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EDITED TRANSCRIPT

ST.N - Sensata Technologies Holding PLC at Wolfe Research Global Auto, Auto Tech, and Mobility Conference

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PRESENTATION

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Okay. Thanks a lot. Excited for the next session here with Sensata, the premier supplier of measurement devices to a variety of industries. They produce well over 1 billion parts per year, $3.5 billion of revenue in 2019 with a very strong operating margin of 23% and really good free cash flow conversion. Market cap is around $7 billion. The business is quite diversified. A little bit below 60% of the revenue goes into light vehicle auto, around 16% heavy vehicle and off road, 10% industrial applications like factory automation, 6% appliance and HVAC, and 5% aerospace. And the growth has been really brisk. At its 2017 Analyst Day, Sensata projected revenue growth at 4 to 6 points above market. And they've been consistently achieving that since.

We've been covering this company since October and have found quite a bit of controversy around the name, largely around the sustainability of content growth and whether electrification is good for Sensata or not. Some think EVs will have less relevant, high-value content and an increasing market share for EVs could lead to less content for Sensata. Our view is that most pure ICEs are going to eventually hybridize, clearly a positive for Sensata. And on the EV side, the ability to measure temperature, position, pressure is critical, and Sensata's capabilities should translate really well, not to mention other opportunities that we'll dig into during Q&A.

But first, I'm going to turn it over to Paul Vasington, the company's CFO; and Joshua Young, Head of Investor Relations, for some opening remarks. Thanks.

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

Good morning. Thanks for having us. I agree with everything you said. We are a company that is benefiting from some very strong secular growth trends. If you step back, think about Sensata at a very high level, we are developing sensor-rich solutions for mission-critical applications and systems of our customers.

And they focus on some key secular trends. One of the biggest and the most relevant today is around clean and efficient. So a lot of vehicles, heavy vehicles, farm equipment, stationary equipment is in need, either through regulation or through customer preference and needs, to be more efficient, to be clear, to be safer. And that's where we're seeing a lot of our business today, a lot of our revenues today, and that growth will continue for many years to come.

A lot of the business is currently gas- and diesel-driven powertrains. There's tremendous amount of content on those systems. And we enjoy that content per vehicle. We enjoy our leadership position in the markets and the customers that we serve today.

We have great margins. You talked about the 23% operating income. Very strong free cash flow, about $450 million-plus of free cash flow last year in 2019. Our conversion of our free cash flow to our adjusted net income is around 80%, so a highly cash-generative company, a strong balance sheet with net leverage around 2.8x.

Over the last 4, 5 years, we've been very acquisitive. We bought a company back in 2014 called Schrader. This business has been incredibly important to our tire pressure -- or it is the leader in tire pressure modeling systems and has also enabled us to take their wireless capability and expand that, expand that out across the business, particularly into our heavy vehicle business, which we'll talk a little bit more about how that's manifested into a new vertical for us in terms of tire pressure sensing and also the clouds for our Smart & Connected initiatives in the trucking industry.

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Our business is made up of automotive. About 60% is automotive. You talked about the 16% heavy vehicle. And then we have this large Sensing Solution business, which is primarily an industrial business, around $725 million industrial business and then a $200 million-ish aerospace business, both very profitable pockets of growth and that Sensing Solutions business that are leveraging the secular growth that we're seeing in our Performance sensing business.

In terms of where we are today in terms of Electrification, which is one of our biggest end market that we're pushing for, both from an organic and inorganic perspective, back a couple of years ago we bought a company called GIGAVAC. And there is some question about you're a powertrain company, you focus on powertrains that use fossil fuels. What does it mean when you become electrified or that market becomes more electrified? And we recognized that early on and looked for both organic and inorganic ways to intersect that. And one of the inorganic ways was a company called GIGAVAC that we acquired, it has a great position, premium position, differentiated position in high-voltage contactors where we're really, really important and performance of electric vehicles as voltage levels rise, and as charging times are -- come down.

That's an inorganic activity. That's really built a nice platform for us in terms of our content per vehicle and our future in Electrification. We also have a very strong organic platform. It's leveraging our core technology to intersect the electrification trend. And that means pressure sensing that is being utilized in a number of different systems on electric vehicles. You mentioned hybrid. Hybrids are great for us. We take a gas powertrain engine, we can take this, convert it to a hybrid vehicle. And we get more content, primarily on the braking system, which adds to the content we already have.

As you move up the scale to purely electric, what we're seeing is that they don't have a gas or diesel powertrain anymore. But what they do have is a need for more sensor capability and more efficient subsystems around in the cabin or in the thermal management system or regenerative braking, which so -- which means we want a vehicle that has greater range, is more safe, is more efficient. And we're finding that pressure sensing and our core pressure sensing technology today is -- can be used and is in need or is in demand in those more advanced systems that are developing over time.

So we think the Electrification trend is going to be very, very relevant for Sensata. Our goal and view is that we're going to become agnostic about whether it's gas or diesel or purely electric or hybrid, that we can serve all those different platforms with equal or more content per vehicle than we've seen in the past.

QUESTIONS AND ANSWERS

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Great. Thanks for the intro. And I guess when you talk to investors, I mean basically what are the common themes that they want to see out of the company over the next few years? And I guess if you were on their side, like why would you want to dedicate capital toward Sensata?

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

Seriously, it's things we've talked about is where we have this great position, a leadership position in many of the markets that we serve with -- these are not me-too products. These are really great mission-critical or I say rich -- sensor-rich solutions that are serving very hard to do mission-critical applications. And so we see ourselves as being able to offer a differentiated solution. It's a sticky business. It's a long-cycle business. Incumbency matters. The relationship with the customer matters. So we feel like we're really well positioned with our customers to continue to evolve with them. We see that the growth in the company will continue for the next 3 to 5 years based on the core technology and the core position that it has today. So we have a very strong pipeline of new business wins that we're executing on.

The thing about Sensata, you have to understand is that the business that we win today, it takes a few years before that product actually gets launched into a system. So it's a long design cycle. There's years of validation that goes, then when it launches, then you see a big ramp-up over a 5-year period with revenue. So we're really well positioned to say with a lot of good business that we've won, that we're executing on that. We'll continue to propel our growth for the next 3 to 5 years.

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And we talked about something about outgrowth to the market. Our markets, we can't control the market. And as all of you know, in this industry, our industry in particular, we've seen a lot of decline in end markets around the world. But we are outgrowing those markets substantially. Over the last couple of years, we've averaged about 500 basis points of outgrowth to the market in automotive. Our heavy vehicle and off-road business, we've outgrown that market nearly 700%. And so we're well outgrowing the markets that now we know that the market -- net-net, the growth hasn't been as great as we would like, but we're certainly continuing to get more than our fair share of that market with the new business wins that we've been launching and the execution around that.

And then the continued priming of that pump for future new business particularly on the electrification side, so we see over the Electrification pipeline growing, which is really exciting because that will be the future of growth as EVs become more and more significant in the [car park].

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

You've got a CEO succession happening at the moment. Where do you think Jeff's leadership will be a continuation of Martha's vision? Where might they differ? And then where does the company really need to be diligent about, making sure that the transition is smooth?

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

So Jeff's been with the company for 13-plus years and has had a number of different roles within Sensata. So he is deep into what has been happening in Sensata over that period of time. In the last, I guess I'd call it 5 or 6 years, he's been more -- in more operating roles. So he ran operations for a number of years, moved into a responsibility for the Sensing Solutions business. In the last year, as President, he's had responsibility for all the businesses. He's been incredibly critical and deeply involved in some of our initiatives around Electrification, such as the acquisition of GIGAVAC. He's been driving the Smart & Connected initiative with our Chief Technology Officer, Steve Beringhause, to really get that thing going because we see there's a tremendous opportunity for Sensata. So he's been deeply involved in all these key strategies and the things that are disrupting sort of our traditional markets.

And so I have great confidence in him and his leadership and his understanding of our business and the strategy going forward. I think you're going to see a similar -- very similar approach -- as to what Martha put in place over the years. So it's again, it's going to be around growth, innovation, productivity, leading margins, great cash flows, smart capital deployment. Those are the things that's going to continue with the same kind of approach and feel that you've seen with Martha over the last 6, 7 years.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Okay, got it. I think one of the things that we've been impressed by is that you've -- the light vehicle development process is long. There's huge investments into validation. Things need to work for 12, 15 years. It's a serious engineering validation process. You guys have shown the ability to kind of take products developed through that process and kind of port those over to other end markets using similar building blocks. Can you give us an example of that and talk about what opportunities you see to do this in the future?

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

If you -- the automotive market was the biggest sensor market out there for Sensata. And so we developed a number of different sensor capabilities, [big pressure] as an example, and brought that to the market for a certain application and then fanned it out into other applications within systems within the vehicle, and then took that pressure sensing capability and then took it into a new vertical, call it Heavy Vehicle & Off Road, which have the same needs around cleaner, more efficient operations of the powertrain. We then took that pressure sensing capability and brought it to the industrial landscape, when we saw the need for pressure sensing and getting in ventilation and air conditioning systems.

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So you kind of build capability and scale. You spread it out across that industry, and then you push out into other verticals. And why that makes so much sense for us is that we get to leverage a huge amount of scale in our main -- in both in engineering and also in our production. So now you're building similar products at a much larger scale. You're getting the cost benefit of scale.

The other thing that's interesting about Sensata, even though we get the scale benefit, all of our products are highly-customized to the needs of our customers. So we're ultimately delivering a customized sensor for a specific application that's built off a global footprint with significant scale, where the differentiation is happening late in the manufacturing process. So it really drives as very productive, efficient manufacturing process.

We're also going to reuse the engineering design. And it's not so much it's the technology. We're taking existing technology. It's in our ability to package that to optimize that for the needs of the customers. So it's highly engineered. Over which can leverage a significant common footprint or baseline to be able to then expand from.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

And that's what leads to the higher margin.

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

That's that's what leads to the higher over time.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Got it. Got it. So I think you've had some tailwinds over the last few years around regulatory, tire pressure monitoring, regulatory around different type of exhaust after-treatment in heavy truck, industrial, light vehicle. I guess how do we get comfortable? And maybe there's -- those -- some of those tailwinds continue. But how do we get comfortable that the outgrowth is not really just related to regulatory, that there's opportunities to kind of continue that out into the future, out over the next few years?

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

Okay. I think regulatory is an important attribute that sort of drives the urgency for improvement in assist -- ultimate systems and applications on the vehicle or the equipment. And our close relations with the customers, it allows us to have the opportunity to develop sensors that are helpful in that regard. I'd also think there's a significant customer pull for higher-performing, safer, more efficient whether it's vehicles, or it could be heavy vehicle, it could be farm equipment, it could be air conditioning systems. I mean so I think it's a combination of regulatory, efficiency, greater productivity.

I mean one of the productivity elements, I think, of our business that's not talked about a lot is in our Heavy Vehicle & Off-Road business, which we talk a lot about trucking. Well, one of the things we did, we bought a company a few years ago called DeltaTech, which has designed and developed a very robust electronic interface in the cabin for the operator to operate large construction equipment and farm equipment to get away from all the hydraulic controls. So now you've got a very sophisticated arm rest with a very sophisticated technology that allows the operator to work it like a with a joystick.

So that is not regulatory-driven, but that is productivity, efficiency, a better customer experience. And we're seeing a lot of that in parts of our business. But there's no doubt regulatory tightening or improvements are going to drive the industry to continue to evolve. There's the modernization of China in terms of just the general improvement that you're seeing in the sophistication of those -- of passenger vehicles or trucks.

Tire pressure sensing is a great example where we knew there was a mandate coming into the '19, '20 -- 2019, 2020 time period. We actually saw a ramp-up in demand for tire pressure sensing in China because customers wanted it. In OEMS, were looking at their competitive set and said, we

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need to offer this because we need to be competitive because it's a feature that customers want. And so we saw an uptake or take-up rate that was greater than what the regulation would have driven. So there was a combination of both regulation and customer preference, I think, is driving the continued demand for better, more efficient, cleaner higher-performing product.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Got it. And kind of on China, can you remind us what your content per vehicle is there versus kind of on average, sort of?

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

So it's about 18, approaching 20 ...

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

$18 per vehicle.

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

$18 also for content per vehicle. So it's the kind of average across the fleet. I mean we -- in any car, you could have much higher, but we don't obviously have content in every car. So we look at the average content the vehicle across that market. And I would say North America and Europe, it's going to be in the high 30s. So there's a lot of runway in terms of what's possible.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Is there a path to get to that high 30s level? Or is it a more fragmented market?

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

No I definitely think over time, there's a path. As those vehicles become more and more sophisticated, as the regulation continues to drive them to be more efficient, to be cleaner, to be higher-performing, to be safer, there's definitely a path to that over time.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

The outlook in 2020. One of the things that we've kind of heard from investors is that, that the guidance requires kind of a larger margin uplift in Q2 to Q4, which is typically higher margin than Q1, but maybe it's a little bit larger uptick than a normal year, even ex kind of coronavirus type of impact. Can you talk about like kind of what your confidence level is in achieving those margins? And what are some of the drivers of why the gap is a little bit bigger this year?

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

Sure. In first quarter of every year as a supplier in automotive industry, a lot of our customers receive an annual price down at the beginning of the year. So you get immediate impact from that. How we offset that is through cost reduction. We look at our manufacturing footprint, our fixed cost structure and we're always looking to optimize and improve that. Material is a big part of our -- a big part of our building materials, and we constantly look to design our products at a lower cost point. It could be just a different design, less different materials, less materials. It could be just working with suppliers to create a better economic situation. It could be increasing the efficiency in which we would produce products or taking less waste

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out. It could be having a faster cycle times with lower logistics costs. So I mean we are obsessed with driving cost out of the business. Because we have to do because we're dealing with a large customer, Dave, that is looking for annual productivity gains, understandably because they're giving you business for many years. And so you're on the platform for many years. And so it's important that we work with them. And they're willing to work with us to try -- to find that balance.

But those productivity initiatives are more -- happen in a ratable way versus the impact of price. So it's always tougher on us in the first half in terms of margin profile. The margins typically improve as the year goes on as those productivity initiatives are generating more and more savings on the volumes that we're producing. Second half of the year, we expect to see better volumes. We set -- it -- volume's clearly something that allows us to drive productivity. When we have a declining market, when volumes are down, they're typically in product lines that are more mature, that are higher profitable -- have a higher profitability to them because they've been running for a long time. They're a higher scale.

And so our business has a dynamic of today, and we talked about in the earnings call, where it has some relevance to the second half where we've been scaling up some new products that are being driven by regulation in China and in Europe, which is related to gas injected engines and gas particulate filters, which we provide sensors to serve those applications. And we won a lot of business in 2017 -- excuse me, that accelerated that demand, and we've been working really, really hard to -- and effectively, to meet that demand.

And so that -- so we've been ramping up these products. As the products ramp in a large scale, they're not going to be as profitable as something has been running for a number of years. So we're growing in new scaling products, which are -- currently have a lower margin rate because they're scaling and they haven't hit their level of maturity and efficiency. And we have a decline of products that are highly profitable, that are declining, which is creating an unfavorable mix. That impact will be less so in 2020. And as you get into the second half, we expect to see better volumes of more higher-margin, mature products that will help push margin rates up.

I guess, the other thing is that you're going to see is that last -- in 2019 because of the lower performance, we did not perform to the promise, and so incentive compensation was much lower. We're looking to bring that back to more normal levels to ensure that employees are engaged and everyone's working hard for the future of the company. So there's going to be a year-over-year impact as it relates to incentive compensation. We're going to benefit from some of the repositioning actions that we saw, so that will help in sort of the second and third quarter than the first quarter.

So there's a number of different moving pieces, but I think in general, the key takeaway here is productivity and volumes improve over the course of the year. It's going to drive continued margin expansion.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Got it. Getting into this kind of some of the kind of the more unique opportunities, recurring revenue is something we hear about a lot from the supply chain. And kind of you guys have what's been one of the few to kind of really hone in on a specific opportunity there, which is the Smart & Connected efforts. Give us a brief rundown of what that is, where you stand and kind of what's the key value proposition you're offering to customers.

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

We're really excited about the Smart & Connected initiative. It goes back to your earlier question about how we take it to existing technology and fan it out. So when we acquired Schrader, we acquired its great direct tire pressure monitoring system business, the industry leader, but it came with very robust wireless protocol, a sensor proxy communicates with it, with the vehicle.

We took that tire pressure business. We brought it to the heavy vehicle knowing that there's a need, there's a regulatory need necessary at the time. But that it provided a savings to the owner-operator and certainly provide safety when you're monitoring your tires and making sure they're properly inflated.

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So now we have, take a big 18-wheeler, you've got a whole bunch of sensors on that truck, on those wheels, and you have to aggregate all that data to know what's happening in all those wheels. And so we had to put in place a network on that vehicle, create a wireless network on that vehicle to receive the inputs from these wireless sensors. And that led to an understanding that there's a lot more that we could do on the truck in terms of information needs that the owner has, by using sensors to sense what's happening on various applications on the vehicle. It could be with the tires. It could be weight load. It could be the need to have a truck in the trailer, in the back of the trailer, being able to be connected.

So we saw all these sensor needs -- all these needs, I should say, that the customer had, that was -- they are unmet, pretty basic stuff, where we can provide sensors to help understand what's happening in those areas and aggregate that data into a wireless network. So what we're focused on primarily is that sensor layer. How do we continue to proliferate sensors on a large truck? That information will be helpful to improving the performance of that truck for the owner-operator. And it could go through the OEM channel. And that's about a billion-dollar market, we think, TAM. Or it can go through the retrofit channel, which we think is about a $6 billion TAM.

So a very large market opportunity to get after that sensor layer, to proliferate sensors on that vehicle, to aggregate that data into a wireless network, and then be in a position to then provide that information to an owner-operator because they want to know what's happening on the truck. They want to know what's the load. They want to know the tire pressures. They want to know how the load is distributed. When they're backing it up, they want to be able to see what's behind them. They want to be able to connect the truck and the trailer together so they're integrated.

Now trailers, every truck is not aligned to that trailer. There's many, many, many trailers. You could be without truck. And so how do you create that connection? Today, you don't have a wired connection. We can bring a wireless connection. We are bringing wireless connection. You could also take that to measuring the temperature within the trailer.

So a lot of different things, there are a lot of things that the owner-operators want to know. And our ability to have -- already have a position on the sensor layer of that vehicle, I think is incredibly powerful.

The next step would be how do you then take that -- how do you get that information to the cloud, either through an net telematics provider over to a user-operator who wants to be able to understand that information and use that information to manage the performance of that vehicle. We think it's really exciting. It's early days. We're doing proof of concepts with a number of large leading freight carriers. We're running tests. We've got sensors on the trucks. They're gathering data. And so we can see how it's all working in getting a reaction from the -- actually owners-operators of those vehicles.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

So you're not competing with telematics providers.

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

No. No. I mean right now, what we're focused on is the sensor layer. I mean it is interesting to think about what other -- how we can take that data and make that data more useful and how that data -- how we can help in terms of signing applications for the user. But it's not our intention to become a telematics company. It's more of a -- bringing the data to those who need the insights to help them improve the performance of the assets that they own.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Got it. Let me pause to see if there's any questions in the audience. If something comes up to mind, just raise your hand and I'll get to you.

So Electrification. So I guess at the highest level, like explain to us what your content looks like on a highly efficient ICE vehicle? And if that vehicle was substituted with an EV, kind of where would you lose and where would you add? Maybe take us through that.

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

Sure. So I would start with Sensata's core technology in terms of serving the needs of an electric -- electrified platform. And as I said before, on a gas powertrain vehicle, it's probably in the low 30s, mid-30s in terms of content per vehicle. And sometimes we talk about it being much higher or lower. It depends on the vehicle, but we look at 30 to mid-30s as an average across all vehicles in, think of North America, which is the largest for us in terms of gas.

Diesel is higher. Diesel's probably closer to 40. But we just looked at this pressure sensing technology that we have that serves gas and diesel. On electric vehicle, that's about 20 today.

And that also includes tire pressure sensing, right? So tire pressure sensing is in the same numbers for gas and diesel. And so where the pressure sensing becomes important is when you start looking at braking systems, where regenerative braking systems on EV or hybrid EV. So it's an important purpose to help extend the range of the vehicle by capturing energy, but it also then still -- then it drives the requirements for more pressure sensors in the braking system. These are multiple braking systems. So that's an added content for us of an existing pressure technology that we have today.

In the cabin, you have air conditioning systems. Normal air conditioning system on a gas vehicle is probably one sensor. We start getting into more electrified platforms. They're looking for more sensors because they're looking for more efficiency. Because again you don't want to pull power out of the battery to run the air conditioning system. You wanted to provide range. And so what we're seeing is even a greater proliferation of the need for sensors around just a broader need to manage the thermal conditions of the vehicle. And so that pulling the need for more pressure sensing technology, of which we have a great position. So a great core position and pressure, and we see more need for pressure in those -- in that type of a system in a thermal management system.

What you're losing is you're losing the power train. You're not -- you don't have a gas or diesel powertrain. So the net-net, it's -- without -- just with our core, we're talking about 20, maybe it's only moving up the stack a bit. Maybe it could be more than that thing on how far thermal management goes. But let's just say we're in the 20s.

Then you add on GIGAVAC. So GIGAVAC, the acquisition of GIGAVAC brought to us a premium, highly-differentiated, high-voltage contactor that is needed for vehicles that have higher voltages and to increase the safety around faster charging times. And so that brings us, on average, another $20 of content.

So that kind of gets you to about 40 just based on what we have today. And I think the future in the road and the path forward, I should say, it could be even higher than that obviously with some of the other things we're working on.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

And contractors, like is that assuming they're only on luxury vehicles? Like what -- so it's not assuming that on every vehicle...

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

The matter to everyone, and so there's different levels of contractors in terms of what are the need that they're serving. But assume on average a contractor is $40. And it could be 2 to 4 on the vehicles we're serving, so it could be well north $100 of content on the vehicles that will ultimately require the technology.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Got it.

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

So that's what we get to the -- and today, we are 20 though is on whatever we can serve. So it's not on that full population of cars there. It's only on the electric vehicles that are out there, and that 20 is how we characterize that based on the market that there is to serve. But if it's 40, harder to say. We start to become agnostic with to whether it's diesel, gas, or electric.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Yes. And in the powertrain of an EV itself, I think you have potential in motor positioning?

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

Yes.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Is that how you put it there?

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

We think there's -- now, that does include that. So there's some other things that we're pursuing around smart sensors that measure the pressure of the battery to ensure there's no thermal runaway. We're looking at electromotor precision sensing. We're looking at wireless battery management sensing. So the battery pack is huge. It's wired. It's just at the bottom of the car. How do we bring an equal or better solution that's wireless? And so we're looking at how we can take all the wire out of the battery pack, still provides a level of sensing that's required to manage that battery tracking in electric vehicle in an efficient, effective way. And then they make it easier for the manufacture -- manufacturer of the battery pack for its modularity. They then have to be wired, so you can have different configurations. So we're working through with that. We think the technology -- we have great -- we think -- we know the technology works. We think it's very robust. And again, it's leveraging Schrader in terms of wireless protocol. I think what we're now doing is just working with customers around proof of concept, what our business model should be, but there's a need to be served and we think we're in a good position to serve that need. It's just a question of where we should be in the value stream.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

So that's really interesting. I think one of the things about EVs today and the supply chain is that most of the EVs that have been on the road, or maybe you're launching in the last year, were maybe 20,000, 30,000 units a year type of platforms for compliance purposes. That's not super-interesting to a supplier like yourself that needs to invest in kind of application-specific parts. For the next generation, we see a bunch of OEMs pursuing high-volume global platforms. I guess, does that -- and with the ability of kind of supply chain scale to really kind of push down the cost, push up the efficiency of these vehicles because they're -- the ones that are on the road now are not particularly competitive relative to the leaders. So does that change impact your willingness to invest in application-specific parts? And do you think that, that gives you a better ability to win a high share of sensor content on kind of the next-generation of EV platforms?

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

So our investment in anything is going to be based on is it a differentiated sensor-rich solution or an application system that's going to be really hard to do and that's really mission-critical? Because that creates the margin profile that we're looking for, it creates the stickiness that we're looking for, and it's the business that we want to have. And so I think what we're doing as an organization is looking at the Electrification landscape and how it's evolving and how architecture's changing. And trying to understand where we fit best with that requirement.

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And so I don't think we're going to chase business just to chase business. We want to be a differentiated partner and solution provider to our customers. And so we're being very careful in terms of making sure that whatever we do, it's going to provide that sort of differentiated solution.

And we want to be a something of scale, right? We want to build a scalable business. We want to continue to take what's inside of it as well, which is take a technology, fan it out, do things on a customized basis on a global scale to get that productive efficiencies that we enjoy today.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Got it. Got it. Anything on kind of sensing solutions that you wanted to highlight, kind of the industrial and other end market business?

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

So we don't talk about too much, but I think it's a very interesting part of the business, there is a core technology. It's our -- it's still refer to it as the controls business -- it's electromechanical -- electrical protection devices. They are highly profitable. We have a great position in the marketplace. We produce the products at scale. And they have created a nice, I guess, vertical or baseline to go take our pressure sensing technology into similar customers who are looking for a different solution. Take our bi-metal electric protection device that's in an air conditioning system to move to variable speed ventilation system that now uses pressure sensing in a compressor. So it gives us a great footprint with those customers to bring that technology through that channel. And the legacy business is very profitable. It's not very growthful, but it is very profitable.

That's a big part of the business. Probably half-ish, if you would say. Then we have this industrial pressure sensing business, which is we're expanding into HVAC, water management, heating management systems where pressure is important and sensing parameter that these systems are evolving and developing into their architecture. There's -- our Aerospace business was about nearly $200 million Aerospace business, which is a legacy business. That serves the OEMs like Boeing with aircraft circuit breakers. We also have position sensing that serves those customers in terms of their actuators on their wings and the little flusters. So really kind of niche on position, we're in a very strong position, very profitable.

And so I'm talking about a fragmented business, but that one, we think we have a very good position to build from. And so we see organic opportunities to grow in those particular verticals with those particular platforms. We also see a significant inorganic opportunity to grow there as well. And then trying to and align that industrial business into some key sectors around energy management, automation, electrification and then diversified industrials.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Got it. Got it. Kind of a lot of new opportunities we talked about. Anything you see in the business that's going to change the capital intensity or the free cash flow conversion of the business coming up? Talk a little bit about R&D. You're growing a little bit this year, but kind of what's the outlook of that line item?

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

I think on the R&D piece, so we have R&D that you see in the P&L and then with the E piece, which is just standard unit sits within cost of revenue and gross margin. So all in all, we spend about 8% of revenue on RD&E. Where we've been growing is in the R&D area. And that is twofold. It's growing because we're reallocating resources to more design development effort. And so taking what we have on certain product families that may be slowing or maturing, and redeploying that engineering resource to faster-growing, more emerging megatrends. And then we're also investing incrementally in those megatrends.

And so we're spending a lot more money, and Jeff mentioned it on the call in the Smart & Connected initiative because we see that as something where we want to intersect quickly. We want a great position. We see it as being a huge opportunity given the size of the market. And we want to

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invest to make sure that we're going to be successful because we see the opportunity in front of us. And we believe that we can be very successful there. And so we're spending more money there, obviously because we see it as a real revenue of opportunity within the next couple of years.

With regards to capital, we're -- we run somewhere between 4% and 5% of revenue. The capital we spend today doesn't really materialize into revenue for a number of years because usually we're putting new lines of capacity for future business that we've won. So it's better to look at it over the next couple of years, and what that percent as a relative to revenue.

And then on free cash flow, it's an area that we're currently focused on, and it's around driving better working capital efficiency. I think we've done a good job on improving the working capital efficiency around our customers in terms of receivables and working with suppliers in terms of optimizing our ranges and suppliers. But we've certainly not done as great a job as we would like around inventory. We just struggling a little bit with managing our inventory in the most efficient way. And we're going to spend a lot of time and effort this year to make that a better process because it is really about the overall quarter to delivery process and it's room for improvement.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Got it. And quick on capital deployment, how do you balance kind of leverage reduction and the buybacks which you've done a lot of recently?

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

So we're trying to stay within the 2.5 to 3.5x net leverage. And so trying to balance the capital deployment in that leverage range, we think, is important. We want to grow value for shareholders. And we see M&A as the best way to do that. And -- but there comes more -- with more risk at times with M&A, and that's not always actionable. And so our pivot is always going to be to M&A. I think I would say it's going to be towards more towards the non-auto piece of the business, but I wouldn't say we're not initiating something that's relevant in auto. But that's the bias.

And that's also a bias towards smaller mid- bolt-on type acquisitions that leverage the strategy that we have. So when we talked about industrial. With those great positions we have in industrial and good industries and use both organic and inorganic means to scale those up and make them more robust and more competitive and leaders in their space.

As well as the share repurchase, we use share repurchase as an additional deployment of capital when we see the returns being a better return for the shareholder. And so we've been buying more over the last couple of years, the M&A activity has been less. We sold a business called valves, we got about $170 million of cash, redeployed that in the share repurchases. For a long time, we were a Netherlands company. We became a U.K. company. When became a U.K company, we ramped up our share repurchase for a period of time. And so even more -- we've been more -- we've been leaning in on the share repurchases, staying within that leverage range. But that can change based on the M&A opportunities in front of us.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Okay. We're out of time. Thanks a lot.

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

Thanks a lot. Appreciate it.

Daniel V. Galves - *Wolfe Research, LLC - Director of Equity Research & Senior Analyst*

Yes. Thanks, everybody.

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FEBRUARY 26, 2020 / 4:05PM, ST.N - Sensata Technologies Holding PLC at Wolfe Research Global Auto, Auto Tech, and Mobility Conference

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