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ST.N - Q1 2020 Sensata Technologies Holding PLC Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the Sensata Technologies Q1 2020 Earnings Call. (Operator Instructions) Please note, this is being recorded. I would now like to turn the conference over to Mr. Jacob Sayer, Vice President of Finance. Please go ahead.

Jacob A. Sayer - *Sensata Technologies Holding plc - VP of Finance & CFO of Performance Sensing Gbu*

Thank you, Keith, and good morning, everyone. I would like to welcome you to Sensata's First Quarter 2020 Earnings Conference Call. Joining me on today's call are Jeff Cote, Sensata's CEO and President; and Paul Vasington, Sensata's Chief Financial Officer. We are also joined by Paul Chawla, EVP of our Automotive business; and Vineet Nargolwala, EVP of our Industrial HVOR and Aerospace businesses, who will be available to provide additional market-specific insight during Q&A. 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. We'll post a replay of today's webcast shortly after the conclusion of today's call.

Before we begin, I would like to reference Sensata's safe harbor statement 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 certain risks and uncertainties. The

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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.

On Slide 3, we show Sensata's GAAP financial results for the first quarter of 2020. We encourage you to review our GAAP financial statements in addition to today's presentation. Most of the subsequent information that we will discuss during today's call will be related to non-GAAP financial measures. Reconciliations of our GAAP to 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 11 and 12 of the presentation, which are the primary measures management uses to evaluate the business.

Jeff will begin today's call with a review of our overall business in the first [quarter], particularly impact from COVID-19 and our responses as well as the strong financial position of the company. He'll also discuss Sensata's revenue outgrowth relative to underlying markets during Q1 and provide an update on recent progress in some of our key megatrend growth areas. Paul will then cover our detailed financials for the first quarter of 2020, provide insight into our financial model and describe leading economic indicators that we use to estimate the future performance of our businesses. We will then take your questions after our prepared remarks.

Now I'd like to turn the call over to Sensata's CEO and President, Jeff Cote.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Thank you, Jacob. As we shared with you earlier this month, you can see on Slide 4 that we recognized the global impact of COVID-19 early and took a wide range of steps across our organization designed to, first and foremost, to ensure the safety and health of our employees, while also enabling us to serve critical customer needs and enhance our financial flexibility. These actions position Sensata to emerge from this worldwide disruption even stronger so we can better serve our customers, employees, shareholders as well as our communities. Working with local, state and federal government health agencies in many countries, we moved quickly to implement measures to help protect employees and minimize the spread of COVID-19. At a high level, these actions included sanitizing our facilities, instituting safe distancing for our essential workforce, staggering work times, implementing health checks at our facilities, providing paid leave for affected employees and mandating remote work as much as possible. While it's been a challenge for all of us to learn how to work remotely from our colleagues, we recognize the importance of doing so, especially given that some of our employees are not able to work from home. I'm pleased to report that our teams are stepping up and adapting to the new normal. As I speak today, after brief closures in certain locations, our manufacturing facilities are open, and we have sustained production adjusted for demand levels. Governments have issued shelter-in-place orders and closed nonessential businesses. By working with authorities in jurisdictions where we operate, most of our manufacturing facilities have been deemed essential. We manufacture critical products for industries such as essential transportation, defense and medical equipment. So it is important that we keep operating during this crisis. We are in a strong financial position, and we have taken steps to enhance our financial flexibility. We have lowered our operating expenses for the second quarter through management salary reductions and employee furloughs, implemented reductions in discretionary spending and are ramping down production in certain facilities in line with expected end market demand. For the second quarter, I am taking a salary of $1, and we have reduced the cash portion of our nonemployee directors compensation by 50%. All members of senior management are taking a 25% reduction in pay, and we are seeking a similar reduction in pay through furloughs from all indirect employees. We are reducing capital expenditures and managing our working capital very carefully. We drew down on our revolving credit facility to enhance our cash position, more than $1.2 billion in total at the beginning of the second quarter. And we have temporarily suspended our share buyback program. We also withdrew our financial guidance for fiscal year 2020 in early April as our visibility into the economic impact of this crisis became less clear. Paul will discuss leading indicators we are tracking to estimate future revenue shortly. Throughout these unprecedented times, we've proven ourselves to be a strong and reliable partner to our customers as they, too, face uncertainty and disruption. We are continuing to make progress on our key initiatives around Smart & Connected and Electrification, which I will discuss in more detail momentarily. We have proven ourselves as good stewards of capital, rightsizing our organization to the environment, yet still investing in areas that offer significant long-term growth opportunities. We have demonstrated the integrity of our global supply chain and flexible cost structure under the most difficult times. All of this gives us confidence in our strategic direction and our ability to continue to execute.

The continued focus on our strategic direction remains central, and we are aggressively managing our operations during this unprecedented market environment. As shown on Slide 5, the rapidly escalating worldwide impact of COVID-19 has adversely affected the global economy, our

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entire industry, especially our employees, suppliers, partners, customers and the communities in which we operate around the world. I'm so proud of how our entire organization has responded to this crisis, locally and globally in extraordinary ways. The health and well-being of our employee base is our first concern, and we're doing everything we can to protect them from the spread of the virus.

Some examples of the extraordinary times in which we currently operate include: China reported a GDP decline of 6.8% year-over-year in the first quarter as the government shut businesses. This is the first decline in Chinese GDP since quarterly record-keeping began in 1992. Global light vehicle production in the first quarter dropped 20% year-over-year. And within our industrial markets, we also experienced a 15% decline in global market volumes in the first quarter, driven primarily out of China. Given that the response to the spread of COVID-19 came later in the first quarter for Europe and the U.S., we expect this slowdown to accelerate in the second quarter. According to the latest automotive production data released by IHS, global production for the second quarter is forecasted to decline 47% year-over-year, with Europe expected to decline 61%, China expected to decline 9% and North America is expected to decline 70%. Also according to IHS, for the full year 2020, global automotive production is now expected to decline 22%. In addition, a substantial decline in global GDP is predicted for Q2, which will impact our other end markets.

Despite these challenges, Sensata has demonstrated progress in the first quarter on our strategic goals for the year, we delivered significant end market outgrowth despite substantial market declines. We are continuing to win new business and invest in opportunities that, once we're through this period of disruption, will drive long-term growth for the company.

Now let me discuss our performance by end market for the first quarter of 2020. Overall, volumes were substantially lower, and we reported revenues of $774.3 million, which represented an organic revenue decline of 10.4%.

Slide 6 shows organic revenue performance by end market for the first quarter. I will begin with our heavy vehicle off-road business. HVOR posted an organic revenue decline of 10.7%, outperforming a 20% end market decline. Our China on-road truck business continued to post better-than-expected growth, as a result of strong content performance, driven by the adoption of NS VI emissions regulations. Industrial, aerospace and other revenue declined 10.4% organically for the first quarter of 2020. Our aerospace business declined 2% organically with continued content growth offsetting the grounding of flights, reduced production and a roughly 6% market decline. Our industrial businesses declined 12.3% organically, driven by declines in China of more than 33% from extended pandemic-related shutdowns and a global industrial market slowdown of approximately 15%. Our automotive business posted an organic decline of 10.4% in the quarter. This was primarily driven by an end market decline of 20%. The China automotive market declined 49% in the first quarter. However, Sensata's strong content growth helped to offset a significant portion of this decline. As facilities begin to reopen and production ramps up in this region, we expect to see substantial recovery. In our North American and European automotive businesses, we saw meaningful revenue declines linked to our customers' closing plants for the last 2 weeks of the quarter. Globally, we still posted 600 basis points of market outgrowth. In addition, we saw OEMs, primarily in China, build inventory during the quarter, in part, to ensure that they have supply when reopening their plants and ramping production. We estimate that to be approximately 310 basis points of growth coming from this inventory build, and we would expect this to unwind in the coming quarters.

Despite the underlying challenges in the end markets in the first quarter, we delivered significant revenue outgrowth as shown on Slide 7, relative to our end markets. Sensata serves high-growth segments in all of our end markets. Our competitive position is strong in sensor-rich solutions for efficient, connected subsystems as well as cleaner and more electrified equipment. We have secured significant new business wins in recent years that enable us to achieve secular growth, and we are on pace to continue to outgrow underlying end market production. Underlying most of our recent new business wins has been regulatory and consumer-driven trends towards safer, cleaner and more efficient equipment, which are the fundamental long-term drivers of our business. Despite current end market headwinds, we continue to demonstrate significant outgrowth relative to the end markets that we serve in the first quarter, posting market outgrowth of 930 basis points in heavy vehicle off-road, 600 basis points in automotive and 430 basis points in aerospace. The adoption of NS VI emissions regulations in China and BS VI in India is driving significant new content for us with local HVOR and automotive OEMs. Similar to the EU 6 regulations in Europe, these regulations are aimed at reducing emissions. To meet these regulations, OEMs are installing more advanced

exhaust control systems that include our high-temperature and differential pressure sensors. Similar trends in Europe and North America are driving strong market outgrowth in these regions as well.

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Moving to Slide 8. I want to share some updates on key progress we are making in our megatrend initiatives. We continue to believe these investments will further our end market diversification, increase our long-term growth rate and provide important competitive advantages as these trends transform our world. Despite the impact of COVID-19, we see no evidence that customers are meaningfully slowing their investments in these areas. During Q1, we closed $15 million of new business with customers for sensing and vehicle area network solutions within our Smart & Connected initiative. This brings the total new business to over $90 million, with a further $75 million being quoted. We are testing proof of concepts within Smart & Connected with some of the world's leading fleet managers. Initial results of 4 active pilots demonstrate that our solution works very well in real-world environments, so far capturing more than 2 million miles of mission-critical data on trucks and trailers in our customers' fleets in North America, providing them with information on vehicle readiness, and reducing downtime and maintenance costs.

On the Electrification front, we are expanding the products and solutions we provide to include those for critical applications for hybrid and battery electric vehicles as well as other electric equipment, such as charging stations. During Q1, we closed $50 million in new business wins in the area of electrification. Our -- as electrification gradually increases its penetration, it represents an increased opportunity for our high-voltage contactor, e-motor precision, thermal management,and thermal runaway sensing offerings. The acquisition of GIGAVAC expanded our electrification offerings into high-voltage contactors and fast disconnect devices. We are quickly establishing ourselves as the premium -- the standard for premium equipment, particularly for the most challenging applications with high current levels.

During the first quarter, we began production of high-voltage contactors in Aguascalientes, Mexico to facilitate growth with a new highly efficient production line. We are pleased with our demonstrated progress against these 2 initiatives, which offer important long-term diversification as well as significant new market opportunities for Sensata.

I'd now like to turn the call over to Paul to review our first quarter 2020 results in more detail and to describe leading economic indicators that we track. After which, I will provide some summary comments. Paul?

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

Thank you, Jeff. Key highlights for the first quarter, as shown on Slide 10, include: revenue of $774.3 million, a decrease of 11.1% for the first quarter of 2019; changes in foreign currency decreased revenue by 0.7%. Excluding the impact of foreign currency, organic revenue declined 10.4%, largely due to the impact of the COVID-19 pandemic. Adjusted operating income was $136.7 million, a decrease of 27.5% compared to the first quarter of 2019, primarily due to lower revenues, productivity headwinds from our manufacturing facilities running at significantly lower capacity, elevated costs to safeguard our employees and local government restrictions, which, altogether, limited our ability to align our costs to the declining end market demand. Higher design and development spend to execute on new business wins and megatrend growth programs as well as higher compensation costs to retain and incent top talent were mostly offset by savings from repositioning actions taken last year. Adjusted net income was $83.2 million, a decrease of 40.3% compared to the first quarter of 2019. Adjusted EPS was $0.53 in the first quarter, a decrease of 37.6% compared to the prior year quarter and slightly better than the decline in adjusted net income, the benefit of share repurchases.

Now I'd like to comment on the performance of our 2 business segments in the first quarter of 2020. I will start with Performance Sensing on Slide 11. Our Performance Sensing business reported revenues of $568.7 million in the first quarter of 2020, a decrease of 11.1% compared to the same quarter last year. Excluding the negative impact from foreign currency of 0.7%, Performance Sensing reported an organic revenue decline of 10.4%. Our Automotive business reported an organic revenue decline of 10.4% in the first quarter, but outpaced its end market by 600 basis points. In addition, organic revenue declined in each of our 3 major geographic regions. Our HVOR business reported an organic revenue decline of 10.7% in the first quarter, but outpaced its end market by 930 basis points, primarily due to strong content growth in our China on-road truck business, driven by the adoption of NS VI emissions regulations. Performance Sensing operating income was $129.1 million in the first quarter of 2020, a decrease of 14.2% as compared to the same quarter last year. Performance Sensing profit as a percent of revenue was 22.7% in the first quarter, a decline of 80 basis points from the same quarter last year. The decline in segment operating income was primarily driven by lower revenues, manufacturing facilities operating at significantly lower capacity and higher design and development effort to execute on new business wins and megatrend growth programs, somewhat offset by savings from repositioning actions taken last year.

As shown on Slide 12, Sensing Solutions reported revenues of $205.6 million in the first quarter of 2020, a decrease of 10.8% as compared to the same quarter last year. Excluding the negative impact from foreign currency of 0.4%, Sensing Solutions organic revenue declined 10.4%. Revenue

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in our industrial business declined 12.3% organically in the first quarter as industrial end markets declined 15%. Revenue in our aerospace business declined 2% organically in the first quarter, producing 430 basis points of growth above its end market, which declined 6.3% on OEM production delays in a weaker aftermarket. Sensing Solutions operating income was $55.9 million in the first quarter of 2020, a decrease of 25.4% from the same quarter last year. Sensing Solutions profit as a percentage of revenue was 27.2% in the first quarter, a decline of 530 basis points from the same quarter last year. The decline in segment operating income was primarily due to lower revenues, manufacturing facilities operating at significantly lower capacity and unfavorable product mix, somewhat offset by savings from restructuring actions taken last year. Corporate and other costs not included in segment operating income were $88.8 million in the first quarter of 2020, which includes a $29.2 million loss related to an intellectual property litigation judgment, which we intend to appeal. Higher compensation costs to retain and incent our top talent and higher administrative expenses contributed to the higher corporate and other costs as compared to the same quarter last year. Excluding charges added back to our non-GAAP results, corporate and other costs were $47 million in the first quarter of 2020, an increase of $12.3 million from the same quarter last year due primarily to higher compensation and administrative costs.

Slide 13 shows Sensata's first quarter 2020 non-GAAP results. Adjusted gross profit declined 17.2% as compared to the same quarter last year to $243.9 million. And gross margins declined 230 basis points to 31.5%. The decline in gross profit and margin were primarily due to lower revenues, productivity headwinds from our manufacturing facilities running at significantly lower capacity, elevated costs to safeguard our employees and local government restrictions, which altogether limited our ability to align our costs to the declining market demand. We continue to increase design and development spend to execute on new business wins and megatrend growth programs, primarily in the areas of Smart & Connected and Electrification. Despite this higher investment, R&D costs were down 1.8% as compared to the same quarter last year due to savings from repositioning actions and favorable changes in foreign exchange rates. Higher compensation to retain and incent our top talent was the primary driver of the $1.9 million increase in SG&A costs as compared to the same quarter last year or a 2.9% increase. As a result, adjusted operating income was down 27.5% compared to the prior year quarter. Our tax rate as a percent of adjusted profit before tax increased 410 basis points compared to the prior year, primarily due to jurisdictional profit mix. And finally, adjusted EPS was $0.53, down $0.32 or 37.6% as compared to the first quarter of 2019.

On Slide 14, using 2019 financial data, we provide a breakdown for the types of spend that make up our cost structure and their relative size to net revenue. The majority of our costs are variable in nature, the largest portion of which is material purchases, followed by direct labor wages, freight and operating supplies. These types of costs scale directly with revenue and are reduced through continuous product design and cost productivity improvements. Some of the variable costs are comprised primarily of indirect salaries and benefits, project spend, outside services and utilities. These costs are more structural in nature and scale with revenue to some extent, but require more specific management action to drive this outcome. Fixed costs include items such as depreciation, facility leases and licensing and support costs related to our enterprise operating systems. In the first quarter of 2020, we saw a decremental margins higher than normal as the COVID-19 pandemic restricted our operations and limited our ability to manage and align our costs to the rapid decline in demand and from our actions to protect our employees. Moreover, government mandates in certain locations required us to continue to pay our direct labor despite plant closures, and freight costs increased dramatically as logistics supply chains were disrupted. We have taken a number of strong actions going into the second quarter to reduce our costs given the anticipated lower revenue. For example, as Jeff mentioned, we have reduced salaries for management by 25% during the quarter and implemented furloughs across the employee base, in line with regional and country-specific rules to achieve a similar savings across our indirect labor population. We are also closely examining all of our operating costs to ensure they are prioritized appropriately. We expect these actions to generate approximately $15 million to $20 million in cost savings during the second quarter. It's also important to note that approximately 5% of our total operating costs are noncash, such as depreciation expense, amortization expense and equity compensation. In short, we are actively managing our business and cost structure to diminish the impact of the operating challenges we are facing and the end market declines we're experiencing and anticipating, while continuing to invest in our people, our future and to create increasing value for all of our stakeholders.

Slide 15 demonstrates Sensata's ability to manage down its net leverage and net leverage ratio, which has declined steadily from 4.6x at the end of 2015 to 2.9x today, reflecting our strong cash generation and effective capital deployment. Having drawn down $400 million from our revolving line of credit on April 1, we entered the second quarter with $1.2 billion in cash on the balance sheet. We have substantial buffer to our leverage covenants and our debt agreements. And the first outstanding maturity of our debt is not until October 2023 when a $500 million unsecured note becomes due. Consequently, we are confident about our liquidity position and our ability to manage through and adapt to the current market environment. Free cash flow was $69 million during the first quarter of 2020 or 83% of adjusted net income, which is a dramatic improvement

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when compared to 51% of adjusted net income in the same quarter last year. We are reducing capital expenditures by $45 million to $120 million to $130 million for the full year 2020 to further improve our financial flexibility.

As announced earlier this month, we have withdrawn our full year guidance as the negative impact of the COVID-19 pandemic on our business remains highly uncertain, quickly changing and unpredictable. However, based on current indicators of demand, revenue in the second quarter of 2020 will likely be down significantly from the first quarter of 2020. On Slide 16, I show a number of economic indicators that we track to help assess future demand for our products and solutions. IHS is our primary source for information on future automotive production. Currently, they are predicting a 47% decline in global automotive production in the second quarter and a 22% decline for the full year. In addition, we track automotive plant closures and communicate routinely with our automotive customers to gain alignment on future demand expectations which strongly influence our view of the market. Each week of auto production in North America and Europe is worth approximately $25 million in revenue to Sensata. We estimate that during the second quarter, auto OEMs in these regions will shut down their production lines for an average of 4 to 5 weeks. For our heavy vehicle and off-road business, we use various production forecasts from third-party firms such as LMC to help us understand future production levels. For the second quarter, LMC is projecting a 60% decline in North America Class 8 production rates. We also evaluate economic indicators to gauge the health of our HVOR customers and the markets they serve and which we believe are strongly correlated to demand for our HVOR products. These indicators include freight load factors, inventory sales ratios, building permits, industrial production, crop futures and farm machinery, and public statements from our large customers in the construction and ag sectors also helped them to form our view of the market. For our industrial business, we evaluate regional PMI data and forecast for GDP and housing starts without a forward-looking view of industrial demand, given their strong correlation with our historical industrial revenue. For aerospace, expectations for future OEM commercial and defense production and passenger miles flown are good indicators of future demand for our aerospace products and aftermarket services. In February, we expected lower production and demand relating to COVID-19. We lower our revenue by $40 million and our operating profit by approximately $20 million in the first quarter of 2020. Those estimates proved to be insufficient as we experienced a drop in both revenue and operating profit of roughly twice that of what we predicted as COVID-19 spread worldwide. Until we have a good sense for future levels of demand, it is difficult to accurately project revenue, operating profit and other financial metrics. With that said, we will continue our efforts to align our costs to normalized demand levels that we anticipate to develop over the coming quarters, while ensuring we are able to protect our employees and serve the needs of our customers.

In closing, I'll echo Jeff's comments that we are operating in unprecedented times. We're fortunate that our employees are healthy and that as an organization, we have risen to meet the challenges this crisis has presented. While we cannot currently provide more comprehensive financial guidance for the remainder of 2020, we're all working diligently to ensure some [path] emerging from this time in a stronger financial position. I'll now turn the call back to Jeff for summary remarks.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Thank you, Paul. Before turning to Q&A, I want to wrap up with a few key messages that I show on Slide 17. We continue to actively monitor all of our end markets and customers to ensure that our resources are balanced against changing forecast and prioritized against critical growth opportunities. We are adjusting manufacturing flows not only to protect employees, but also to match demand from our customers. We have been highly effective at outgrowing our end markets no matter what conditions we face. We remain confident in our ability to deliver attractive end market outgrowth this year and into the future. We continue to deliver solid cash flow performance, which demonstrates Sensata's resilient financial model. We continue to plan investments in our megatrends and other growth initiatives, and we are making excellent progress on this front. And lastly, we continue to believe that the overall market environment may provide interesting opportunities to further strengthen our portfolio through value-creating bolt-on M&A.

Our first priority remains the health and safety of our employees. We have long-standing relationships with our customers, and our financial position is strong. This position will allow us to emerge from this period of crisis as a stronger company. Now I'll turn the call back over to Jacob.

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Jacob A. Sayer - *Sensata Technologies Holding plc - VP of Finance & CFO of Performance Sensing Gbu*

Thank you, Jeff. Given the large number of listeners on the call, I'll ask each of you to try to limit yourself to one question, and then what we're going to do is circle back for follow-ups if time permits. Keith, please assemble the Q&A roster.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question comes from Wamsi Mohan with Bank of America Merrill Lynch.

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

Jeff, can you talk a little bit about how you view Sensata in this cycle versus the financial crisis? Maybe talk about some of the things that have changed between the 2 cycles? And maybe if you can contrast the peak to trough margin performance? I know you guys commented a little bit on decrementals being a little different. What's driving that?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes. That's great, Wamsi. Thanks for the question. I think where we're different is that we're a more diversified business, from both an end market, geographic, product category standpoint. So that's an important area where we're very different from where we were in '08 and '09. We're obviously much less leveraged than we were in '08, '09. Before our IPO, we were private equity owned, and we had a fair amount of debt on our balance sheet, a lot more than we have today, for sure.

I think the areas where we're the same are quite important. We still have a very variable cost model our cash flow characteristics are very similar in terms of capital needed to drive our business. Paul went over the low amount of fixed cost in our business. And we also continue to focus on mission-critical, hard-to-do applications. So we've stayed very true to that, which is demonstrated in our overall margin profile.

I think the other area where we're the same is around our commitment to come out of this a stronger company and to do the things that we need to during this market cycle that will allow us to do that.

So those are my thoughts on that one. I appreciate the question.

Operator

And the next question comes from Samik Chatterjee with JPMorgan.

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

Jeff, I want to check in with you. We understand the tough end market conditions at this point, but what kind of impact is that having on the launch cadence or launch plans for the back half given the current disruption? Are you seeing any material slowdown there? And at the same time, there is some talk about kind of a rollback in emission regulations in the U.S. Are you seeing any other countries kind of follow the same path or likely to follow to ease the recovery? And what kind of impact will that have?

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Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Great. Well, I'll hit this a little bit from a high level, and then I'll ask Paul Chawla to give a little bit of commentary in terms of what he's seeing on the ground with his customers. I would direct you to look at sort of what we've produced in the first quarter in terms of outgrowth. That should suggest to you that at least in the first quarter and also my prepared comments around our confidence associated with continued outgrowth for the balance of the year around the nature of how our customers will launch new platforms, we're not seeing them change their perspective on this, and we're continuing to feel very confident. There may be some push-outs a month or 2 or 3 associated with folks' inability to collaborate and do things that they normally would, but we're not seeing any meaningful change in terms of the long-term outlook. I'll let Paul Chawla address the question associated with emissions regulation push-outs and other factors that you mentioned.

Paul Chawla - *Sensata Technologies Holding plc - EVP of Performance Sensing Automotive*

Thank you, Jeff. Here is Paul Chawla. As Jeff said, correctly said, we are not seeing any major change on the landscape in front of us. In China, in Q1, we had still very strong pull for National VI content and that carries on happening. We are seeing the same in India for BS VI. And also in Europe, despite there are discussions of some delays of the -- around the CO2 potential penalties the industry will have to pay, even though there are some delays, we are not seeing anything in launches or content. Some model years, facelifts of vehicles and platforms could be shifting by 2 to 6 months. But especially in the Electrification area, we're still seeing very strong pull and business as normal.

Operator

And the next question comes from Craig Hettenbach with Morgan Stanley.

Craig Matthew Hettenbach - *Morgan Stanley, Research Division - VP*

Understanding you're not providing specific guidance, but looking at kind of adjusted operating margin of 17.7% last quarter, anything from a range that you'd expect in the coming quarters in terms of just kind of puts and takes to think about for the adjusted op margin?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes. So Paul Vasington, if you wouldn't mind hitting on some points about that, that would be great.

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

Sure. I think the big point here that we made in my prepared remarks is the fact that we're taking actions to reduce our cost structure through pay cuts and furloughs and watching our operating expenses, reducing any discretionary spend that's not critical. And that's what we're making in Q1 -- I'm sorry, in Q2. As we look forward, we're going to continue to look to align our cost structure to the anticipated demand that we're going to see, applying all the same tools and maybe other tools to achieve that outcome.

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*

I guess, maybe a comparable question but on the revenue side, when I think about June quarter revenues, to your point, we can see what IHS production numbers look like on a year-over-year basis. What are the puts and takes to that as you go forward? And very specifically, I think a lot

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of your peers have talked about June being the trough and revenue starting to improve post that. Would you endorse that belief system at this point?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes, Amit, great question. Based upon what we're hearing from third-party forecasters and some of the quotes that we provided, for instance, in the automotive market, given that Q2 is forecasted to be down so dramatically and the full year is clearly expecting a recovery from the Q2 rate. Obviously, we look at those third-party forecast. We talk with our customers. If you look at the specifics around what's happening in the second quarter associated with our customers, many of them are shutting down for a lot of the quarter, 4, 5, 6 weeks their production will be down. And so unless we see continued impact associated with quarantine measures, which force our customers to continue those, we would expect things to recover. I think the big question that relates back to the question that Craig asked, which is what is the normalized demand profile. And obviously, we'll be looking to align our cost structure to that as opposed to a more depressed outlook in terms of any given quarter. So that's sort of what we look at. That would be our view as well that Q2 would be the lowest based upon where the third parties are forecasting, and we'll continue to monitor that activity as well as engagement with our customers' fill rates and so forth to better judge how we'll come out of Q2. Thanks for the question.

Operator

The next question comes from Mark Delaney with Goldman Sachs.

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

Yes. I was hoping the company could provide an update on recent order trends that it is seeing globally. And then also if you could specifically comment on what Sensata is seeing in China in terms of orders and how the orders in China are comparing to pre-COVID levels.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Mark, thanks for the question. So I'll give some very high-level commentary regarding orders, and then I'll ask Vineet Nargolwala to amplify a little bit in terms of discussions with customers. I think from -- I think you all know, we tend to quote fill rate in the quarter. And what we've determined is fill rate, given customers are shut down and their attendances on other matters other than their fill rate, that's not a very reliable measure for us right now. And we've been working with them to manage through that. But certainly, you can see that because we built inventory or our customers built inventory in the first quarter, some of that is due to them building inventory to make sure they're ready for a recovery. Some of it was GDI feeds and so forth that didn't get shut off because their response didn't happen quick enough. This was a very significant decline in a very short period of time. And so the response rate took some time. Vineet, why don't you provide a little bit more color in terms of what we're hearing from our customers in terms of fill and so forth.

Vineet A. Nargolwala - *Sensata Technologies Holding plc - EVP of Sensing Solutions*

Sure, Jeff. This is Vineet Nargolwala. So as we -- as Jeff outlined, our end markets continue to be pretty volatile, and it's -- the demand patterns continue to be pretty uncertain. As we look at it regionally, we are seeing China come back to normal, though the export markets out of China continue to be challenged. Our customers in North America and Europe continue to be in various stages of a lockdown, with plans of reopening their plants in a phased and a gradual manner. We're also seeing significant disruptions in the overall supply chain, which is also affecting our customers' production plans. Despite this, we continue to be very engaged with our customers in terms of understanding the state of operations and ultimately, demand. As we think about our order books, especially in the industrial markets, they're continuing to be pretty stable relative to our historicals. But what is not clear is how does the demand shape up once our customers come back and what does the follow-on demand look like.

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From an inventory standpoint, we are seeing some levels of inventory buildup in the channel as some customers took product to be ready for when the plants reopen. We expect that will draw down over the following quarter as the plants reopen and the normalized demand pattern comes into view. But we continue to work with our customers on new business opportunities and providing them the support to fill their clients as they come back online.

Operator

And the next question comes from Shawn Harrison with Loop Capital.

Shawn Matthew Harrison - *Loop Capital Markets LLC, Research Division - MD*

A quick clarification and then a long-term question. The 600 basis points of outgrowth, did that include any of the benefit from the prebuy activity? Or is that adjusted? And then second, just wondering if you're seeing any kind of market share opportunities here during this downturn? Are there other suppliers unable to fulfill demand, or Sensata out of executing in that, maybe you can see some incremental outgrowth as we come out of this recession?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes. So let me hit on the market share question, and then Paul Vasington can touch on the outgrowth. You know from our business that share doesn't shift dramatically. We're a long-cycle business. We're designed into applications with our customers, and there's a lot of engineering work that's done to allow our products to enable the functionality in the systems that we go into. So share shift tends not to happen dramatically in most of our end markets. There are some small pockets of our end markets that we serve, where they're more shorter cycle where there's an opportunity to shift. I think the key here that we're observing is that during these difficult times, customers look to financial stability of their partners, and they look to whether or not we're weathering the storm with them. And that's what allows us to continue to build these long-standing relationships over a very long period of time. And customers remember that. And so we'll -- we've been around for 100 years as a company. We've established these relationships for decades with our customers. And we'll continue to do that. No major shift in share. But certainly, the more we work with our customers through these tough times, they'll put the thumb on the scale in terms of who they pick for their next opportunity. So that's what we're viewing as the biggest opportunity: work with them, and they'll continue to choose us more frequently than others in terms of opportunity. Paul, you want to hit on the outgrowth question?

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

Yes, quickly. The 600 basis points of outgrowth in automotive does not include the build in inventory. So the build inventory would be incremental growth, and that occurred mostly in China and a little bit in Europe.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Thanks, Shawn.

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*

An automotive question for me, Jeff. Can you talk through the prebuy 310 bps outperformance? That seems to indicate no more than 700,000 wafer [equal]. Is that even -- is that math even right? Can you help us provide your updated [PPOE]? And relatively, I think PE indicated roughly a 3 million wafer prebuy work. I mean, that itself is a rough estimate, by the way, but can you help bridge that difference between the 3 million versus your maybe 700,000 wafers. And maybe is that all driven by maybe a product category of sensors or maybe your supply base being overweight in China, which itself had production hiccups in the quarter, et cetera? Anything -- any color on that is helpful.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Sure. Let me try to hit this high level and then if Paul, if I get anything wrong in terms of what you're seeing, please, please correct me or amplify it. So let me quantify first the magnitude of the inventory that we've observed. And so this is a little bit -- it's not precise, right, because we're looking at production levels across a wide range of mix of customers geographically and at customers. And we're comparing that actual production to what our revenue looked like, right? So we're not getting specifics associated with we've built x amount of inventory. We've forecasted that to be about $20 million to $25 million of inventory build. So not a huge amount, right, this 400 basis points in the automotive market that Paul Vasington mentioned.

We've also believed that, that's largely in China. And so when you look at the content per vehicle in China, which is about half of what it is in Europe and North America, that translates to about 1 million units. But again, it may not have ended up in vehicles. It might have just been in raw material or inventory at our customers, so they could continue to be ready to expand. And so those would be my thoughts. Maybe, Paul, you could connect this to sort of what we're seeing in terms of end market inventory days in the various markets that we have across the world.

Paul Chawla - *Sensata Technologies Holding plc - EVP of Performance Sensing Automotive*

Yes. So Paul Chawla here. We are seeing some inventory increases in China. It is -- we -- it is on the slightly the higher side with respect to the quarterly run rate we're used to. But we do believe that will dilute over the next 6 months. North America inventory has also gone up, but it's not on the highest peak level where it's been historically at 4.1 million units. And again, that's been due to reduced mobility of consumers and sales that have slowed down in the last 6, 7 weeks. So as Jeff, I think, correctly said, our customers have been adopting mixed strategies around being ready for a comeback, not knowing exactly when that would be in place. And making sure that in case supply chain is disrupted, they had enough to start-up with. And we do believe that these peaks of inventory, both at our customers in their dealerships and on the raw material side, are going to dilute back as production comes through in the next 2 quarters.

Operator

And the next question comes from Stephen Fox of [Fox Advisers].

Stephen Fox

I just -- a little -- still a little confused by the China comments. But you've talked about sort of China returning to normal from a production standpoint. But relative to where production is, say, today or last week, what does that mean relative in terms of demand? It seems like there's a lot of inventory questions you've raised, and even though the factories can produce, it doesn't seem like they're producing a "pre-Chinese New Year normal." So if you could just sort of help us understand that a little bit.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes, that's a good question. So March was quite strong in China. And Paul may have the exact number in terms of -- specific to the automotive market. But we saw things come back pretty strong across all of our end markets in March. That's a very good indication in terms of where we think

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Q2 is going to be. Obviously, we're looking at a number of other factors in terms of customer orders there. We're looking at just the flow of people. As you know, we have significant presence, both from a manufacturing standpoint, but also from a business and engineering standpoint on the ground in China. And by no means are they back to normal, but they're certainly significantly advanced from where we are.

We're also seeing some incentives, I guess, is what you would call it, but in the form of relaxing rules around license plates and other things that are issued in major cities to incent more purchases. There is -- there are a number of other government incentives that are in the work -- works, none of which I'm aware of that has launched yet. But certainly, when they relax regulation around where vehicle license plates can be issued, you can imagine that has a pretty strong impact on the overall demand. So listen, we're not calling it out the -- out of this in China yet. But certainly, when we look at China versus other markets that we serve, it seems to be much more robust than what we're seeing. Paul or Vineet, if you have anything you'd like to add to this, please do.

Vineet A. Nargolwala - *Sensata Technologies Holding plc - EVP of Sensing Solutions*

Just 2 points here. Yes, you're right. Retail year-over-year was down, but definitely, March was better than February. Wuhan, the dealership sales reopened. And actually, the local team is telling us there's some good sales pickup there. We're monitoring 2 factors, as Jeff said. One is the local incentives, government incentives and dealership incentives; but also a potential trend where consumers now, post-COVID, could be using less public transportation and prioritizing, again, an individual means of transportation. So those are 2 things we're watching and whether they will -- they should bring back a stronger demand over the next 3 quarters.

Operator

And the next question comes from Matt Sheerin with Stifel.

Matthew John Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

I wanted to just ask about the aerospace section. I know that's a relatively small segment for you, but you've had nice mid-single digit growth for the last few years there. And obviously, we're seeing a big impact on demand in terms of what's going on there. And your peers are also talking about really not seeing any signs of recovery anytime soon there. So could you talk about your footprint there and what you're seeing, Jeff?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes. So again, I'll give some very high level, and then Vineet, who runs this business, can give a little bit more color. It's always great when you have a business that has an 8- or 10-year order book. But it is also an end market that's quite troubled right now. The passenger miles are way down in all end markets. China has recovered, again, not to keep going back to that, but China/Asia, more broadly, has recovered back to, I believe, somewhere around 50% of pre-COVID levels, whereas Europe and North America are down still very dramatically. And we're looking very closely at what the longer-term impact would be associated with where we might be able to serve this market as it comes back, enhanced environmental systems on planes and so forth, that might be opportunities. But Vineet, why don't you provide a little bit more color on in terms of the order book and what we're seeing, if you would?

Vineet A. Nargolwala - *Sensata Technologies Holding plc - EVP of Sensing Solutions*

Sure, Jeff. This is Vineet again. So our aerospace business, we have 3 broad segments: One is commercial OEM; the second is defense and military; and the third is aftermarket and maintenance and repair operations, or MRO. Our defense and military business is actually holding up pretty well, and we're seeing pretty strong resilience in that segment. As Jeff pointed out, it's a long-cycle business from a commercial OEM standpoint. We've got a very strong order book. And we're supporting both the major airframe manufacturers and their tiers. So far, we haven't really seen a major impact to the order pattern in the commercial OEM space, other than what was already well-known around the Boeing 737 MAX challenges. And I think that's pretty public in terms of what's out there. That was already factored into our plan. We are seeing an impact to our aftermarket business

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as flight hours come down dramatically. There is less need for spares and maintenance. And so we're seeing an impact to our aftermarket segment. But I think broadly speaking, we continue to monitor and work very closely with our distributors in that space as well as with our tiers in the commercial OEM space to see if there are any changes to our long-term demand here.

Operator

And the next question comes from Joe Spak with RBC Capital Markets.

Joseph Robert Spak - *RBC Capital Markets, Research Division - Analyst*

I was wondering if we could circle back to maybe some of the factors that help explain the decremental margin differential between Performance Sensing and Sensing Solutions in the quarter? Are there major differences in variable costs? Is Sensing Solutions more automated? And you also seem to be indicating that decremental margins could be worse in the second quarter. Maybe if you could give a sense of what the last 2 weeks of March looked like as a guide post for how to think about that.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes. It's Jeff.

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

Yes, Let me...

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes, go ahead.

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

No, so there are differences between Performance Sensing and Sensing Solutions. The cost structure performance is a little bit higher. The variable costs are a little bit higher. The variable costs in the [Sensing Solutions] business is lower. So the profit drop out on volume, while we're not able to try to -- I'm not able to mitigate or influence those changes has a bigger impact. And so we laid out on the slide deck, paid to try to break down whatever our variable, semi-variable and fixed costs. Our variable costs move with volume. But we also, every year, are working to take those costs out through new product designs, cost productivity initiatives, and we've been very successful in the years in the past and we'll continue to be in the future. The semi-variable piece is what we really target in terms of real productivity improvement around structural changes, and that takes time to do. It requires management to engage on productivity initiatives. And in this environment, we're struggling with being able to do that with the restrictions in terms of our operating conditions, the incremental costs that we're incurring to safeguard the employees, the disruption we're seeing in the supply chain and the duplicate salaries that we're paying when a plant or I should say the sites we're paying when the plants are closed, all those types of things are driving our costs higher and preventing our ability to drive the same level of productivity that we normally do. And that's why you're seeing the bigger drop out.

The Sensing Solutions business also had some mixed headwinds in the quarter that we typically don't see given the significant drop out in some of the higher-margin industrial business as well as they're in our heavy vehicle business.

So hopefully, that explains it. We tried to lay it out in the slides, provide some greater transparency of what we're seeing in terms of the reduction in the margin rate on the volumes that were -- declines that we're seeing.

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Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes, and Paul, let me add a little bit on a point that I think Joe was getting at as well around Q2. We want to align our cost structure to a more normalized run rate. I think we're hearing from every company that's reporting that Q2 is going to be a tough sweating in terms of demand profile. But I don't think anybody is forecasting that Q2 levels are long-term normalized levels. And so I think you're reading incorrectly that as we look at Q2 and as we think about ways to align the cost structure in the business, we're thinking about what the more normalized level would look like. And I don't think at this point, we're calling Q2 as a normalized level. But certainly, there is a new normal in terms of where we entered the year versus where we think we're going to end the year. But Q2 seems like it's more negative than where we would expect the balance of the year. And that's evidenced by, obviously, a lot of the third-party forecast as well.

Operator

The next question comes from Brian Johnson with Barclays.

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

Yes, in your ongoing kind of opening, you talked about coming out stronger. Can you tell us, are you seeing any or are you thinking about, once this business stabilized, M&A opportunities, either your balance sheet could [push our net leverage up], obviously, particularly that that's going to deteriorate [maybe a little bit] cash deals. But you certainly have a stock that held up better than many. So is that something we should think about over the remainder of the year?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes, absolutely. So we're going to definitely aim to keep the pipeline full. As I think everyone knows, there's always a period of time when there's a market dislocation like this where buyer expectations align much more quickly than seller expectations. So you've got to go through an equilibrium process there that will eventually occur. But there are a number of things in the pipeline of varying sizes but

I want to be very clear, there's nothing that's shoed in our pipeline right now. That doesn't mean that we won't identify opportunities over the coming quarters where we will pursue opportunities, but the pipeline is more bite-sized

bolt-on type M&A-related activity that I think it's in our best interest to continue to pursue those to look forward to where the business is going. But at the same time, make sure that we're doing the right thing around the financial flexibility on the business. So clearly, there's been a slowdown more broadly in M&A-related activity. We are continuing to work very diligently on the pipeline, and we'll monitor it and keep you posted.

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

Okay. And can you do bite-sized deals with stock?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

We can -- with the $1.2 billion in cash available to us, with a very strong financial position, we think that, that's the preferred currency in terms of what we would do, smaller deals. We don't see our stock at this point as being the currency that we needed to go to for deal activity.

Operator

And the next question comes from David Kelley with Jefferies.

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

Just quickly, could you provide some color on your supply chain, if you're seeing any significant disruptions there and how you're navigating the volatile environment with your suppliers?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes. So yes, absolutely. The supply chain has been disrupted. The team has just done an absolute fabulous job of engaging with all of our supply chain. Vineet and Paul have provided commentary in terms of how we, as suppliers, to our customers and partners, to our customers, have engaged with them. And we're doing the same thing with our suppliers. They're all dealing with the exact same issues that we are. We haven't had any significant changes in terms of our terms, so we haven't had any large suppliers that have called us looking for financial assistance. That's not to say that we won't see that. But we're going to make sure we do everything possible to maintain our very critical supply chain intact. And we've been navigating shortages of parts as we've continued our essential activity, but we've been able to manage through it quite nicely and due to a lot of work on the part of the teams around the world to make sure it happens. But there's been disruption there. And as well, and Paul mentioned, the logistics supply chain has been dramatically disrupted. A large portion of logistics transport is in the belly of passenger jets. And with that down dramatically, we've navigated that aspect of it as well as trying to shift to other modes of transportation that would be more appropriate given the circumstances.

Operator

And the next question comes from Joe Giordano with Cowen.

Joseph Craig Giordano - *Cowen and Company, LLC, Research Division - MD*

First, I just wanted to clarify some real quick, if you could. You mentioned in the aero business, the defense, the OEM and the aftermarket. If you could just break those down into, like, how big they are relative to the total aero? And then my question is, just given the final assembly nature of a lot of your product and the variable cost nature, like what does that mean in, like, a social distancing future from here? Like is it just the manual intensity of it? How do you have to think through? Does it shift your view on, like, normalized decrementals and ability to put through capacity in the facilities?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes, Joe. So let me hit the second question regarding impact of social distancing on the operating model, if you will, if I've got the question right. And then I'll let Vineet give the specifics on the airline or the aerospace business.

So it's interesting. We spent a lot of time thinking about what the impact would be more broadly on our end markets associated with this. Paul Chawla touched on the fact that if -- as things start to normalize, people will be less willing to do mass transit and so forth. We think there are instances where the trends that will continue will be beneficial to our customers and, therefore, beneficial to us.

In terms of the supply chain, we've implemented a number of measures already because we've continued to operate. Much like if you think back to 9/11 and the protocols that were required to be put in place post that in terms of security checks and so forth, there are a number of protocols that have been implemented in terms of social distancing in our sites, screens being put in place, wearing of mask, temperature checks, health checks, cleanliness-related features in terms of what we're doing in our sites and people's habits regarding washing hands and so forth. I don't see those, in a meaningful way, impacting business model or cost structure. Clearly, we would have to adjust the way we do things. Shift changes will be very different when you have a large site where large numbers of people are coming in and out. But I think we'll be able to navigate those once we get to a new norm and we implement those protocols and people get accustomed to them. And I don't see it changing in a big way, some additional supplies and so forth, but nothing dramatically impacting cost structure or business model.

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Vineet, do you want to touch on the breakdown of aero?

Vineet A. Nargolwala - *Sensata Technologies Holding plc - EVP of Sensing Solutions*

Sure, Jeff. Joe, and so the way to think about our business, Joe, is we're roughly 1/3, 1/3, 1/3 with commercial OEM, defense military and then our aftermarket and MRO business.

Operator

And the next question comes from Jim Suva with Citi Investment Research.

Jim Suva - *Citigroup Inc. Exchange Research - Research Analyst*

Jeff, I just have 1 question. Some of the OEMs have talked about working back down the supply chain to get more cost efficiencies or pressuring prices for some of their suppliers. I'm just wondering, does that reach back to Sensata a little bit? Or it's just that dollar content for automobiles and trucks and vehicles just such a small part of the bill of materials that it doesn't hit their radar screen?

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Thanks, Jim. So I think folks know that our contracts with our customers often have volume-related requirements associated with those. And they also have commercial concessions that we've contracted long term. Now granted, in a very difficult environment, every company is looking for its partners to work together to figure out to get to the win-win so that we can all navigate through this. But we have historically been able to, and we would expect to continue to be able to navigate that quite well. Certainly, we've made concessions with customers in terms of getting them product when they need it based upon the disruption that they've seen in their business, working with them through that in terms of the dropout of their order rate that was within a order fence, frozen order fence that, technically, we could have contractually forced them to take the inventory, but we didn't believe that was the right long-term answer.

But in terms of the economic arrangement we have with our customers, we haven't seen significant impact there. Historically, when we see significant volume drops, we're able to fare reasonably well from a financial standpoint in our customer contracts. Appreciate the question, Jim.

Operator

Next question is a follow-up from Amit Daryanani from Evercore.

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

I guess 2 quick ones. One, everyone is really focused on the decremental margins that you guys are seeing in March quarter. Is there a way, Paul, to perhaps slice that and say, here's what it would look like if this was a normal revenue deleverage versus the incremental headwind you had from factors that you couldn't control, your restraints and controls by governments in place? I don't know if there's a way to slice those 2 numbers, then that would be great. And then maybe I missed this, but free cash flow expectations for June quarter as well.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Paul, do you want to take those?

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

Yes, sure. Thanks for the question. So in the past, our drop out on volume was closer to the 30% to 40% range depending on the different product lines in which they were moving up and down. The dropout that we're seeing now, as I mentioned earlier, is just much more dramatic given the restrictions that we're seeing in the plants, the disruptions we're seeing in the supply chain, the higher costs or elevated costs we're incurring to protect employees, to deal with disruptions to -- not the social distancing, the inability to have the plants running at the full level of capacity. And so all that is creating a whole bunch of disruption that is unusual and is driving the drop-through in our revenue decline at a bigger percent. So that's why you're seeing the significant volume profit drops and significant volume declines that would be unusual, given our past performance and experience.

And so as things begin to normalize, we will be able to manage those costs more effectively. We'll be able to do more structural changes when we are able to fully operate the plants and the sites as we have done historically.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

And on the free cash flow question, we did not provide guidance on Q2 for free cash flow. But from a qualitative standpoint, the transparency around our cash structure -- or excuse me, our expense and cost structure, hopefully will be helpful there. And we have a very keen focus on making sure that we manage our working capital, and we've taken a number of steps that will reduce our cash cost to the business in terms of the furloughs and the pay cuts and so forth on the indirect side, essentially reducing that cost structure by about 15% on a net benefits basis because, obviously, when people take pay cuts, there's still the benefit side of the equation in there. And so we're focused on making sure that we manage cash flow very aggressively during the second quarter, given the disruption that we're seeing.

Operator

And we also have a follow from Wamsi Mohan with Bank of America Merrill Lynch.

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

Just a follow-up on your comments, Jeff, on free cash flow. You noted both lower CapEx and managing working capital. Any way to give us some guide rails around those on cash conversion cycle, maybe we go through the course of the year? And also, I don't know if I missed this, but can you give us some sense of the utilization rates of your manufacturing sites? In China now, things seem to be more normalizing over there versus out of China.

Jeffrey J. Cote - *Sensata Technologies Holding plc - President, CEO & Director*

Yes, great. So I'll hit the utilization question. And then, Paul, if you could hit the cash flow point.

Utilization, obviously, varies very dramatically around the different locations around the world. In China, I would say we're running at about 70%, 75% utilization. But in other locations around the world, we're running quite significantly lower than that. But I would say that in our larger sites, everything is running at about 50% or better. And then some of our smaller sites, where there hasn't been as much of a demand in Q2, we see instances where it might be a little bit lower than that. Every one of our sites is operating in some -- at some level of capacity. And again, we've been working with local governments to make sure that we run at the rate that our customers need us. So we're going to do everything we can to make sure that we deliver raw demand, and we don't see a supply chain disruption and an impact on revenue that's caused by us. Paul, do you want to hit the cash flow point?

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

Sure. Mohan, the cash flow was pretty good in Q1. We talked about the $69 million of free cash flow in Q1. Conversion rate was high. It was at 83%, which is very good. So far, customers, we've been engaging with customers. They're paying on time. We haven't seen any major disruptions in terms of the collections and receipts. And so as it stands now, things feel pretty normal. I think the DSO was about -- it was the low 60s for the quarter. So things are progressing fairly normal on that front.

Operator

Thank you. And as that's all the time we have for questions right now, I would like to return the floor to Jacob Sayer for any closing comments.

Jacob A. Sayer - *Sensata Technologies Holding plc - VP of Finance & CFO of Performance Sensing Gbu*

Thanks, Keith. I'd like to thank everyone for joining us this morning. Sensata will be participating in the upcoming JPMorgan TMC Investor Virtual Conference on May 13. Thank you all for joining us this morning and for your interest in Sensata. Keith, you may now end the call.

Operator

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

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