REFINITIV STREETEVENTS

EDITED TRANSCRIPT

ST.N - Sensata Technologies Holding PLC at RBC Global Industrial Conference (Virtual)

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CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

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

PRESENTATION

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

Good afternoon, everyone. Thanks for joining us. Sorry. We're a little late here with some technical difficulties. I'm Joe Spak, research analyst here at RBC Capital Markets. Especially we are very pleased to be joined by Sensata, a leading sensor provider to auto and other end markets, about $3.4 billion in 2019 sales, about $6.7 billion market cap. We're pleased to have with us today CEO, Jeff Cote; and CFO, Paul Vasington.

QUESTIONS AND ANSWERS

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

Just to start the conversation, Jeff, I know you've been with the company for about 13 years, but basically over in March, clearly a difficult time to navigate through and a rough start. But I think you've done an old job right off the bat here. So -- but was wondering how you're viewing your top long term priorities. And if they've changed here now in a post-pandemic world?

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

Yes, absolutely, Joe. And I do apologize for being late for the technical challenges here. Yes, the timing is everything on taking over in a new role. However, the 14 years that I've had with the company have been very helpful. We've been through a lot over 14 years in starting with the divestiture from Texas instruments. And there are a lot of things, as you mentioned, that will continue to be the same. We'll continue to leverage our core capabilities and strong operating cadence and commercial excellence. But there are also some things that we've changed over the last couple of years that we'll continue to emphasize in terms of, if you will, pivoting our strategy. And Martha and I worked very closely in several years prior to the shift here.

And the key areas around strategic focus, aside from obviously the day-to-day and making sure that we protect our people and serve our customers during this very interesting time is to make sure that we continue to build capabilities to be able to serve the megatrends that are impacting our customers' end markets. We've talked a lot about the trends associated with Electrification, Smart & Connected and autonomy, which will change the end markets we serve more in the next 10 years than they have in the last 50 years.

And also as we do that, to focus on more end market diversification. But the core elements are focusing on the hard to do mission-critical applications that drive differentiated margins will stay the same.

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

Great. And I know you recently updated your third quarter guidance. It sounds like it was mostly due to North American and European auto. And not too surprised. I think given some of your initial expectations and how we've seen production come in quarter to date. But maybe you could talk a little bit more about what you're seeing on the ground. And as we begin to look in the fourth quarter, it still seems like maybe your some of your assumptions also had a discrepancy versus IHS. So how should the market think about some of your planning assumptions there?

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

Yes. So last week, we updated guidance to the positive. When we gave our initial guidance for the third quarter of this year, we stated that we were about 1.7 million units behind IHS from an auto production standpoint. The upside is almost exclusively coming from North America and European automotive. You may also recall if you follow IHS forecast that since we provided guidance, IHS increased their forecast by another 500,000 units of production, again, in Europe and North America.

And today, our updated guidance is pretty much on top of the IHS guide. We're about 200,000 units behind them on Europe, just being a little bit more conservative given the potential challenge in the European market because they are still considerably down from third quarter of last year.

And the reason, Joe, for the more conservative guide was that the last 2 quarters, Q1 and Q2, the customer order shipments or the customer orders have not materialized to shipments the way we would have expected. As the quarter progressed, our customers dropped out some of those orders. We allowed them to do that given the relationship that we have with them. In the third quarter, those orders have converted quite nicely to shipments. So we've seen a lot of stability in the order conversion to shipments. And we believe that it's translated to end market demand for our customers. So we don't believe that the guidance uptick is, in any way, increasing inventory in the supply chain. Very positive news as we go into the fourth quarter.

We remain cautious, but we're optimistic about where things could go. The third-party forecast to show the fourth quarter continuing to increase, which would represent a nice recovery from the very low Q2 levels that we all experienced.

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

Great. And maybe that's, if you will, sort of the industry. We've also got, obviously, some very Sensata-specific content gains there. And one of the things we sort of like to measure is sort of the outgrowth -- of its growth over market. It was really strong in the first half. I understand that can be lumpy. There's a little bit of, I think, implied moderation in the back half. So maybe you could just talk to that. But more importantly, what are you seeing in the marketplace that gives you confidence that you can sustain that 400 to 600 basis points of outgrowth on the light vehicle side and maybe 600 to 800 on the commercial and the HVOR side?

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

Yes. So you're pointing out the outgrowth and the secular growth that we experienced in our business, essentially, as our customers implement road maps to achieve their objectives, whether it be regulatory required for safety or emissions or other feature sets that does drive outgrowth or content growth for us. And we've experienced over the last 2 years, somewhere between 400 and 600 basis points of outgrowth in automotive and between 600 and 800 in HVOR a little bit north to the midpoint of that over the last 2 years.

For the first half of 2020, as you know, it was quite strong, 750 basis points of outgrowth for the half of the year for auto and 850 basis points of outgrowth for HVOR. And we expect that to tail off a little bit in the second half of the year, partly due to just normal seasonality. Third quarter sees fewer launches of new products than the first and second quarter due, but also some COVID impact as many of our customers adapted to the work-from-home environment. Some of those launch schedules slipped a quarter or so. We feel very strong confidence in the full year impact in 2020 and really beyond.

The big benefit we have associated with the long-cycle business that we operate is that we see new business wins and engineering effort that will convert into revenue over the next 1, 2, 3 years, depending on the end market that we're serving. And so that visibility into that secular outgrowth is strong, and we continue to have a lot of confidence in it. I'd also note that it's resulted in the first half of this year into good NBO wins that will convert into revenues in the future as well.

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

Maybe if we could dive a little bit deeper into some of the outgrowth. And you mentioned a couple of times already sort of electrification, and I know you've got a lot of sensors on traditional internal combustion engine vehicles. You also had organic content on electrified stuff a lot on the hybrid side. And you made some acquisitions to get even more content, especially as you sort of move up to better electric vehicle side. But the world, which I think you sort alluded to, especially post-COVID and because of some of the regulatory requirements seems to be shifting maybe a little bit faster.

So how do you see the CPV maybe on either on a powertrain basis or on a blended basis, sort of evolving with what you're seeing on the ground? Because you pointed to $108 million in, I think, new electrification wins in the first half. But I think it's a little bit difficult to sort of translate that into how and when that hits the P&L.

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

Yes, absolutely. So we've reduced that to our content, Sensata content per vehicle. And in North America and Europe on a gas or a diesel engine or light vehicle, it's somewhere between high 30s and low 40s of content, Sensata content. That's average. But we aim to have a number of applications across a wide set of customers, so there's not a lot of variability there.

In China, that's about $20 of content today. And so as China continues to fan out different emissions regulation and other feature sets, that content will continue to grow. And in fact, the content on ICE engines will continue to grow over the next 5 or 10 years. Clearly, there'll be a migration toward electric vehicles as more and more of our OEM customers convert to electric platforms and more appropriately, customers choose to buy battery electric or hybrid applications. We set out 3, 5 years ago to make sure that the opportunities that we had in an electrified environment were positive as well. And today, we feel very confident based upon what we've won, that the content per vehicle and a pure battery electric vehicle application would be about $50 of content average.

So we feel good about the trend. The trend is continuing to progress at a very fast pace. And that's a trend that creates a positive tailwind from a revenue standpoint for Sensata. I'd also note that it's not just light vehicle. These megatrends are impacting all of the end markets we serve and the capabilities that we're developing internally and that we're acquiring would apply to all of the end markets because these trends really are impacting not only light vehicle but heavy vehicle off-road, industrial applications and in some cases, the aerospace markets.

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

Yes, for sure. Maybe for Paul, who I think was able to get on. I think one of the impressive things from last quarter was generally, you were able to generate positive free cash flow despite EBITDA down well over 50%. Now that was aided by some strong working capital management and some CapEx cuts. But how do we think about the working capital dynamics in the back half as you have a sales -- a sequential sort of sales recovery?

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

So Joe, it's Jacob Sayer speaking. I don't think Paul was able to join us.

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

Oh, I apologize.

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

It's quite all right, but I'll answer the question for you. You're absolutely right. Free cash flow was quite strong in the first half of the quarter, first half of the year, despite the volumes dropping pretty dramatically. We generated $114 million of free cash flow in the quarter -- in the first half.

We haven't guided to specific free cash flow numbers, but I guess I'd point to a few areas that were beneficial to us. We cut cost pretty dramatically in the second quarter including a lot of temporary cost reductions, which obviously save us cash directly. We put some controls around CapEx, and we've lowered our full year guidance with regard to CapEx spend for the year from $160 million down to about $120 million. And areas of inventory management have been taken a quite robust stance on inventory management, which is providing cash in the quarter as well. We expect that would continue in Q3. And then as volumes ramp, the revenue generated from those volumes will drop through and provide strong profit and cash flow generation as we go through the balance of the back half of the year here.

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

Right. So you mentioned some of the, I guess, austerity cost savings in the second quarter. And Jeff, it seems like one of the great challenges here as the world gets back on its feet is, sort of how to begin to layer some of these costs back in as you sort of have a sales recovery. So maybe you could just spend a second talking about how you are approaching that as a company? And are we going to see that impact some of the, I guess, sequential incremental margins or maybe year-over-year decremental spending, I guess, pick your poison on how you want to look at it?

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

Yes. So listen, I think when we were faced with the challenge in the second quarter, as Jacob said, we put some temporary cost actions in place and all of the employees globally contributed to that either through pay cuts or furloughs. And then we -- as we were trying to figure out what the size of the organization to -- based upon the recovery that we're seeing in the third quarter, I think we're going to be on the right side of that. Things are snapping back a little bit more quickly than we had anticipated. Again, caution regarding the fourth quarter and potential lockdowns and things. But we feel like we're in a pretty good position on that. Some of those cost actions are still trundling in the third and fourth quarter.

So from a margin standpoint, clearly, we've got more cost savings in the second quarter that we are getting in the third quarter and in the fourth quarter. But as we get into first quarter of next year, that $60 million to $65 million of cost savings are expected to be fully baked into the cost structure in -- starting in the first quarter of next year. So we feel as though we'll be in a good place position for ability really, Joe, to invest in growth first. So infrastructure-related costs and G&A-related cost will wait. But certainly, we want to make sure that we're able to continue to invest in the very significant growth areas that we see.

And we've called out in our second quarter call some transparency around some of those investments. We've broken out some megatrend-related investment into the corporate reporting segment, so that investors see where we're investing. And we'll continue to provide that transparency on not only spend, but the success that we're experiencing in those areas. So that -- clearly, that's where we'll start to reinvest first around the growth areas. And then as we get to more normalized levels and back to 2019 levels, we'll have to reinvest in the support-related structures of the business. But that will come after we have more confidence in where the long term is going.

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

Great. And with that, unfortunately, I think we're out of time. So again, thanks for the time, even if it was abbreviated. And thanks -- in behalf of everyone to RBC for joining us and the investors on the line. Thanks for joining as well, and we'll be in touch. Thanks to Sensata team.

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

Great. Thank you, Joe. Appreciate it. Take care. Bye now.

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

Take care.

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

Thanks, Joe.

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