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ST.N - Q4 2021 Sensata Technologies Holding PLC Earnings Call

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OVERVIEW:

ST reported 2021 revenue of $3.8b and adjusted EPS of $3.56. For 4Q21, revenue was $934.6m. Also, expects 2022 revenue to grow 8-12% YoverY.

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PRESENTATION

Operator

Good morning, and welcome to the Sensata Fourth Quarter 2021 Earnings Conference Call. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference over to Jacob Sayer, Vice President, Finance, Investor Relations, Sensata Technologies. Please go ahead.

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

Thank you, Andrew, and good morning, everyone. I'd like to welcome you to Sensata's fourth quarter 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.

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In addition to the financial results press release we've 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. This conference call is being recorded, and we'll post a replay webcast on the Investor Relations website shortly after the conclusion of today's call.

As we begin, I'd like to reference Sensata's safe harbor statement on Slide 2. During this conference call, we will make forward-looking statements regarding future events and financial performance of the company that involve risks and uncertainties. The company's actual results may differ materially from the projections described in such statements. Factors that might cause these differences include, but are not limited to, those discussed in our Form 10-Q and 10-K as well as other subsequent filings with the SEC.

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 non-GAAP financial measures. Our GAAP to non-GAAP financials, including reconciliations, are included in our earnings release and the appendices of our presentation materials. The company provides details of its segment operating income on Slides 8 and 9 of the presentation which are the primary measures management uses to evaluate the performance of the business.

Jeff will begin today with highlights of our business during the fourth quarter and full year 2021. He will then provide an update on our recent progress in our key Electrification and Insights strategic growth areas. Paul will cover our detailed financials for the fourth quarter of 2021, including revenue growth and market outgrowth by business unit, and he will also provide financial guidance for the first quarter and full year 2022. We will then take your questions after our prepared remarks.

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

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

Thank you very much, Jacob, and welcome, everyone. I'd like to start with some summary thoughts on our strong performance during the fourth quarter and full year 2021, as outlined on Slide 3.

While automotive production declined substantially during the quarter compared to prior year due to supply chain shortages, we responded effectively to deliver our customers' orders against strong consumer demand and produced solid financial results for shareholders, delivering $935 million in revenue, or growth of 3.1% from the prior-year period, above the guidance range we provided in October.

We once again produced strong market outgrowth, well above our target range. As a company, we delivered 800 basis points of outgrowth during the quarter and 960 basis points for the year. Since 2018, on average, we have produced 640 basis points of outgrowth annually. This demonstrates Sensata's secular growth potential and the vital role we play for our customers. Paul will discuss our strong revenue outgrowth in more detail.

Sensata was awarded a record $640 million of new business wins during full year 2021, nearly half of it coming from our megatrend growth vectors. We expect these new business wins to translate into Sensata's future revenue outgrowth. Sensata's revenue outgrowth to market is increasingly driven by our rapidly growing positions in the megatrend areas of Electrification and Insights.

We continue to invest in these growth initiatives, both organically and inorganically. Xirgo and SmartWitness expanded our capabilities in the telematics and Insights ecosystems, while Lithium Balance, the Churod joint venture, Spear Power and Sendyne added to our differentiated Electrification product and solution offerings.

During the fourth quarter, we benefited from our resilient and flexible and focused organization that continues to successfully navigate the ever-changing supply chain landscape and deliver on our customers' needs. We are working diligently to limit the effects of supply chain challenges, including working with our customers, to offset these costs commercially. Despite these elevated costs, we delivered $198 million in adjusted operating income during the quarter, representing 21.1% in operating margin for the fourth quarter.

Full year revenue grew by 26%. Operating margins for the year were 21.1%. And adjusted EPS grew by a very impressive 61%. I'd like to recognize the innovation, agility and hard work of our entire team in achieving these strong results.

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As you may recall, Sensata published its first sustainability report in September, and we're very proud of our progress in these areas. Virtually every product Sensata makes today results in a cleaner, safer and more efficient world. We also take our responsibility to reduce the carbon emissions from our own operations and our supply chain seriously.

To that end, we established specific goals in each area of environment, social and governance in line with leading companies around the world, and we made good progress in 2021 against these goals. For example, Sensata's Board of Directors is now 36% diverse and we are investing $3.3 million in energy-saving capital improvements during the coming year. We will report out -- on our continued progress in an updated sustainability report later this year.

Moving to Slide 4. Sensata is making excellent progress in winning new business in Electrification components, subsystems and full turnkey solutions, in part because we take a holistic view of electrification and its growing impact on all the markets we serve.

During 2021, we saw a dramatic uptick in the amount of new Electrification business awarded to Sensata, amounting to $270 million in annual future revenue. We are discussing with customers additional opportunities representing a future pipeline of over $1 billion in potential new Electrification business.

Revenue from Electrification efforts across our business was $260 million in 2021, including automotive, heavy vehicle, off-road and clean energy solutions. We are expecting a greater than 50% increase in revenue in 2022 from these efforts. And Electrification revenue in automotive is expected to grow over 70%, supporting our view that battery electric content per vehicle reaches 2x that of internal combustion engine vehicles within 5 years.

As an example of the expansion of sensing and electrified solutions, we were awarded new e-motor temperature and position sensing business with a large European OEM, representing over $30 of content per electric motor. And this content doubles in vehicles with dual motor configurations.

During the quarter, we acquired Sendyne to add their differentiated, current sensing, isolation monitoring and simulation technology to Sensata's expansive offerings. These are critical components in transportation as well as industrial high-voltage energy storage architectures.

On February 22, we'll webcast a teach-in covering our Electrification product and solution set and customer use cases so listeners can gain a better understanding of the rapidly evolving market, our offerings and our go-to-market strategies in this key growth vector for Sensata. We hope that you can join us.

On Slide 5, we share an update on our continued progress in Sensata Insights. The Insights initiative addresses the large and fast-growing telematics space, and we're pleased by the traction we are gaining. As evidenced by the value-added nature of our solutions, we were awarded new business worth $37 million during 2021, and we have identified a pipeline of more than $200 million in potential future business wins that we are discussing with customers.

The Insights growth initiative generated $75 million of revenue during 2021 and is expected to grow by greater than 100% in 2022. An example of a large recent win includes a tire pressure and gateway solution that will be installed by a leading heavy-duty trucking firm with a total contract value of $17 million. This solution enables the fleet to remotely monitor tire condition across their trucks, to streamline their maintenance efforts, saving money while also preventing accidents and roadside events.

I'm also pleased by the progress we've made in quickly integrating SmartWitness into our Insights business, and we are already winning business on a combined basis. SmartWitness' video solution comprised proprietary software and hardware purpose-built for telematics service providers, and they were given an innovation award at the recent Consumer Electronics Show.

In summary, I'm really encouraged with our continued progress in these megatrend growth initiatives. As I've said before, we see numerous opportunities to utilize our strong financial position, engineering capabilities, supply chain and customer relationships to meaningfully enlarge our addressable markets through organic efforts as well as bolt-on acquisitions and partnerships within these areas.

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Now I'd 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 fourth quarter, as shown on Slide 7, include revenue of $934.6 million, an increase of 3.1% from the fourth quarter of 2020. Adjusted operating income was $197.6 million, an increase of 1% compared to the fourth quarter 2020, primarily due to acquisitions and favorable foreign currency, somewhat offset by lower organic volume and higher megatrend spend.

For the full year 2021, record revenue of $3.8 billion represented an increase of 25.5% over 2020. Adjusted operating margin of 21.1% represented an increase of 260 basis points from the prior year. And adjusted earnings per share of $3.56, an impressive increase of 61.1% from 2020 and the same level of earnings per share we set in 2019.

Now I'd like to comment on the performance of our 2 business segments in the fourth quarter of 2021, starting with Performance Sensing on Slide 8. Our Performance Sensing business reported revenues of $685.1 million, a decline of 0.6% compared to the same quarter last year. This was driven primarily by the 16% market decline in automotive, offset by our substantial market growth of 520 basis points in automotive and 1,700 basis points in heavy vehicle, off-road; as well as revenue from acquisitions. Automotive customers appear to have consumed a small amount of inventory built earlier in the year.

Performance Sensing operating income was $185.6 million, with operating margins of 27.1%. Segment operating income increased due to acquisitions and favorable foreign currency, offset by the impact of lower organic volume.

As shown on Slide 9, Sensing Solutions reported revenues of $249.5 million in the fourth quarter of 2021, an increase of 14.7% as compared to the same quarter last year. This was driven primarily by growth in the industrial markets and strong market outgrowth, including the launch of new industrial Electrification applications.

Sensing Solutions operating income was $74.5 million, an increase of 5.4% from the same quarter last year, with operating margins of 29.8%. The increase in segment operating income was primarily due to higher volumes, partly offset by higher supply chain costs.

On Slide 10, corporate and other operating expenses not included in segment operating income were $72.8 million in the fourth quarter of 2021. Excluding charges added back to our non-GAAP results, corporate and other costs were $61 million, an increase of $2.5 million from the prior-year quarter, reflecting higher research and development and business development spend to support our megatrend growth initiatives. We currently expect between $60 million and $70 million in megatrend-related spend in 2022 to design and develop differentiated sensor-rich connected data solutions for the fast-growing and transformational megatrend vectors of Electrification and Insights.

As shown on Slide 11, we generated $117 million in free cash flow during the fourth quarter. Free cash flow was impacted in the quarter by our decision to increase raw material purchases in order to maximize production flexibility, given the widespread part shortage in our supply chain. For the full year 2022, we expect free cash flow conversion to be approximately 80% of adjusted net income and we expect capital expenditures to be in the range of $165 million to $175 million.

Sensata's net debt-to-EBITDA ratio was 2.8x at the end of December, near the bottom end of our target operating net leverage range. Sensata's primary use of cash on hand is to acquire businesses that will extend our position within our key growth vectors of Electrification and Insights. We expect our net leverage ratio to decline to 2.2x by the end of 2022, excluding the impact of further M&A.

In addition, we resumed our share repurchase program in the fourth quarter, purchasing $48 million worth of shares. And the Board recently issued a new share repurchase authorization in the amount of $500 million.

We are providing financial guidance in the first quarter of 2022, as shown on Slide 12. Our expectations are based upon the end market outlook as shown on the page. We are more conservative than IHS regarding global light vehicle production in the quarter, down 9% versus down 2% on a revenue-adjusted basis. The revenue components of our guide include market outgrowth, completed acquisitions and foreign exchange.

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We do not expect supply chain inventory to unwind during the quarter. Our current fill rate is approximately 96% of the revenue guidance midpoint for the first quarter. At the midpoint, adjusted operating income margin is expected to be 18.5%, which includes the impact of lower organic revenue and normal price movements when compared to the same period last year. We are making good progress offsetting increased operating costs associated with global supply chain challenges, with customers that continue to face rising material and labor inflation.

In addition, we are increasing investments for growth in megatrend-related areas as well as in our recent acquisitions, which will have lower margins than our core business as we invest to rapidly scale these new growth vectors. Sensata's adjusted operating margins typically decline sequentially from the fourth quarter to the first quarter, primarily due to annual pricing changes with customers and this year are further impacted by the rise of inflation. This decline typically offset by productivity improvement throughout the balance of the year, and we expect this to be the case again in 2022, particularly as revenue grows through the year.

We are also providing financial guidance for full year 2022, as shown on Slide 13. Our expectations are based upon an end-market outlook that I will discuss in a moment. Revenue growth between 8% and 12% includes the impact of market outgrowth, acquisitions and foreign currency. We do not expect the roughly $90 million of inventory built in the automotive supply chain during 2021 to reoccur in 2022. At the midpoint, adjusted operating income margin is expected to be 20.7%, which includes volume leverage and productivity more than offsetting price and input cost inflation impacts and increased investments for growth.

On Slide 14, we provide our estimates for OEM production growth for 2022 as compared to 2021. We currently expect automotive production to increase approximately 7% this year. Once again, our outlook is more conservative than current IHS automotive production estimates, as we see production constraints from global supply chain shortages lifting slowly through the year.

As Jeff highlighted earlier, Sensata's organic revenue outgrowth to the market, as shown on Slide 15, has grown annually since we set those targets at the end of 2017. On average, over that time, the company has delivered 640 basis points outgrowth. And last year, we delivered 960 basis points of outgrowth.

Looking forward, we are simplifying the outgrowth target to be a company-wide target of 400 to 600 basis points of revenue growth above markets. And for 2022, we expect to be at the top end of that range. Each of our businesses will continue -- will continue to contribute to that total, some higher and some lower in any period, so that in aggregate we reflect the value of our innovative engineered solutions for all our customers through revenue that grows faster than underlying markets.

In addition to the organic revenue growth over market, we also intend to grow by acquiring businesses that give us access to fast-growing differentiated applications that address our customers' needs. Our long-term target is to acquire new revenue streams that add an additional 400 to 600 basis points of inorganic M&A revenue growth to Sensata each year. Our acquisition engine is warming up. We achieved 250 basis points of acquired revenue growth last year, rising to 370 basis points in the fourth quarter.

Now let me turn it back to Jeff for closing comments.

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

Thank you, Paul, and let me wrap up with a few key messages, as outlined on Slide 16.

Sensata's business and organizational model is strong, resilient and reliable. We deliver mission-critical, highly engineered solutions required by our customers. We aim to outgrow the markets we serve in total by 400 to 600 basis points per year. We are confident in our ability to sustain this attractive end-market outgrowth based on our record levels of new business awards and our large and expanding pipeline of new opportunities.

We continue to invest in our megatrend growth initiatives that are opening up large and rapidly growing opportunities for Sensata across all our end markets. We are making excellent progress in Electrification and Insights, both organically through strong new business wins and inorganically through bolt-on acquisitions or joint ventures. We are targeting adding 400 to 600 basis points of inorganic revenue growth annually.

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We will continue to innovate on behalf of our customers. solving their hard-to-do engineering challenges in sensing and electrical protection. We will also continue to provide differentiated Electrification and Insights solutions to a broad array of customers. Solving these mission-critical challenges enables Sensata to continue to deliver industry-leading margins for our shareholders while also increasing investments in our growth opportunities and our people.

And finally, I'm excited about Sensata's long-standing mission to help create a cleaner, safer and more connected world, not just for our customers' products, but also through our own operations. We believe we are meaningfully contributing to a better world. We are on our way to achieving the targets laid out in our first sustainability report, bolstering the long-term sustainability and success of the company for all of its stakeholders. We look forward to reporting more about our progress in these areas in future updates.

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

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

Thank you, Jeff. We'll now move to Q&A. (Operator Instructions) Andrew, go ahead and start the Q&A roster.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Wamsi Mohan with Bank of America.

Wamsi Mohan - *BofA Securities, Research Division - MD in Americas Equity Research*

Yes. In your last call, you had called for about $9 million in supply chain headwinds year-over-year in the fourth quarter, and it seems like it came in much lower, impacting you by just a $0.01 headwind. Why was it so much better than expected? And why is that benefit not flowing into the first quarter where it seems to be hitting you relatively hard again, if I'm interpreting your comments and numbers correctly?

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

Wamsi, it's Paul. I think we've done a better job than expected around trying to recover costs from customers. And so that's worked out quite well. But the costs keep rising, and so we're chasing it a bit. And so as we look at the first quarter, material prices and inflation conditions around labor have continued to rise. We continue to work with customers to recover a large portion of that cost.

But in the first quarter, it's a bigger impact. And throughout the rest of the year, we have a number of different productivity initiatives that we have to fall back those impacts, whether it's continuing to improve the performance of our sites, restructuring our costs and being more cost effective and also the benefit of volume leverage as we see revenues growing sequentially through the year.

So you can see a big step-up in Q2, 3 and 4. And that's with the supply chain starting to soften a little bit and getting better supply from customers and our customers also -- from the suppliers and our customers also seeing better supply conditions.

Operator

The next question comes from Scott Davis with Melius Research.

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Scott Reed Davis - *Melius Research LLC - Founding Partner, Chairman, CEO & Research Analyst of Multi-Industry Research*

I'm going to ask just maybe a little bit of a long question, hopefully not too long for you. But the 4 acquisitions that you made seem interesting. Can you give us a little bit of color on what gaps they fill for you and how they're integrating and how you plan on integrating them and maybe some early read on what you're seeing or what you like about those deals? Specifically something -- a little bit more color, I think I'm looking for.

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

Yes, Scott, I'll be glad to. So they're really to fill out our portfolio of offering around these megatrend areas. So we've been very clear for the last several years that the area of IoT or Insights and Electrification were focus areas for us as a company, and we've been investing more organically through the funding that we describe as megatrend spend in our corporate segment. We've also been very clear that our M&A activity was going to be focused in these 2 areas. And we also have talked about the fact that it's going to be more of a serial approach as opposed to a big bang approach.

And so I think it's less about filling gaps, it's about building out a portfolio for the future based upon what we're hearing from our customers and where the markets are going. And every time we identify another opportunity, it rounds out that solution set in terms of how we go to market, what the offering is and other capabilities.

In terms of your question regarding integration, it's a great question because some of these businesses are very different in terms of the solution that they're providing and also the markets that they go after. You know that the bulk of our core business is a long-cycle OEM business. And when you're going after an Insights opportunity with a large fleet, that can be a much shorter cycle approach, and you need to bring something to market in a quarter, not in 5 years.

So from an integration standpoint, we're running these as business units within our segments. They have separate general managers to run these businesses. And we're being very mindful to make sure that we retain the great talent that we brought in and that we're executing in the market.

In terms of early read, we're expecting significant growth from these 2 vectors in 2022, we quoted that. In the Electrification side, we're expecting 50% or greater growth as a company. On the Insights side, over 100% growth. Now that's a mix of organic and inorganic. But it's pretty impressive in terms of what the team has been able to build in a very short period of time by focusing on these segments.

And we believe it justifies a little bit heavier and in terms of investments going into 2022. And so you see that in our megatrend spend in our guide for the year. So sorry for the long-winded answers, but it's a very good one, and I appreciate the opportunity to share some thoughts.

Operator

The next question comes from Christopher Glynn with Oppenheimer.

Christopher D. Glynn - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

I wanted to talk about the $640 million of the net new business wins, up quite a bit over the prior year. Maybe you had some nice chunky wins in there, but Electrification is really coming on for you. Just curious if you think you can replicate that number or if a little more volatile path over the next couple of years is more in the cards.

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

Yes. Thanks, Chris. We're really excited about it. So I'm glad that you're noting the significant amount of wins. Before I dive into the -- some of the details, I'd tell you that it accelerated throughout the year as well, which was equally impressive, especially given what -- the commentary Paul

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provided in terms of cost inflation and going back to our customers to engage with them regarding recovery. We're not seeing that impact our ability to win business with our customers, which is great.

In terms of the acceleration here, we got $465 million wins last year, $400 million on average the 3 years prior. As the business grows, you're going to see a natural lift on this, but obviously the NBOs are growing faster than that, as we really focus on these megatrend areas. And we gave a little bit of insight into what the opportunity set looks like. In Electrification, we have over $1 billion group of business that we're pursuing. Now obviously, we're not going to get all of that. And we have over $200 million of opportunity just in the Electrification and Insights here, plus all of the other core business aspects that we're pursuing.

So we're going to continue to try to push this to make sure that we can deliver on our 400 to 600 basis points of outgrowth going forward. And we feel really good about the success that we're seeing.

Operator

The next question comes from Matt Sheerin with Stifel.

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

I wanted to just ask a clarification question regarding your commentary of inventory build at customers. I think you talked about $90 million. Is that still a headwind that you're seeing this quarter? I think you said that you don't see it playing out in 2022. I just want to clarify that.

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

Sure. I'll try to answer that one for you. So this year, we shipped into customers about $90 million more than production. So that was a nice tailwind. We served our customers well based on what they ordered. We're not expecting that to repeat next year. So we want to be very clear that, that $90 million is a year-over-year headwind for revenue.

In the fourth quarter, which is included in that $90 million impact, we did -- it does look, based on our analytics, that our customers did consume some of that inventory that was built up during the earlier part of the year.

Operator

The next question comes from Mark Delaney with Goldman Sachs.

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

I'm hoping to talk a little bit more on the investments the company is making, targeting these fast-growing areas, we're having some nice order momentum and the impact it's having on margins. I think the '22 margin, talked about a 90 bps headwind. Could you be a little bit more specific on the buckets that add up to that 90 bps?

Megatrend, I think, is a big part of it, but it seems like there's some others. But at a higher level, when do you think the company will be at a point where it's making these very important investments but also where margins would actually start to expand as revenue grows?

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

Yes. So Mark, let me touch on the commercial side and why we're doing it, and then Paul can provide a little bit of color and unpacking regarding the investment and impact on margin.

So hopefully, the growth rates that I described in terms of 2021 to '22 in these very specific growth vectors is evidence that it's a worthwhile effort to invest in these growth areas. In addition, the level of new business wins and the percent of them that are coming from these growth vectors hopefully is validation.

Obviously, we're seeing that in terms of customer engagement and opportunities that we have, but we understand that we need to show our investors proof points that this incremental investment is worthwhile in terms of investing in to grow the business going forward. It's the direction of where a lot of our customers in the industries are going. It's a great opportunity for us. And I think we've shown some very early -- very strong proof points that it's gaining momentum and it's a well worthwhile investment.

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

Yes. I agree. So Mark, the 90 bps is a combination of both the increased investment in the megatrends organically, which we called out in the slides, and is also the impact of the acquisitions that, as I mentioned in prepared remarks, have lower margins than the core business. So they're not going to expand margins, there are going to be a margin dilution for a period of time as we scale those up.

I think it's the right investment. You can see it's helping in terms of -- for the proof point, I would say, in the NBOs. And it's future technology that we see huge revenue opportunity in these key growth vectors that we're investing in.

And yes, over time, as these businesses start to scale and we start to be able to create modular designs for which we can leverage volume on, they'll become much more profitable than they are today. And that is the strategy. And that is something we have shown historically we do extremely well.

Operator

The next question comes from Samik Chatterjee with JPMorgan.

Samik Chatterjee - *JPMorgan Chase & Co, Research Division - Analyst*

I guess I wanted to ask on the inorganic M&A and revenue growth target of 400 to 600. Clearly, that implies you have to accelerate what you've been doing already to some extent. So wanted to kind of get your thoughts around it. Is it you've acquired a fair amount of assets recently that you're targeting to try and sort of keep the size similar, try and do more of the same? Or are you trying to sort of now look at larger size acquisitions? And maybe if you can talk about the pipeline, how you think about that pipeline shaping up between automotive, related to maybe other segments that are non-auto.

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

Yes. I'd be glad to address that. So the focus is going to be in the megatrend areas, right? So we haven't had any surprises during 2021. We've talked about Electrification, Insights being the focus area, and the acquisitions and the joint ventures that we've done have been in those areas. So we're going to stay focused on that.

Our goal is serial M&A, so it's not lumpy. That does not mean that if a great opportunity comes along that more sizable, we wouldn't entertain that. But that's not the focus area for us. It's to make sure that every year we can show some level of growth, 400 to 600 basis points is the target, against

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this inorganic growth initiative in the focused areas to drive our strategy. We're going to stay financially disciplined. So we're not going to do deals just to get to that. We're going to be very transparent regarding our progress.

And it took some time to build the funnel, right? So we really started this in late 2020 in terms of our serial M&A strategy. We executed against that in 2021 with some deals early in the year, April with Xirgo and then some later in the year. So we were able to achieve 2.5% inorganic growth in 2021. Obviously, the lapping effect of those transactions results in about 2.5% already baked for 2022, which is in the guide that we've provided.

But the guide does not include or assume any additional M&A. If we do M&A, that will be in addition to what we've produced there. And that's what we're going to execute against and continue to try to stay focused on doing just that.

Operator

The next question comes from Steven Fox with Fox Advisors.

Steven Bryant Fox - *Fox Advisors LLC - Founder & CEO*

I was wondering if you could dig into your thinking on HVOR markets for '22. I know you don't want to give any specific outgrowth there, but maybe sort of where you think you're benefiting from outgrowth generally.

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

Yes. The outgrowth -- so company-wide, we believe we'll be on the high end of our range that we provided of 400 to 600. HVOR has really been an area that we benefited significantly from in terms of outgrowth due to a lot of different reasons in terms of market trends but also the offering set that we have in that market. And we would expect HVOR outgrowth to continue.

The market itself in HVOR is -- we're forecasting globally to be pretty flat this year. In the first quarter, it's going to be down pretty dramatically, about 13%, 14%. That's variable by market. In the first quarter, I think every market that we serve is down a little bit, but China on-road is down more than the most of the other categories. And for the full year, we would expect some modest growth everywhere but in China on-road. And so that's a little bit more color in terms of unpacking the HVOR business.

Operator

The next question comes from Luke Junk with Baird.

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

Jeff, hoping you could touch on your outlook for organic megatrend spending this year. Last quarter, I think you had given an indication initially of $50 million to $55 million in spend or so versus the $60 million to $70 million outlook that you outlined today. What's the upside there? And especially, is there any updated perspective you can provide on the mix of spending between your major growth opportunities?

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

Sure. So we spent about what we said we were going to in 2021. Fourth quarter was a little bit lower, primarily due to vacation schedules and other things that brought down that spend in the fourth quarter. Wasn't at all due to our lack of continued commitment around that. And we thought long and hard, we believe that an incremental investment in this area, given the success that we're seeing, is justified. It's not a significant ramp.

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It's another $10 million on the high end, $60 million to $70 million for the year. But we will continue to be very disciplined in terms of our approach on that and make sure that we're allocating that investment to where we're seeing commercial success with our customers.

In terms of the split, the majority is in the megatrend-related areas. There are some other -- some small amounts of spend in there that are new growth opportunities within each of our end markets. But the vast majority of it is in Electrification and Insights, and equally split, maybe a little bit more slanted more toward the Electrification given the magnitude of the opportunity that we're seeing there and the need to invest long term with our customers regarding this trend.

Operator

The next question comes from Nik Todorov with Longbow Research.

Nikolay Todorov - *Longbow Research LLC - Analyst*

Yes. I have a question on the EV wins. Maybe can you help us understand the mix between that? Maybe if you think about between components versus subsystem solutions versus turnkey solutions, and how do you expect that mix to trend over time?

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

Yes. Great question. The vast majority is on OEM wins on components. You'll note that -- and automotive-focused as well. So that's where the bulk of the wins are.

When you start talking about subsystems and turnkey solutions, you're migrating out of automotive into heavy vehicle, off-road industrial applications. And most notably, Spear Power is an example of one of those turnkey solutions where we're providing energy storage solutions into specialty vehicle markets.

So it's different than a component play, but the vast majority of the end deal wins that we experienced in 2021 were in the markets that you know well in terms of automotive. And it gives us, again, more confidence in our line of sight to double the content. So it's all connected in terms of our commitment to get to that double content per vehicle on battery electric in the next 5 years.

Operator

The next question comes from Chris Snyder with UBS.

Christopher M. Snyder - *UBS Investment Bank, Research Division - Analyst*

I believe in the prepared remarks, the company said it expects Electrification auto revenue to grow 70% in 2022. Could you disclose how much of this is organic? And then what type of unit growth is underpinned by this forecast? So we can get some visibility into electric content per vehicle expectations.

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

Yes. So -- yes, so automotive specifically, and as I just mentioned on the prior caller's question from Nik, that's largely on the component side. And we're expecting that to grow 70%. It will grow faster than our expectation for battery electric vehicles. So again, it supports the notion that we're going to see double the content per vehicle as this market grows.

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I think it is important also to note that most forecasters and we would forecast that over the next 3 years, all types of vehicles will grow in terms of market. So the automotive market is nowhere near peak. So our forecast would be that over the next 3 years, we see growth across all of those segments, internal combustion engines as well. But then after that 3-, 4-year market starts to cross over where battery electric vehicles become faster grower, and then you start to see some obsolescence on the internal combustion side.

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

And so plug-ins and battery electric is expected to grow about 40% units production from '21 to '22, and we're growing around 70%. So significant outgrowth to the production, which drives up our content per vehicle about $5.

Operator

The next question comes from Shreyas Patil with Wolfe Research.

Shreyas Patil - *Wolfe Research, LLC - Research Analyst*

Just when I was -- wanted to -- just 2 things. I just wanted to confirm how should we be thinking about typical incremental margins for the business. I think in the past, you've talked about maybe 35% to 40% flow through. And then you mentioned, obviously, the acquisitions would convert at lower incrementals initially, but should we be assuming that -- or how should we think about how long it will take to get the margins on those programs up to corporate average where you are today and then potentially even above that to support margin expansion?

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

So if you look back, historically, on average, maybe we haven't been as clear as we should be, but on average, our incremental profit and incremental revenue runs at about 30%. And that's about what we saw in '21. And for '22, if you're unpacking, you back out the impact of our growth investments and the acquisition impacts, we're largely in that range. So that's a pretty good benchmark to use.

But as we said in the past, subject to other things that may happen such as increasing our megatrend investment over the inorganic efforts around driving our growth vectors. So I think that's a good proxy in normal terms, 30%.

As we go forward in terms of driving better margins in the acquired business, we certainly expect that. But that will come with scale, and that will come with designs that are more marginalized that we can create the scale from. Today, not the case. A lot of new designs and activities in the market around new developing markets make it a little bit more fragmented and more challenging to get that volume scale that we normally would expect.

But over time, we will achieve that, we will get that. And we expect these businesses with similar business models to have similar margins to our core business. Some businesses will have higher cost to serve, but they will be extremely [local] and we think that's okay.

Operator

The next question comes from Jim Suva with Citi.

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

In your prepared comments, I believe you mentioned around $90 million of excess shipments into your customers or the channel. My question is, is that due to your customers or subassemblies just not having enough parts to complete the entire automotive car vehicle? Or are they sitting on

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a lot somewhere or in the supply chain? Or was it out of concern of not having enough components where your customers are just ordering a little bit more to make sure there's no hiccups? Or was it like a catch-up from 2020 because we've been in supply chain issues basically for a couple of years now?

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

So I guess, Jeff, I can tackle it. I would start with -- we continue to be a very good supplier to our customers. And so that demand was placed on us and we delivered to that demand. Our analytics based on some parts that we have that have really high market share.

In 2021, it was clear that we were shipping more product to customers than they were producing, which gives us the $90 million of buildup of our parts in their warehouses or in cars that are partially complete or almost fully complete. We do not expect that buildup again in 2022. And so it's a year-over-year headwind of $90 million to our revenue growth.

That's all we're just trying to illustrate, but we continue to serve our customers extremely well. We serve to their demand. And we work very hard to do that, and we're very proud of that outcome.

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

Yes. The only thing I'd add, Jim, is a point that you actually made, which is, if you look at the year-over-year, if you go back to 2020, we do believe we left 2020 with many of our customers depleted versus a normal average. So some of that growth in inventory during '22 (sic) ['21] was to get back to normal levels. And call it, half was to get back to normal levels and the other half was to build inventory that at some point will unwind. But we're not assuming that it will happen certainly in -- early part of 2022 or for the balance of the year.

Operator

The next question comes from Brian Johnson with Barclays.

Jason Flynn Stuhldreher - *Barclays Bank PLC, Research Division - Research Analyst*

This is Jason Stuhldreher on for Brian. Maybe just back to the cost question, which we addressed first. As we think about sort of your success in recovering elevated costs in 4Q last year, moving to this year, elated costs, some of which may not be recovered right away. But the balance of the year, I think, as you mentioned, Paul, there are kind of some definite -- or some initiatives in place to get those back.

I guess, specifically, when it comes to getting cost recoveries back from customers, any indication on sort of what percent of elevated costs, whether that's material, whether that's labor, customers are willing to sort of give you back and what the timing of that is? Because it sounded like in the remainder of the year, the initiatives were more cost related rather than recoveries related. And so is there a potential upside to the margin target if recovery is kind of coming better than expected?

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

I would say that in each of our businesses, the activity to offset these rising -- whether it was the impact of the chip shortage because we're expediting lots of material or rising material or rising labor, it varies by business and how you do that commercially. And in some of our market -- some of our business, it is just more challenging. They really want to see the detail of what the costs were.

I think our teams have done an exceptionally good job working with our customers based on their expectations in getting recovery, and that recovery has accelerated throughout 2021. But the challenge is that material prices are rising day 1 out of 2022. Buyers are raising prices, and we

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have to continue to knock that down through a number of activities. One is working with customers to recover more. Two is being more productive, and we have lots of levers on the productivity side to drive our costs down and to be more efficient.

And as volumes grow throughout the year, we are going to get the benefit of that volume leverage on our fixed costs. So it's a combination of things, but we feel pretty comfortable that we can achieve the outcome that we set out here in terms of productivity improvement.

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

Yes. The only thing I'd add to that would be, the nature of how we've gone after this has obviously changed as the fact pattern has evolved, right? So early 2021, we were absorbing a lot of these costs when there was a question as to whether or not if the cost inflation we were seeing was more transient or sustained, second half of the year with surcharges.

As we go into 2022 and beyond, it's not a surcharge anymore. We're adjusting prices. Our customers understand that. They're doing that in the markets that they serve. And it's never an easy conversation with customers, but it's understandable. Everybody understands that there is cost inflation occurring broadly in the market and Sensata needs to respond to that to continue to make sure that they perform for the shareholder.

Operator

The next question comes from David Kelley with Jefferies.

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

Maybe just on the industrial end market step-down in 2022 that you're expecting, can you talk about where you see pullback or maybe give us a sense of demand and order patterns in industrials? And just curious if there's any conservatism here following the strength of your 2021 industrial revenue growth?

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

Yes, it's a great question. We have a fairly diversified industrial market base that we're serving. So what you're pointing out is something we're constantly looking at to try to understand what's going to happen in the industrial market, but it's very diversified in terms of the market that we serve. And we're -- you said it, we're calling basically flat for -- 2020, up a little bit, call it 3% in the first quarter of the year.

And we'll continue to unpack that, but it's a wide base. We tend to look at things like PMI index and other very high-level indicators as well as our fill rates in the individual quarter. So the fact that the first quarter is going to be a little bit stronger means that we'll watch it closely and see how that translates through the balance of the year.

Operator

The next question comes from Joe Giordano with Cowen.

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

I just want to clarify on the cost recoveries in auto. Like are these like visible to you with like a defined start date? Like do you kind of know that price kicks in like in the second half or something like that just based on these discussions on average? And is there like a certainty that those discussions have already kind of crystallized into something and it's just the timing of when that kicks in?

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

So let's just split the 2. I mean if you're talking about productivity that our automotive customers expect to see every year, that typically happens at the beginning of the year. Every year, the business awards have a certain level of productivity of price downs that they would expect may kick in at the beginning of the year because we get the benefit of being on those platforms for 5 to 10, if not longer years.

As specific to the recovery, and I don't know if it's -- we want to get too much into the [plumbing] here, but our commercial teams work with our supply chain to understand the rising costs that we are incurring, whether it's material or logistics costs, by customer. And then we use that information to work with our customers to have them share a portion of that cost, the more the better, obviously. But it is a very integrated activity within our business to then present that to our customers.

As Jeff said, we did that in the midst of a lot of supply chain shortages, a lot of demand, expediting to customers, customers hand to mouth for product. And now we're moving to more long-term view of these costs -- rising costs will likely be with us. So we're taking a different commercial approach to get better pricing over time to reflect that higher cost base that we're likely to experience for a period of time.

Operator

The next question comes from Michael Filatov with Berenberg Capital Markets.

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

I was wondering if you could provide a little bit more kind of quantitative detail around some of the cost headwinds you're expecting to experience in 2022, right? I mean there's everything from material cost inflation to logistics and labor costs. Is there any way you could maybe quantify those buckets in terms of the headwind you're expecting this year and maybe how you anticipate offsetting those?

I know you just talked a lot about sort of recoveries and maybe commercial negotiations, but also specifically on those commercial negotiations at the start of the year, was there any really material change you were able to accomplish with those negotiations?

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

Well, as we laid out in the presentation, net -- we still think that -- we still believe in our model and our guide provided that we're going to have some margin expansion due to net productivity. And that's a big bucket of lots of things. It's price -- it's all the things I just talked about as well as other activities that we're taking on to drive the cost profile for the business. So net-net, we think we'll expand our margins through productivity gains.

The biggest challenge is material. Material prices are rising, that shouldn't be a surprise to anybody. It's broad-based. Suppliers are using that as a leverage of the supply chain situation to be able to raise prices. And so that is the largest impact. And we are, like I said, working with customers and internally looking for ways to mitigate that rising cost.

Labor inflation is also rising around the world, that shouldn't be a surprise. And it depends on which jurisdiction and potentially, but clearly that's another headwind that we need to be more productive in our manufacturing sites to mitigate that rising costs. And we have good productivity plans within the plants to do that. We feel like we have a lot of actions -- a lot of defined actions that we're working as to deliver the outcome that we shared with you today.

Operator

The next question comes from Amit Daryanani with Evercore.

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

I apologize if this was addressed already. But when I think about the 200 basis points of margin drop that's embedded in the March quarter guidance to volume and productivity, I believe, is there a way to decouple this and talk about how much of the headwind is the productivity issue, the supply chain issues versus volume?

And then as you ramp this up throughout the year, I think you talked about margins ranging from mid 18% to 21%. What's enabling the margin expansion? Is that these productivity inefficiencies going away or volume kind of kicking in? If you really break those 2 up, that would be really helpful.

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

So happy to help there. So we talked about -- every year, we have new pricing with customers in the automotive side, which usually is lower than the year before. So that's nothing new. This drop surprisingly from Q4 to Q1 is very similar on average what you've seen in the last 10 years.

What's different would be the material costs that are rising more quickly, so the new pricing is going to affect some suppliers. And the growth investment, which we should be spending more of the time, I think, talking about because that really is going to drive our future. And so it's a combination of the businesses we acquired, which we noted, and also the increased megatrend spend from, I think, $12 million to $3 million or $4 million more in Q1. Those are the major drivers.

And as time goes on, 21% margin business, as volumes grow, we get a lot more profit contribution and volume scale. We don't have to add a whole lot of -- there's no fixed cost associated with that. So we get volume leverage from volume fill. And that's what we expect to happen throughout the year, as long as a lot of the actions we're taking to drive better cost start to kick in and we get a lot of traction there.

Operator

Yes. We have a follow-up from Chris Snyder with UBS.

Christopher M. Snyder - *UBS Investment Bank, Research Division - Analyst*

I just want to follow up on my previous question. You guys kind of talked to 70% auto Electrification growth versus around 40% EV unit growth. So that content per vehicle growth that we're seeing, is that more so driven by a higher revenue pie on these next-wave EVs that are coming to market? Or is it more so driven by a similar revenue pie and you're just taking much higher share of that?

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

Yes, absolutely, Chris. So the former, right? So the scope of the opportunity set that we've identified that we can serve for our customers is bigger. The share that we're experiencing is pretty similar. Our goal is to be #1 or #2 in the particular application or a path to get there. That has not changed. We want to be a leader. And so it's really about the size of the pie becoming bigger given the capabilities that we have as an organization to help our customers deliver on this change in their markets. So that's where we are.

Operator

The next question comes from Joe Spak with RBC Capital.

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

Just maybe on the outgrowth and sort of tying some of the EV commentary together. I know you're talking 400 to 600 basis points of outgrowth overall. But given that the Electrification business is primarily related to automotive, it would seem, and your 50% growth we're talking about like an EV target of about $1 billion seemingly by mid-decade, what type of outgrowth specifically in auto is embedded in that?

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

Yes. So where we've been on auto outgrowth has been, again, at the high end of our -- what we had quoted as 400 to 600 in the automotive business. So I would expect that as we continue to penetrate the market in terms of these new applications, that we'll continue to see the high end of that range in auto. It's going to be a little bit lumpy depending on when things launch, I think you all know that, and that's why we were going with the full company outgrowth.

And we'll continue to monitor our NBOs that we win with customers, that is the best indicator of long-term outgrowth that we expect in these businesses. But given the level of NBOs that we've won, we have a lot of confidence in our ability to continue to do so.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Jacob Sayer for any closing remarks.

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

Thank you, operator. I'd like to thank everyone for joining us this morning. Sensata will be participating in upcoming investor conferences sponsored by Barclays, Wolfe, Berenberg and Morgan Stanley during the first quarter. And as Jeff mentioned, we also expect to offer a webinar on our Electrification initiatives on February 22. So we look forward to seeing you at one of those events or on our first quarter earnings call in late April.

Thank you for joining us this morning and for your interest in Sensata. Andrew, you may now end the call.

Operator

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

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