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EDITED TRANSCRIPT

ST.N - Q3 2022 Sensata Technologies Holding PLC Earnings Call

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OVERVIEW:

ST reported 3Q22 revenue of $1.018b and adjusted operating income of $197.3m.

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PRESENTATION

Operator

Good day, and welcome to Sensata Technologies Q3 2022 Earnings Call. (Operator Instructions) Please note, this event is being recorded. I would now like to turn the conference over to Mr. Jacob Sayer, VP Finance. Please go ahead.

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

Thank you, Sarah, and good morning, everyone. I'd like to welcome you to Sensata's Third Quarter 2022 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.

This conference call is being recorded, and we will post a replay webcast on our 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 or the financial performance of the company that involve risks and uncertainties. The company's actual results might 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.

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 and non-GAAP financials are including reconciliations are included

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in our earnings release and in the appendices of our presentation materials. The company provides details of its segment operating income on Slides 9 and 10 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 results during the third quarter. We will then provide updates on several of our growth initiatives. Paul will cover our detailed financials for the third quarter, and he'll also provide financial guidance for the fourth quarter. We'll then take your questions after our prepared remarks. Now I'd like to turn the call over to Sensata's CEO and President, Jeff Cote.

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

Thank you, Jacob, and welcome, everyone. I'd like to start with some summary thoughts on our strong performance during the third quarter, which is outlined on Slide 3. Our underlying markets returned to growth in the quarter despite continued supply chain disruptions. We produced 650 basis points of market outgrowth and 330 basis points of acquired growth during the quarter. Despite foreign exchange -- currency exchange rate changes representing 330 basis points of headwind to revenue, we produced solid financial results for shareholders, delivering $1.018 million in revenue, up 7.1% from the prior year period, with higher margins sequentially.

Excluding greater headwinds related to unfavorable foreign exchange rates, our results are above the high end of the guidance range we provided in July. Quoting activity for new business awards was extremely active during the quarter as well as year-to-date. And as a result, we have already exceeded the $640 million record level of new business wins we were awarded in all of last year, securing $840 million of new business wins in the first 9 months of this year. Approximately 70% of these wins are in our electrification growth vector, which translates into Sensata's future revenue outgrowth and are a direct outcome of our Megatrend investments over the past several years.

During the quarter, we closed the previously announced acquisition of Dynapower, a leader in mission-critical, highly engineered power conversion solutions focused across renewable energy generation, industrial and defense applications. Dynapower is on a run rate to generate more than $100 million in annualized revenue and approximately 20% operating margins this year. As we have mentioned, we expect market dynamics and Dynapower's offering to provide 30% revenue growth per year over the next several years.

During the third quarter, we benefited from our resilient, flexible and focused organization that continues to successfully navigate the fast-changing supply chain landscape and deliver on our customers' needs. Continued inflationary impacts on input costs have led us to become more agile to offset these costs with commercial pricing actions. As a result, our margins have steadily improved on a sequential basis and we expect this to continue in the coming quarters.

I'd like to recognize the innovation, agility and hard work of our entire team and the support from our customers in achieving these strong results. We recognize that the economic outlook appears weaker today, and we are closely monitoring with our customers across diverse business segments to understand their underlying demand. We are carefully managing our cost structure, including targeted cost reductions to prepare the organization for uncertain market conditions.

Sensata has a very experienced management team, and we have weathered economic challenges successfully in the past, and we are confident we will emerge stronger and with even better growth prospects after any market disruptions. Sensata is continuing to make excellent progress in utilizing in-house and acquired capabilities to better serve a broadening base of customers and win new business in our Electrification growth area. As we outlined during our Electrification teach-in, we are participating in the global efforts to reduce greenhouse gas emissions that are leading to substantial investments in renewable power generation, better ways to store and use energy and the ever-increasing pace of conversion to battery electric light and heavy-duty vehicles. IHS now expects nearly 1/3 of all light vehicles produced in 2026 will be battery electric or plug-in hybrids, up from one quarter at the beginning of this year. That's a multimillion-unit vehicle production jump in just 9 months. We intersect these growth areas with engineered solutions for our customers designing high-voltage electrified systems. We also help our customers convert and store energy with high-voltage converters, inverters and rectifiers to better meet the power demands placed on electricity grids by end users.

In this rapidly growing area for Sensata, we have more than doubled our business wins from last year in the first 9 months of this year. We continue to expect to increase our Electrification revenue to more than $2 billion by 2026, as content on battery electric vehicles grows at twice that of

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traditional combustion engine vehicles and as industrial electrification applications grow rapidly. We are well on track to achieving the near-term goal of Electrification revenue growing 50% this year compared to last year, and we expect this growth rate to continue.

On Slide 5, we highlight our progress in High Voltage Junction Boxes, a specific area of growth for Sensata with in Electrification. Sensata's High Voltage Junction Boxes are system-level solutions that enable customers to electrify their equipment. As we expand our capabilities Electrification, our customers -- and our customers refine their electrification architectures for the future, we are responding to demand for more integrated and thermally efficient system-level solutions that meet increasing power requirements.

We have previously announced meaningful business wins in this area with several global customers, including the single largest piece of business in Sensata's history last quarter. More recently, Sensata was chosen again by a large European heavy vehicle OEM to provide charging units for their electrified platforms that will launch starting in 2025, representing more than $60 million in annual revenue. This is an area of significant growth opportunity for Sensata. The addressable market is growing rapidly and is expected to reach $7 billion by 2030. In addition to the $250 million in annual business we've already won that will launch in the next few years, we are currently discussing with customers potential additional new business representing over $500 million of annual revenue.

While we typically share more information about our new growth vectors in these quarterly updates, it is important to note that our core, safe and efficient growth drivers for Sensata are growing significantly and profitably, providing funding for other investments. Our heavy vehicle business has been outgrowing its markets for several years now, driven by global emissions regulations, increases in electronic control applications and the expansion of our Insights business.

Looking forward, this business will also benefit from global tire pressure regulation in heavy vehicles. As you know, Sensata is a leader in tire pressure sensing and we have won new heavy vehicle tire pressure sensing business for the past few years based upon the robustness of our solution and our ability to solve unique application challenges in the heavy vehicle market. These sensor programs are beginning to launch now. We expect more than 40% annual growth in this application over the next 5 years as it becomes a $100 million annual revenue stream generating great margins for Sensata, given our scale and leadership in this category. This is another example of how Sensata's core sensing activities continue to drive growth for the company.

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 third quarter, as shown on Slide 8, include revenue of $1.018 million, an increase of 7.1% for the third quarter of 2021. Revenue growth reflected strong outgrowth across the company of 650 basis points, market growth and acquisitions, partly offset by customer inventory movements and foreign currency headwinds.

Adjusted operating income was $197.3 million, a decrease of 1.8% compared to the third quarter of 2021. This decreased despite higher revenue was primarily due to unfavorable movements in foreign currency, investment in the Megatrends of Electrification and Insights, customer mix and the divestiture of our Connects semiconductor test and thermal business during the quarter. Also, global supply chains continue to be constrained. Margins improved sequentially, and we expect this trend to continue in the coming quarters. Excluding unfavorable foreign currency impacts, results were above the high end of our financial guidance for the quarter.

Now I'd like to comment on the performance of our 2 business segments in the third quarter of 2022, starting with Performance Sensing on Slide 9. Our Performance Sensing business reported revenues of $754.5 million, an increase of 6.8% compared to the same quarter last year. Automotive revenue increased from higher pricing, new product launches and market growth lessened by customer inventory movements, all somewhat offset by unfavorable foreign currency. Last year, we estimated approximately $70 million in inventory was built in the third quarter. And this quarter, we estimate approximately $20 million of inventory came out of the channel. Growth in heavy vehicle off-road revenue reflects strong outgrowth and the impact of acquisitions in the Insights, Megatrend, offset somewhat by declining markets, $5 million in inventory built in the third quarter last year and unfavorable foreign currency. Performance Sensing operating income was $188.6 million, with operating margins of 25%. Segment

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operating margins declined year-over-year due to customer mix and favorable foreign currency, the dilutive impact of acquisitions and the impact of persistent supply chain challenges.

As shown on Slide 10, Sensing Solutions reported revenues of $263.7 million in the third quarter, an increase of 7.8% as compared to the same quarter last year. This was driven by strong outgrowth, including the launch of new industrial electrification applications and the benefit of acquisitions in clean energy net of the divestiture of Connects, all somewhat offset by unfavorable foreign currency. Sensing Solutions operating income was $73.6 million, with operating margins of 27.9%. The decrease in segment operating margin was primarily due to the impact of acquisitions in clean energy, inflationary impacts on material logistics tempered by higher customer pricing and the impact of operating in a constrained supply chain.

On Slide 11, corporate and other operating expenses not included in segment operating income were $76.4 million in the third quarter of 2022. Adjusted for charges excluded from our non-GAAP results, corporate and other costs were $63.3 million, a decrease from the prior year quarter primarily reflecting lower incentive compensation and foreign exchange impacts, partially offset by higher research and development and business development spend to support our Megatrend growth initiatives. We expect between $65 million and $70 million in Megatrend-related spend in 2022 to design and develop differentiated solutions for the fast-growing and transformational Megatrend vectors of Electrification and Insights and currently anticipate about the same level spend in 2023. We are confident that this investment is the right long-term trade-off as it has enabled our record new business wins of $840 million so far this year and the rapid revenue growth we are experiencing in these areas.

Moving to Slide 12. We generated $57.5 million in free cash flow during the third quarter and $242 million in free cash flow over the last 12 months. Free cash flow in the quarter was impacted by our decision to increase inventory to ensure continuity supply in uncertain markets and from acquisition-related compensation payments. For the full year 2022, we expect free cash conversion to be approximately 65% of adjusted net income, reflecting higher inventory levels to ensure continuity of supply for customers. Capital expenditures are expected to be in the range of $135 million to $145 million. .

Sensata's net debt-to-EBITDA ratio was 3.6x at the end of September, just above the top end of our target range. Sensata's primary use of cash on hand is to acquire businesses that will expand our position within our key growth vectors of Electrification and Insights. Our balance sheet is strong with more than $1.1 billion of cash and no debt maturing before October 2024. Absent further M&A, our net debt-to-EBITDA ratio is likely to approach 3.4x by year-end, which is within our target range.

Given this financial strength and expected future free cash flows, we also look to return capital to shareholders. Consequently, we repurchased $98 million of our shares in the third quarter and recently announced a quarterly dividend of $0.11 per share as expected to be paid on November 23, and to shareholders of record on November 9.

We are providing financial guidance for the fourth quarter of 2022, as shown on Slide 13. Our expectations are based upon the end market growth outlook as shown on the right side of the page. We remain more conservative than IHS on automotive production estimates for the quarter because of extended macroeconomic risks. Foreign exchange represents a $15 million greater headwind to revenue in the fourth quarter than we expected in July of this year when we last provided guidance. Our current fill rate is approximately 93% of the revenue guidance midpoint for the fourth quarter.

At the midpoint, adjusted operating income margin is expected to be 19.9% or 9%, a 50 basis point increase from the third quarter of this year and reflects the benefits of higher volumes tempered by persistent supply chain challenges, higher pricing more than offsetting inflationary impacts on input costs, investments for growth in Megatrend-related areas including acquisitions as we rapidly scale these growth vectors, the unfavorable impacts from foreign currency movements and the divestiture of our Connects business. We expect margins will continue to improve sequentially as we work our way back to our medium-term target margin of 21%, while still addressing challenging market conditions, unfavorable foreign currency exchange rates and investing in growth. On a preliminary basis, looking to 2023, we expect foreign exchange to be a 2.9% headwind to revenue and an $0.11 headwind to earnings per share given current exchange rates.

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

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

Thanks, Paul. Let me wrap up with a few key messages, as we outlined on Slide 14. Sensata's business, organizational model and growth strategy are strong, resilient and reliable as we deliver mission-critical, highly engineered solutions required by our customers. While we expect markets to be volatile in the near term due to high inflation, rising interest rates and geopolitical events, we have strong management team experience in navigating choppy markets. We are confident in our ability to sustain attractive end market outgrowth based on our strong track record of continuous improvement, our record levels of new business awards, our diversifying customer base and our large and expanding pipeline of new opportunities.

We continue to invest in our Megatrend-driven growth initiatives as we transform the business to focus on these rapid growth opportunities across all of 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 and/or joint ventures. Whatever market volatility we experienced in the coming quarters, we are confident that Sensata will emerge stronger and better positioned in these fast-growing markets because of these investments.

We continue to innovate on behalf of our customers, solving their hard-to-do engineering challenges and providing differentiated solutions to a broad array of customers. Solving mission-critical challenges enable Sensata to enhance long-term customer retention and deliver leading industry margins for our shareholders, while also increasing investments in our growth opportunities and our people.

And finally, I'm pleased about our efforts in delivering on 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 making good progress to achieve targets laid out last year and updated in our most recently published sustainability report, bolstering the long-term sustainability and success of the company for all of its stakeholders.

Now let me 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) Sarah, if you introduce the first question, please?

QUESTIONS AND ANSWERS

Operator

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

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

Yes. So you noted the margin improvement here sequentially, which has been nice to see it come through. But I think you also recently noted an expectation of achieving 21% operating margin next year. Can you talk a little bit about the key drivers that get you there from this exit rate close to 20% in the fourth quarter? And maybe some of the key assumptions that underpin that margin improvement.

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

Wamsi, it's Paul. As we've talked about either in material -- prepared material in our previous discussions, the drivers of margin improvement come from improve volumes, better pricing execution, which we're seeing and the trends now that we're producing and adjusting our cost structure to a likely will be a more subdued 2023 just given where things are today. But those 3 things will be the key drivers. We're going to continue to invest in the Megatrends at the same level, and we're investing today because, obviously, we're seeing great results with the $840 million of new business

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wins. So those would be the key underpinnings to next year. That will continue to work on over the next quarter and provide guidance in February.
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Operator

Our next question comes from Mark Delaney with Goldman Sachs.

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

You mentioned in your prepared remarks about being in close dialogue with your customers about the weaker macroeconomic backdrop. Can you elaborate more on what customers are saying on this topic and also clarify whether Sensata has seen macroeconomic impact its orders either in 3Q or quarter-to-date? .

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

Yes, Mark, I'd be glad to. So all of our customers are monitoring the same metrics we are to make sure that they're prepared for any eventuality. I want to be careful not to temper things too much. We'll see where things land. Obviously, in the third quarter, things ended up better than we had anticipated. And we've always said that we'll be able to deliver on that. So if you look at the individual end markets that we serve during the third quarter, 3 of the 4 of them ended up better than we thought. Auto, we expected about a 13% growth, it actually grew about 26%. Again, we delivered on that. HVOR was the only one that was down. We expected it to go down about 8%. It was down 11%. Aero, we expect up about 4%. It was up about 8%. And then in the industrial side, we expected it to be down about 4%. It was only down 1%. That constant dialogue with our customers is really to get a longer-term view, but it's also to make sure that we can deliver in the near-term for them because you know that given how we're designed into their products, if we can't deliver, they can't make product. And we don't want to be the bottleneck in that process. We don't believe we have been a big bottleneck, but we're watching that trend closely. You see in North America that inventory days increased slightly. But our view is there's still significant demand in the larger end markets that we serve that is still not being served. So we'll continue to watch it. Third quarter was a good outcome. We're expecting another $1 billion fourth quarter, and we'll continue to give you perspective on that as we talk with customers, but also look at the broader macro environment.

Operator

Our 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 ask just on the outlook for auto relative to the supply chain issues that your customers have been seeing. I know that's been a headwind and now you have macro concerns as well. And any signs that things are improving in terms of your customers, their supply chains and inventory? And then on inventory, you did talk about still some headwind you're seeing year-over-year in terms of customer inventories, could you elaborate on that?

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

Yes. Let me touch on sort of what we're expecting from a market standpoint, and then maybe Paul can touch on the puts and takes on the inventory balance that we've seen. It's a little complicated given inventory growth last year. So it probably makes sense to touch on that. So specifically in the automotive market, so second quarter was the lowest quarter in terms of overall production rates. But I would actually start with the statement that broadly across the globe, there is more demand for vehicles that can be produced. But we're seeing that start to abate. It has been abating over the past several quarters. To me, the fact that North American inventory days crept up a little bit, seems to suggest that, that issue is dying

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some. But again, we're still in a mode where there's more demand than our customers can produce, which is a great position, obviously, for our customers to be in. But it is getting better.

Second quarter was the lowest quarter in terms of production levels at close to [19 million]. Third quarter, we had forecasted 19 million , it ended up about [21 million]. So that was a good outcome, and we delivered on that. Going into the fourth quarter, we would forecast a similar rate around 21 million . I think IHS is slightly higher than that. But last quarter, you remember that we were guiding to below the pessimistic view of IHS. We're more in line with their base case for fourth quarter, but not tremendous growth, but steady performance third quarter to fourth quarter. Yet to be determined what 2023 looks like. But the last point I would leave you with in terms of automotive market is globally -- even at these levels, we're still well below the high end of what we've seen historically. I mean we've seen 17 million units in North America. We've seen much higher levels in Europe and China, and we're well within what those peak markets are. So if the consumer stays resilient, our view is that we'll continue to see some growth there, but more to come as we get a better understanding of 2023. You want to touch on inventory?

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

Yes. I would say -- I would start with, number one, the order book for automotive this quarter was a little bit more stable. We have seen a tremendous amount of drop out at the end of the quarter and previous quarter. We still saw that phenomenon, but it was less -- which is good news. It shows a little bit more stability in the orders that are being placed on Sensata to deliver. As it relates to inventory, last year, based on very high market share components that we have, we did analytics to say, what -- how much was produced by customers? How much did we ship into that? And last year, an analytic to us, our customers built $70 million of inventory. In this quarter, doing the same analysis, it looks like our customers contracted inventory reduced inventory by about 20%. So that's a $90 million swing year-over-year that we've contemplated in our growth profile here. Probably we'll see something similar in Q4. A little bit of contraction is what we're expecting, but nowhere near what we saw last year, but we're seeing some contraction. We think that's probably because production levels are higher, and we're not quite shipping into that level in terms of view it to production.

Operator

Our next question comes from Luke Junk with Baird.

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

Just a question as it relates to the fourth quarter guidance, if I look at the end market growth, you're looking for markets to be down 2%. The organic growth, however, up about 9% at the midpoint. That's better than the typical outgrowth that you'd expect the business. Just hoping you could unpack what's going on there? Why? And if there's any particular pieces of the business we should be zeroing in on?

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

Yes. So you've interpreted it, right? We've always said that outgrowth is not constant across quarters. It's something that you should look at over a year or a longer period of time. As platforms launch, as mix of vehicles have higher take rates, it does have some impact on overall outgrowth in our business. But we do expect the fourth quarter to be a strong quarter. We've had over 600 -- we've been over the 600 basis points of outgrowth each quarter already this year. For the last 4 years, we've been higher than that. And so we would expect the fourth quarter to be strong. But I think what we're -- we continue to be really excited about is the momentum that we see longer term associated with that outgrowth, given the dynamics we've talked about, the new business wins that we have, record new business wins, the progress toward 2x content on electrified vehicles. This all will drive outgrow to market as this inevitable shift in light vehicle, but also in heavy vehicle markets and in the industrial markets continues to trend. So you're interpreting the guide correctly.

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Operator

Our next question comes from Samik Chatterjee with JPMorgan.

Unidentified Analyst

This is (inaudible) on for Samik. You just mentioned that the industrial market declined minus 1% relative to your prior expectations of minus 4%. And also, yes, in global PMIs are declining. So how exactly do you explain that the market is behaving better than expectations despite the PMI is declining. So what exactly are we missing, can you please help us understand this?

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

I didn't -- you were a little -- I think you're at a -- a little bit of a bad connection. I'm not sure I got ...

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

This question was around industrial markets, which we're forecasting to be down in the fourth quarter. And why that's ...

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

Got you.

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

I think I think it's in comparison to strong comps last year when things were running very well. Customers were rebuilding their inventory in their channels. What we're seeing going from Q3 to Q4 is this normal seasonal decline and a little bit of weakness in the end markets, that is being portrayed by the fact that the PMIs are weaker. What's offsetting what would be a weaker market is strong content growth, particularly in our clean energy business. And so we have market weakness, but we've got outgrowth because we're now launching quite a bit of new product into areas like infrastructure as an example.

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

Thank you for the question.

Operator

Next question comes from Christopher Glynn with Oppenheimer.

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

So just curious, given the success of your Electrification and the wins, particularly with the battery disconnect systems. I'm wondering if that influences your thoughts on capital allocation, if it might cause you to kind of refocus on the core execution, maybe downplay chunkier deals and focus on debt reduction. I'm just thinking out loud, curious your thoughts.

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

Yes, Chris. So we're constantly evaluating our success from an organic standpoint and looking at capital allocation. But I don't think there's anything that's changed that would dramatically change our perspective on capital allocation. And the reason is, let me share a lot of the core execution of the business is driving this success. But if you look back at some of the acquisitions that we've done, associated with GIGAVAC back in 2018, the joint venture with Schrader in 2021, the acquisition of Sendyne for current sensing, Lithium Balance around battery management, those acquired capabilities dramatically accelerated our ability to gain a better capability in that market. Now we're supplementing that with the $70 million of investment that we're making across the mega trends organically. But we will continue to look at based upon what our customers are looking for, understanding what future architectures look like, we'll continue to look at where to invest that money organically but also look to what we can complement with acquired capability activity as well. And so we're not done yet, right? I mean, we feel very good about our progress towards this $2 billion target in Electrification. We feel really good about our 2x content on battery electric vehicles but there's more opportunity out there. And I think that given our strong cash generation and strong balance sheet, we should continue to look at opportunities to expand that capability. Appreciate the question.

Operator

Our next question comes from Amit Daryanani with Evercore.

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

Jeff, I wonder if you could just talk a little bit about how do you think content growth number shakes out as you go forward for '23 maybe? And then this inventory that's going in excess in the channel, which I think about $50 million at this point. Is that the right number as you go forward? Or could that be a bit more a headwind in '23 as that gets more down? So anything on content by geographies and the inventory number in '22 would be helpful.

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

Yes, I'd be glad to address it. So we're a long cycle business. So it's -- the opportunities that we're winning now will see revenue in 3 to 5 years from now, that is accelerating. Our customers are increasing or speeding up their design cycles for sure. So what historically had been a 5-, 7-year design cycles in some of our end markets, that's contracting. But we'll see content growth grow or outgrowth grow as we get to those out years when more of these programs launch for sure. But for now, we're going to stick with our 400 to 600 basis points where we've been above that, right? So we're -- you can interpret that we're sticking with the higher end of that range given that there is some mix dynamic that can happen associated with how vehicles actually get produced. But we're feeling really good about that outgrowth, and it's demonstrated in the results, and it's demonstrated in the future look in terms of the MBOs that we've won and how they'll play out. I think that the remaining inventory balance question, I'll share my thoughts, and Paul can jump in. .

I think we were a little surprised that the inventory came down a little bit in the third quarter. Our expectation would be that our customers would hold on to that inventory. But upon reflection, I mean, we're working to manage our inventory down a little bit as well to make sure we can generate more cash flow. So it logically makes sense. It's an indication to me that not only are we seeing some lessening for abating of the supply chain challenges. But I think folks are starting to go back toward a more normal inventory operating model. That was always our expectation that, that would correct over time. It's just a question of over what period of time it will correct.

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

I think that's a good way to think about it. I do think we're going to -- we're estimating a little bit of contraction like I said earlier in Q4. I mean we're in unprecedented times. We've never seen this kind of inventory movement. So I'm trying to model it out is very challenging. But -- so the 2, I mean we're going to -- we haven't quite got there yet in terms of what we think that will look like. But clearly, we're starting to see it in the current results. So it's becoming more relevant as we go forward.

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

Thanks, Amit, for the question.

Operator

The next question comes from Shreyas Patil with Wolfe Research.

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

Just -- I think you alluded to it a little bit before. Just in terms of the ability to get back to that 21% margin target, how should we think about the levers that you have to pull if end market demand continues to weaken. As you mentioned, we are seeing -- you're indicating pretty sharp declines in industrial and HVOR in Q4. I am just trying to get a better sense of some of the cost actions that you can take. And should we also assume that Megatrend spending will continue to grow into next year? Or are you saying that you'll just maintain a high level of spend? .

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

So I'll answer that last piece right away. So in the prepared remarks, we said that for '23, we're going to keep our Megatrend spend flat to $65 million to $70 million of research development, innovation work to continue to intersect these growing trends of Electrification and Insights. So we're going to maintain that. As we think about 2023, we're going to be cautious about the top line, just given the economic environment we're operating in. And the levers we can control continue to be more than recovering the input costs that we're seeing in the business, so continuing to drive pricing across the business, not just in automotive, but across all of our end markets. And it's making sure that our cost structure aligns to the demand profile, which we've done as a company for decades. And so if we see weaker end markets, and we're going to align the cost structure to support that, which would ultimately take excess costs out of the system. We built the business to be bigger and the support structure should be bigger. So we'll take those costs out to bring down the cost, improve margins in a weaker environment, if that ultimately is what we see going into 2023. We're having mindful of currency rates. They've been very negative here in the second half of this year versus our guide. We probably $0.20, $0.21 were soft -- or $0.10 worth soft or a $0.21 year-over-year impact on the FX in the second half. So clearly, that's something we're going to have to be very careful and mindful of as we enter 2023, when we provide a perspective what we're going to deliver. But we're locked in on delivering that our goal to deliver the 21% as our medium-term target. And we will work the cost side of the equation and pricing to help us get there.

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

And we're marching towards that, right? Every quarter this year, we've seen an increased margin. And even in the third quarter with a slightly lower revenue base that in the second quarter, we increased margin. The guide for the fourth quarter was a lower revenue base with an increase in margin profile. So we're doing the right things to manage that process, and its many levers, as Paul mentioned. Appreciate the question.

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

Thanks, Shreyas, for question.

Operator

Our next question comes from Gavin Kennedy with Jefferies.

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Gavin Lorne Kennedy - *Jefferies LLC, Research Division - Equity Associate*

Good to see that your 2022 expectations of 50% growth in Electrification was reiterated. But we were wondering if you still expect more than 100% growth in Insights as well this year. And related, if you could talk about some of those key growth drivers and insights, that would be great.

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

Yes. Insights will grow more than 100%. We're seeing really great order book. I would say the supply chain is the limiting factor there. But even with that limiting factor of weaker supply chain hard to get parts, we'll deliver the 100% growth. So very confident about that. It's good growth in all the businesses that we have acquired in that space. So really excited about how they're executing in the toughed market and a tough supply chain.

Operator

Our next question comes from Joe Giordano with Cowen.

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

Can you speak specifically to price within auto and what that was in the quarter and kind of what the outlook is there? Like the discussions you've had with your customers to raise prices here. And how long does that last? And when do you have to have like the next round of renegotiations?

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

Yes. So we've been -- I think we've been very transparent that those discussions have lagged but we're gaining significant steam with our automotive customers. So if I rewind the clock way back to 2021, we didn't get any of the pricing second half. We got cost recover. And really starting in 2022, we started going after that price. It's supported with details around the impact that we're seeing associated with the material inflation, logistics increasing costs and our customers to always a challenging conversation. Our customers are very understanding in terms of what we're experiencing and the trade-offs we need to make to make sure that we can get the raw material we need to deliver the parts for them. And we'll continue to have that dialogue. And to me, I would say the proof that we're doing that very well is that we do have record new business wins, right? So in an environment where we're having really tough conversations regarding the inflationary pressures that we're seeing. We're continuing to see good achievement.

Now year-to-date, I think we'll be about a balance on that, but we have still some work to do because those pressures won't stop as we go into 2023. I think they'll be lower but they won't stop and we'll continue to have to work this muscle with our teams but also with our customers going forward. Thanks for the question.

Operator

Our next question comes from Travis Bucknall with Truist Securities.

Travis Robert Bucknall - *Truist Securities, Inc., Research Division - Research Analyst*

I'm calling on behalf of Will Stein this morning. My first question, I was just curious if you could provide any clarity on how the fill rate has dipped down to 93%? I think last quarter it was 95% in the quarter and in '21 was also 95%. I'm just wondering if you could also maybe touch on what you would classify as an optimal level there.

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

I think that's -- it's reflective of 2 things. One, it's the order pattern is changing a little bit. So we're seeing some -- a reversion back to a little bit more of a normal order pattern than in the past. We saw a lot of order early in the quarter because customers were making sure that, that you're replacing orders to get in line for supply. And so with a more normalized pattern, 93%, I feel like a good place to be in terms of delivering the $1 billion of revenue at the midpoint. We were at 95% last quarter. We did a little bit better than the guide. So I think we're right where we need to be. I think it's a good indication that we have confidence to be able to deliver to the midpoint on revenue in the fourth quarter.

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

Thanks, Travis, for the question.

Operator

Our next question comes from Jim Suva with Citigroup.

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

How do you guys look at -- and maybe the answer is it's just not that material. When you see news reports about some of the automakers building 99.9% of the car, and then having to wait for that the golden screw or the chip or something? I assume is it your parts they're waiting on. But how do you think about that? And how should we think about it? How should investors be thinking about it? Does it impact your outlook materially? Or are those stories just a lot of talk and just the materiality of the numbers don't really impact to your production outlook numbers?

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

Yes. So on the first part of the question, are we the impact? I'm sure there are instances where we are creating challenges for our customers. But I would say, based upon the conversations I've had with our customers directly, their -- I don't think we're their biggest problem on that front. So from a Sensata standpoint, I feel as though we're delivering against the raw demand that they tell us. So the broader question that you're bringing up around vehicles being largely produced but waiting for a final piece. There is no question that, that's happening. But the magnitude of it, I think, is more of a news bullet as opposed to being meaningful. I mean, we're talking about maybe 0.5 million vehicles in a much bigger marketplace. And we're also looking at an instance right now where in North America, which is a dealer inventory model, there's 32 days of inventory versus a normal model of 60, right? So it's not as though I think -- I don't think there's going to be an abrupt change in terms of what we see in terms of demand for production. I think eventually all of those vehicles that are largely produced will help fill the funnel of the vehicle a lot. It's not just a U.S. phenomenon, of course. So my sense is it's something we should watch, but it's not something that we think is going to have a shock to the system.

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

The only thing I would add, Jim, is that it just suggests that our customer supply chains are disrupted. And so how they order parts and what it might mean to our revenue, we talk about this the inventory impact. So that disruptive supply chain that they have could be affecting when they buy parts from Sensata. And so anecdotally, I mean, it probably is causing some of this effect just because we don't have an efficient supply chain. (inaudible) the industry.

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

Thanks, Jim.

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Operator

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

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

Thanks, Sarah. I'd like to thank everyone for joining us this morning. Sensata will be participating in upcoming investor conferences sponsored by RW Baird in early November and Melius in early December in the fourth quarter. We look forward to seeing you at one of these events and/or at our fourth quarter earnings call in late January. Thank you for joining the meeting and your interest in Sensata. Sarah, you can 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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