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EDITED TRANSCRIPT

ST.N - Q4 2022 Sensata Technologies Holding PLC Earnings Call

EVENT DATE/TIME: JANUARY 31, 2023 / 1:00PM GMT

OVERVIEW:

ST reported 4Q22 revenue of $1,015m and adjusted operating income of $204.3m.

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PRESENTATION

Operator

Good day, and welcome to the Sensata Technologies Fourth Quarter 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, Vice President of Finance. Please go ahead.

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

Thank you, Jason, and good morning, everyone. I'd like to welcome you to Sensata's Fourth 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 will post a replay webcast on the Investor Relations website shortly after the conclusion of today's call. As we begin, I would like to reference Sensata's safe harbor statement on Slide 2. During this conference call, we will make forward-looking statements regarding future events or the financial performance of the company that involve risks and uncertainties.

The company's actual results may differ materially from the projections described in such statements. Factors that might cause such differences include, but are not limited to, those discussed in our Forms 10-Q and 10-K as well as other subsequent filings with the SEC. We encourage you to

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review our GAAP financial statements in addition to today's presentation. Most of the 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 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 company. Jeff will begin today with highlights of our business results during the fourth quarter and full year 2022. He will then provide updates on our new business wins and key growth initiatives. Paul will cover our detailed financials for the fourth quarter, and he will also provide financial guidance for the first quarter of 2023. 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 performance during the fourth quarter and full year, as outlined on Slide 3. During the fourth quarter, we produced $1.015 billion in revenue, up 8.6% from the prior year period, despite a 360 basis point headwind from foreign currency. Adjusted operating margins moved higher by 70 basis points sequentially to 20.1% as we continue to focus on improving our margins to our target level of 21%.

For the full year 2022, we produced a record $4.029 billion revenue, which is up 5.5% from the prior year. Our underlying markets were pressured last year by continued supply chain disruptions, and we experienced a 240 basis point headwind associated with foreign currency. Nevertheless, for the full year, we produced 820 basis points of market outgrowth, continuing our above-target performance for the third consecutive year. We appreciate the dedication and expertise of our Sensata team members who contributed to these results.

Quoting activity for new business awards was extremely active during the year. As a result, we achieved a second consecutive year of record wins. In 2021, we achieved record new business wins of more than $640 million. And in 2022, they exceeded $1 billion. Even more notable is that approximately 70% of these wins are in our Electrification growth vector, which will drive Sensata's future revenue outgrowth and are directly due to the incremental investments we have made over the past several years.

During 2022, we also made substantial progress toward our environmental, social and governance goals. We reduced our greenhouse gas emissions intensity by more than 10% last year, reaching our 2026 target 4 years earlier than anticipated. In addition, Newsweek named Sensata as one of America's most responsible companies for 2023. 23, overall, ninth in the technology hardware sector and first in Massachusetts.

All of us anticipate more change in the end markets Sensata serves over the next 10 years than we have seen in the past 50, and as our customers transform their businesses and product portfolios to adjust to decarbonization trends, many equipment categories are electrifying and significant investment is being made in global infrastructure to support this trend. It is a strategic imperative for Sensata to enable this transformation for our customers, and we are very pleased with our accomplishments thus far as we execute on this strategy.

As shown on Slide 4, over the past several years, we have made significant investments, including both acquisitions and internal development efforts, to develop the products, technologies and capabilities our customers need as they transform their businesses. The commercial success resulting from these investments is clear. Last year's awards included the single largest business win in the company's history and represented a substantial shift in our business toward electrification-related areas.

Sensata largely serves long-cycle end markets, which underscores the benefit of pivoting to where the market is going, and we appreciate our investors' patience through this investment cycle to secure our bright future.

The success that we have achieved to date from our organic and inorganic investments in the growth vectors demonstrates that we have built a strong foundation for future growth.

Now we are focused on leveraging the benefits of these investments. This includes completing the integration of the businesses we've acquired to maximize growth and focusing organic P&L investments in areas where we are having the greatest success. Consequently, as we look to 2023

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and beyond, we are focusing on organic growth, improving adjusted operating margins and increasing conversion of earnings to cash flow. While we will continue to return capital to shareholders through our dividend and opportunistic share repurchases, improving free cash flow will naturally allow leverage to decline and returns on invested capital to improve over time.

Paul will speak to the specific capital allocation targets later.

During 2022, we posted approximately $460 million of revenue in automotive and industrial electrification areas, up 77% from 2021. Insights posted $175 million of revenue last year, up 133% from 2021.

During our Electrification teach-in last February, we forecasted that Sensata would produce more than $2 billion in Electrification revenue and that Sensata content in battery electric light vehicles would grow to double current content in a comparable internal combustion light vehicle by 2026. We are well on our way to bringing this vision to life.

While we still need to deliver on the product designs, underlying business wins in hand, these awards, coupled with our existing business and expected market growth over the coming 3 years, is now sufficient to deliver on our Electrification revenue target. The demonstrated commercial success from our investments establishes Sensata very well to assist our customers in their transformational journeys and to realize our own exciting potential. 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 $1.015 billion, an increase of 8.6% from the fourth quarter of 2021. Revenue growth reflected strong outgrowth across the company of 1,180 basis points in quarter as well as acquisitions, partially offset by foreign currency headwinds and overall market contraction. Adjusted operating income was $204.3 million, an increase of 3.4% compared to the fourth quarter of 2021. This increase is primarily due to higher volumes, pricing and productivity improvements, somewhat offset by unfavorable movements in foreign currency, impact from investments in the growth vectors of Electrification and Insights and divestiture of our Qinex semiconductor test and thermal business last year.

Adjusted operating margins improved 70 basis points sequentially to 20.1%. Adjusted earnings per share in the fourth quarter grew 10.3% from the prior year quarter and faster than revenue. We saw approximately the same $5 million decline in channel inventory this quarter as we did a year ago. So channel inventory movements had no impact on our outgrowth in the fourth quarter on a year-over-year basis.

Turning to Slide 8. As we entered 2022, inflation significantly impacted our component and logistics costs at a time when we were also increasing investments in our growth vectors. This impacted adjusted operating margin significantly, leading them to decrease from the 21% margin level that we delivered during 2021. Substantial improvements in pricing to offset increased costs, better material availability and supply chains slowly improved. Productivity improvements and cost control have driven a steady increase in the adjusted operating margin through the year.

While our financial guidance for the first quarter includes a sequential decline to 19.5% on lower volumes, we intend to continue these efforts and return to our target margin rate of 21% as quickly as possible. Now I'd like to comment on the performance of our 2 business segments in the fourth quarter of 2022, starting with Performance Sensing on Slide 9. Our Performance Sensing business reported revenues of $757.7 million, an increase of 10.6% compared to the same quarter last year.

Automotive revenue increased from strong content growth, higher pricing and market growth, partially offset by unfavorable foreign currency. Growth in heavy vehicle off-road revenue reflects strong outgrowth and the impact of acquisition in Insights, partially offsetting -- offset by declining markets and unfavorable foreign currency. Performance Sensing operating income was $196.9 million, with operating margins of 26%.

Segment operating margins declined year-over-year due to the dilutive impact of unfavorable foreign currency, acquisitions and product mix. As shown on Slide 10, Sensing Solutions reported revenues of $257 million in the fourth quarter, an increase of 3% as compared to the same quarter last year. Industrial revenue decreased from weaker markets, especially in HVAC and appliance, and unfavorable foreign currency. Aerospace revenue increased strongly in the quarter due to strong content growth, market and pricing.

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Sensing Solutions operating income was $74.4 million, with operating margins of 28.9%. The decrease in segment operating margin was primarily due to the impact of acquisitions and clean energy. On Slide 11, corporate and other operating expenses not included in segment operating income were $65.5 million in the fourth quarter of 2022. Adjusted for charges excluded from our non-GAAP results, corporate and other costs were $65.5 million, an increase from the prior year quarter, primarily reflecting higher research and development -- and business development spends to support our Megatrend growth initiatives, partially offset by lower compensation -- incentive compensation and favorable foreign exchange.

We invested $70 million in Megatrend-related engineering spend in 2022 to design and develop differentiated solutions for the fast-growing trends impacting our customers, and we expect to spend about the same level in 2023. The record new business wins of more than $640 million in 2021 and more than $1 billion in 2022, along with our rapid revenue growth in these areas, clearly demonstrates how Sensata's expanded capabilities are appealing to our customers and driving market outgrowth.

Moving to Slide 12. We generated $184 million of free cash flow during the fourth quarter and $311 million in free cash flow during the year. Free cash flow this year was negatively impacted by increases in receivables as our business and revenues grew. Our decision to carry higher inventory levels to ensure continuity of supply in uncertain markets and from acquisition-related compensation payments.

For the full year 2023, we expect free cash flow conversion to be approximately 75% of adjusted net income, reflecting Sensata's long-term average. Capital expenditures are to be in the range of $170 million to $180 million for 2023. As Jeff mentioned previously, acquisitions and organic investments have provided us with the needed assets and capabilities to achieve strong leadership positions and growth in the areas of Electrification and Insights. Consequently, we expect operating margins to improve and free cash flow to grow, which will naturally lead to lower net leverage over time.

As a result, we are updating our target net debt-to-EBITDA range to 1.5 to 2.5x, which will likely take 2 to 3 years to attain. Our net leverage ratio was 3.4x at the end of December 2022. We returned capital to shareholders during the fourth quarter, repurchasing $50 million of our shares under our existing stock repurchase authorization, a reduction from the third quarter, and we recently announced a quarterly dividend of $0.11 per share that is expected to be paid on February 22 to shareholders of record on February 8.

In addition, we intend to pay down $250 million of our outstanding variable rate term loan during the first quarter, which is currently the most expensive piece of debt in our capital structure. Moreover, we will continue to evaluate the company's liquidity needs and manage the capital structure according to our new net leverage target range. We are providing financial guidance for the first quarter of 2023, as shown on Slide 13.

Our expectations are based upon the end market growth outlook shown on the right side of the page. We remain more conservative than IHS on automotive production estimates for the fourth quarter because of broad macroeconomic and China COVID-related risks. Foreign exchange represents an expected $27 million headwind to revenue in the first quarter. Our current fill rate is approximately 92% of the revenue guidance midpoint for the first quarter. At the midpoint, adjusted operating income margin is expected to be 19.5%, a sequential decline from the fourth quarter, largely reflecting lower volumes.

This also represents 80 basis point year-over-year increase from the first quarter of 2021 on flat revenue, primarily due to improved productivity and pricing. Our first quarter guide anticipates that our operating income at the midpoint grows at 4% and earnings per share increases at 10% from the prior year quarter, faster than the rate of anticipated revenue growth.

Looking to the balance of 2023, we expect foreign exchange to be a 1.1% headwind to revenue and an $0.08 headwind to earnings per share, given current exchange rates. Given market and macroeconomic uncertainties facing Sensata and other companies in our sector, we are discontinuing our practice of providing full year guidance, choosing instead to only guide for the upcoming quarter. We believe data from third-party market forecasters and our customers is reasonably accurate such that we can forecast the next few months, while visibility into future quarters is currently less clear, given broader economic concerns. Now let me turn the call 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 end markets to continue to be volatile in the near term due to inflation, rising interest rates, the risk of recession in various geographies and geopolitical events, we have a strong management team with proven experience in navigating choppy markets.

We also expect 2023 to be another year of above target market outgrowth for Sensata. We continue to invest in our growth initiatives as we transform the business to focus on these rapid growth opportunities across all the end markets we serve. We are making excellent progress as demonstrated by strong new business wins and significant revenue growth. This success allows us to focus on strengthening our financial returns through organic growth, improved margins, stronger free cash flow and return -- increase in returns on capital.

Part of this is targeting a new net leverage range of 1.5 to 2.5x over the next 2 to 3 years. We continue to innovate on behalf of our customers, solving their hard to do engineering challenges and providing differentiated solutions to an ever broader array of customers, while leveraging our expanded product set and capabilities. Solving mission-critical challenges enable Sensata to enhance long-term customer retention and deliver industry-leading margins for shareholders.

And finally, I'm pleased about our results in delivering on Sensata's long-standing vision to help create a cleaner, safer, more electrified and 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 on achieving our ESG targets, and we'll look to update them in our upcoming sustainability report, bolstering the long-term sustainability and success of the company for all of its stakeholders. 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. Given the large number of listeners on the call, please limit yourself to 1 question each. Jason, go ahead and introduce the first question.

QUESTIONS AND ANSWERS

Operator

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

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

I appreciate the $460 million you just had in Electrification and your $2 billion target here. How are you viewing the opportunity for Sensata in the face of the price cuts that have been announced by EV makers? And I guess, it's a twofold. Firstly, does it change the trajectory in your mind of either adoption or how you get to your $2 billion? And secondarily, do you anticipate price pressure on your own pricing? Or do you still see that as a net positive lever in '23?

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

Thanks, Wamsi. A lot to unpack there, but let me start with a view of a trend of electrification given what we've experienced, but also the more recent OEM price cuts to be more competitive on OEMs. Listen, the last 3 to 5 years, as we've looked at forecasts associated with EV penetration, every year, it's gone up. And that's why we've been investing heavily in this space because we do believe that, that is the future and that trend is accelerating.

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So I would say that, that trend would likely continue as we go forward. And so the investments that we made were the right ones. Now we've had great success in winning opportunities. There has been a lot of quoting activity as our customers gear up for this trend. The quotes around our new business win and the focus on electrification support that that's where we're aiming and that's the success we're achieving, that's where our M&A targets have been, that's where our organic investment has been disproportionately in these areas to prepare for this transition.

On the last point around your question of the pricing, pricing is always difficult with our customers. And I think everyone knows that we lagged a little bit in the early part of 2022 because we were trading off the dialogue with customers to make sure that we were winning the new business associated with that. But there -- our customers expect us to be a long-term partner. They understand the need for us to address this point.

And I would expect that not in '23, but as we go forward, we'll get back into more of a mode where we can deliver productivity year-over-year as inflation eases and will be able to continue the more normal business model associated with helping our customers succeed in the marketplace.

Operator

Our next question comes from Scott Davis from Melius Research.

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

Can we talk about the new leverage rates and just how that really impacts -- how you think about M&A as part of the growth algorithm?

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

Yes. I guess I would start with the fact that from a strategic standpoint, over the last 2.5 years, we've been investing in the capabilities to be able to bring solutions to the marketplace based upon what we've been hearing from our customers and what we believe will be the trend in the future. And we've made an enormous amount of progress. And so from our [stand and the NBO] wins that we've achieved, I think, demonstrate that. $700 million alone in 2022 of wins associated with electrification. And so I wouldn't start with the conclusion that we wanted to delever as being the strategy.

The conclusion was we have all the pieces that we need, and now we need to reap the benefits associated with all of those investments that we've made. And that will naturally result in us spend more of our time on the organic growth associated with the acquisitions and the current customer relationships, improving margins and delevering will happen as a result of that. So there is a focus here on making sure we realize those benefits associated with the work that we've done. And we've set a new -- we set a new leverage target associated with that.

Operator

The next question comes from Samik Chatterjee from JPMorgan.

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

I guess if we can spend a bit of time talking about the margin guidance that you have for the 21% for FY '23. And one of the questions we're getting this morning is if you have visibility into reaching that margin number that has to be predicated with some level of visibility on the revenue trajectory through the year. So just wondering sort of how to think about what revenues that's been predicated on as well as what's -- I know you called out the macro environment, but what sort of impact you're seeing on autos or fill rates from macro environment and what's driving that sort of higher uncertainty in your business?

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

I mean I couldn't quite hear that.

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

Yes. So if they -- I think the question was around our comfort to get to the 21% margin given the market dynamic. Clearly, volume will help us achieve our 21% margin target. So we're not giving full year guidance, but we have management intent associated with marching towards that target over time. Volume will help either in the form of outgrow to market or market growth, FX tailwind versus headwind will help. And as we go into 2023, at least into the first quarter, we have a market decline, and we have foreign exchange headwinds. So it's a little bit harder to get to that incremental margin profile and so we will get there over time.

The question is, at what point in time, and I think that will depend on market forces and other things that are helping associated with the tailwinds to get to that margin profile.

Operator

The next question comes from Matt Sheerin from Stifel.

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

I wanted to ask a question on your -- within Sensing Solutions, the appliance and HVAC market, it looks like you're going to be down year-over-year for the fifth quarter in a row here. I know post-pandemic, there's been weakness there in inventory. But could you talk about visibility there? And when do you see that market bottoming?

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

Well -- Yes. For the first quarter, we are anticipating the -- our industrial market, which is where our HVAC market lives to continue to go down as destocking occurs and other impacts associated with the real estate market and so forth, take hold. But we've seen a couple of quarters now of decline. And so the question will be, when does that return to a more normal level and start to recover. It's hard to predict because it's the one end market where there is more channel inventory rather than our OEM focused markets.

But I really feel as though the transition that's happening associated with the -- excuse me, the HVAC market associated with [Puron] levels associated with the need for other sensing content and equipment given the change in the refrigerant there's lots of long-term opportunity there that we're excited about that we're seeing success. In the near term, we're just going to have to manage through it, but the last couple of quarters for our industrial business have been down pretty dramatically.

Operator

The next question comes from Luke Junk from Baird.

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

Jeff, you stated in your prepared remarks and has followed up with that in Q&A, this strong foundation you've built for future growth. Now you're focused on leveraging the benefits of those investments. Want to put a finer point on the M&A piece of that. You go at this time, you laid out a vision of annual M&A growth of 400 to 600 basis points, are you pulling that back today? Just how should we think about squaring what you're seeing today versus the vision you laid out a year ago and what has changed specifically?

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

Yes. So yes, we are. So we've been very clear that in the past, our capital allocation was to ensure we pay the dividend and then to do M&A to make sure that we were prepared for the future with our customers. And we feel as though we are well prepared now, the NBO opportunity to support that, that we've won and the engagement with the customer supports that. And we believe now is the time to really continue to invest organically.

And we've also said that we'll stay in that $65 million to $70 million organic investment level to bring those products to market to realize the potential associated with this. So the M&A focus is going to go away at this point. We're going to digest the M&A-related activity that we've done and continue to drive organic growth in the business to a level that is commensurate with the opportunities that we see in the market. Thanks for the question.

Operator

The next question comes from Mark Delaney from Goldman Sachs.

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

Nice to see the EBIT margin expansion. When you think about the plan to expand margins over the course of 2023, how secure is the pricing needed to achieve that? And do you need several OEMs to still accept higher pricing? Or is the pricing mostly or entirely set at this point?

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

I can take it. So we do expect elevated pricing in '23 over '22. And it comes in many different forms, depending on the end markets. They have all different behaviors around pricing. But much of the pricing that was secured last year continues into 2023. Now we're going to have to continue to secure new pricing as inflation or other costs drive up, and so we'll continue to work with customers. But we have a very good track record now in a process with our customers to have those conversations to engage with them around the cost that we're seeing and the cost that we want to pass on to them.

Operator

Our next question comes from Christopher Glynn from Oppenheimer.

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

So curious on the pretty notable new business wins. In 2023, do you think you can replicate that level you put up for '22? Or should we think of '22 as naturally interim peak on design and cycles?

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

Yes. Great question, Chris. The opportunities are based upon what in '22 was a very robust pipeline of sourcing opportunities at our customers. As we look into 2023, it's still quite robust, but it's not at the level that it was when we entered 2022. So it's a great point, $1.046 billion is what we wanted new business opportunities in '22. We'll keep charging toward that. But when you look at the pipeline of opportunities that are out there right now, getting to another $1 billion is going to be challenging, but we'll keep driving toward it.

And candidly, there will be sourcing opportunities that come out during the year that we don't know about yet. So I think the key point here is based upon the business wins that we have in hand and expectations that third parties have on our market growth in our current business, we feel

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very comfortable that we have all we need to get to that $2 billion. But clearly, I know that following question is, okay, when are you going to increase it beyond the $2 billion? And we're going to keep driving at it to make sure that we realize the full potential associated with the future revenue base for the business. I appreciate the question, Chris.

Operator

The next question comes from Amit Daryanani from Evercore.

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

I guess I understand the hesitation to not provide a full year guide, but maybe just touch on your expectations for outgrowth in '23. I think last quarter, you first talked about outgrowth to be the high end of the 400 to 600 basis points range in calendar '23. Would love to sort of get an update on that, if you could. And maybe you can talk about how much of that do you think is content versus pricing as well?

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

So we have developed our delivered outgrowth much greater than the targets that we set over the last 3 years, which has been a great outcome. For next year, based on what we have visibility to, which is pretty high, we would expect our outgrowth to be in the high end of our target range for '23 or slightly or a bit above.

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

I guess Paul, would there be a split between pricing versus content on that number? Or is it all content?

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

It is going to be more content than pricing in '23.

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

But pricing is part of that...

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

Pricing is going to be part of that. Like I said earlier, it's elevated year-over-year, but the content is certainly is the biggest driver of that outgrowth.

Operator

The next question comes from Shreyas Patil from Wolfe Research.

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

Just wanted to circle back to the comment on channel inventory. I believe last quarter you mentioned a $20 million headwind associated with that. It looked like it was -- sounded like it was flat in Q4. So just how to think about channel inventory destocking as we get into 2023?

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

I guess the first comment would be that we saw a $20 million contraction in Q3. We thought there'd be contraction in Q4. There was about $5 million. So year-over-year, it's no impact on growth because we had $5 million contraction last year. So it wasn't as bad as low or as high as we thought it might have been. But we saw a very good performance in the auto business, delivered significant growth in the quarter, both from market growth and outgrowth. So executed really well, delivered a really good outcome.

As we look forward, we've looked back to 2021, we know that there was a depletion in inventory. It was a build in inventory in '22, and it was about, I guess, about $70 million or so we thought we would have to unwind. We've seen some of that unwind this year. There could be some more unwind next year. But we are seeing inventory levels increase in the channel in terms of wholesale in the market.

So maybe that has come to an end, but we're still going to need to watch it carefully because it appears based on the math that there should be more of an unwind to occur. It's difficult to know the timing of that.

Operator

Our next question comes from Chris Snyder from UBS.

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

I wanted to ask on margins. When the company says operating margin will improve through 2023 towards the 21% target, does this mean that the 21% can be hit in the back half of the year? Or just that margins will grow off the 19.5% pace in Q1? And I ask because, historically, Q1 is always the seasonal trough for margins. So is that just kind of typical seasonality? Or should we expect a more substantial build than that?

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

Yes, the expectation is for margins to grow sequentially from the 19.5% upward. The 21% is an annual target level that we're striving for. So I would expect us to have margins that continue to move up and very likely to be 21% in a quarter. But we're really talking about can we deliver 21% for the year? We're going to work to get to that as quickly as possible. But as Jeff said, volume is a big contributor to the margin expansion. So with better volumes, we obviously have a better chance to get into that number more quickly.

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

And it's worth noting that during 2022 from Q1 to Q4, we saw 140 basis point improvement in margins, given that focus. And as Paul said, we'll continue to work toward it. Thank you.

Operator

Our next question comes from Jim Suva from Citigroup.

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

Jeff, in your prepared comments, you mentioned a lot about new business wins and going to be starting to gain traction. Can you give us a little more color where are those new business wins? Are they more like exterior of the car, battery management, charge stations for the car, interior, heating and controls for car? I'm just trying to picture and visualize where you're seeing the great success with this.

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

Yes, absolutely. So obviously, it's based -- it's distributed across the end markets that we serve. So this isn't all about automotive new business wins, but it's the biggest end market that we have. It's the biggest portion of our revenue and it's the biggest portion of the $1 billion. There are really 2 big areas that we're winning. There's a bunch of sockets that we had long-term positions in, so tire pressure, [rate] management, environmental control that continue and grow going forward.

Because in a battery electric environment, those systems need to be more finely tuned and more efficient. So we see more opportunity for outgrowth in those areas. The new areas are around that -- what will be the powertrain. It's the battery management process, so it's contactors, fuses, isolation monitoring, battery disconnects. We've been talking about a lot of these capabilities that we both acquired and developed and we're seeing incredible progress.

And it's not just in light vehicle, it's in HVOR, it's in stationary or battery charging systems; it's in industrial applications. So all of these products and solution sets that we've built play across those markets. And last year, $700 million of our $1 billion of NBOs were in the area of Electrification, so those areas that we've talked about there.

Operator

Our next question comes from David Kelley from Jefferies.

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

Maybe one more follow-up on the margin discussion from my end. I was hoping you could give us a view into your own supply chain and maybe you can give us a sense of how you're thinking about material electronics and maybe even logistics cost inflation and some of the component availability embedded in that targeted margin ramp in '23?

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

So Jeff and I, we guess we can both take it. In terms of the supply chain, I mean, it has slowly been improving. We're seeing more improvement on the automotive side. Still strongly a little bit on the industrial side in terms of the supply chain and availability of electronics. And we do see inflation -- material inflation next year continuing and at a rate similar to what we probably -- what we experienced this year. So it's still going to be a challenge. But again, the pricing is there to mitigate that.

Logistics was a headwind in 2022 in terms of both rate and because of the disruption of the supply chain, the need to expedite material. We see the logistics cost turning the other way becoming favorable as rates start to come down and continue to come down in a more stable supply chain that allow us to manage the movement of the material in and out of the factories much more efficiently. So it should be -- should not be the headwind that was -- that what it was in 2022. In fact, it could be a tailwind for us.

Operator

Our next question comes from Joe Giordano from Cowen.

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

Can you just clarify the 2x battery target versus ICE? Where are you exiting 2022? And how linear is that journey to the 2x in 2026? And just to clarify, is all of that content on the car itself? Or are you considering like peripheral stuff on like charging equipment as well in that calculation?

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

Yes. Joe, thanks. So the $2 billion target is broader than light vehicle. It's across the company, the target to get to electrification revenue in all of the end markets that we serve. The 2x battery electric is very specific to the light vehicle market. And similar to our confidence in being able to get to the $2 billion revenue in Electrification as a company with opportunities in hand, we are making great progress and feel very good about the double content on battery electric.

In a lot of the areas that I've talked about, the question that Jim Suva asked around where that content is coming from, we're seeing increasing opportunities to get really important sockets with our customers, not only in the legacy areas that we've gone after in internal combustion platforms but also on electrification, in light vehicles. So we feel great about the 2x content by the same time frame. Thanks for the question.

Operator

Our next question comes from Travis Bucknall from Truist Securities.

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

I'm calling on behalf of Will Stein this morning. We're wondering if you could update us on what you're observing in the supply chain by each end market. More specifically, we're also wondering if you can give an update based on China and the impact that they've had from recent lockdowns having ended?

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

Yes. So I think two parts of the question around the supply chain, which I'll elaborate a little bit more. Paul will provide a perspective as to what we're seeing in terms of the impact on supply chain. And the second part, I think, was around what we're seeing in China. So on the supply chain question, I would echo what Paul said, right? We're seeing some of that abate, but it's not gone away. We still do see inflation across some of our raw material categories.

We still do see pockets of challenge associated with shortage of parts, but it's clearly abating from where it was at its peak. But it's still upside down from what is a normal business model where we would be able to operate in a normal environment, and we'll keep working away at that. Obviously, we're getting a lot better at managing through that. The team has done an outstanding job, but we're not completely out of the woods in terms of the supply chain challenges that we've been experiencing.

On the China question, candidly, I think the rebound in China in the fourth quarter was a bit of a disappointment. I would have expected there to be more of a recovery in China in the fourth quarter because I just inherently believe that the Chinese government would put incentives in place to stimulate the economy. Clearly, the move away from a Zero COVID policy is at least getting things moving again, unfortunately, having negative impact in terms of infections and death in the country.

But the expectation would be that going into first quarter, it's going to continue to be a little bit choppy in terms of the overall market environment in China. But hopefully, as we progress throughout the year, we'll see some improvement there as things get back to a more normal steady state. It's an important market for us. But again, we serve a global market, and things balance out in terms of puts and takes across markets and geographic markets and end markets that we serve.

Operator

There are no more questions in the queue. This concludes our question-and-answer session. I would like to turn the conference back over to Jacob Sayer for any closing remarks.

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

Thank you, Jason. I'd like to thank everyone for joining us this morning. Sensata will be participating in the Morgan Stanley Technology Investor Conference in San Francisco in early March. We look forward to seeing you at that event or on our first quarter earnings call at the end of April. Thank you for joining us this morning and for your interest in Sensata. Jason, you can now end the call.

Operator

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

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