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# EDITED TRANSCRIPT

ST.N - Sensata Technologies Holding PLC at Stifel Cross Sector Insight Conference (Virtual)

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

## CONFERENCE CALL PARTICIPANTS

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

## PRESENTATION

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

Yes. Good afternoon, everyone, and thanks for joining us. I'm Matt Sheerin, the Technology Supply Chain Analyst at Stifel, and we're pleased to have with us at the Stifel Cross Sector Insights Conference, virtual, with -- starting today with Sensata, in -- CEO, Jeff Cote; as well as Jacob Sayer, who's VP of IR. Welcome, Jeff and Jacob.

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

Thank you, Matt. It's a pleasure to be here.

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

Yes, thanks, Matt.

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

So Jeff, you became CEO just a few months ago in March of this year, but Jeff has been at Sensata since 2007, first as CFO and and most recently as Chief Operating Officer, certainly taking over the helm at an interesting time. We're going to hear from Jeff a few slides he's going to go through, and then we'll go into Q&A. And I do want to remind everyone that you can ask questions on the web portal there. Any questions you have, we'll go through that and ask them later. Jeff?

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

Excellent. Thanks, Matt. And yes, timing is everything. As Matt said, I took over as CEO of the company on March 1. And it's a pleasure to be with you here today to share a little bit about what's going on in the company. And I thought it would be helpful to start with just a quick 5-or-so-minute overview of the company for some of you that are listening in that don't know Sensata.

We are a 100-year-old plus company, although we've only been a public company for about 10 years. We were part of Texas Instruments for 50 years of our history. And although you may not know Sensata by name, I'm very certain that you know our products and you use our products every day, whether it be in your homes, your place of work, in your cars and your public transportation. I know a lot of these things aren't being used right now, but Sensata provides a lot of content into these end applications, and I'm certain that you use our products every day.

We're about a $3.5 billion company in 2019. That's where our numbers came in. We are a global business. So we employ over 21,000 people globally, many of which are direct labor, but we have about 4,000 to 5,000 indirect labor that run the company across the globe. And we do operate in 11 different countries around the world.



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Next slide, please, Jacob. We serve a number of end markets through primarily OEMs and tiers, although we do have some of our business that we serve through aftermarket or through distribution channels. And those end markets include automotive, heavy vehicle, off-road, including on-road truck and off-road vehicles such as agricultural and construction equipment, as well as some recreational vehicles. We also serve the aerospace industry into commercial aerospace, the defense and military as well as the aftermarket into those end markets. And a number of industrial markets, such as smart buildings, smart factories, clean energy and a variety of diversified industrial markets.

This slide shows the examples of some of the content that you might see on a commercial jet, for instance, where there could be up to 1,500 Sensata products in a commercial jet. There may be 50 of Sensata products in an agricultural or construction equipment. Then the point primarily being here that there is not one application that we serve as a company, there are dozens of applications that at the key point is we're helping our customers solve some of their most difficult challenges.

Next slide, please, Jacob. We benefit as a company from a number of trends including the need for clean and efficient systems. And that -- many of those trends are regulatory driven. But also, there are 3 key megatrends that are impacting our business in a very positive way, the trend around electrification, autonomy and also smart and connected, which drives the need for more of our products and also drives what we tend to speak about in terms of outgrowth to the market or secular growth in the business. And in times where you see market contraction, the secular growth in our business is most pronounced because our business goes down at a much slower rate than the end markets we serve. It's also evident, obviously, in growing markets, when we can call out the amount of our growth driven by the need for more sensors in the end products that we go into. We've demonstrated this secular growth over the past several years. Over the last 3 years, our automotive secular growth has been about 500 basis points over and above what the market growth was in the heavy vehicle off-road market. That growth has been about 700 basis points. So over the last 3 years, we've been able to demonstrate this secular growth story in our business. And the way we are able to look forward at that secular growth is by looking at our new business wins that we are able to achieve with our customers, given that we are a long-cycle business, the new business wins that we achieved in 2020 will generate revenue 3, 5 years out. And so when we look at the last 3 years, we've been able to have new business wins in excess of $400 million per year on average over that 3-year period, which gives us high levels of confidence into the ability to continue to demonstrate that secular growth on a go-forward basis.

Next page, please, Jacob. From a capability standpoint, we tend to focus on designing and manufacturing very hard-to-do applications, mission-critical, sensor applications, electrical protection applications that help our customers, as I mentioned, solve their most difficult challenges. So all of our customers have product road maps that we're engaging with them from an engineer-to-engineer standpoint to help manage that product road map to achieve the objectives that they have. And more and more, we're extending beyond just sensor components into subsystems, software and other aspects of delivering insight to our customers. And that's being achieved because our customers are pulling us further beyond just sensor components into delivering valuable insight.

We are focused on very high-value sockets, high-growth sockets, and we have a proven low-cost -- very variable cost structure that has served us very well over our history during good times and in bad, where we've been able to adjust our operating model to new market realities, whether it's in a growth cycle or in a contraction cycle. And we have a very long history of continuous improvement, which allows us to generate differentiated margins in our business. And if you compare our margin profile to our peer groups, you'll see that we enjoy very high margins in the business, which -- and that's with incremental investment in the business as well.

So we work every day to balance what is a return to shareholder, but also incremental investment in a very promising future around opportunities that we see with our customers. Those margins are converted into strong cash flow because we have a variable cost structure model with very low portions of our business being fixed cost in capital, low capital requirements. And that generation of cash flow allows us to invest beyond the organic growth that I spoke about in terms of value-creating capital deployment, such as share repurchases and M&A-related activity.

Next page, please. Thank you. Like many other companies, we have clearly been impacted by the disruption associated with COVID-19. And over the last quarter, we've had a very strong focus on safeguarding our employees, but also ensuring that we continue to serve our critical customer needs. And this has resulted in us instituting preventative measures and protocols that allows -- that has allowed us to stay running during the pandemic given that we have been deemed by our customers, but also by the local municipalities and locations where we operate as being essential. We've been deemed essential by those government agencies, and in many instances, audited for our safety precautions to make sure that our people are kept safe.



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As a result of the pandemic and the impact to the markets we serve, we did take a number of moves to increase our financial flexibility in -- early in the -- or the end of the first quarter, early in the second quarter. And that included drawing down as a precautionary measure of $400 million revolving credit facility that continues to sit on our balance sheet. We've also taken measures to increase our working capital, including reducing capital expenditures and we've also instituted a number of temporary spending measures to improve our cost position, given the significant decline that we are anticipating in the second quarter.

Some of those temporary measures include the Board taking a 50% pay cut, all of our senior team and all of our direct personnel taking either a 25% pay cut or taking additional unpaid time off. And I personally have taken a salary of $1 in the second quarter to align our cost better to what we were expecting as being a very difficult second quarter as many other companies are facing.

We would expect the second quarter to be the worst, with April being the worst of those months during the second quarter. And although no one can predict the pace of recovery, we're certainly seeing our recovery, that's in line with what anticipated expectations are. We watch many of the measures that you watch as well as being indicators of what the end market demand will be from our customers ultimately to our business and our revenue. And we're doing this in a way that will allow us to come out of the other side of this stronger. We've talked about the fact that once we have a view toward more normalized demand levels for our business, we will take permanent cost actions. We've started to institute those. We've communicated them openly with our employee base, and we're doing that while continuing to invest in what we view as being a very promising future.

During this time, we've watched very closely for signals or any signs of any product launches or slowing of NBO activity. And although we've seen some very small deferrals associated with customer product launch, we continue to be very optimistic regarding the longer-term content growth we see in our business, as was evidenced by the strong NBO activity in the first quarter of the year. And obviously, we'll continue to provide visibility to that.

So that's what I had for some opening comments. Matt, back to you for questions.

## QUESTIONS AND ANSWERS

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

Okay. Great. Jeff, thank you for that overview. Maybe just starting off of your comments on demand. It doesn't sound like you're seeing any major changes from what you had expected. I think you didn't us give specific guidance, but I think most analysts are looking down 25% to 30% sequentially, which is in line with a lot of your peers with auto exposure. And we're looking at a 60-plus percent drop year-over-year in production in -- higher in other regions. But there is an expectation, as you said, for somewhat of a snapback just in terms of more production days in North America and Europe. It sounds like China is coming back. So could you give us any just more color in terms of what you're seeing by region, any surprises in terms of the recovery?

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

Yes, absolutely. So we entered the second quarter -- as you mentioned, we pulled guidance because we are in a unique position because the normal visibility we have into the business had disappeared given the uncertainty that all of our customers face. And so we did pull guidance we did state that we expected second quarter to be the low point. I think that our view is still that it will be the low point. IHS, for instance, is calling automotive production to be down dramatically in the second quarter on a quarter-over-quarter basis, and sequentially. And that's expected, given that many of our customers had shut down their factories for anywhere from 4 to 6 months -- or 4 to 6 weeks during the second quarter.

As we look at the balance of the year, however, and we look at more near-term indicators as to where the business is going, IHS would forecast automotive production to be down about 20% for the year, a little bit higher than that in North America and Europe, less than that in China. I think that's playing out in the China market. Remember, they're about a quarter ahead of us in terms of the pandemic and the implications with that.



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The read that I get and the dialogue I have with my teams in China is that things are somewhat back to normal relative to where they were in the first quarter where they had extended shutdowns aligned with their lunar holiday.

And so we're seeing a pretty strong recovery. Yet to be determined what that recovery looks like elsewhere in the world. But again, we're watching very closely for forward indicators regarding what the overall market recoveries will look like. And we continue to feel good about the news coming out in terms of what we're seeing. But we're going to watch -- continue to watch closely and then make a call as we get closer to the end of the second quarter, and we start to look at the balance of the year.

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

Yes. That makes sense. And I know that IHS is looking for, as you said, a really big drop-off in Q2, but I think something like 60% sequential growth in production in Q3. I guess the question is the correlation of your business because I know there's -- we do know that there's some inventory put in the supply chain. And of course, there's a unit inventory that has to work out. So is there a correlation? I know that -- and as you pointed out, Jeff, in the last few years, you've certainly outpaced the overall auto production numbers with your content growth. But with this big dramatic drop-off in an expectation for somewhat of a snapback, can we get some sort of correlation between the production numbers and what your volumes might look like?

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

Yes, you absolutely can. So specifically, as it relates to some of our businesses that can be very accurately modeled based upon third-party forecast and production rates in the supply chain with our customers. Obviously, automotive in some of the heavy vehicle off-road markets are very modelable in terms of forecast and what the demand profile and the production rates for our customers look like. And that's because there's not a huge amount of supply in the chain associated with those markets. Those customers have become very adapt to a just-in-time inventory model. It's unusual where we would see a significant amount of inventory build. And the way I validate that is if we miss a delivery, our customers are calling us very quickly saying that we're at risk of shutting down their lines.

So we often have a very good feel for the thin level of inventory that we would have in the supply chain for our customers. We did call out in the first quarter that we -- based upon our modeling of our revenue versus production rates across the globe, that we felt that there was a little bit of inventory build, not a huge amount, right, to the tune of about $25 million, really concentrated in the China market.

We would expect that some of this would unwind in China in the second quarter, but we wouldn't expect that the North American and European customers, specifically in the automotive sector, to build a little bit of inventory, primarily as them being cautious to make sure that their supply chain doesn't have any disruptions and also just lack of visibility in their end markets as well as they start to come back online and plan for various levels of production levels. But again, not huge numbers. I know that some other folks of our peers have called out higher level of inventory build we'll provide more visibility into that as we get to the end of the second quarter, but we're not seeing any indication that it would be a large amount. And we would expect it to unwind fairly quickly. I can't imagine our customers leaving 2020 with any meaningful supply or excess inventory in the supply chain.

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

That's right. Yes. And as we get past the September quarter, I guess, December really depends on -- by that time, you would think that the auto supply chain will at least be back to sort of normal or some stability. So that would really depend on what the end demand looked like at the end of the year in terms of whether that 20% IHS number is right or not, right?

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

I think that's absolutely right. And they'll adjust accordingly. Interestingly, in the end market, in the automotive end market, there hasn't been a real significant increase in the amount of inventory. There's been an increase in the number of days because of the sales figures are calculated, it distorts the days, but I think they've done a good job with the shutdowns to make sure that there wasn't a real significant amount of excess finished goods inventory in the automotive supply chain.

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

Got it. And then the -- your HVOR business, which is a really important above-market grower for you. I know you're sort of going through -- we were just basically at the peak of that spending cycle. So you were seeing some slowdown in general, and now you've got this pandemic. So how is the demand situation there in the HVOR market?

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

Yes. You absolutely said it right. We started to see a normal market decline in the heavy vehicle off-road market, call it, second half of 2019. And we anticipated that market to be down in 2020, not to the magnitude that it is. On-road in North America is now expected to be down 40%, 45%. European on-road is expected to be down about 40%. So even more dramatic than what we're forecasting for the automotive market. Less so in China, about 20% in China. And the (inaudible) construction market, we would say, 15% to 20% down for 2020.

So overall, that market down more versus auto, but nearing the end of that market cycle. So we would have normally expected that come in fourth quarter or first quarter of next year, we would start to see a little bit of a recovery. The events of what's going on in terms of COVID may have an extension on that. But typically, HVOR market cycle is about 18 months. And so we would expect to see signals of a stronger recovery in that market going forward.

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

Got it. Okay. And then just switching on that demand question on your the Sensing Solutions business, which has a lot of industrial exposure, HVAC, also exposure to military, aerospace. So there's some end markets that are stronger, others weaker. What's the outlook there?

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

I think broadly across the industrial side, I wouldn't expect as much of an impact, if you call the auto market down 20% and the HVOR market down a little bit more than that, we would not expect that kind of impact for all of 2020 on the industrial front. Although the industrial business that we have does not have as much of the secular growth. There is -- there are elements of that market that have secular growth, but not as much as we would see in the HVOR and the automotive sectors. Clearly, many of those customers were down as well. But there -- it is -- it does have some concentration in the China market, which has recovered, as we talked about, fairly nicely. The export markets out of China continue to be challenged in the same way that some of the other markets are. But overall, industrial, which is a focus sector for us, should see less disruption than -- overall during the year than some of the other end markets that we're seeing.

On the aerospace side, it's a smaller business for us. So it's only about 5% of our total company. That's being impacted or was being impacted by the challenges associated with the 737 MAX, and is being further impacted by order cancellations and the significant reduction in overall air travel. It's a mix of commercial and also defense and aerospace -- or excuse me, defense and military, and so as air traffic miles start to recover, which they are starting to recover, I think China is at a 60% or 65% rate compared to where they were pre-COVID, less so in Europe and North America, but there is a slight increase in terms of the overall air travel, which is welcome in that end market that we serve.

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

Okay. Got it. I wanted to turn to your product portfolio, particularly on the Performance Sensing side. Traditionally, obviously, you've got a lot of product within the engine, a lot of pressure sensing. But you've also been moving to EV, into other parts of the vehicle, autonomous, for instance. So could you talk about the portfolio as it exists today and as it evolves, and particularly in terms of content and dollar value that we should be thinking about?

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

Yes, absolutely. So clearly, given that the vast majority of the fleet, whether it be a light vehicle or heavy vehicle, is a combustion engine of some sort now. There is a lot of content that we have in those vehicles. And so if you were to look at a light vehicle environment, call it an average in North America and Europe of around $38, $40 of content, about half that in China, with a growing trend with higher content growth as all of those OEMs continue to ramp-up in terms of their their product portfolio in their end markets, that will continue to grow quite nicely for us.

But it's inevitable that power plants will convert to an electrified platform, whether they be hybrids or full battery electric. And we've been investing organically on capability to be able to serve that market, as well as we've been looking for potential acquisitions that would position us in that market to be able to serve electric vehicle platforms. And 3 years into that investment cycle, as the trend continues toward electrified vehicles, we're very confident that, that trend is a positive trend for Sensata.

So not only do a number of the sensors that are applicable in a combustion engine environment, they pour it over. So hydraulic braking applies. And so whether it's an electrified platform or a combustion engine, we would have sensors in that application. So about half of the content ports over to an electrified platform. But also, we have a number of products and solution sets, including high-voltage contactors, e-motor position, battery pressure sensors to manage risk of thermal runaway, early-stage development around battery management for electric vehicles, whether it be Wireless Battery Management or also an investment in a company that does Wired Battery Management outside of the automotive sector. And so we feel really good about the work that we've done to prepare us for the eventual transition into electrified platforms.

And now let's keep it in context, by 2030, most would forecast that only 30% of the fleet would be either hybrid or battery electric. So there's still a very long tail associated with combustion engines, and we're still conserving customers on that side. But we are prepared for the transition that will inevitably occur.

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

Okay. That's great. And we're actually -- just a few minutes left. And I did want to talk about your cost structure and margin structure. Near term, you talked about some of the things that you're doing but longer term, I know it's just 2 years ago, basically that you had that Investor Day where you talked about long-term growth rates as well as EBIT margins targeting in the 25% range, and you're basically there. And then obviously, volumes are lower now. So talk about what gets you back to that margin range? Is it really volumes? Or does the volume level have to be lower -- could it be lower just from some of the cost actions that you've been talking about?

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

Yes. So during the beginning comments, Jeff outlined a number of short-term kind of temporary cost actions that we're taking in order to reduce the cost base during the second quarter. We're in the process right now of evaluating where the -- what revenue will look like for the beginning of 2021, full year next year. And we're taking permanent action in terms of cost reduction, really in job elimination, both voluntary and involuntary, to make sure that we've got the right cost basis to match up with that revenue stream. We'll do that in a balanced approach because, obviously, there are areas that we'll want to continue to invest in, including the -- some of the megatrend areas that Jeff alluded to in one of the prior questions.

We do have a highly variable cost structure, so that protects us somewhat in the down cycle. And we'll get positive incrementals as we go up through the cycle as well. We think Q2 is the bottom of this particular cycle. In terms of the margin targets, we're looking to size the cost base to



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get pretty close to where we had margins in 2019, at least within a couple of hundred basis points of that. As a reminder, in 2019, we had operating income margins just shy of 23%. And then with volume uplift over time, we'd expect to get back to that target of 25% as revenues improve in the coming years.

Obviously, that's going to depend on the level of investment as well as -- we make in some of the megatrends areas as well as the revenue levels.

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

Okay. Great. And actually, there's some questions in. One quick question just regarding the competitive environment. Specifically, some of the big connector suppliers have been in this space through acquisitions, moving both on the industrial and automotive. Jeff, what do you think about the competitive environment?

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

The competitive environment in our business, given that it's -- the applications that we serve are highly mission-critical and differentiated, it doesn't change a lot, I think that when it changes for us, it's because we're entering a new segment, but we tend not to see a lot of shift in terms of market share or new competitive entrants, if you can imagine an engineer who is working on the design of a new engine platform for a vehicle or a new electrified platform, they're going to pick a supply chain that's proven so we tend not to see massive shifts.

I know that some of the companies you mentioned are acquisitively going into the sensor space by buying smaller businesses. And it's -- to me, it demonstrates the -- what we're talking about in terms of the attractiveness of the market, the growth rate that we'll be able to achieve and also the differentiated margin profile but we don't see big shifts in terms of the competitive dynamics.

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

Okay. Got it. Okay. It looks like we're out of time. Thank you so much, Jeff and Jacob, for your time and look forward to speaking with you and seeing you soon.

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

Great. Thanks, Matthew. Talk soon.

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

Thanks, Matthew.

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

Okay. Bye-bye.

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