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ST.N - Q2 2019 Sensata Technologies Holding PLC Earnings Call

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PRESENTATION

Operator

Good day, and welcome to Sensata Technologies Q2 2019 Earnings Call. (Operator Instructions) Please note, this event is being recorded.

Now I would like to turn the conference over to Mr. Joshua Young, Vice President, Investor Relations. Please go ahead, sir.

Joshua S. Young - *Sensata Technologies Holding plc - VP of IR*

Thank you, Keith, and good morning to everybody on the call. I'd like to welcome you to Sensata's Second Quarter 2019 Earnings Conference Call. Joining me on today's call are Martha Sullivan, Sensata's CEO; Jeff Cote, Sensata's President and Chief Operating Officer; 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 Relations website, and we will post a replay of today's webcast shortly after the conclusion of today's call.

Before we begin, I'd like to reference Sensata's safe harbor statement 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. Factors that might cause such differences include, but are not limited to, those discussed in our Forms 10-Q and 10-K as well as other subsequent filings with the SEC.

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On Slide #3, we show Sensata's GAAP results for the second quarter of 2019. We encourage you to review our GAAP financial statements in addition to today's presentation. Most of the subsequent information we will be discussing during today's calls -- call will be related to non-GAAP financial measures. Reconciliations of our GAAP to non-GAAP financial measures are included in our earnings release and in our webcast presentation. The company provides details of its segment operating income on Slides 12 and 13, which are the primary measures management uses to evaluate the business.

Martha will begin today's call with an overall business summary. Jeff will then provide more details on our secular growth drivers and investments in electrification. Paul will then cover our financials for the second quarter of 2019 and provide guidance for the third quarter and an update to our full year 2019 guidance. We will then take your questions after our prepared remarks.

Now I'd like to turn the call over to Sensata's CEO, Martha Sullivan.

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Thank you, Joshua, and thanks to everyone on the call for joining us this morning.

During the second quarter, we continued to significantly outperform our end market while advancing important electrification initiatives that will benefit our long-term revenue growth. While we generated lower volume in Q2 as a result of incrementally weaker end markets, we still delivered solid earnings and margin performance. This performance reflects our ability to respond quickly to market changes as well as the impact from our capital deployment program.

On Slide 4, I list some of the key highlights of the second quarter. For the second quarter, we reported revenues of $883.7 million, which represented an organic revenue decline of approximately 1.6%. We delivered adjusted EPS of $0.93, which was within the range of our guidance and flat with the EPS we generated in the second quarter of 2018. HVOR continued to be our fastest growing business, generating organic revenue growth of 1%, which partially offset a 1.1% organic revenue decline in our automotive business and a 4.1% organic revenue decline in Sensing Solutions.

One of the key developments in the second quarter was that our end markets continued to weaken and were lower than our expectations. The most notable declines were in the China auto end market, which was down 20%; and the European auto end market, which was down 10%. Additionally, the industrial end market was down 7% in the second quarter, and the North American on-road truck market was also weaker.

Despite this difficult end market environment, we continued to deliver strong secular growth for the overall company. This was led by our automotive business, which outgrew its end market by 650 basis points and continued its trend of accelerating content growth. Our HVOR business outgrew its markets by 280 basis points, below its recent trend due to the timing of customer product launches. We believe our strong secular growth will be sustained into 2020, and Jeff will talk later in the call about why we have visibility into continuing this trend.

We were highly effective in managing our margin and EPS performance in the quarter despite generating lower revenues as a result of end market weakness and facing a higher tax rate. Our Q2 adjusted operating margin of 23.2% was in line with the midpoint of our guidance, and we reported flat year-over-year EPS despite generating $30 million less revenue. This is a result of actively managing our discretionary operating expenses and generating benefits from our capital deployment program.

As part of our efforts to continue to advance our electrification initiative, we partnered with Lithium Balance in Q2 to help us deliver battery management subsystems to industrial, HVOR and material handling markets. We believe this partnership will also complement our wireless battery monitoring initiative in our auto business.

Finally, our Board has authorized a $500 million repurchase of Sensata shares, which we expect to utilize over the next 12 to 24 months. We are always continuously weighing the return profile of buying back our shares against executing additional M&A opportunity. We believe that our shares are an attractive use of capital, particularly during periods where M&A transactions are not actionable.

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Slide 5 shows organic revenue growth by end market in the second quarter. I will begin with HVOR, which posted 1% organic revenue growth in the quarter. This was 280 basis points above an end market decline of 1.8% in the second quarter. Strong content growth from our China on-road truck business as a result of China's [fifth] legislation offset weaker end market demand. After a period of solid growth over the past 2 years, our construction and agriculture businesses declined in the quarter as customers adjusted their inventories and production to lower global demand. We continue to see very strong sales activity for our wireless hub and the high-voltage contactors we acquired from GIGAVAC. We have a number of large deals we expect to close over the next few quarters, which will help to establish the foundation for future growth.

Next, our automotive business posted an organic revenue decline of 1.1%, which was 650 basis points above a 7.6% end market decline during the second quarter. As a reminder, at our Investor Day 18 months ago, we committed to delivering higher content growth in auto and we have delivered on that promise, posting competitive outgrowth versus underlying production over the past 6 quarters. The clear drivers of the secular performance in Q2 were our China auto and European auto businesses, both of which are benefiting from new legislative mandates and the launch of applications to treat gasoline exhaust systems. We also advanced our electrification initiative by winning new business on a number of subsystems for battery electric vehicles as well as further growing our electrification sales pipeline. As a result of our Q2 performance, we are lowering our projections for global automotive production for the remainder of the year, but we expect to offset much of this decline with sustained content growth.

Finally, I want to turn to industrial, aerospace and other end markets, which are served by our Sensing Solutions segment. For the second quarter of 2019, we posted a 4.1% organic revenue decline due to weak demand for our electrical protection products sold to industrial customers serving the appliance, HVAC and automotive markets. As a reminder, we generate just over $250 million in annual revenue from our legacy electrical protection products, which have high margins but grow in line with end production. About half of our electrical protection revenue is generated in China. These products sit pretty far back in the supply chain. As a result, we see significant inventory fluctuations in this business when end markets are volatile. In Q2, our electrical protection products generated a double-digit organic revenue decline. Much of this was driven by the end market, which we estimate was down 7% in Q2. This decline in the industrial end market was significantly greater than what we experienced last quarter. This was partially offset by growth in our aerospace business, which posted strong double-digit organic revenue growth in the quarter. We continue to see sequential PMI decline in North America, Europe and China, which is resulting in many of our industrial customers slowing down their production schedule. As a result, we are much more cautious on the demand outlook for our industrial customers for the remainder of the year, and this is reflected on our next slide.

On Slide 6, I show in more detail how our end market expectations have changed for 2019 compared to our previous guidance. We are lowering our expectations for global auto production and now expect a decline of 5% for the full year 2019 compared to our previous expectations for the market to decline 3% to 4%. This assumes the European auto end market will decline 4% to 5% versus our previous expectation of a 4% decline. We expect that China auto end market will decline 11% to 12% compared to our previous expectation of 5% to 6% decline in China auto. Additionally, as a result of weaker markets in both our on-road and off-road businesses, we are lowering our assumptions for the HVOR end market and now expect that HVOR will decline 4% for the full year compared to our previous expectations of a 2% end market decline. Finally, we expect our industrial end market to decline 6% compared to our previous expectation for a 1% decline. Despite this end market volatility, we remain confident in our secular growth performance for 2019 and longer term. We have also made tremendous progress over the past 2 years in strengthening our position in electrification.

I'd like to now turn the call over to Jeff to talk about this in more detail. Jeff?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President & COO*

Thank you, Martha. It's a pleasure to be on today's call.

On Slide 7, we show some of the drivers of our secular growth. We are generating solid content growth across our business as a result of these multiyear trends, and we are making investments that further position the company for long-term secular growth. While our content growth in automotive is significant, our efforts to diversify our business into the heavy vehicle, off-road, industrial and aerospace end markets has created compelling long-term growth opportunities that we are investing in and realizing. For example, in HVOR, we have outgrown the end markets by

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550 basis points for the first 6 months of 2019. We are seeing content growth in the on-road truck market as new regulation drives additional safety and emissions requirements. Additionally, our off-road business is seeing content growth opportunities from the fan out of electronic controls.

Last quarter, we spoke about our wireless gateway or vehicle area network, which represents a content driver for Sensata, as our customers look to use the data our sensors capture to enhance the safety and efficiency of their equipment. In industrial, we are seeing sensors being added for a range of requirements as customers generate better digital insights through Industry 4.0 efforts. In aerospace, we are seeing sensors being added to monitor the environment of the cabin as well as to improve the efficiency and effectiveness of flight controls. In automotive, we see similar trends and we have accelerated our outgrowth relative to end market production. Over the past 2 years, we have increased our outgrowth by 380 basis points and have grown the automotive business 570 basis points faster than end market for the first 6 months of this year.

I want to emphasize that we have high confidence in sustaining secular outgrowth in all of our businesses over the long term. Our confidence is underpinned by the strong growth and new business wins we have generated over the past 4 years. Since 2015, we have expanded our new business wins from $370 million to over $500 million last year. As a reminder, these wins represent incremental revenue for us that will be recognized over a 3- to 8-year time horizon. This long-cycle nature of our business model provides us with high level of visibility into our future content growth. While visibility into end markets remains challenging, we can confidently commit to sustaining significant end market outgrowth as a result of the business we have already secured.

On Slide 8, we show the progress we have made on our electrification efforts over the past 2 years. Through internal development, partnerships and acquisitions, we have entered markets and developed solutions that position Sensata as a key player in solving mission-critical electrification challenges for our customers, and we are seeing great early returns on our investments. We have established electrification as a clear strategic imperative for our business and the initiatives we are pursuing represent large untapped markets for future growth. Over the past 2 years, we have expanded our capabilities that will allow us to access a $32 billion market opportunity over the next 10 years. These served markets are expected to grow at close to 18% per year over the next decade, and we are already closing business today related to these opportunities.

I want to dig in some on the details of the opportunities we have listed on the slide. We spoke in detail about wireless battery monitoring last quarter, which we first introduced to investors at our Investor Day 18 months ago. Since that introduction, we have already validated the technology and are actively engaged with [S-Volt], our first customer. The solution has the potential to bring value to many of our customers by reducing their material and labor costs associated with electrified drivetrains while helping improve reliability and modularity.

We have also spoken about GIGAVAC as another proof point related to our progress in electrification. GIGAVAC more than doubled our content on battery electric vehicles. We are also seeing new opportunities in markets such as charging stations and energy storage.

From a product road map standpoint, we are developing a product that combines the functionality of a high-voltage contactor and fuse, which will further differentiate us from competitors in the market. Additionally, our products are unique in their ability to function at very high voltages, which is required to extend range and reduce charging times. We are also developing customized sensors that help customers detect thermal runaway for electric vehicles, which in many markets is being mandated over the next few years.

Today, we announced a partnership with Lithium Balance. On Slide 9, we show in more detail the strategic rationale related to this partnership. Lithium Balance will enable Sensata to offer a more comprehensive battery management solution to customers across all of our end markets, and Sensata will leverage its extensive global sales channels and application understanding to drive broader adoption of Lithium Balance's technology. One of the more exciting markets we intend to address as we develop solutions with Lithium Balance is the energy storage market. As the world increasingly moves toward generating and storing power in a more distributed way to solve the growing grid balance issues, we believe energy storage will become more and more prevalent. An example of this is the proliferation of renewable energy sources. Lithium Balance and Sensata are poised to help solve this challenge. Lithium Balance has developed their own energy storage system that utilizes their battery management technology, and early installations already have been deployed in Europe. Additionally, as we further develop wireless battery monitoring solutions for our automotive market, Lithium Balance's hardware and software expertise will be valuable in customizing solutions for our automotive customers.

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Before I turn things over to Paul, I'd like to address Slide 10 with an overview of the key messages from the quarter. We are accelerating our content growth and significantly outgrowing the end markets we serve. We have confidence in this secular growth, that it will be sustained, and we are actively investing in exciting initiatives for the long term. We delivered operating margins in line with our guidance despite the revenue shortfall we faced in the quarter. We are responding quickly and further aligning our cost base given the weakening end markets, and we are executing on value-creating capital deployment. Our M&A pipeline is active and strong; we are investing in partnerships such as Lithium Balance that will help our growth; and our Board has authorized a share repurchase program of up to $500 million, which reflects our belief in our long-term strategy, growth prospects and focus on shareholder value creation.

I'll now turn the call back over to Paul to review the second quarter results in more detail and to provide guidance for the third quarter and full year 2019. Paul?

Paul S. Vasington - *Sensata Technologies Holding plc - CFO, CAO & Executive VP*

Thank you, Jeff. Key highlights for the second quarter, as shown on Slide 11, include revenue of $883.7 million in the quarter, a decrease of 3.3% from the second quarter of 2018. Changes in foreign currency decreased revenues by about 1%. The net effect of our valves divestiture and the acquisition of GIGAVAC decreased revenues by 0.7% year-over-year. The net result was 1.6% organic revenue decline in the quarter. Adjusted operating income was $205.1 million in the quarter, a decrease of 6.5% compared to the second quarter of 2018, due primarily to the net effect of acquisitions and divestitures, net productivity headwinds partly related to scaling new product launches and higher tariffs. This was partially offset by lower operating expenses and lower variable compensation. Adjusted net income was $150.4 million in the quarter, a decrease of 6.5% compared to the second quarter of 2018. Adjusted EPS was $0.93 in the second quarter, flat compared to the prior year quarter which reflects a $0.07 decline in operational performance, a $0.06 decline for the net effect of acquisitions and divestitures and a $0.07 increase from foreign currency as well as a $0.06 increase from share repurchases.

Now I'd like to comment on the performance of our 2 business segments in the second quarter 2019. I will start with Performance Sensing on Slide 12. Our Performance Sensing business reported revenues of $644.5 million for the second quarter, a decrease of 4.7% compared to the same quarter last year, reflecting both the negative impact from foreign currency of about 1% and the net effect of acquisitions and divestitures which reduced revenue by 3%. Excluding these factors, Performance Sensing reported an organic revenue decline of 0.7% compared to the prior year.

Our HVOR business reported organic revenue growth of 1% in the second quarter. HVOR once again had the strongest revenue growth in the segment and outpaced its aggregate end market by 280 basis points due to the solid underlying content growth in the business. Our automotive business reported an organic revenue decline of 1.1% in the second quarter but outpaced the end market by 650 basis points. Our content growth benefited from new legislation in China and Europe, particularly for sensors used on gas particulate filters that clean gas powertrain exhaust.

Performance Sensing operating income was $168.1 million, a decrease of 10.3% as compared to the prior year. Performance Sensing profit as a percent of revenue was 26.1% in the second quarter, a decline of 160 basis points from the same quarter last year. The decline in segment operating income and margin was primarily driven by the net effect of acquisitions and divestitures, productivity headwinds related -- partly related to scaling new products and higher tariffs.

As shown on Slide 13, Sensing Solutions reported revenues of $239.2 million in the second quarter, an increase of 0.7% as compared to the same quarter last year. On an organic basis, factoring in a negative impact from foreign currency of 1% and a positive contribution from the acquisition of GIGAVAC of 5.8%, we reported an organic revenue decline of 4.1%. This decline was primarily due to the slowdown in global industrial demand, particularly in China. We also saw significant year-over-year decline in our semiconductor business. This was partially offset by double-digit organic revenue growth in our aerospace business.

Sensing Solutions operating income was $77.1 million in the second quarter, a decrease of 2.5% from the same quarter last year. The decline in operating income was primarily the result of lower volumes and operating leverage in our core business, somewhat offset by the acquisition of GIGAVAC. Segment margins declined primarily due to the GIGAVAC acquisition as we continue to invest for significant long-term growth in electrification. Corporate and other costs not included in segment operating income were $45.4 million in the second quarter, down approximately

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$8.1 million year-over-year, largely due to lower variable compensation expense. Excluding charges added back to our non-GAAP results, corporate and other costs were $37.8 million in the second quarter of 2019.

Slide 14 shows Sensata's second quarter 2019 non-GAAP results. Adjusted gross profit declined 7.1% year-over-year to $313 million, primarily due to the negative effect from acquisitions and divestitures, net productivity headwinds partly due to the scaling of new products and higher tariffs. R&D costs were lower year-over-year by $1.3 million but consistent as a percentage of revenue due primarily to changes in foreign currency. SG&A costs were $8.5 million favorable year-over-year due to lower variable compensation costs, foreign currency and cost controls. As a result, adjusted operating income was down 6.5% compared to the prior year quarter. Our tax rate, served on this line as a percent of adjusted profit before tax, was up 110 basis points year-over-year. We expect our full year tax rate to be approximately 9%, slightly below our previous guidance of 9.3%. Finally, adjusted EPS was flat as compared to the second quarter of 2018 as the decline in adjusted net income was offset by the benefit of share repurchases.

Now let me turn to our guidance for the full year 2019, as shown on Slide 15. Our updated guidance for the full year 2019 now anticipates the lower end market outlook that we shared with you earlier in the call. As a result, we expect revenue between $3.46 billion to $3.52 billion for the full year 2019, representing a decline between 2% and 0%. We expect foreign currency to decrease revenues by approximately $15 million, and the net effect of acquisition -- and the net effect of our acquisition of GIGAVAC and our divestiture of valves will reduce revenues by approximately $5 million. Our organic revenue guide represents a decline of 1% to 1% growth for the full year. We expect adjusted operating income between $807 million and $823 million, which would represent a decline of 1% to 3%. On the bottom line, we expect adjusted net income between $596 million and $612 million and adjusted earnings per share between $3.67 and $3.77 for the full year 2019, which represents growth between 1% and 3%.

We mentioned earlier that we're implementing additional actions to streamline and align our cost structure to the lower market demand as well as to improve productivity. These actions will include our voluntary retirement program, further site consolidation and other restructuring actions to further reduce our cost. This will result in approximately $25 million of incremental restructuring costs, which will be added back to our non-GAAP financials. Some of these costs were already incurred in Q2, while others will be reflected over the next 2 quarters. On average, we would expect about a 2-year payback for the actions we are taking. We will see some savings in 2019 and substantially more savings in 2020. A large portion of the severance costs will be funded this year and will lower our free cash flow in 2019.

We expect to generate free cash flow of approximately $460 million to $480 million. This free cash flow guidance assumes annual capital expenditures of approximately $150 million to $170 million for the full year 2019. The 2 primary drivers of our lower free cash flow guidance are lower net income reflected in our guidance as well as the incremental cash outflows associated with the restructuring actions I just mentioned.

On Slide 16, I show our financial guidance for the third quarter of 2019. Overall, we expect to report revenues between $847 million and $871 million, representing a reported revenue decline between 0% and 3%. At the midpoint of our guidance, we expect that foreign currency will increase revenues year-over-year by approximately $1 million in the third quarter of 2019, and the net effect of acquisitions and divestitures will further increase net revenues by approximately $5 million. Excluding the impact of foreign currency and the net effect of acquisitions and divestitures, we expect to report an organic revenue decline of 1% to 4% in the third quarter.

Our current fill rate is approximately 88% of the revenue guidance midpoint for the third quarter. We expect to report adjusted operating income between $196 million and $202 million. On the bottom line, we expect to report adjusted net income between $143 million and $149 million, which would represent a decline of 5% at the midpoint of our guidance. We expect to report adjusted EPS between $0.88 and $0.92, which will represent a decline of 3% to growth of 1%.

I'd like to conclude my comments with the following key points. Sensata is delivering strong secular growth despite a meaningful decline in most of our end markets. We expect underlying production in our end markets remain weak for the balance of 2019, and we are taking various actions to quickly streamline and align our cost structure to the weak market demand we are expecting. Finally, in terms of capital deployment, we will continue to take a balanced, returns-driven approach to create the most long-term value for our shareholders. An example of this approach is reflected in our decision to repurchase up to $500 million of Sensata stock.

Now I'd like to turn the call back over to Joshua.

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Joshua S. Young - *Sensata Technologies Holding plc - VP of IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And this morning's first question comes from Jed Dorsheimer with Canaccord Genuity.

Jonathan Edward Dorsheimer - *Canaccord Genuity Corp., Research Division - MD & Analyst*

I guess first one, Martha, given the decline particularly in China, while overall unit volumes are down, I would assume that the dollar content per unit has actually increased as a function of decline. I was wondering if you could provide a bit of an update in terms of content today and then how the market changes and dynamics have kind of changed your -- what we should expect as we look out for content growth.

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes, Jed. It's a good point and it's a really important observation. So despite a pretty precipitous drop in overall production in China, which we've now seen for a few quarters, our launches continue to be on track. If we go back to our Investor Day at the end of 2017, we talked about increasing our content per vehicle in China by 50%. We're actually running ahead of that on a linear basis, so the content is doing quite well. If you look at our overall growth in China, we were actually just flat despite -- in China broadly despite these really tough end markets that we're facing.

We have launched National VI content. That was an important thing that had to happen in 2019. So that is very much on track. Having said that, the market now is dealing with legacy National V content vehicles, and that's making the inventory situation challenging from an end market perspective. But we're doing very well on the content per vehicle front, continue to be driven by National VI changes which are in place and more of those launches ahead of us. Take rates on TPMS are also helping to drive growth. Electrification, really important in China. Some of the wins that we're alluding to are happening in China, which is now the fastest-growing NEV market in auto. So all of that bodes well for our content growth.

Jonathan Edward Dorsheimer - *Canaccord Genuity Corp., Research Division - MD & Analyst*

Great. That's helpful. I guess in the energy storage area that you're looking at increasing your exposure to with Lithium Balance and other growth in that area, I was wondering if you might be able to maybe give us a little bit more deeper perspective on what we should expect in terms of your moves in that particular market.

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

For a minute, let's -- Jeff has been working this one closely. He's going to talk to you about that.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President & COO*

Yes. So I think it's a great question. The opportunity around energy storage we believe will continue to grow quite rapidly. We mentioned in the script that Lithium Balance already has a solution that they're bringing to market in that area. They're a fairly small company, however. And so as we engage with them and continue to develop our partnership, we will certainly take their technology and go to our customers to evaluate continued opportunities to be able to pursue as that market continues to evolve. And so that's only one of the many areas that we see as being an

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opportunity associated with Lithium Balance. We also mentioned that it will help us in terms of battery management on a wired basis within our industrial and HVOR markets, and it will also complement the wireless battery monitoring activity that we have that's been an ongoing organic effort for us in the automotive market.

Jonathan Edward Dorsheimer - *Canaccord Genuity Corp., Research Division - MD & Analyst*

Great. That's helpful. One more question, then I'll jump back in the queue. Martha, it looks as if you've done a really good job in terms of shifting over to a more variable cost model, which should help you through this downturn if it becomes a prolonged one. It also looks as if the shift to electrification is happening sooner. So I was wondering if you might be able to provide -- as you steward this company, provide a perspective on how you might be able to sort of shift the business away from the more unit economics that it's still heavily reliant upon on the ICE-based vehicles and how you're thinking about the electric as well as automated trends in the marketplace.

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. I think there are really 3 dimensions. First, if we look at our overall automotive business, it's making sure that we are positioned very well and winning in applications that are growing with some of the disruptions happening in that market, electrification being #1 for Sensata. We also see opportunities when we look at what's happening from a connected perspective in the automotive business.

I'd say just as important though is the work that we're doing beyond auto. And it has 2 impacts: one, it brings secular growth into other end markets; and two, it's helping to diversify our business. So you can see at the current run rate now we've dropped below the 60% mark in terms of our automotive exposure, and so we're enjoying secular content in areas like material handling and HVAC and aerospace. And that's really helping to strengthen our overall business model. So really appreciate the question. It's a very important dynamic at Sensata.

Operator

And the next question comes from Wamsi Mohan with Bank of America Merrill Lynch.

Wamsi Mohan - *BofA Merrill Lynch, Research Division - Director*

Paul, thanks for the color on restructuring. I was wondering if you could just maybe give us a little more insight into sort of what segments, regions, end markets these actions are being taken in. And how much of these savings will actually flow through the bottom line versus reinvested in the business, particularly in 2019? And then I have a follow-up.

Paul S. Vasington - *Sensata Technologies Holding plc - CFO, CAO & Executive VP*

So the areas where the restructuring is going to impact the business is actually across the globe. So many of the markets which are weaker, we are taking actions to improve the cost structure. And so you would see the savings coming across all parts of the business for Sensata. The savings, we're going to see a little bit of that savings in 2019. Most of the savings will come through as we're looking to restructure the organization to be more productive, and so looking to realize most of that savings as we enter into 2020.

Wamsi Mohan - *BofA Merrill Lynch, Research Division - Director*

Okay. And Martha or Jeff, you had very strong business wins over the last few years. How are business wins tracking here in this much weaker sort of auto OEM end market? And particularly, as it pertains to any weak trends in China, which you alluded to on the call, how are you thinking about the risk of too many players and being able to underwrite the strength from design wins longer term?

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Jeffrey J. Cote - *Sensata Technologies Holding plc - President & COO*

Good question, Wamsi. So we talk about the fact that the secular trends that are impacting the business continue to track in a very strong way. Regulation, electrification, smart, connected, autonomy, all of these are very good for Sensata, and it's really resulted in an increase in our overall NBO wins over the last several years. We mentioned that in 2015, we won $370 million of NBOs. Last year, it was $500 million. We're tracking very nicely toward a good amount of wins during 2019 as well. And the pipeline continues to be quite full, so there's lots of opportunity and we're engaging with customers to make sure that we engage with them to get those wins behind us because they are ultimately what drives that secular growth for us going forward.

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

And then, Wamsi, in terms of the number of players, just the segmentation of our end markets is really important as we see the dynamics play out. And that's particularly true in China. That's been a discipline now that we've been observing for as long as we've been in the automotive market in China, just given the number of players that are there.

Operator

And the next question comes from David Kelley with Jefferies.

David Lee Kelley - *Jefferies LLC, Research Division - Equity Analyst*

A quick follow-up on the auto outgrowth accelerating here. And just given some of these changing regulations in China and Europe, I guess is the recent pace sustainable? Is there another leg on the horizon of outgrowth you see? Would just love to get your thoughts on kind of the content pipeline over the next 12 to 18 months.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President & COO*

Yes. So just to sort of level set in auto, in the first quarter, we had outgrowth of about 490 basis points, 650 in the second. So year-to-date, 570. We're feeling good about that trend continuing not only through 2019 but beyond as well. And we've talked about the number of opportunities that are really driving that: Euro 6, NS VI in China, a number of different regulations associated with fuel evaporation requirements, electrified platforms. So there are dozens of opportunities. I think that's the most important aspect to really zero in on. It's not just 1 or 2 different things that are creating opportunity for the company. And as we continue to expand our capability base, it then multiplies into other areas, so the TPMS opportunity as it fanned out through Europe and now into China and then eventually into HVOR. And so something Sensata does really well is take those capabilities that we've developed for one end market to solve a challenge and then fan it out over time. So we feel quite confident and ultimately that the trends that we see and the opportunity, we'll continue to see that outgrowth.

David Lee Kelley - *Jefferies LLC, Research Division - Equity Analyst*

All right. Great. And then maybe to switch gears a bit and as a follow-up. If we look at the Performance Sensing margin, which we think held up fairly well given some of the end market deterioration, can you just talk about some of the cost levers you are pulling and have to pull given, a, you're scaling new product launches; but also b, you've got some restructuring initiatives taking place in -- on the horizon here?

Paul S. Vasington - *Sensata Technologies Holding plc - CFO, CAO & Executive VP*

The Performance Sensing business, I think you've characterized it well. I think the scaling of the new products is an intense process that we've been talking about for a while. And so we see good growth in those areas. And then to offset some of the weakness we've seen in some of the more

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mature products is impacting our operating leverage that we would expect to achieve and realize. Cost reduction is all across the P&L. It's driving better productivity in our manufacturing process. It's leaning out and streamlining our overhead costs, all with the intention of continuing to sustain and drive margin improvement in that business over time.

Operator

And the next question comes from Amit Daryanani with Evercore.

Amit Jawaharlaz Daryanani - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Two questions for me as well. First is on GIGAVAC. Could you maybe give us a sense on the revenue opportunity you have today as we think about this over the next 2 to 3 years? And just from an investment perspective, could you quantify how much the headwinds in the Sensing Solutions margins from the investments you're making for GIGAVAC for the revenue opportunity ahead?

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. I think the business, when we announced at the time of the acquisition, running around something like $90 million in revenue and growing very strong double digits, like 20% to 30%. But that small base is -- it was great. What really compelled us to follow on the transaction was the opportunity horizon. We talked about a $300 million sales pipeline already developed in auto alone for the high-voltage contactors. And we've since extended that now to end markets like HVOR and material handling. This play that we're talking about with Lithium Balance and the opportunity it brings us into an energy storage system also allows us to bring high-voltage contactor content into a very large end market. So it's really important. We talk about it as being a strategic imperative at Sensata. That means it's a must-do and it's all opportunity-based. I think relative to Sensata -- Sensing Solutions margins, the investments that we're making in GIGAVAC is largely to [tool] that portfolio for the automotive market. So most of that investment you're seeing inside of the Performance Sensing segment.

Amit Jawaharlaz Daryanani - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Got it. Got it. And then I guess just on the free cash flow run rate for the back half -- and I know that you guys updated the full year guide for free cash flow. But you expected to do something like $300 million in the back half of the year versus $170 million I think in the first half. And H2 2019 guide -- implied guide, I should say, is up year-over-year as well. Just can you just touch on the levers that can get you to this free cash flow ramping up in the back half of the year?

Paul S. Vasington - *Sensata Technologies Holding plc - CFO, CAO & Executive VP*

Well, similar to what we've seen in the past, second half cash flow is stronger than the first half. We're going to continue to invest in capital, but the rate this year is more level set than it has in the past. So more balanced quarter-by-quarter in terms of CapEx, then continued improvement in working capital, continued improvement in driving down our receivables. There's linearity improvement in the fourth quarter. What we typically see, sort of revenues are more flat month-to-month. So we typically see a much better cash flow in the second half than the first half. So I feel pretty confident. If you look at our operating cash flow, the A&I improves throughout the second half, more aligned with 100% conversion. So I feel pretty good about our ability to do that. We're going to be at our -- the restructuring that we're taking, the funding of that will happen mostly in the second half, so that will be a drag. And also the change that we talked about in terms of the profit will be a drag from where we thought we're going to be. But all in all, I think it's very achievable.

Operator

(Operator Instructions) And our next question comes from Samik Chatterjee with JP Morgan.

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Samik Chatterjee - *JP Morgan Chase & Co, Research Division - Analyst*

Martha, just wanted to get your thoughts on the business outlook but in a different -- on the outgrowth but in a different aspect, on the market share opportunities that you're seeing both organically and inorganically. Often when the industry volumes do get challenging, some of the smaller players do struggle. So when you're looking at this tough environment, are you looking at some of the organic -- how you're thinking what the organic opportunity is as well as the M&A pipeline?

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. We always have a mindset when markets get tough that we're going to get stronger, and it really is around the activation that you make, Samik. There are a number of things that happen. Yes, more marginal competitors struggle to compete. We're very focused on maintaining the value that we bring to customers but also making sure that we follow through on commitments for launch, new product quote and that serves us really, really well. So we've continued to see nice share gains, most of that coming through new content in new applications, and that will continue. We're very disciplined in our capital allocation process, so keeping an eye on M&A valuations is important, making sure that we have the optionality to buy back shares. And so given tougher markets, we would expect to see valuations get more attractive and interesting over time. And so that's part of making sure we have the optionality to do what is best for our shareholders in terms of creating returns.

Samik Chatterjee - *JP Morgan Chase & Co, Research Division - Analyst*

Perfect. And If I can just follow up on the China automotive market. We understand the outlook is not great here. But in your discussions with the OEMs, what are you hearing in terms of what can get that market to stabilize or potentially like return to growth maybe next year? Are there any policy actions? Anything that you're hearing could potentially help on that front?

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. We have been spending a ton of time on China, but both myself and Jeff have actually been on the ground in China over the past few months trying to get a sense for exactly that. When you look at it from a policy perspective, the incentive and stimulus put in place so far have been fairly municipality-based, and so that's got to get to a critical mass where it really has an impact on the overall end market. And we're not expecting that in 2019. What's been very important to us is to make sure that mandates stay on track and are enforced. And we're feeling very good about that. We're seeing it in the new content that we're shipping. We're seeing that in the production build for things like NS VI. Those are stabilizing. I think relative to overall end market volatility, the prospective we come away with is that there is a negative sentiment at the business level in China. And so just getting to the point where there are fewer surprises on the horizon is going to be important to our customers. Trade is a piece of it. It's probably more pronounced in the past few months than it has been. That's our sense as we've talked to overall OEM customers. But it has not impacted what they're bringing into the market, the new applications that they're putting onboard, and we think that, that is the most important thing to understand as they move forward in the end market.

Operator

And the next question comes from Joe Giordano with Cowen.

Robert G. Jamieson - *Cowen and Company, LLC, Research Division - Research Associate*

This is Robert on for Joe. I guess to kind of follow on, on China as it relates to your view into 2020. There's a lot of debate out there on where Europe and China will be in terms of production next year, with some more bearish than IHS data. In China, they have this overcapacity and high inventory dynamic going on. And I just wanted your opinions on how you think that dynamic balances with the government that doesn't want to see another year of declines for such an important industry for them. So any kind of thoughts on 2020 would be very helpful.

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Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. Look, we don't have all the answers. We're watching it closely. One of the things that we're really keeping our eye on, and I would encourage you to do the same, is looking at where overall vehicle inventories sit. There is generally information around rolling averages on month on hand. We would expect that, that needs to come down as we get towards the end of the year, and that will be an important leading indicator on 2020. It has not come down and that's part of our revised call on the balance of the year. Relative to the importance of maintaining an automotive market, you definitely see that in some of the incentives again that we're seeing rolling out into municipalities. A really important piece of that is the new energy vehicle component in China, and that is very much on track. And then beyond automotive, there are very important end markets for China -- in China for Sensata as well. And so I'm more encouraged by what we see relative to technology uptakes in end markets like materials handling, on much more efficient infrastructure going into buildings and other areas. And the government is definitely encouraging those as well.

Operator

And the next question comes from Shawn Harrison with Longbow Research.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

Martha, I was hoping you could maybe talk about the inventory situation in the HVOR sector as well as kind of the broader industrial markets and maybe how long you think it may take to clean out whatever excess is in those markets.

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. I think on the industrial side -- I'll start there. We mentioned in our prepared remarks that we've got about $250 million annualized revenue and a portion of our business that is attractive but moves with end market and sits pretty high back in the supply chain. We're expecting continued inventory corrections through the end of the year, and that's a phenomena that we see in that overall business. When we look at industry online data, which is a good source for trying to understand whether or not we're seeing major changes, we haven't seen a rise in inventory at that level, but it's sitting at fairly high levels. And we would expect that, that needs to come down as well.

I think relative to HVOR, I'm going to let Jeff speak to that. Again, he's been spending a lot of time on that part of our business.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President & COO*

Yes. So on the HVOR side, the first half of the year with -- about flat growth, up 1%. It turned out somewhat like we would have expected. We were always forecasting second half of the year to come down more dramatically though, and several of our larger customers had announced the fact that they intend to take inventory out. So I think on the HVOR side, the inventory correction has started toward the end of the second quarter, but more of that will happen during the second half of the year. And we get some visibility into that as we examine our customer orders and we talk through that with them, but it will take a quarter or 2 for that to work through the pipeline, I would estimate.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

And then Jeff, if I may follow-up. A comment on timing related in terms of just the lower HVOR market outgrowth in the second quarter. What would you expect your market outgrowth to accelerate to in the back half of the year?

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Jeffrey J. Cote - *Sensata Technologies Holding plc - President & COO*

It will be higher than second quarter for sure, but the -- if you recall, the first quarter was significantly higher. It was 850 basis points in the first quarter. We -- I would expect that it's going to be more similar towards the year-to-date number, around that 400 to 500 basis points.

Operator

And the next question comes from Brian Johnson with Barclays.

Brian Arthur Johnson - *Barclays Bank PLC, Research Division - MD & Senior Equity Analyst*

A couple of questions. You flagged China or so-called National VI in particular around the trucking business there. But could you maybe tell us how you think, despite the unit volumes, your content might benefit from that in the light vehicle marketplace in China?

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. Our content is actually benefiting from that right now, Brian. So we are on the production launches associated with National VI. We've been watching very closely to make sure that those launches are on track and that production is actually changing over. We're very encouraged that it has and that it will continue to see launches against that mandate as we move into the second half of the year. The complicating factor is that as a result of this changeover in a down market, there's quite a bit of National V vehicle inventory -- light vehicle inventory sitting in place. And that needs to be worked off. That is our assumption in our -- one of the things that drives a reduced outlook from Sensata for the China auto market.

Brian Arthur Johnson - *Barclays Bank PLC, Research Division - MD & Senior Equity Analyst*

Okay. Second -- just a quick follow-up there. Do you have any -- could you give us a sense of how your business is split between premium in China, larger foreign JVs, larger local OEMs and then the smaller OEMs where the sales decline seem to be the largest?

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. We've gotten -- you can really track it based on what is the overall sensor content that then -- let's say a local brand versus a multinational brand. So the fastest growing part of our content is actually with those local brands that are coming from a fairly low point but having to meet the overall mandate. So that's been an attractive part of the business. Our revenues in China against that mix are very much a reflection of the shares that those players have in China. So it is not as though we've got just a couple of auto OEM customers. We're pretty well represented across the fleet if you look at the top 20 producers.

Relative to premium vehicles, it's important to understand that our products show up in mission-critical applications. So you'll find us in braking systems, you'll find us embedded in the tires, we're sitting in exhaust systems, we're increasingly now designed into traction motors and working on applications that protect thermal runaway in an electric vehicle. The point being that we're not part of the convenience or sort of gadgetry that you might see in an overall premium vehicle versus more of a mass-market vehicle. And so therefore, we don't see a lot of swings in our business if there are changes in the take rates across those segments.

Operator

And the next question comes from Deepa Raghavan with Wells Fargo.

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Deepa Bhargavi Narasimhapuram Raghavan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

So good to see the step-up in outgrowth and also the margin resiliency was pretty good. So that's good. But the issue obviously is the end market and the lack of visibility. So Martha, you touched a little bit on China markets, but what are some of the conversations you're having with the European automotive clients given the lack of visibility there? I mean for now, regulations are helping. But beyond that, what is their sense for how the market is going to play out? Or what is the time line for recovery? Anything you could provide color on what your -- how your conversations with the European clients are going, that will be helpful. And I have a follow-up.

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Okay, sure. Yes. Europe, a really important end market for us. In terms of the overall visibility, I would say the visibility we've had coming into the quarter relative to European players has been okay. So not a lot of surprises inside the quarter. As we look at more of the intermediate term, really trying to keep our eye on what is impacting them; what has impacted them in, let's say in the past 12 months, things like WLTP; and how is that playing out in 2019? So we've spent quite a bit of time on that topic. We don't expect to see another major dislocation in demand given some of the WLTP changes that will be happening again in September, so watching that closely. But one of the impacts that we are seeing in Europe is something of a knock-on effect to the China end market. So we have important customers. There are major Tier 1 systems integrators coming out of Europe that actually ship into China. There are still engines that go into China as well. And so that is having an impact on the overall Europe market. And to the extent that, that is volatile, that does affect the visibility that our European customers have and hence our visibility.

Deepa Bhargavi Narasimhapuram Raghavan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Got it. But any -- okay, so there's not really much visibility, you're saying? The conversations are not necessarily, at this point in time, how the markets recovers, but it seems like it's more a block-and-tackle at this point in time. All right.

My follow-up would be, can you talk about your truck markets across the globe? Just what your assumptions are? North America, obviously peakish; Europe trucks, somewhat underperforming, a [weak] business market; and China, HVOR benefiting from TPMS, obviously. But can you update us what your views are? What is the kind of momentum you saw? And if you can provide us expectations by region and how this flows into your lower end market guidance, that will be helpful.

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

Yes. We can try to give you a bit of that. I would just start off high-level by saying we actually think that the market will slow more in the second half of the year than it has in the first half of the year as it relates to the heavy vehicle and off-road business. We had been anticipating somewhat of a correction on-road in North America, and we're seeing that. I think it came a little bit sooner into the second quarter. We thought that would be more second half-based. We think that's going to be a double-digit down end market in the second half of the year. In Europe, we expect to get marginally worse as well but probably more in single-digit down, and we're beginning to see other portions of our off-road market now being impacted. So ag and construction are both important end markets in our HVOR section. We expect that those will be down from an end market perspective in the second half of the year.

Operator

And the next question comes from Mark Delaney with Goldman Sachs.

Mark Trevor Delaney - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Just one question from me. I think you implied 4Q '19 EPS guidance of about [$1.04 to $1.05], plus high single-digit EPS growth off of about 3.5% to 4% revenue growth year-over-year. I know that's not an unusual amount of EPS leverage. But last year in the fourth quarter, OpEx was managed

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pretty tightly and I think maybe tax rate was a little bit of a headwind year-over-year. So maybe just help us better understand what's driving some of that year-over-year leverage and where we may see that show up in the P&L this year.

Paul S. Vasington - *Sensata Technologies Holding plc - CFO, CAO & Executive VP*

Sure, Mark. Let me [address the benchmark to you]. Last year, Q4 operating income index was 24.8%. And so this Q4 is slightly better than that. What we would expect will be continued improvement in the cost structure. The restructuring actions that we've taken will certainly help the bottom line just continue improving our productivity initiatives, which gets stronger as the year goes on. It's managing our costs very smartly given where the end markets are. So I feel it's very consistent with what we've seen before in terms of the ramp-up in profit sequentially. And you're right, that does deliver a nice EPS result in Q4 to help us get us to our -- the midpoint of our guidance that we've provided.

Operator

And the next question comes from Jim Suva with Citi.

Zhen Yang - *Citigroup Inc, Research Division - Assistant VP*

This is Tim Yang calling on behalf of Jim Suva. TPMS rollout in China, do you still expect the rollout to be in the second half of this year? I believe you mentioned $90 million revenue opportunities for Sensata. Is that still the case?

Martha N. Sullivan - *Sensata Technologies Holding plc - CEO & Executive Director*

So we have already seen that momentum take place. We saw that begin last year. We've seen it move into this year as well. We're seeing content growth in the first half of 2019 as it relates to TPMS. So really, I'd say well underway. We would expect to see that continue as we move into the second half as well. Jeff alluded to the fact that there is another leg coming on TPMS, which is really in our heavy vehicle and off-road business. So some of the new business opportunity wins that we've had in 2018 and in 2019 relate to new content that will be coming on the HVOR side of the business as well in tire pressure monitoring.

Operator

And the next question comes from Ethan Puritz with Morgan Stanley.

Okay. As there is nothing on this line, that is all the time we have currently for questions. So I would like to return the floor to Joshua Young for any closing comments.

Joshua S. Young - *Sensata Technologies Holding plc - VP of IR*

Thank you very much. I'd like to thank everybody for joining us this morning. Sensata will be attending the following investor conferences during the third quarter: the Canaccord Growth and Transportation Conferences in Boston and the Citi Technology Conference in New York. We hope to see you at these conferences, and we invite you to visit us at our headquarters in Attleboro, Massachusetts.

We appreciate your continued interest in Sensata. Thank you and good day.

Operator

Thank you. The conference has now concluded. Thank you for attending today's presentation.

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