REFINITIV STREETEVENTS

EDITED TRANSCRIPT

ST.N - Q3 2020 Sensata Technologies Holding PLC Earnings Call

EVENT DATE/TIME: OCTOBER 27, 2020 / 12:00PM GMT

OVERVIEW:

Co. reported 3Q20 revenue of $788.3m, adjusted net income of $103.6m and adjusted EPS of $0.66. Expects 4Q20 revenues to be $810-850m and adjusted EPS to be $$0.64-0.72.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

CORPORATE PARTICIPANTS

Jacob A. Sayer *Sensata Technologies Holding plc - VP of Finance*

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

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

CONFERENCE CALL PARTICIPANTS

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

Bharat Daryani *JPMorgan Chase & Co, Research Division - Analyst*

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

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

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

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

James Dickey Suva *Citigroup Inc., Research Division - MD & Research Analyst*

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

Luke L. Junk *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

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

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

Michael R. Filatov *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Nikolay Todorov *Longbow Research LLC - Analyst*

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

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

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

PRESENTATION

Operator

Good morning, everyone, and welcome to the Sensata Technologies Q3 2020 Earnings Conference Call. (Operator Instructions). Please also note, today's event is being recorded.

At this time, I'd like to turn the conference call over to Mr. Jacob Sayer, VP of Finance. Sir, please go ahead.

Jacob A. Sayer - *Sensata Technologies Holding plc - VP of Finance*

Thank you, Jamie, and good morning, everyone. I'd like to welcome you to Sensata's Third 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.

In addition to the financial results press 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 will post a replay of today's webcast shortly after the conclusion of today's call.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

As we begin, I would like to reference Sensata's safe harbor statement on Slide 2. During 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 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 results for the third 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 relate to our non-GAAP financial measures. Reconciliations of our GAAP to non-GAAP financial measures are included in our earnings release and in our presentation materials. The company provides details of its segment operating income on Slides 10 and 11 of the presentation, which are the primary measures management uses to evaluate the business.

Jeff will begin with key highlights of our business during the third quarter and first 9 months of 2020. He will then provide an update on recent progress in our key Smart & Connected and Electrification Megatrends growth areas. Paul will cover our detailed financials for the third quarter of 2020, including organic and market outgrowth by business unit, describe our financial and balance sheet progress in the quarter and then provide select financial guidance for the fourth quarter of 2020. We'll then take your questions after our prepared remarks.

Now I would 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, and welcome, everyone. I'd like to start with some summary thoughts on our performance, as outlined on Slide 4. The rebound from lockdowns and quarantines instituted by governments around the world was dramatic in our end markets during the third quarter. Our revenue grew 37% in the quarter sequentially to $788.3 million, even higher than the updated financial guidance that we provided on September 8. It is a strong testament to the flexibility and resiliency of our manufacturing model and supply chain that we were able to capitalize on improving markets and support our customers as they rapidly ramped up production during the quarter. I'd like to recognize the agility and hard work of our entire team in achieving these results.

We continue to deliver strong market outgrowth. For the 9 months of -- first 9 months of 2020, we delivered 840 basis points of outgrowth in our heavy vehicle off-road business and 610 basis points in our automotive business. We now believe that the inventory build by our automotive customers in the first half of the year was consumed in the third quarter.

We continue to be confident that we will sustain our market outgrowth for 2020 in the range of 600 to 800 basis points for our heavy vehicle off-road and 400 to 600 basis points for automotive, consistent with our long-term goals, and supported by our higher levels of new business wins.

During the quarter, we closed over $95 million of new business wins, bringing us to more than $320 million year-to-date. This pace is tracking ahead of last year, and we believe our ability to close new business despite the disruptions of the pandemic or caused by the pandemic clearly demonstrates the mission-critical nature of Sensata's products.

Sensata today is in a very strong financial position. We generated $100 million in free cash flow in the third quarter and $213 million year-to-date, and we have taken several steps to enhance our financial position and flexibility. We are aligning our cost structure to demand levels through our restructuring program and cost controls, expected to generate savings of $60 million to $65 million next year.

During the quarter, we raised $750 million in unsecured debt through a 10-year note issued at historically low interest rate of 3.75%, lowering our overall cost of capital and extending the maturity of our capital structure. And we repaid our revolving line of credit, lowering our interest cost, given improving financial markets and customer stability.

Finally, as I will discuss in more detail momentarily, we continue to invest in our Megatrends growth initiatives and achieved a meaningful milestone in Smart & Connected. We recently reached agreement with the first fleet manager to install and operate our Smart & Connected suite of hardware and data services within their heavy commercial vehicles on a subscription basis enabling this effort to move from trials to commercialization.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Additionally, our progress in our Megatrend -- electrification Megatrend continues to advance, not just in automotive and other electrified equipment but also in areas of smart grid infrastructure. Year-to-date, we have closed $140 million in electrification business wins.

On Slide 5, I want to provide an update on the meaningful milestone we achieved in our Smart & Connected initiative. As we've shared before, we have been testing proof of concepts of our full stack technology offering with several leading fleet managers for the past year.

Recently, we signed our first commercial agreement in the Smart & Connected space with a top 25 North American fleet manager, demonstrating our ability to move from selling hardware to providing data insight.

The fleet manager has opted for a full subscription model paying for the hardware, maintenance and support and ongoing data analytics services on a monthly subscription basis per vehicle over the life of the agreement. While this initial award is small, we are planning to demonstrate the value we bring before fanning out across the remainder of their fleet. Several other proof-of-concept trials are also moving forward and toward commercialization, and we are confident that others will understand the value of our solution.

On this basis, we continue to believe that our Smart & Connected fleet management initiative opens $6 billion in addressable markets for Sensata by 2030. And we are very pleased that we've reached a new stage of initial commercialization with this exciting solution.

In the new equipment space, we expect several leading OEMs to join this program expanding the $90 million in new business wins announced to date for Smart & Connected solutions. Additionally, we are investing in expanding our technological know-how in Smart & Connected. Moving beyond heavy commercial vehicles into light-duty vehicle prognostics, through third-party collaboration, adding to the long-term opportunities ahead of us with our differentiated solutions.

Moving to Slide 6. In electrification, we are expanding the solutions we provide for critical applications across all end markets we serve. During the third quarter, we closed another $32 million in electrification new business wins, bringing our year-to-date total to $140 million. These business wins demonstrate important ongoing progress against our long-term target to transform the electrification Megatrend from opportunity to material revenue for Sensata.

This pace of business wins so far this year is much faster than last year despite the pandemic, and these wins are expected to generate significant revenue growth for Sensata in the coming years. For example, we are expanding our capabilities and charging infrastructure and smart grid applications through third-party collaboration. As overall electrification trends accelerate, the increased opportunities for our solutions across all end markets represents an estimated $6.5 billion addressable market for Sensata by 2030.

To date, we have closed electrification new business wins with some of the largest and the most innovative automotive OEMs around the globe. In our core markets, the average content on battery electric vehicle now materially exceeds that of the average combustion -- internal combustion vehicle. Sensata generates approximately $50 in content in these battery electric vehicles as compared to $38 to $40 on average in internal combustion engine vehicles, representing a significant growth opportunity for the company as electrified vehicles increase and become a larger portion of the vehicle fleet worldwide.

Sensata has the strongest offering in the segment for longer-range and shorter charge time electric vehicles. All evidence indicates that this is where the industry is heading.

While the automotive space will be a large beneficiary of electrified Megatrends, the projected growth from widening electrification should benefit all of our end markets. We are pleased with our demonstrated progress against our Megatrend initiatives and intend to continue these efforts to expand Sensata's applications for these areas organically, through third-party collaboration and through acquisition.

We see numerous opportunities to utilize our strong financial position and significant cash flow to meaningfully expand our addressable markets through serial bolt-on acquisitions within the Megatrend areas. These acquisitions should bring unique offerings that position us to grow quickly in large and fast-growing markets. We continue to believe that investments in electrification and Smart & Connected will further our end market diversification, increase our long-term growth rate and provide important competitive advantages as these trends transform our world.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

I'd now like to turn the call over to Paul.

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

Thank you, Jeff. Key highlights for the third quarter, as shown on Slide 8 include revenue of $788.3 million, a decrease of 7.2% from the third quarter of 2019. Organic revenue decreased 7.5%, largely due to the impact of the COVID-19 pandemic. Changes in foreign currency increased revenue by 0.3%, and sequentially from the second quarter, reported revenue increased 36.7%, reflecting a substantial rebound in our markets.

Adjusted operating income was $154.8 million, a decrease of 22.4% compared to the third quarter of 2019, primarily due to lower revenues, lower productivity in our manufacturing operations, revenue mix and higher incentive compensation aligned to improve financial performance, partially offset by savings from cost reduction programs.

Adjusted net income was $103.6 million, a decrease of 28.3% compared to the third quarter 2019. Adjusted EPS was $0.66 in the third quarter, a decrease of 26.7% compared to the prior year quarter.

On September 8, we updated our financial guidance for the third quarter based on shipments to date, our order book and market information available at that time. Throughout the quarter, we saw continued strengthening, especially within our North American and European automotive end markets, which enabled us to exceed the higher revenue and earnings guidance that we provided in September.

Now I will discuss our performance by end market in the third quarter of 2020, as outlined on Slide 9. Overall, we reported an organic revenue decline of 7.5% year-on-year against an overall end market decline of approximately 12.3%, representing market outgrowth of 480 basis points for the company. Our industrial business decreased 2.2% organically as global industrial end markets remain weak. Strong growth in factory automation and medical equipment, which includes sensors for ventilator manufacturers, mitigated some of the market decline.

Our aerospace business decreased 24.4% organically from reduced OEM production and lower air traffic, which has negatively impacted our aerospace aftermarket business. New product launches, primarily in the defense market, partially offset the significant aerospace market decline.

Our heavy vehicle off-road business posted an organic revenue decrease of 7.8%, representing 860 basis points of outgrowth as compared to a 16.4% end market contraction. Our China on-road truck business continued to post better-than-expected growth from accelerated adoption of NS6 emissions regulations.

While our China on-road business grew in the third quarter, we experienced substantial declines in both Europe and the Americas as production levels in these geographies declined year-over-year. Year-to-date, we have delivered 840 basis points of outgrowth in the heavy vehicle off-road business.

Our automotive business posted an organic revenue decrease of 7.9%. Our automotive production was down 4.1% during the quarter, production ramped rapidly through the quarter, creating challenges to serve all the demand that was presented to us. This drove customers to work down inventory from their supply chain, which had a negative 6.7% impact on revenue. Against that backdrop, our automotive business had market outgrowth of 290 basis points as expected, led by continued new product launches and emissions, electrification and safety-related applications and system. Year-to-date, we have delivered automotive outgrowth of 610 basis points as compared with our long-term target range, 400 to 600 basis points.

Now I'd like to comment on the performance of our 2 business segments in the third quarter of 2020. I'll start with performance sensing on Slide 10. Our performance sensing business reported revenues of $580.9 million, a decrease of 7.6% compared to the same quarter last year. Excluding the positive impact from foreign currency of 0.3%, performance sensing organic revenue decreased 7.9%.

On a sequential basis, performance-sensing revenue grew a dramatic 51% in the second quarter as OEM customers ramped up production through the quarter to replace production loss for the prior quarter shutdowns. Sequentially from the second quarter, our automotive business reported an increase of 59% and our heavy vehicle and off-road business reported an increase of 26%, demonstrating the strength of the market rebound.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Performance sensing operating income was $151.6 million, a decrease of 10.9% as compared to the same quarter last year with operating margin of 26.1%. The decrease in segment operating income was due primarily to lower revenues which also contributed to productivity headwinds in manufacturing and unfavorable revenue mix, somewhat offset by savings from restructuring and other cost reduction actions.

Sequentially, performance sensing generated incremental margin of 46% on a higher revenue, despite the profit and margin headwind caused by second quarter temporary cost reductions not continuing.

As shown on Slide 11, Sensing Solutions reported revenues of $207.4 million in the third quarter of 2020, a decrease of 6.2% as compared to the same quarter last year. Excluding the positive impact in foreign currency of 0.2%, Sensing Solutions organic revenue decreased 6.4%.

On a sequential basis, Sensing Solutions revenue grew 8% in the second quarter as OEM customers ramped up production through the quarter. Sequentially, from the second quarter, our industrial business reported an increase of 7%, and our aerospace business reported an increase of 17%.

Sensing Solutions' operating income was $58.2 million, a decrease of 18.6% from the same quarter last year, with operating margin of 28.1%. The decrease in segment operating income was primarily due to lower revenues that also contributed to productivity headwinds in manufacturing and unfavorable revenue mix, somewhat offset by savings from restructuring and cost reduction actions.

Sequentially, Sensing Solutions generated incremental margins of 15% on the higher revenue, which reflects the impact of second quarter temporary cost reductions not continuing and unfavorable revenue mix within the segment.

Corporate and other costs not included in segment operating income were $61 million in the third quarter of 2020. Excluding charges added back to our non-GAAP results, corporate and other costs were $53.4 million, an increase of $12.8 million from the prior year quarter due to higher global incentive compensation costs, aligned to our improving financial performance and higher Megatrend investments, somewhat offset by savings from cost reduction initiatives.

Items added back to our non-GAAP corporate operating expenses include restructuring-related and other costs and financing and other transaction costs. Megatrend investments were $8.8 million during the third quarter, an increase of $3 million from the prior year quarter. We currently expect approximately $33 million in Megatrend-related spend this year in order to design and develop differentiated solutions for our customers that should generate substantial long-term growth and further our end market diversification.

Historic operating profit and operating margins on slides 10 and 11 reflect a reclassification of Megatrend costs on the operating segments into corporate and other.

Slide 13 shows Sensata's third quarter 2020 non-GAAP results. Adjusted operating income was down 22.4% compared to the same quarter last year. Adjusted operating margin decreased 390 basis points to 19.6%, which is still near the top of our peer group and represents an attractive operating income margin profile, especially considering how the pandemic has affected operating conditions.

The decrease in adjusted gross profit and adjusted operating income largely reflects the lower revenues we have experienced due to the impact of the COVID-19 pandemic and the related operating and productivity challenges. We took action early during the pandemic to align our cost structure to a lower demand profile, while continuing to invest in Megatrends that are shaping our markets to be able to deliver long-term sustainable growth.

Incentive compensation costs are also rising and are aligned to increasing operating income as our end markets continue recover from the low point in the second quarter of this year.

Adjusted net income declined 28.3%, compared to the same quarter last year. The decrease reflects lower adjusted operating income, higher interest expense related to our bond issuance in the third quarter of this year and higher taxes due to jurisdictional profit mix.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Finally, adjusted EPS was $0.66, down $0.24 or 26.7% as compared to the third quarter of 2019, as a decrease in adjusted net income was partially offset by the benefit of share repurchases in intervening periods.

On Slide 14, we highlight the strong financial and balance sheet management of Sensata, during the pandemic that has resulted in improved liquidity. During the third quarter, we generated $100 million in free cash flow, representing a 96% conversion rate of adjusted net income. This brings free cash generation of $213 million year-to-date, representing a nearly 100% conversion rate.

Last quarter, we announced a series of actions to structurally reduce our semi-variable costs by about 10% to align our cost structure, to expected lower demand levels and to achieve expected $60 million, $65 million in savings from these actions. We achieved the targeted $7 million savings from these programs in the third quarter and expect to achieve $11 million to $12 million in savings during the fourth quarter.

During the third quarter, we took advantage of historically low interest rates to raise $750 million through a 10-year unsecured notes offering. Expand the maturity of Sensata's debt profile and lowering our cost of capital, given improving end market conditions and strengthening financial markets, we repaid our revolving line of credit we had drawn in April.

Sensata's net debt-to-EBITDA was 3.6x at the end of September, slightly above our target operating range of 2.5 to 3.5x. Our capital expenditure guidance for the full year 2020 is now $110 million to $120 million, $10 million lower than prior guidance based on the benefits of continued capital controls.

Over the past 9 months, we have taken significant actions to strengthen our financial position with improving economics and business conditions. We are focusing on meaningfully expanding our addressable market through small, bolt-on acquisitions and partnerships and strengthen our position within both our existing business segments and our growing Megatrend initiatives. These acquisitions as well as partnerships and third-party collaborations should bring unique capabilities and offerings that position us well to intersect large and fast-growing markets. By way of example, building on the PRECO Electronics acquisition that we announced last quarter.

During the third quarter, we signed a partnership agreement with Uhnder for digital radar object detection for heavy vehicles to expand our heavy vehicle safety offerings.

In February 2021, we'll evaluate an early redemption of our 6.25% notes due 2026, depending on market -- financial conditions at that time, and our stock repurchase program remains on hold.

We are providing financial guidance for the fourth quarter of 2020, as shown on Slide 15. Our guidance assumes our customers and we can keep our manufacturing facilities open despite resurgence in the COVID-19 pandemic and potential government responses to try to prevent the spread of the virus.

As a result of improving economic conditions and better stability and strength, customer order patterns, for the fourth quarter of 2020, we expect to generate revenue between $810 million and $850 million, representing a reported revenue decrease between 4% and flat year-on-year, and reported revenue increase between 3% and 8% sequentially from the third quarter. At the midpoint of guidance, we expect that foreign currency will increase revenues year-over-year by approximately $7.5 million. Excluding the impact of foreign currency, we expect to report an organic revenue decrease of 5% to 1% in the fourth quarter.

Our current fill rate is approximately 96% of the revenue guidance midpoint for the fourth quarter. Based on our third quarter experience, we see our fill as a more reliable indicator of revenue in the coming quarter.

We also continue to monitor leading economic indicators and third-party forecasts to help form our view of future market demand. We expect to report adjusted operating income between $160 million and $176 million. On the bottom line, we expect to report adjusted net income between $100 million and $114 million, which would represent a decline of 29% to 20% compared to the fourth quarter of 2019.

We expect to report adjusted EPS between $0.64 and $0.72, which includes a $0.01 positive impact in foreign currency at the guidance midpoint.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

In summary, Sensata has delivered strong financial performance, for the first 9 months of 2020 despite the challenging environment, and we expect to continue -- this to continue into the fourth quarter as demonstrated by the financial guidance we're providing today. Driving this performance is our continued ability to achieve our secular market outgrowth targets, including 400 -- 400 to 600 basis points for our automotive business, 600 to 800 basis points for heavy vehicle business.

Now let me turn the call back to Jeff for closing comments. Jeff?

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

Thanks, Paul. I'll wrap up with a few key messages on Slide 16 before we go to Q&A. Sensata has responded very well to the rapid upswing in many of our end markets. Demonstrating the flexibility of our manufacturing base and the resiliency of our supply chain, enabling us to capitalize on the improving end markets. Our ability to respond quickly to shifting demand positions us very well as a trusted source for our customers.

We are delivering attractive end market outgrowth. We remain confident in our ability to continue to deliver this end market out growth for full year 2020 and expect to maintain this performance into the future based upon our strong new business wins.

We continue to deliver strong free cash flow, which demonstrates Sensata's resilient financial model. We continue to invest in Megatrends and other growth initiatives that are opening up large and rapidly growing opportunities for Sensata across all of our end markets, and we are making excellent progress as evidenced by the first commercial fleet adoption for our Smart & Connected fleet initiative, and by the $140 million in electrification new business wins so far this year.

In addition, we continue to believe that the overall market environment may provide interesting opportunities to further strengthen our portfolio through strategically important value-creating acquisitions. We are pursuing technology collaborations and partnerships with third parties to expand our technological capabilities, and accelerate our Megatrend commercialization.

And finally, as we emerge from this recessionary period caused by the pandemic, while we may not return to peak margin rates in the short term, we do expect to deliver industry-leading margins for our shareholders, while increasing investments in our growth opportunities and in our people.

Now I'd like to turn the call back to Jacob.

Jacob A. Sayer - *Sensata Technologies Holding plc - VP of Finance*

Thank you, Jeff. Given the large number of listeners on the call, please limit yourself to one question each and a follow-up. If we have time, we'll circle back to the group for further questions. Jamie, please assemble the Q&A roster.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today comes from Mark Delaney from Goldman Sachs.

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

The revenue guidance for 4Q is well above The Street and trends a very good improvement. I'm hoping the company can speak a bit more on some of the recent order trends that it has been witnessing. And I think the fill rate that's implied in that 4Q outlook is 96% compared to about 88% last year. So hoping to understand, is there something that Sensata has seen in its order book that is suggesting order rates are going to be slowing in

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

the fourth quarter compared to what it experienced a year ago? Or is that simply conservatism to account for some of the uncertainty for factors such as COVID?

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

Yes, Mark, thanks for the question. This is Jeff. And so there was a sequential recovery again into the fourth quarter, about a 5% sequential that leads us to about 2% off for fourth quarter versus last year. Obviously, auto continues to recover. HVOR notably turned positive from a revenue standpoint quarter-over-quarter that's been an 18-month trend on HVOR. Industrial tends to be a little seasonally lower in the fourth quarter. And obviously, the aero business, as we know, is still lagging, it's 23% down from last year.

You noted the fill rate, 96%. Absolutely, that's higher than it typically is. We do remain conscious regarding lockdowns. We all see the news about what's going on. On the positive side, we feel as though all of our customers have done an amazing job of figuring out how to continue to stimulate demand with their end customers. We've also all done a tremendous job in terms of keeping our supply chains open. But given those concerns and also given that the last couple of quarters have seen some volatility in order rates from the time we entered the quarter until when we exited the quarter, we are remaining a little cautious. But I'm very optimistic about where things would go.

October started off quite strong, which gives us a view that things will continue to be strong. But just watching the news and making sure that we're being cautious about where things could go Mark.

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

That makes a lot of sense. And for my second question, I was hoping to better understand the EBIT margins. And Jeff, you made some comments about just being an industry leading margin, but maybe not quite peak rates. Maybe you can dive a little bit more into that topic. I mean, is there anything in the fourth quarter impacting margins that we should be aware of, you're investing in some of these Megatrends and talked about a lot of really exciting things there, but any incremental investments or other factors influencing margins in the fourth quarter? And any kind of commentary about what you may consider to be industry-leading, but not peak margins as you're thinking about next year, especially as you're starting to implement this -- more fully implement this cost reduction program?

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

Mark, its Paul. Just thinking about the movement sequentially, we're going to see increased investment in Megatrends. And we've got some integration spend related to the PRECO acquisition. We still have the COVID sort of disruption that's happening in the supply chain. And then a little bit of higher incentive comp as our numbers continue to improve. So those would be the kind of headwinds against the stronger volume growth that we're seeing sequentially.

Operator

Our next question comes from Joseph Spak from RBC Capital Markets.

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

Just wanted to talk about the restructuring to align to the demand and that is saving you $65 million. When you announced that, you talked about meeting some lower end market demand, but now it does appear that demand is recovering faster than expected, at least in some end markets. So are those numbers still valid? Or does some of that go away as you look forward?

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

So Jeff, I can take it. It's Paul. The numbers are valid, they're related to restructuring actions, a lot of savings is people-related savings, we continue to execute on those restructuring programs. But not all done, as we said, we're implementing over the course of this year and well into next year. But the plan is to continue to implement those programs and generate that savings.

Some of that savings ultimately may get offset with a higher investment in our Megatrend initiatives, but that's to be determined as we develop our 2021 plan.

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

Okay. And then just on the electrification, I was wondering, obviously some positive developments here with the awards and the higher CPV commentary. Can you just remind us how big the electrification business is today? And then aside from the higher CPV, what about the margin profile of that business? Because I assume it doesn't have the scale of the ICE business today. So where are they today and where can they go in the future?

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

Yes. So when you think about the total company, that's the way we think about the current electrification business and the opportunity for the business in terms of that $6.5 billion SAM. Electrification represents only about 5% when I think of the new trend of electrification. Obviously, we've got a -- our legacy control business that serves as a self-setting circuit breaker in the market. And I wouldn't necessarily include that in the broader electrification theme, but it's a small portion today, but it's very rapidly growing. And it's a target area that we're looking at around high-voltage components and broad grid infrastructure, which will be needed to really allow the Megatrend to continue to move in this direction.

We're seeing very positive signs from our customers. Everybody has continued to invest in this trend, regulation continues to support this trend. Big NBO's almost half of our -- almost half of our NBO's thus far this year were in this area. And we're continuing to develop not only organic capabilities but also look at M&A to focus on this as well.

Operator

Our next question comes from Nik Todorov from Longbow Research.

Nikolay Todorov - *Longbow Research LLC - Analyst*

Congrats on great results. I was wondering if you can talk a little bit about the -- you mentioned unfavorable mix in both performance and in sensing. Maybe can you unpack that a little bit and talk about the puts and takes into the fourth quarter gross margin? And maybe how much of COVID costs expect into the fourth quarter? I think, Paul, you mentioned about $60 million or $65 million in the third Q.

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

The mix is -- we've got performance sensing business that's auto and HVOR and that the Industrial Aerospace business the latter being more profitable. As we look for Q3 to Q4, you can see this is pretty significant decline, which is seasonal and normal in nature in our industrial business. And our aerospace business still continues to be down, as Jeff mentioned, almost 22%, 23% year-over-year. So those 2 parts of our business are driving down the unfavorable revenue mix to some extent. It's also our automotive business is really recovering very quickly, and that is our lower-margin business when you think of the 4 segment business units that we have.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

So it's just a dynamic of where they are in terms of recovery cycle and the probability across the portfolio of businesses so far that's driving that mix.

Jacob A. Sayer - *Sensata Technologies Holding plc - VP of Finance*

COVID cost was the second question.

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

Yes. So COVID cost. They've been running somewhere in the $5 million to $10 million a quarter. It's just depending on just -- its labor inefficiencies or logistics inefficiencies, the supply chains have been disrupted, and it's all the elevated costs related to protecting our place. So they're running $5 million to $10 million on average in every quarter. Some more -- some quarters were a bit higher than that, somewhere in the lower end of that range.

Operator

Our next question comes from Amit Daryanani from Evercore.

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

I guess, first off, just on the December quarter guide, I think the implied assumption is auto production is down 4%, 5% in December. Could you just maybe talk about what are the geographical assumptions over there for auto production? And I'm curious, do you think this guide could prove to be as conservative as the one you had in September because inventory in the auto ecosystem still seems to be fairly lean at this point.

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

Yes. So let me touch on where we think automotive will be -- I think you got it right, about 4%, 5% down year-on-year in the fourth quarter. North America, we're calling it about down 3% versus fourth quarter last year, Europe 2%. So a pretty significant snapback in terms of performance sequentially in Europe. China is down, right? So that's another big change as China was in a growth mode and now is down 7% versus fourth quarter of last year. And then Japan and Korea are down 8%, 10% as well.

I note that from an overall production rate, it is an improvement during the fourth quarter, about 1.7 million units based upon Sensata's mix, but still lower than where they were fourth quarter of last year.

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

And I would just add that we're pretty much on top of the IHS estimates for Q4 that we adjust our business mix compared to the production that is in the IHS estimates, you'll see a little bit more negativity on the market than what you would see on pure IHS numbers when you exclude Toyota.

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

That's really helpful. And I guess as a follow-up, I mean, you guys have had a really impressive recovery, I think, from the bottoms of COVID over here operationally. So I'd love to get your perspective on what do you think gets you to go back to the buyback program and reinitiate that? What triggers that? Are you trying to wait for end market and demand to get better? Or are you trying to wait for the debt pay down to happen? I guess what triggers the buyback to come back would be helpful to understand?

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

I think we tried to lay out for you how we're thinking about capital deployment going forward. Really excited about the opportunities on the M&A side and continue to grow our businesses and into the Megatrend issues either organically or inorganically. So that's probably -- if you think of the priority, that's where the priority is right now. The call of the 6.25% is a highly NPV driven transaction. So we like the economics around doing that. But that will be determined like if assuming economic conditions remain good, certainly would be interested in getting that value for the company. I think share repurchases are still an important part of our capital deployment strategy. You see them as a third leg in the third of the 3 options that we have right now. Still important, but probably deemphasizing that a bit from work from the other 2.

Operator

Our next question comes from Samik Chatterjee from JPMorgan.

Bharat Daryani - *JPMorgan Chase & Co, Research Division - Analyst*

This is Bharat on for Samik. So just one question from me. If I look at your 4Q guidance. Sensing solutions, you expect the end market to decline 13% to 14%. So if you could just help us think about between industrial and aerospace what are you thinking about like each segments? How much improvement you're expecting in industrial? And within aerospace, I mean, defense continues to be strong, like are you seeing any signs of hitting in the other subsegments there within aerospace?

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

Sure. Yes, sure. So on the industrial side, fourth quarter is still about 9% down from prior year on a revenue basis. That's seasonally, usually, the fourth quarter is a little bit lower for the industrial business. And then on the aerospace side, it's still down pretty dramatically, 26% versus prior year. So that's what we're seeing in terms of the end markets there. So Paul, do you want to add anything to that?

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

No, I think that covers it.

Operator

Our next question comes from Luke Junk from Baird.

Luke L. Junk - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

First, just wanted to better understand the first commercial agreement for your heavy vehicle and off-road Smart & Connected fleet management offering. Maybe if you could just comment on how the revenue breaks down from a -- just a model standpoint between the more onetime aspects in terms of sort of front-end sales and the recurring piece? And then you also cite $90 million of Smart & Connected business wins in total year-to-date. And just wondering if you could provide a little more color on that as well.

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

Yes. I'd be glad to. So it's a first commercial experience with this in terms of closing business. And as I'm sure you know, fleets don't do a big bang in terms of how they roll this out. They start with a pilot, they roll it out to additional vehicles, and then they continue to expand that over time.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

And that's what we would expect across not only this one fleet manager that we've engaged with, but the others that we're in the process of having pilots with.

So it's a small start. That's a small revenue base to start with, but it's a clear indication that the solution provides value and the fleet managers are engaging with us to roll it out. And as I mentioned, a lot of these fleets in the aftermarket have tens of thousands of vehicles, right. So the magnitude of the addressable market that we've talked about of $6 billion is real based upon a conservative view of fan-out across that market.

And so different fleet managers will choose different business models and contract structures on this. So this particular fleet manager wanted a full subscription basis. So in that environment, we buy the equipment or build the equipment. We work together to install it, and then they pay us on a subscription basis over a 6- or 7-year time frame. Others will choose to buy equipment upfront and then just pay for data services.

So every model will be slightly different and will tailor it to the interest and the desire of the individual fleet manager. I'm very excited about the opportunity, very excited about bringing it to commercialization in a very short period of time, and looking forward to providing more updates as we continue to fan this out with other customers and with this particular customer.

Jacob A. Sayer - *Sensata Technologies Holding plc - VP of Finance*

So Luke had mentioned as well, the $90 million in NBOs. It is important to note Luke that's in the OEM market rather than in the aftermarket. So those will be with the truck and trailer manufacturers rather than the fleet manager. So more traditional hardware sale from Sensata.

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

Right, great point, Jacob. So it's important to note, and we've talked about this in the past, but the foundation of our Smart & Connected initiative here is around tire pressure and in an on-road truck environment there are unique requirements associated with enabling tire pressure, which introduces the notion of a hub or a vehicle area network, which is the foundation for collecting lots of additional sensor data to feed information and insight into the cloud. So that's the part that's being implemented in OEM's and we're doing the same thing in aftermarket with a broader suite of offering.

Luke L. Junk - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Okay. That's super helpful. And then maybe just as a follow-up, maybe more of a hypothetical. So the U.S. election coming next week, if, of course, there's a change of administration. Biden has signaled that he would move to rise fuel economy standards fairly sharply, above even the prior level contemplated under the Obama administration. Can you just talk about what that impact might look like in your business in terms of the clean and efficient driver? And ultimately, how does Sensata win the stricter fuel economy standards in the U.S. potentially?

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

Yes. It's -- regulation and environmental policy is a long-term game. And it's not something that can change overnight. But the trends are very positive in terms of being favorable to what it is that we offer as a company, what our value proposition is.

And I would view that a tilt toward more environmentally friendly and more regulatory-driven policy would, over time, be quite positive for us as a company. And so hard to know exactly how that will fan-out. But certainly, we feel as though, even with the current administration, the opportunities are significant if there's a shift toward more conservative policies from an environmental standpoint, it could -- it has to help us in the long run.

Operator

Our next question comes from David Kelley from Jefferies.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

I guess first one, starting with automotive. I believe in the prepared remarks, you referenced challenges to support outsized customer demand ramp. Just curious if there were any onetime costs such as overtime in the quarter to meet the more aggressive industry snapback than we all expected?

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

No. No, David. It's just -- we run our business very lean, managing our cost of demand as tightly as possible. And with the rapid improvement in the end market, and we weren't able to serve all the demand that our customers were ordering for product. And so that had some of an impact on the amount of revenue we were able to generate in the quarter. Long-cycle business, we've got some long lead-time items. It takes a little time to get caught up and we'll get caught up, but it did create a little bit of a bump in terms of our ability to generate all the demand that was out there.

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

Yes. And the only thing I'd add to that is that in the third quarter, you know that the trend improved dramatically through he quarter. And so, given the guide that we provided when we -- in July, you could probably sense that July was strong, but not as strong as September. And so the growth of demand during the quarter was quite strong. We're going to approach that a little bit differently in the fourth quarter, given that the demand is there.

So October, we're starting out strong to make sure that we don't have a December that has a high demand that creates challenges to deliver. But again, you want to go back to the team's efforts on this managing through a very steep decline in the second quarter and managing costs and everything that needs to be done as a result of that and then the snapback managing that, a real testament to the team's capabilities.

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

Okay. Great. That's super helpful. And maybe as a follow-up, in line with that demand discussion. Should we think about outgrowth in auto is beginning to normalize? You target 4% to 6% -- 4% to 6% range go forward, or should we expect some ongoing variability as production slowly or perhaps continue to aggressively returns back to normal?

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

We had called out that the third quarter would be a little bit lower for auto, given COVID-related launch delays, right, in the second quarter as customers were preparing for launch in the third and fourth quarter. They had some challenges in terms of people being able to do what they needed to in terms of testing products and so forth and preparing for launch.

So we called that out. That became true, 290 basis points of outgrowth in the third quarter for the automotive business. Fortunately, our other businesses offset it. So as a company, we were at 520 basis points of outgrowth.

There's always some level of variability by quarter, by business. But again, I would point to the fact that given that we are a long-cycle business for most of our end markets that we serve, we are able to see what that outgrowth is going to look like. They plan for these launches. And we know what the new business wins are. So we have a high degree of confidence in long-term being able to maintain in that range, not necessarily in any given quarter, but long-term, for sure.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Operator

Next question comes from Brian Johnson from Barclays.

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

Very quick housekeeping question, and then the real question. The housekeeping question is, is there anything changing between operating income and EPS in the fourth quarter? Just my math, I'm getting a little lighter EPS than implied by the EBIT upside versus consensus.

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

I think for all the lines, you have 3 things that drive it. It's balance sheet, hedging of currency, exposures. Obviously, interest expense is rising because of the new bond deal, which is a higher coupon than the revolver. And taxes are arising a little bit in terms of mix.

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

Okay. Second question, on the electrification offset that you outlined, are those in actual vehicles right now? Or is it more the products on your shelves have those potential?

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

I'm sorry, the potential for what? In terms of the...

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

Perceived to be offset.

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

I got you. So the $50 of content you're referring to?

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

Right. Is that something that actually customers have filled on? Or you just have a shelf in your store that they could if they wanted there to get back to?

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

No, no, no. No. So these are designed in products for vehicles, for battery electric vehicles that have 50 or greater of content in them. And it's not just we have a product for when and if they chose to buy it. So it's designed in, it's sold business that generates that content per vehicle.

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

Okay. And if you were to think about the market share of these opportunities versus what in your sensors that go in the combustion engine equipment. Do you see any meaningful difference, more concentrated, less concentrated spots?

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Yes. Well, a little -- the wins on the electrification side tend to be a little more lumpy. And what I mean by that is they're bigger because the platforms that our customers are creating tend to be larger and panned out across a larger number of vehicles. So the wins are a little bit more lumpy. Therefore, the product categories tend to be a little bit more lumpy as well in terms of the overall opportunity. But there are many opportunities in the electrified vehicle space that we're either serving today or pursuing that we believe will continue to allow us to -- will benefit from this trend that we're seeing.

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

Yes. And just final follow-up question there. GM announced the LTM skateboard with wireless battery sensing. It was a different company though they highlighted publicly [Advanced Micro] (corrected by the company after the call), for the solution. Does that mean that -- do you still have an opportunity on the GM platform? Is that a competitor in a year? Or did they just choose to highlight a different part of the platform that's not quite the same as what you're selling?

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

For battery management, it's not us that's doing battery management, but we're certainly -- we have an opportunity to serve other components within GM for that platform.

Operator

Our next question comes from Wamsi Mohan from Bank of America.

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

Can you maybe talk about how we should think about incremental margins heading into 2021, especially given that you have some material cost initiatives that you have underway going into next year? And I have a quick follow-up.

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

Wamsi, its Paul. So we're not going to be obviously giving guidance yet for '21, but I will say that with the growing volume, we do expect if the volume does continue at this pace, that it would drive nice incremental margins from that incremental volume if we stay at these levels. Obviously, the repositioning actions will help. We're going to continue to invest in the Megatrends, in our growth initiatives, and as Jeff talked about we are continuing to invest in our people. We have a pay for performance model. So with greater profitability, greater incentives, compensation within the P&L next year.

So I do think margins will expand next year if revenues continue at these levels.

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

So Paul, just to clarify though, the conversion rate itself, the incremental margin conversion rate itself, the drop-through should be higher than historical on those incremental?

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

For a period of time, that's right. For a period of time, maybe I would say, it's got to look a lot like what we've seen on the way down. By the way, we'll see incremental margins higher than normal. At some point, we're going to have to put investment cross back into the business. So that will start eating into the incremental. But right now, we're working in an environment where we have the capacity, margins dropped a lot because we weren't able to just get at our semi-variable and fixed costs, kind of same phenomenon on the way back up. So more of a variable model rate.

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

Right. As a follow-up, I mean, just sort of segues into this, but more on a 2020 basis. And if you look at the revenue guide that you gave at the start of the year pre COVID and where we're ending up. It's about $500 million lower on revenues and about $1.50 lower on EPS roughly. Would you say substantially all of that is COVID for revenues? Or do you think that there were other moving pieces in there? And then what about on the decremental margin side, can you maybe parse that again into COVID versus the restructuring versus the Megatrend spends or anything else that you think is material?

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

At a high level, I think we've done a good job delivering on our outgrowth targets. So I think we executed the things that were in our control, and so the outgrowth has been strong. I think most of this is -- not all of this is market-related, and I would suggest that it's all related or mostly related to COVID-19.

In terms of our cost structure, we've talked about a few times that in the first half of the year, we weren't really able to get at our semi-variable and fixed cost. So we were seeing our cost structure moving in line with -- our volumes move more aligned with our variable costs. We took actions in Q2 around temporary furlough. It generated $22 million in savings, so that was a temporary benefit. It didn't repeat in the second half. Now we're doing permanent cost actions because the demand levels are lower and they will be lower for some period of time.

I think those are the major drivers of profitability. We're adding -- we are investing more in Megatrends because we see a lot of opportunity to grow, and we want to pursue those opportunities for long-term sustainable growth. So that is a lever as well. But for the most part, I mean, I think we're just cycling through a much -- a very depressed end market that's now starting to recover, and we're showing strong results because of it.

Operator

Our next question comes from Jim Suva from Citi Investment Research.

James Dickey Suva - *Citigroup Inc., Research Division - MD & Research Analyst*

Can you just talk a little bit about any visibility you have on channel inventory? Or sometimes you sell into a middle harness maker or a middle aggregator, whether it be Delphi or other, both on the automotive side as well on the HVAC side?

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

Yes. So the auto side is a lot more transparent to us. To be candid auto, HVOR, aerospace is a huge amount, more transparent. We talked about the fact that we believe we built about $25 million of inventory in the channel in automotive in the first half of the year. We believe that, that has unwound in the third quarter. We had originally expected that to unwind over the balance of the year, so it unwound quicker than we had thought.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

We don't see any evidence that in aerospace, HVOR, and in auto, that there's any significant inventory builds. And candidly, Jim, we judge that based upon discussions with our buyers, but also calls we get if something doesn't ship on a Friday, and it was supposed to. And that supply chain is fairly tight. We don't believe there's a lot of inventory.

On the industrial side, it's a little harder. You point out, that's the one area where we do sell-through some distributors. The indications that we get is that there's not a ton of inventory build there. I think we all experienced this being consumers in terms of going to try to buy major home appliances or other goods. There is a backlog in terms of demand that has not been able to get fulfilled. And I would use that as a proxy for belief in terms of at least our products, whether or not there's any significant pent-up inventory in the system. We're not calling anything else that we're viewing will unwind in the near term.

James Dickey Suva - *Citigroup Inc., Research Division - MD & Research Analyst*

Okay. And so unwinding, does it get you back to equilibrium? Or is unwinding get you back to a little bit too lean than where you'd like to be?

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

There isn't anything to unwind. And so, I would say that we're probably about an equilibrium now in terms of inventory in the supply chain. I would say that with the increased demand, you might see customers trying to build a little bit more inventory to make sure that they can serve end market demand rather than in a mode of cutting back on inventory. That would be where I think we are on the continuum.

Operator

Our next question comes from Michael Filatov from Berenberg Capital.

Michael R. Filatov - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

I was just wondering if you could update us sort of on the revenue for GIGAVAC and sort of how that performed in that business and the high-voltage contactor has performed relative to the rest of the business? And then also sort of broadly speaking, I know there's more high-voltage contactors on sort of higher performance electric vehicles. And I was wondering how many contactors, generally speaking, on average, do you guys have right now on EVs or BEVs and how that -- you see that trending over time for your business?

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

Yes. So a couple of points in there. So on the GIGAVAC business, although we're not calling it out directly, I would say in a significantly down market GIGAVAC has continued to grow quite nicely. And that's driven based upon the content growth that we're seeing for the offering that they have.

And so, we had a -- when we bought this business, we knew what was going to be a very fast grower, very accretive growth rates to Sensata overall, and that's what we're targeting from an M&A standpoint. The businesses that can have differentiated margins, but also be growers that grow at rates much faster than the core business, GIGAVAC has fulfilled that.

In terms of the number of contactors, that's a platform system architecture question. There are a number of vehicles out there today that have 4 to 6 contactors in place, others have 2 contactors in place. Given the magnitude of the cost associated with contactors, I would expect that over time, that will -- the architecture associated that will push down to fewer numbers. But going in the other direction or pushing in the other direction for more protection, and therefore, more contactors is that understanding what this application does. It protects the most valuable asset in the vehicle battery, and it also protects the charging equipment and the person applying the charge. So it performs an incredibly important function. OEMs will always look to take out cost to be more competitive, but we don't view that as being anything that would be unusual or a negative toward our investment case on this particular acquisition.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Operator

Our next question comes from Joseph Giordano from Cowen.

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

This is Robert in for Joe. I just first wanted to see if you could provide a view of what you're seeing in terms of underlying investment in auto production facilities. Is this more like filling existing capacity? Or are you seeing anything different across the various regions?

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

In terms of our customers, Joe, is that what you're asking or how we're building out our capacity. I'm sorry, just -- if you could be a little more specific on the question.

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

Sorry. In terms of your customers, like at their facilities where their underlying investments being directed?

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

Yes. I don't see any meaningful change in terms of our customers where they're designing manufacturing assembling vehicles. And no major change on our part either in terms of how we're doing this. We just talked about GIGAVAC. We now have automated high-speed lines in both China and in Mexico to serve the global automotive market.

And so we've navigated through some of the challenges in terms of trade and so forth that have been expressed, but we -- I just haven't seen it result in any major change in terms of supply chain development.

Operator

Our next question comes from Craig Hettenbach from Morgan Stanley.

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

Jeff, looking at the industrial market, beyond what looks to be kind of an industrial kind of recovery here. Can you maybe just frame the growth expectations in that market? I know autos get a lot more attention given the significant size, but just across the portfolio you have kind of in the mid to longer term, what type of growth opportunities do you see in industrial?

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

Yes. Great question. I appreciate the opportunity to talk about some of the other end markets that we serve. Obviously, industrial is an enormous market, highly fragmented. We have a number of different products and end markets that we're serving there. You know that the third -- it's actually the market that's gone down the least, but it also has recovered the least amount during the year. So that different that -- market concentration in terms of a lot of different areas has been very helpful.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

So third quarter was a very strong quarter for our industrial business. It was only down about 2%, really driven based upon the demand for medical device, a small portion of that overall business, but had really helped it. It's a target area for us.

So when we start to talk about things like smart grid infrastructure that would fall more squarely in the industrial business, certainly, we'll continue to explore all industrial IoT-type applications within that business. So lots of opportunity. It's important also to note that the biggest component of that business is the -- our legacy controls business. And it's a very profitable business, a very sticky business, but a slower growing business. And so when you look at that business, in total, our target areas will be on the faster-growing areas as opposed to the core businesses that we have in there that are GDP-like growers.

Operator

Our next question comes from Deepa Raghavan from Wells Fargo Securities.

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

Jeff, can you talk about the Megatrends investment in terms of autos versus HVOR versus industrial? And I assume autos, obviously, investments are increasing, but can you also talk about any -- our spends -- our investments in industrial accelerating as well? How do you think about that Megatrend investment portfolio?

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

Yes. So I apologize. I think I got the nature of the question, but let me repeat it just to make sure. So it's -- where the Megatrend investment is being focused across end markets? Is that the nature of the question?

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

Yes. I mean, is that also in the industrial portion, and also a portion in the auto.

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

Yes. Okay. Okay. Yes. So we're being very purposeful that our Megatrend, our investments are company-wide initiatives. And because we believe that these Megatrends will impact all of the end markets that we serve.

Now it's critically important that we have a very strong position in electrification, in auto. So as the trend from combustion engine to electrified platforms continues that we're well positioned for that. But make no mistake. We are targeting capabilities that can serve the broader market.

And so clearly, as we look at the organic development that we have ongoing, that will serve auto, industrial, the HVOR market, a little less so the aerospace for obvious reasons. I think electrification is a little further out but it serves all of those end markets. And you'll see that both our organic and our M&A-related activity will be focused on all of the end markets as we pursue these Megatrends.

And yes, that applies to the Smart & Connected as well. More concentration in Smart & Connected around transport and logistics chains. But certainly, the focus would be to look at it pretty broadly across a number of market segments.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Got it. One on potential costs heading into 2021, I think since you were able to talk about, any early thoughts, but also, how do you think about momentum exiting 2020, entering 2021? And if you can also focus a little bit on the inventory situation in auto, HVOR here in the U.S. as we exit. Do you think the OEMs would have replenished efficient inventory by end of the year? Or should that continue to influence production into 2021 also and thereby benefits suppliers like yourself?

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

Yes. So obviously, we're not going to provide specific guidance on 2021. But if you look at all of the third-party forecasts, it would suggest that the growth will continue from 2020 where we landed into 2021. If you look at all of our end markets, even at the fourth quarter guide, they were down fairly dramatically from 2019, and candidly, nowhere near peak levels, right? So if we pick the automotive market specifically, we're forecasting, call it, down close to 20% year-over-year. The peak auto markets were back in 2016, 2017. So we're nowhere near peak automotive market.

So our view would be that 2020 is a fairly good low point in terms of to recover from, we're not taking that for granted. Everybody is watching signals to see whether or not there could be a double dip or other impact, but the feeling is that from here, there will be some nice growth potential over the next year or couple of years, depending on the rate of recovery. Certainly, the recovery thus far this year has been stronger than at least I would have anticipated.

Operator

Our next question comes from Matt Sheerin from Stifel.

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

Just a couple of quick ones for me here. Just regarding the commentary around M&A, Jeff, and that being a priority for cash use. You've also talked about focusing on areas of growth, emerging markets, all the things that fit into your technology themes. But could you talk about a little bit more on that strategy, particularly, are we continuing to expect more tuck-in acquisitions versus the larger deals you did 4 or 5 years ago?

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

Yes. I am glad you asked that to sort of clarify. So we've kept the pipeline for M&A quite full during this time. Although we've been for obvious reasons, cautious in terms of capital deployment in the area of M&A, other than the one small transaction that we did with PRECO. The near-term focus will be on more bolt-on byte sized type M&A. So nothing in our sort of target zone of that $1 million purchase price or $1 billion purchase price type range.

The target areas will be around the electrification and Smart & Connected areas. So electrified equipment broadly, not just auto, electrified equipment and smart grid infrastructure. And also around Smart & Connected, transport and logistics, and that is a focus.

We're also going to be focused on not only high growth segments, but businesses that will be highly accretive to Sensata's growth rate, right? So they're not value play where we're going to buy something, we're going to extract cost. We believe that the businesses that we're targeting can have differentiated margins perhaps not at Sensata's margin but differentiated margin, but very high-growth rates, and where we have the ability or the right to play, right?

So solutions or competencies that we have or end markets where we have specific knowledge regarding bringing mission-critical solutions. So that's our target area, not big bang type transformational stuff, more bolt-ons to further our strategy.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Operator

Our next question comes from Shawn Harrison from Loop Capital.

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

I guess my inability to remember to hit star 1, got me a lot of e-mails, asking more on the guidance, specifically, a lot of inbound e-mails, just asking about, if we could even further define, Paul, the step-up in the OpEx sequentially, I know you cited incentive comp and more investments and some other factors. But just is there a way to quantify the exact dollar amount you're seeing step-up in OpEx into the fourth quarter to kind of level set us as we start to then think about '21?

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

I'd say [--operating profit] (added by the company after the call), so we're up sequentially from Q3 to Q4 around $13.5 million. And I would have said if without the incremental investment we would have been up about $20 million with improved volume. So it's probably $7 million, $8 million incremental investment, that's when you consider the items I mentioned earlier on the call.

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

Very helpful. Okay. And then as a brief follow-up. Just on the electrification side of the car, Jeff. Maybe if you could speak to 3 years out, it's $50 of content now. I think we all expect range to go up, charging time to come down. What would that potentially -- and maybe other items you can add into the vehicle, take your content up to from $50 on average now to, say, 3 years out?

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

Yes. So I think it's a question of the item that you pointed out, how quickly our customers migrate toward these harder to do applications. I believe strongly that it's the direction that everything will go, and that requires the types of capabilities that we have. Given the fact that we believe on those vehicles today, we have $50 of content based upon where we're sold in. Obviously, we're not stopping there. And we'll have a number of organic initiatives underway that will continue to drive that north. And we'll also without question target other M&A-related activity that we'll continue to move that north of that number.

And so, it's a large world out there in terms of the target opportunity, don't want to make a specific call on what our target content per vehicle is, but there's ample space, if you will, for us to pursue that can continue to drive that in a very positive direction for us as a company.

Operator

And ladies and gentlemen, with that, we've reached the end of today's question-and-answer session. I would like to turn the conference call back over to Jacob Sayer for any closing remarks.

Jacob A. Sayer - *Sensata Technologies Holding plc - VP of Finance*

Thank you, Jamie. I'd like to thank everyone for joining us this morning. Sensata will be participating in the upcoming R.W. Baird Industrial Investor Conference on November 10 and the Melius Industrial Investor Conference on December 9. We look forward to seeing you at one of those events or on our fourth quarter earnings call in early February. Thank you for joining us this morning and for your interest in Sensata. Jamie, you may now end the call.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Operator

Ladies and gentlemen, with that, we will end today's conference. We do thank you for attending. You may now disconnect your lines.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2020, Refinitiv. All Rights Reserved.

©2020 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

