said some of these would be sustainable into next year, so, again, color around this would be appreciated. Thanks.

Martha Sullivan - *Sensata Technologies Holding N.V. - President and CEO*

I think it is just recognizing that there have been some dislocations on that business. For example, in China, with the downturn that we're seeing, we looked very hard at what we could expect overall emerging market growth to be for that business. And it is going to be very slow. In the case of the appliance market, the HVAC market, China is beginning to perform more like a developed country.

That being the case, then, our alignment of our OpEx needs to be aligned to that new reality, and we think that's quite sustainable. We've looked closely at utilization rates in our factories for that business and we see opportunity to consolidate there, as well. So, again, quite sustainable as we go forward.

Jeremy Capron - *CLSA - Analyst*

Thanks. And quickly on the R&D, you had a large increase in R&D spend year-over-year. I understand quite a bit of this comes from acquired businesses. I wonder if you could give us an idea of how to think about R&D intensity going forward as a percentage of sales, for example?

Paul Vasington - *Sensata Technologies Holding N.V. - CFO*

You are correct in terms of much of the year-over-year increase relates to acquisitions. But we've also been very proactive in adding engineers to support our new business wins and our opportunity pursuits, primarily on the performance sensing side. We will continue to make those investments,

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as being appropriate, to support those programs as we win them. So, increase in R&D related to expectations and increase in revenue growth in the future.

Jeremy Capron - *CLSA - Analyst*

All right, thanks very much and good luck.

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?

Jacob Sayer - *Sensata Technologies Holding N.V. - VP of Treasury and IR*

Thank you, Keith. I'd like to thank you all for joining our third-quarter 2015 financial results call today.

Later in the quarter Sensata will be participating in RBC's technology investor conference in New York on November 10, and Bank of America Merrill Lynch's high-yield conference on December 3. These events will be webcast live and available for replay from the investor section of our website at Sensata.com.

We appreciate your continued interest in and support of Sensata and look forward to speaking with 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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