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EDITED TRANSCRIPT

ST - Q4 2016 Sensata Technologies Holding NV Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the Sensata Technologies' Q4 and full-year 2016 earnings conference call.

(Operator Instructions)

Please note this event is being recorded. I would now like to turn the conference over to Joshua Young. Mr. Young, please go ahead.

Joshua Young - *Sensata Technologies Holding NV - Head of IR*

Thank you, Keith, and good morning, everyone. I would like to welcome you to Sensata's fourth quarter and full-year 2016 earnings conference call.

Joining me on today's call are Martha Sullivan, Sensata's President and CEO, and Paul Vasington, Sensata's Chief Financial Officer. In addition to the earnings release we issued earlier today, we will be referencing a slide presentation during today's conference call. The PDF of this presentation can be downloaded from Sensata's Investor Relation's website, and we will also post a replay of today's webcast shortly after the conclusion of today's call.

Before we begin, I would like to reference Sensata's Safe Harbor statement, which I show on slide 2. During the course of this conference call we will make forward-looking statements regarding future events or the financial performance of the Company that involve risks and uncertainties. The Company's actual results may differ materially from the projections described in such statements.

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Factors that might cause such differences include but are not limited to those discussed in Forms 10-Q and 10-K, as well as other subsequent SEC filings.

On slide 3 we show Sensata's GAAP P&L for the full-year 2016. We encourage you to review our GAAP financial statements in addition to today's presentation. Most of the subsequent information that we will discuss during today's call will be related to non-GAAP financial measures. Reconciliations of our GAAP to our non-GAAP financial measures are included in both our earnings release and in our webcast presentation.

Martha will begin today's call with an overall business summary. Paul will then cover our financials for the fourth quarter and the full-year 2016 in more detail and also provide guidance for 2017 and the first quarter of 2017. We will then take your questions after our prepared remarks. Now I would like to turn the call over to Sensata's President and CEO, Martha Sullivan.

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

Thank you, Joshua, and thank you all for joining us this morning. I am pleased to report that Sensata had a strong finish to the year in the fourth quarter and reported solid operational performance for the full-year 2016, which can be seen on slide 4.

Despite facing challenges from soft HVOR and industrial markets as well as foreign-exchange headwinds, we executed well and delivered our full-year 2016 guidance. This demonstrates Sensata's ability to respond efficiently to changing market conditions as well as the multiple levers we have to drive earnings and cash flow growth.

In the fourth quarter of 2016 we reported revenues of $788.4 million and organic revenue growth of 5.8%, which was above the midpoint of our guidance. For the full-year 2016 we delivered 1.6% organic revenue growth and adjusted EPS of $2.89, which was also above the midpoint of our guidance and represented 14.2% organic growth. This strong operating leverage was a result of productivity gains as well as M&A cost synergies.

We generated free cash flow of $391 million in 2016, which represented 12% of our revenues, in line with the guidance we provided earlier this year. This strong free cash flow enabled us to rapidly pay down our debt and strengthen our balance sheet. We reduced our net leverage ratio from 4.6 times to 3.8 times by the end of 2016.

Finally, we continue to see long-term opportunities for growth, and we are investing for the future. We made important investments in technologies that led to new design wins and further expanded our position in electrification. We also made a strategic investment into Quanergy to capitalize on the future growth of the autonomous driving market.

On slide 5 you can see Sensata's performance versus the full-year guidance we provided in February 2016. While we show our organic performance on the slide, you can also see our performance versus guidance on a reported basis in the appendix of our presentation. We met or exceeded our guidance during a year where many of our key markets were declining and we needed to offset significant foreign-exchange headwinds. We also saw volatility from unexpected issues such as Brexit, and we were in the midst of integrating two large acquisitions.

Overall, I am pleased that we successfully managed these challenges and delivered on the promises we made to shareholders. I want to thank the entire Sensata Team for delivering good results in 2016.

On slide 6 you can see the strong sequential margin improvement that Sensata made throughout 2016. I would note that we are highlighting both adjusted EBIT and adjusted net income margins on the slide. We will increasingly highlight adjusted EBIT margins since we believe it is an important indicator of our underlying operating performance and is helpful to our investors.

Since the first quarter of 2016 we have improved our adjusted EBIT margins by 220 basis points and adjusted net income margins by 240 basis points. Our adjusted EBIT improvement reflects the fact that most of the profitability gains that we made during the year were operational in nature rather than being driven by lower interest expense. While it is not uncommon for Sensata to see a ramp in profitability between Q1 and Q4, this slide clearly reflects the profitability improvements being made in our acquired businesses.

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On previous earnings calls I have talked extensively about Sensata's model of acquiring businesses that fit with our strategy to win in sensing. These acquisitions extend our product reach, enable us to expand into new markets, and create cost synergies across all operations. We rarely find acquisition targets that operate at the same high margin levels as Sensata. As a result acquisitions initially reduce our margin due to lower EBIT, upfront integration investment, and interest burden.

These margins move higher over time as we complete integration activities, resulting in strong returns and value creation for our shareholders. We also make front-end investments to accelerate our organic revenue growth in these businesses over time.

Turning to slide 7, you can see how well this model is working. On the left side of the slide we show the combined adjusted EBIT margins of the two businesses at the time of the acquisition, and on the right we show their adjusted EBIT margins for the full-year 2016. Since acquiring Schrader in 2014 and CST in 2015, we have improved EBIT margins by approximately 470 basis points on a combined basis.

Even with the progress we have already made, we still have significant opportunity for additional EBIT improvement within Schrader and CST. Both businesses remain considerably below the EBIT margins of our Performance Sensing and Sensing Solutions segments. We expect to continue to close this profitability gap as we complete our integration activities and extend Sensata's continuous improvement practices. As a result, we have leverage in our operating model to continue to drive margin improvement and attractive EPS growth for the next few years.

On slide 8, I summarize Sensata's key accomplishments for 2016. First, we delivered key integration milestones for Schrader and CST in 2016, and these businesses are contributing to our overall profitability improvement. Next, we secured new business wins in key areas of our business that will contribute to future growth.

We are increasing our sensor content on gasoline engines and electrified vehicles. As this content grows, we are closing the gap with the sensor content we currently have on diesel vehicles. Our position on gas emissions and diagnostics has been strengthened due to our increased competitiveness in low-pressure sensing, which was enabled through the Schrader acquisition.

For example, as new emissions regulations are being put in place, European and Chinese OEMs are implementing particulate filters for gas engines to help comply with these new regulations. During 2016 we secured approximately $50 million of new business wins associated with gas particulate applications.

In our HVOR business we secured a number of important wins for our operator-sensing technologies. These include products such as arm rests and joysticks that came with our DeltaTech acquisition. As OEMs seek to improve the efficiency of operators and move from mechanical to electrical controls, we are seeing increasing demand for our operator-sensing technologies, which we expanded through our acquisition of DeltaTech.

We are also beginning to expand our tire pressure sensors into the on-road market with several nice wins during the year.

Finally, we had a great year of new design wins in our aerospace business. Some of these wins were related to the broader portfolio of products gained from CST. Additionally, we grew our business in several accounts due to superior service and lead times. While aerospace is a very long-cycle business, we are already starting to see the benefits from having a larger position in this market only one year after acquiring CST.

We continue to evolve our systems and processes to help us improve our R&D effectiveness. We have made changes to help our Engineering Teams execute new product development projects more effectively. They are now able to track a greater number of key metrics to improve overall cycle time and agility when responding to new opportunities. Over time this will ensure that we are being as effective as possible with our R&D Teams.

Finally, we understand the importance of continuing to strengthen our balance sheet. Our net leverage ratio steadily improved in 2016, and we are delivering on our promise to improve our net leverage ratio after a period of heavy M&A investment.

Looking ahead, I show our priorities for 2017 on slide 9. Despite modest top-line growth, we had a very strong year of organic earnings growth and cash flow generation in 2016. One of our key priorities is to sustain double digit organic EPS growth and continue to deliver attractive free cash flow generation.

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Next, we continue to expand the margins of our acquired businesses. While we made good progress in integrating Schrader and CST this year, we still have a significant amount of integration activity. Ensuring that we deliver on our integration plans is critical to our success in 2017.

Another key priority is ensuring that we continue to develop new emerging technologies including the LiDAR sensors we are developing with Quanergy. I know that many of you were at the Consumer Electronics Show in Las Vegas last month. We are working very effectively with Quanergy to develop LiDAR sensors for the autonomous driving market.

At CES we showcased a functional demo for the market's first fully solid-state LiDAR sensor, only nine months after we formed our partnership. We continue to be excited about the potential for our sensors to meet the needs of our customer base and enable mass adoption of LiDAR in the autonomous driving market over the long term.

We are also developing our long-term opportunity in wireless sensing. More specifically, we are seeing growth opportunities for sensors that expand the use of telematics and digital platforms within the industrial landscape. We believe we are just at the beginning of this long-term shift in the market.

We will continue to invest and prioritize initiatives that will help us drive long-term revenue growth. We will look to leverage new CRM solutions and sales tools to ensure that we capture every opportunity available to us, and we will maintain our focus on securing new design wins that will drive long-term growth.

Before I finish up and turn the call over to Paul, I want to briefly touch upon recent questions we have received relating to potential changes to US trade and tariff policies. We are actively monitoring this changing landscape and are proactively assessing any potential risks or opportunities these changes represent. That being said, we are operating in a dynamic and fluid environment where the specific policy changes and their corresponding impacts are still unclear.

Let me first say that Sensata has a meaningful presence in the United States with a significant number of manufacturing, R&D, sales, marketing, engineering, and other professional positions based here. Since January of 2014, we have more than doubled our number of US-based employees.

Sensata is very similar to most multinational companies in our sector. A significant portion of our US revenues are supported by manufacturing operations outside of the US. We are differentiated in that we have designed our global manufacturing footprint to have significant redundancies, which enables us to transfer manufacturing activities to support our customers.

Another important point is that none of our major competitors have significant manufacturing footprints within the United States. Finally, I would like to point out that our global supply chain is located near our customers' operations worldwide, so any trade and tariff policy changes are likely to have a considerable effect on the local currencies where we manufacture.

Again, the entire trade and policy situation will need to be closely monitored, and as such we do not believe it would be constructive to comment or speculate until we see whether any new policies are enacted. I would now like to turn the call over to Paul to review our fourth-quarter results in more detail and to provide financial guidance for the first quarter and full-year 2017. Paul?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

Thank you Martha. Key highlights for the fourth quarter, as shown on slide 10, include revenue of $788.4 million in the quarter, an increase of 8.5% from the fourth quarter of 2015. Of this growth, acquisitions net of exited businesses added 5.6% to revenues. Changes in foreign exchange rates represented a net revenue headwind of 2.9%, and organic revenue growth was 5.8% in the fourth quarter of 2016.

Both of our segments reported strong top-line growth in the fourth quarter of 2016. Performance Sensing reported organic revenue growth of 4.7%, and Sensing Solutions reported organic revenue growth of 9.8%, due in part to easier comparisons to the prior-year quarter.

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From a geographic perspective, Asia continued to be our strongest region due to strength in China, followed by Europe, which also posted solid organic growth.

Adjusted EBIT grew by 15.9%, and EBIT margins increased by 150 basis points compared to the fourth quarter of 2015. Adjusted net income was $131 million or 16.6% of revenue, an increase of 100 basis points compared to the fourth quarter of 2015. Adjusted earnings per share was $0.76 in the fourth-quarter 2016, a $0.10 increase from the prior-year quarter. In addition, adjusted earnings per share grew organically by 30% in the fourth quarter of 2016.

As a reminder, we acquired CST on December 1, 2015. Our organic growth in adjusted net income and adjusted earnings per share benefited from the fact that CST incurred an $11 million loss in December of 2015, and the considerable year-over-year improvement helped drive our strong organic results.

The details of our adjusted earnings per share growth for the fourth quarter are illustrated on the bottom half of the slide. Higher volume and net productivity improvements at approximately $0.20 EPS offset by an $0.08 EPS headwind from foreign exchange and a $0.02 EPS loss from two months of CST's acquired results. Also, our organic adjusted net income was 19.3% in the fourth quarter of 2016, which was 360 basis points higher year over year.

Now I would like to comment on the performance of our two business segments. I will start with Performance Sensing on slide 11.

Our Performance Sensing business reported revenues of $588 million for the fourth quarter of 2016, representing growth of 2.8% compared to the fourth quarter of 2015. Excluding foreign exchange and acquisitions left exited businesses, Performance Sensing generated 4.7% organic revenue growth in the fourth quarter of 2016, which was primarily driven by strong performance in our automotive business in China.

Our Heavy Vehicle and Off-Road business reported organic revenue growth of 0.7% in the quarter, which was the first time in 2016 that business generated organic revenue growth. Throughout the year our HVOR business has been able to largely offset end-market weakness with good content growth, and that continued in the fourth quarter of 2016.

Performance Sensing profit from operations was $162 million or 27.5% of revenue, up 110 basis points from the year-ago quarter. Excluding the impact of foreign exchange and CST in both periods, profit from operations would have been 28.4%, a 190 basis point improvement from the prior year due to net productivity gains driven by cost reduction programs and improved operating efficiencies. A reconciliation of our segment performance is shown in the Appendix of our presentation on slide 39.

Now I will turn to our Sensing Solutions performance on slide 12. Sensing Solutions reported revenues of $200.4 million in the fourth quarter of 2016, up 29.9% from the year-ago quarter, due primarily to the impact of acquired revenue from CST. Sensing Solutions reported organic revenue growth of 9.8%, a significant year-over-year improvement, reflecting strength in nearly all of the segment's key product lines and geographies.

I would note that Sensing Solutions also faced easier year-over-year comparisons, due to a challenging market in the fourth quarter of 2015.

Sensing Solutions profit from operations was $63.2 million, an increase of 29.8% from the same quarter last year, due to the effect from CST and higher volumes. As a percentage of revenue, Sensing Solutions profit from operations was flat year over year. Excluding the impact of foreign exchange and CST in both periods, profit from operations would have been 33%, a 60 basis point improvement from the prior year, due to cost reduction programs and operational efficiencies.

Corporate and other costs not included in segment operating income were $46.6 million in the fourth quarter.

On slide 13 we show Sensata's full-year 2016 non-GAAP P&L. Revenues of $3.2 billion grew approximately 7.6% compared to the prior year. Throughout the year we generated good earnings growth in margin expansion, primarily through net productivity gains, as a result of robust cost reduction programs, operating efficiency, and operating leverage. And as a result we delivered 14.2% organic growth and adjusted earnings per share on only 1.6% organic revenue growth.

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From the segment perspectives, Performance Sensing reported revenues of $2.4 billion in the full-year 2016, representing organic revenue growth of 1.9%. This consisted of 2.7% organic revenue growth in our automotive business and a 2.1% organic revenue decline in our HVOR business, which was unfavorably impacted by significant market weakness but still performed better than our guidance. Sensing Solutions reported revenues of $816.9 million, which represented organic revenue growth of 0.6% in the full-year 2016, which was slightly better than our guidance for flat organic revenue.

Moving down the P&L, adjusted gross margins were up approximately 100 basis points compared to the previous year when excluding the impact of foreign exchange. This reflects net productivity gains from cost reduction programs that reduced material on adjusted cost, as well as higher operating efficiencies. SG&A expenses increased year over year by $36.7 million in 2016, primarily as a result of the impact from CST. While reported ANI margins declined by 40 basis points, our organic adjusted net income margin, which excludes the impact of foreign exchange and acquisitions net of exited businesses, totaled 17.9%, a 190 basis point increase over the prior year.

Sensata has delivered on our commitment to rapidly de-lever our balance sheet in 2016. Slide 14 illustrates our debt reduction of approximately $335 million, and net leverage declined from 4.6 times to 3.8. This improvement was within the range of guidance we provided earlier this year. Also, assuming we do not close any new acquisitions or repurchase Sensata's shares, we would expect our net leverage to be approximately 3 times by the end of 2017.

Now let me turn to our guidance for the full-year 2017 shown on slide 15. We are forecasting revenues in a range of $3.15 billion to $3.25 billion for the full year 2017. On a reported basis, revenues to range between a 2% decline and 1% growth.

We expect foreign exchange rates to reduce our revenues by 2%. Excluding foreign exchange, we expect organic revenue growth of 1% to 3% in 2017. We expect adjusted EBIT to be between $734 million and $756 million, which would represent organic growth of 6% to 9%.

We expect adjusted net income to be between $528 million and $550 million and adjusted earnings per share to be between $3.08 and $3.20 for the full-year 2017, which would represent organic growth of 8% to 12%. We expect to generate free cash flow between $425 million and $450 million in 2017, which assumes capital expenditures of approximately $130 million to $150 million.

On slide 16 I show the expected impact of foreign exchange on our adjusted net income and the timing of integration expenses during 2017. I mentioned earlier that we expect foreign exchange rates will lower our adjusted earnings per share by $0.02 to $0.03 for full-year 2017. That being said, foreign exchange will disproportionately impact the first quarter of 2017, and we expect it to lower our adjusted net income by approximately $6 million. We expect for the remaining three quarters, foreign exchange will add $1 million $2 million to our adjusted net income.

As relates to integration spending, we expect to incur approximately $17 million in integration expense for the full-year 2017. Approximately $10 million of that expense will be incurred in the first quarter of 2017, due to the timing of integration activities related to CST. This would compare to approximately $4 million of integration spend the first quarter of 2016, or a $6 million year-over-year difference.

As a result, the combination of foreign exchange and higher integration spending will lower our adjusted net income by approximately $12 million in the first quarter of 2017 compared to the previous year.

On slide 17, I share our financial guidance for the first quarter of 2017. We expect to report revenues between $781 million and $805 million, representing a range of 2% revenue decline and 1% revenue growth. We expect that foreign exchange with lower revenues by approximately $16 million to $24 million in the first-quarter 2017. Excluding foreign exchange, we expect to report organic revenue growth of 1% to 3% in the first quarter of 2017.

Our current fill rate stands at approximately 88% of the revenue guidance midpoint, which is in line with the first-quarter fill rates we have seen for each of the past two years. We expect to report adjusted EBIT between $164 million and $170 million, which would represent organic growth of 4% to 7%. We expect adjusted net income between $114 million and $120 million and adjusted EPS between $0.66 and $0.70, which would represent organic growth of 6% to 11%. We expect the impact of foreign exchange rate to reduce our adjusted earnings per share by approximately $0.04 in the first quarter of 2017.

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I will conclude my remarks with Sensata's investment summary on slide 18. Sensata is focused on delivering profitability improvements that will drive double-digit organic adjusted earnings per share growth. We expect to sustain our industry-leading profitability while increasing the margins of the businesses we acquire.

We have leading and expanding positions in markets with attractive long-term growth opportunities. And finally, Sensata is a high cash-generation business, and we are focused on increasing our strong cash flow generation and deploying capital to create incremental value for our shareholders. Now I'd like to turn the call back over to Joshua.

Joshua Young - *Sensata Technologies Holding NV - Head of IR*

Thank you. Keith, please assemble the Q&A roster.

QUESTIONS AND ANSWERS

Operator

Yes. Thank you. At this time will begin the question-and-answer session.

(Operator Instructions)

At this time we will pause momentarily to assemble the roster.

Shawn Harrison, Longbow Research.

Shawn Harrison - *Longbow Research - Analyst*

Martha, I was hoping you could help me bridge the organic growth that you saw in the fourth quarter, which was quite robust: 2% organic growth in the first quarter here. I know you had some easy comps in the fourth quarter, but was there any pull forward of demand? Are you seeing something change in the demand environment to see from what was a robust second half of organic growth into slower growth starting 2017?

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

In the fourth, demand in China auto was strong. In fact, China in general was strong in the fourth quarter. We're not expecting that same level of demand as we move into the first quarter of 2017.

We've been tracking this phenomena of incentives on vehicle sales in China. And while those incentives are still there, they are at a reduced rate, and we expected that to impact demand. In fact, we're seeing that in our overall fill rate.

So still strong demand in China as we move into the new year, not at what was a very strong rate in the fourth quarter. And just to bring that home, we think production in China auto grew something like 15% in the fourth quarter of 2016.

Shawn Harrison - *Longbow Research - Analyst*

As a follow-on to that, what is your expectation for China auto production growth, either in the first quarter or for all of 2017?

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

In general we sense a global auto production -- our view of the world is that it will be flat. We think China will be probably -- certainly less growth that we saw in 2016. And so if you look in general at what third-party forecasters are calling out, we're not substantially different -- maybe slightly more conservative on China.

Operator

Amit Daryanani, RBC Capital Markets.

Amit Daryanani - *RBC Capital Markets - Analyst*

Thank you. Good morning, guys. I guess maybe to start off with, could you just talk about --when I think about your adjusted net income, I think you're looking at about a 17% exit for 2017 right now adjusted income margins. You target something [north of] 21%. Could you just talk about the timeline to close that gap and what are the initiatives you that need to get there, i.e., is the current integration charges enough to get there or do you need more as you go forward?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

You said 21%? Let me make sure I have the numbers right.

Amit Daryanani - *RBC Capital Markets - Analyst*

Yes. I think you guys have talked about adjusted net income margin targets of 21% plus in the long term, right?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

In the long-term. So that comes back to -- that's a margin framework that we have that we work towards. What is going to drive us in that direction is going to be the continued integration of CST and Schrader. It's continuing to improve the core business that we do every year in terms of operational efficiency and productivity, and it's continuing to execute on the front end and capturing all the opportunities that are out there for us in terms of revenue opportunity.

Again, it's a framework, and it's a long-term framework. And it is one we are working towards and believe that we can achieve it at some point in the longer-term horizon.

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

And then I think you asked specifically about is there enough interest expense movement to drive that. One of the things we're really calling out for investors is on slide 7 of our deck where you can look at what we're doing operationally to improve the overall margins of our acquired business and get the overall business moving toward those long-term targets.

So it's definitely an important part of how we get there is the operational improvement. That comes through very specific integration activities but also comes from just applying the continuous improvement practices of Sensata. That is also key to helping us get there.

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Amit Daryanani - *RBC Capital Markets - Analyst*

Fair enough. And then if just follow up -- to Shawn's question just on the 2017 guide, you're looking at 2% organic growth, and just on the China component you talked about. But can you perhaps just talk about what are you seeing in autos on a geo basis, on HVOR basis? Because it seems like they should be positive offsets to the China headwind that you're talking about. So maybe just frame what is your expectation on auto production, HVOR, and so on for 2017 in that 1% to 3% organic guide.

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

I would talk about some of the markets that we think will be headwinds. We continue to think we'll see some deterioration in the HVOR market when you look at Class V through Class VIII. So not nearly the deterioration that we saw 2015 to 2016 but a continue drop in that end market.

We think that North American auto production is one that will most likely be a headwind as we look forward. That's about 20% of our overall Sensata revenue exposures. Europe growing, not growing strong -- when you net all of that out it's about -- it is really no impact for Sensata in our view of overall production.

Amit Daryanani - *RBC Capital Markets - Analyst*

Perfect. Thank you, guys.

Joshua Young - *Sensata Technologies Holding NV - Head of IR*

Keith, please take the next question.

Operator

Wamsi Mohan, BofA Merrill Lynch.

Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Thank you. Good morning. Martha, the organic growth rate has been in the low single-digit range when you look on an annual basis for the last five years outside of 2014. We have obviously gone through significant industrial weakness period. We've gone through HVOR weakness, now potentially some auto weakness ahead of us, so given your pipeline of design wins, do you think we will see higher organic growth over the next five years versus the previous five? And given what you know about regulatory environment, how feel -- what the major drivers could be over here? And I will follow up.

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

If you look back, we've seen incremental improvements in our organic growth, starting from 2015. So better in 2016, we expect it to be better in 2017, and I expect it to be better as we move forward in the subsequent years. And yes, that is based on our book of design wins, which was strong in 2016.

So we secured about $420 million of new design wins. Think of it as incremental backlog bookings for Sensata, but these play out over the -- launch in the two to four year time horizon and then play out beyond that before they ramp to the stabilized volume. So we are confident, given what we continue to secure in terms of new wins. And we do expect to continue to see a step up in that organic rate as we go forward.

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Wamsi Mohan - *BofA Merrill Lynch - Analyst*

Okay. Thank you, Martha. And then maybe Paul, you had targeted a $0.20 of improvement in 2016 and incremental $0.20 benefit from integration of your prior acquisitions in 2017. How did you execute versus that target? Do you still expect $0.20 in 2017?

And if so, that alone gets you to the low end of your EPS guide, and you've got positive revenue growth expectations and potentially de-levering as well. So, it just seems the low end of your range is already in the bag. What would you say would be some puts and takes in addition to that? Thank you.

Paul Vasington - *Sensata Technologies Holding NV - CFO*

As it relates to how those acquisitions performed in 2016, they performed less than what we had intended. So we had said about somewhere around $0.40 or so -- $0.40, $0.45 -- they did not achieve that. Much of that was driven by weaker volumes that we saw in CST and a little bit in the DeltaTech business, which serves our [control] market.

As we look forward, the integrations continue to be on track in terms of integrating the businesses and the cost synergies. I would characterize it for 2017 -- I would say about half of the EPS improvement that we're going to see next year will be attributed to those three acquisitions and the other half will come from the core business, excluding those three businesses.

Operator

Samik Chatterjee, JPMorgan.

Samik Chatterjee - *JPMorgan - Analyst*

Hello, good morning. I just wanted to first [keep that point] Quanergy, and that's an exciting opportunity in terms of the development of the LiDAR. From your presence at CES, just curious what are you hearing from your customers in terms of what is the price point or the cost target that Quanergy needs to hit for the LiDAR to get the LiDAR as a key part of the sensor package on a vehicle, and when do you think Quanergy could hit those targets?

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

When you look at how fundamental that parameter is to autonomous driving, and you look at the current price points, the current economics, and the obstacles of packaging mechanical LiDAR, our discussions with our customers are not very focused on pricing. They are really focused on overall functionality, and the point being that everyone understands the economics are orders of magnitude different from mechanical price points today.

So, there's not a pinpoint price. I'm sure ten years into the adoption of autonomous vehicles, that will be very much of the overall conversation. Much more important is getting the performance of the sensors and the packaging required to make it more of a mass adopted parameter. That's really where our focus is.

Samik Chatterjee - *JPMorgan - Analyst*

Okay. And just one question on the -- I know you [mentioned] the impact of adjusted taxes, but when we look at the other discussions going around, there is a proposed corporate tax reform plan which mentions something about disallowance of business deduction for net interest expense, and there's also some noise around relaxation of CAFE standards. So have you been able to do any work in terms of what the impact of those two would be on the business?

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

Those are pretty distinct and wide-ranging things that you are asking about. I can comment a bit on CAFE.

This is an area that has always been a bit dysfunctional for the automotive OEMs. And given that it is an average across-the-fleet requirement, generally what happens is they are forced to bring a mix to the marketplace that allows them to hit that standard. Meanwhile, for years and our continued forward future is to make all engines and all powertrains more efficient.

The point being that whether it is an SUV or a pickup truck, consumers are valuing fuel economy, and we don't expect that to change. We do expect that if there is a relaxation of CAFE requirements, that will allow our customers to sell into the market what the consumer wants, and we think that's really healthy for the industry.

Operator

Rich Kwas, Wells Fargo Securities, LLC.

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

Hello, good morning. Martha, I just wanted to follow up on sensing as we think about growth into 2017. In the past you've talked about inventory headwinds coming out of prior calendar years. You have pretty strong growth coming here in the fourth quarter. How would you characterize inventory levels for your key verticals within sensing solutions?

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

We feel that inventories are being well-managed, Rich. So that's not one that I would put us a headwind to us on the first quarter here. So feeling pretty good about the discipline in really all of our markets at this point.

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

Okay. And then, Paul, on your comment previously around half the EPS growth coming from prior deals, does that include debt paydown as a component of that leverage reduction?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

No, I'm just thinking about the operating improvements, if you look on an adjusted EBIT basis, how much of the growth would come from in those three acquired businesses versus the core. It's roughly half. Half and half.

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

So then the other half --

Paul Vasington - *Sensata Technologies Holding NV - CFO*

Would be a little strong on the acquisitions but not enough to get -- to move any --

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

Is there it any meaningful interest savings within the EPS growth for 2017?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

[We're going to assume] above flat. We have a rising interest rate environment. We've paid down a whole bunch of debt, so we're going to assume net interest about flat, focused on net leverage, driving down to 3 times, and keeping our options open in terms of how we're going to get to the 3 times.

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

Okay. And then lastly, Martha, on auto as it relates to Europe, with diesel penetration, you have other suppliers out there, related companies talking about lower diesel penetration in Europe and long-term outlooks where there's grind lower and maybe it picks up steam. How would you characterize what you're seeing from the customer base as you look at your growth rate for the auto business the next three to five years? What are you contemplating for diesel penetration?

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

We expect that we're going to see contraction of that penetration, Rich, over time. So probably about 5 points of market share if you think out in the five-year horizon. One of the things that we're making visible to investors is that we are actually seeing our content grow more quickly on gasoline engines than on diesel engines, and part of that is by design: recognizing some of the market headwinds for diesel and therefore where we have focused on new applications.

So when we get into that time horizon, we get to the point where we're somewhat agnostic about whether or not it is a gas or a diesel engine. But to your specific question, we do expect there to be about five points of deterioration in about a five-year time horizon. If you take that linearly, we think that is about what happened between 2015 and 2016 and an additional step down in 2017. So pretty much on track to where we've called it.

Operator

(Operator Instructions)

William Stein, SunTrust Robinson Humphrey.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Great. Thank you. First on the restructuring side, are CST and Schrader the only two that aren't fully integrated now? And how much improvement to go following 2017 in those deals?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

Well, yes. DeltaTech is fully integrated at this point. It sort of lasted two years and business performing well. So CST -- still early, one year into the integration. Schrader -- we're midway through the integration. Done a lot at the front end, now continuing to integrate the back end.

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

And just keep in mind, I keep making the point that there is pretty strong methodology inside Sensata to constantly be looking at optimizing our supply chain network and constantly be putting in place overall productivity measures. And so that piece of it is forward-looking for our entire business, including DeltaTech, but the specific integration plans, to Paul's point, are targeted at CST and Schrader.

William Stein - *SunTrust Robinson Humphrey - Analyst*

And then the follow-up if I can, Martha, you mentioned this new content growth in gas engine particulate emissions. Is that a new category, when should we see that ramp, and is that a meaningful part of your content growth going forward?

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

It is a new application, and it's one that's important in Europe and in China. One of the things that has allowed us to be successful there is the fact that we have a much more competitive low-pressure sensor offering, so it's a low-pressure device. We also see opportunity down for high-temperature sensing. We talked about the fact that we secured something like $420 million in new business wins in 2016 and about $50 million of those were associated with this new application.

Timing, typical to the long-term cycle here, so again we're focused on the three to four years before launch and then time to ramp from there.

William Stein - *SunTrust Robinson Humphrey - Analyst*

Got it. Thank you.

Operator

Christopher Glynn, Oppenheimer & Co.

Christopher Glynn - *Oppenheimer & Co. - Analyst*

Thank you. Good morning. Nice picture of the Leonard Zakim Bridge on slide 9.

Just wondering if you could give me the integration spend for the fourth quarter and for the full year 2016.

Paul Vasington - *Sensata Technologies Holding NV - CFO*

The fourth quarter it was about $3 million, and for the year it was about $17 million.

Christopher Glynn - *Oppenheimer & Co. - Analyst*

Okay. So that's flat next year. Okay and then on the FX you absorbed $0.08 in the fourth quarter. I think the guide was $0.05. So usually have pretty good visibility on that, so wondering what changed there. And still EPS came in at the high end of the guide, so wondering what the offset was to the unfavorable FX disruption.

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Paul Vasington - *Sensata Technologies Holding NV - CFO*

One of the things is that we don't hedge the Renminbi, so the really strong China revenue came with an offsetting effects and favorable impact. And then there was the very quick and very rapid down decline in the year over versus the dollar in Q4 that -- we're not 100% hedge, we're 85% to 90% hedge that [made a currency], so had a little bit of an impact but the Renminbi was probably the biggest impact, and we also got all the revenue in the process associated with those sales.

Christopher Glynn - *Oppenheimer & Co. - Analyst*

Okay. Makes sense. Thank you.

Operator

Jeremie Capron, CLSA.

Jeremie Capron - *CLSA - Analyst*

Thank you. Good morning, all. First I wanted to confirm, I heard your market assumptions right for 2017. You said overall pretty much neutral, right?

Paul Vasington - *Sensata Technologies Holding NV - CFO*

Yes.

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

Yes.

Jeremie Capron - *CLSA - Analyst*

Okay. And when I look at the organic growth that you delivered in Q4 just short of 6%, clearly accelerating here and understand the benefits of the strengthening in the Chinese auto market, but your guidance for Q1 implies a significant slowdown. I'm wondering what headwinds beyond China you are seeing here.

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

We're not seeing significant headwinds aside from the ones that we talked about. We expect that our Heavy Vehicle, Off-Road market continues to have a headwind there. That may be a piece of it.

If you look at the comp for a portion of our Sensing Solution business, we're fairly weak in the fourth quarter to fourth quarter comparison. And that's not the situation we'll be seeing on a first to first.

Jeremie Capron - *CLSA - Analyst*

Okay. And I didn't hear any guidance around cash flow. You had a good cash flow in 2016, good conversion. Can you give us any sense of what you expect for 2017? Any puts and takes around usual conversion of net income and a word on CapEx, please?

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Paul Vasington - *Sensata Technologies Holding NV - CFO*

So we mentioned on the call $425 million to $450 million of free cash flow and CapEx of $130 million to $150 million. So the midpoint CapEx is $140 million, which would be higher than what we spent this year. I think working capital will be relatively flat year-over-year, so the conversion of free cash flow earnings will improve a little bit.

Operator

Matt Sheerin, Stifel Nicolaus.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Yes, thank you. A couple questions. Just clarifying your revenue growth expectations for the year. That 1% to 3% organic growth -- is that for both segments, both Sensing Solutions and the core sensor business?

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

We expect both segments will achieve organic growth.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Okay. And your commentary around bringing the net leverage down to 3x, that would imply a no additional debt and obviously no acquisitions and you haven't done a deal in over a year. What's your thinking on M&A? Is that still one of your top priorities in terms of growth, and if so, what areas or technological voids would you be looking to fill?

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

Yes, M&A is still very much part of our playbook, as are other ways of deploying capital to create returns for our shareholder. In the event that we actually over perform and we're approaching the 3 times, we have been actively looking at alternative ways to deploy that capital.

When we think about M&A, one of the benefits of the CST acquisition was that it allowed us to develop exposures and now business positions in new end markets where we see sensing opportunity, and we also see opportunity for further sensor consolidation in those verticals. So we're thinking about that carefully.

Relative to technologists, we tend to be a little bit careful and close to the vest about any targeted technologies that we may be thinking about.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Okay. Fair enough. Thank you.

Operator

Craig Hettenbach, Morgan Stanley.

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Craig Hettenbach - *Morgan Stanley - Analyst*

Yes, thank you. On CST you mentioned just a weaker environment that's impacted a number of companies in 2016. But just can you talk about maybe the investment in that business and the intermediate to longer-term growth opportunities you see there?

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

If we rewind to the state of that business at the time of acquisition, it was a business with pretty decent margin performance but very little past investment for growth, and we're changing that.

And I think very delighted that a portion of our overall design wins in 2016 include that portfolio. So particularly in aerospace, for example, and in parts of our off-road market as well. So it takes time to actually turn a business towards growth, but we're making very good progress on that front, and at the same time really performing extremely well in terms of margin improvement in the business.

Craig Hettenbach - *Morgan Stanley - Analyst*

Great. And then just a follow-up question on M&A. When you think about the de-leveraging angle versus you have been very active in your integrating deals, how you put that all together in terms of appropriate timing and opportunity set and what's most important to you in 2017?

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

When we think about that is that we make sure we have the appropriate threshold expectations for our overall M&A. And so during the time where we're more leveraged, that threshold expectation is going to increase significantly.

At the same time, deals are a function of a lot of things that happen and making sure that the valuations are where they should be. Most of what we do are private deals or proprietary deals where we have some impact on the overall timing of the transaction. So we think about it that way as well. So yes, still an important part of our growth story at Sensata.

Craig Hettenbach - *Morgan Stanley - Analyst*

Got it. Thank you.

Operator

Jim Suva, Citigroup.

Jim Suva - *Citigroup - Analyst*

Thank you very much. For your organic growth for next year, can you help us understand has anything changed with pricing or content growth, as the low single-digit growth looks a little bit small? So we're just trying to look at is it more macro driven, or content -- has that decelerated, or how should we think about that?

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

A couple of comments on that front. When you look at our backlog on design wins, our support new business awards, they don't tend to come in in a linear way year-over-year. So long-cycle business, the launch and timing of those depends very much on the platform or what is happening in the region. And I would say our pace of content wins is impacted by that more than anything else.

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We're seeing strong content performance in markets that are still down markets. So our commercial truck market, for example, we've continued to do very well from a content perspective there. Similarly in Europe where foreign currency has been a headwind for us. So no, we don't see it as a slowdown in the overall growth. We do think that there are parts of the business where content is not as robust in 2016 and 2017 as we'd seen in 2014 for example. Given the backlog, we expect to see organic growth rate continue to pace up as we move forward.

The only other comment I would make relative to pricing -- we have not seen changes in the pricing dynamic, but we do have a practice of launching new generation products that generally come in at a lower price point although a higher margin point. And that just allows us to increase our competitiveness and our penetration and provide what is a great economic value for our customers. And we are seeing a little more of that in 2017 than we've seen in the past.

Operator

Thank you. And that is all the time we have allotted for questions, so I would like to return the call over to Joshua Young for any closing comments.

Joshua Young - *Sensata Technologies Holding NV - Head of IR*

Thank you, Keith. I would like to thank everyone for joining us this morning. We appreciate your continued interest in Sensata.

Sensata will be attending the following investor conferences in the first quarter of 2017: the Goldman Tech Conference in San Francisco, the Barclays Industrial Conference in Miami, and the JPMorgan's Industrial Conference in New York. We encourage you to meet with us at these conferences or visit our headquarters in Attleboro, Massachusetts.

Thank you and goodbye.

Operator

Thank you. The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.

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