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EDITED TRANSCRIPT

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

PRESENTATION

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

Okay. Great. Thank you, everybody, for joining us. My name is Mark Delaney, and I cover Sensata for Goldman Sachs. I'm very pleased to have with us Jeff Cote, the CEO and President of Sensata; and Jacob Sayer, the VP of Finance and Head of Investor Relations. Thank you both for joining us.

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

Absolutely. Thanks for having us.

QUESTIONS AND ANSWERS

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

I thought we could start out with one of the key longer-term objectives that the company articulated somewhat recently, which is $2 billion of electrification-related revenue in 2026. And I think $1.5 billion of that is targeted to be organic. Maybe you can give us an update on how Sensata is tracking toward that target?

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

Yes, I'd be glad to. So it seems like yesterday, but we established that target in the first quarter of 2022. So it's been, call it, 1.5 years since we established the target. And I think we've made great progress against it. Right now, given the acquisitions that we've completed, the new business wins that we've been awarded. The current business, last year, the electrification business was about $460 million. It's growing at greater than 50% per year.

So the combination of those 3 factors, we feel as though the $2 billion target is quite achievable. And a lot of work to do to deliver all of the product that we've won with our customers to get to that point in time, but feel quite good about the $2 billion target.

In terms of the mix, I think originally, we had expected about $1.5 billion of it was going to be organic. About $1 billion of the $2 billion would be auto. And so the mix is shifting around a little bit. So probably a little bit more of it will be organic, rather than inorganic. So a little more than the $1.5 billion will be from organic opportunity, and maybe a little more than the $1 billion of the $2 billion will be in the automotive business versus what we had anticipated, but directionally accurate, and the shift will be, as I've outlined.

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

That's very helpful. Some of the auto OEMs have struggled to reach their own EV targets recently. Has Sensata seen any change in order patterns or OEM ramp plans for EVs? And any implications for the 2026 target?

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

Well, we've definitely talked about the fact that in 2023, there have been a couple of pushouts of launches that we had anticipated would happen in 2023. But every report that we look at would suggest that the trend toward electrified platforms in the automotive space are accelerating rather than coming back. And so, as you well know, in 2022, it was a very, very opportunistic and fruitful year in terms of awards with our customers. We were awarded over $1 billion of new business wins with our customers during 2022. And those are all 4 platforms that we'll be launching in the late '24, '25, early '26 time frame.

So a lot of activity happening, a lot of design work happening. And although some near-term sort of disruptions due to lack of readiness on some of the launches, we continue to feel good about the trend associated with electrification in the -- not only in the automotive, but more broadly, in other markets we serve as well.

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

That's good news. And speaking of the new business wins, you mentioned north of $1 billion in 2022. I think the company is targeting $600 million to $800 million for this year. So as you think about the new business when timing and when that starts to flow through to revenue, what are the implications for that in terms of the linearity of reaching the $2 billion of electrification in 2026?

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

Sure. So our business is pretty long cycle. Mark, I think you know. In terms of business win to actual launch of revenue, right, there's the design cycle, the development cycle, where we're figuring out how to manufacture the products at scale. So it's usually about a 3-year lag, give or take. So the business wins that we signed up in 2020 are what we're benefiting from right now this year or early next year.

'21, we had a new record number. That should benefit us at the tail end of next year going into '25 and the $1 billion as we signed up last year, new business should come into our revenue stream starting in '25, going into '26.

The ramp in electrified new business in there accelerated very rapidly. So it went from $150 million to $270 million to over $700 million worth of electrified new business and 70% of what we won last year was in electrification. So you'd expect that same kind of lag in terms of when those programs actually launched, and we see the benefit on the dollar side from a revenue perspective. Now our electrified business is growing quite rapidly right now. We had very good growth last year. We hit a $460 million revenue number last year, and it's growing north of 50% this year. So we're doing quite well on that front.

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

That's all very helpful granularity. Thanks for sharing. And then in terms of your content on an electric vehicle relative to an internal combustion engine vehicle, currently, where do you stand? And then how do you expect that to progress out through 2026?

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

Yes. So today, it's pretty equivalent. So if you look at the global averages and there are difference by region, and obviously by OEM as well, then the global average today, EV is worth about the same to us as an internal combustion engine vehicle. So about $24, $25, if you just do the math on 83 million global produced units compared to our automotive revenue stream.

The business wins that we've signed up, and I described the ramp of those over the last few years means that the content that we expect within electrified vehicles is going to grow a lot faster in the next few years than on internal combustion engine vehicles.

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And that's how we get to the 2x. So that $25 per vehicle, we expect from the content wins that we've had from the new business wins that we've had over the last couple of years to go to -- closer to 50% on a global basis. Again, there will be geographic differences for that.

So today, North America EVs are worth more to us than internal combustion engine vehicles in North America. In China and Europe, they're worth less just because of the timing of when these vehicles were originally designed. China was a lot earlier, then Europe and then the U.S. followed in terms of the design cycle for vehicles that we're seeing on the street today.

Our major content in EVs came in with the acquisition of GIGAVAC started in 2018. That's when we begin to see the ramp in the new business wins around electrification, roll that forward a few years, that's when we expect to see the revenue dollars on EVs.

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

Maybe we could follow up on that. And specifically within China, I think some of the China auto OEMs, you have less exposure in particular with the contactor products that you got with GIGAVAC. What would it take to perhaps improve your content within China and talk through the time lines as to when that may occur?

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

Yes. So it's interesting because 5, 7 years ago, we talked about 20, 25 different OEMs in China. I think more recently, the one OEM that we mostly talk about is BYD, they've demonstrated a clear leadership path in China as well as aspirations to lead outside of China. They're the largest new energy vehicle maker in the world today, 20 years ago, they were a battery supplier for electronics, right? It's amazing what's happened with that business. There's someone -- we talk a lot about needing to win with the winners. And it's very clear that we need to have a leadership position with BYD.

Currently, we do a lot of work with them, but it's outside of the powertrain. So we're selling tire pressure. We're selling environmental control, braking applications. And in their combustion engine platforms, we have a lot of the traditional content that we would have that we enjoy globally. BYD is vertically integrated from a contactor battery pack standpoint. And so it's been challenging to penetrate that market. I had an opportunity with my team to visit with them -- with several divisions of BYD in May. We visited China for the first time in 3 years, very good conversations.

The feedback that I got is they're very interested in working with partners. They're vertically integrated because of the desire to get to market quick, not just -- it's not a standard strategy in terms of wanting to be vertically integrated, but they needed partners to go along with them and they couldn't find partners that were moving fast enough, so they chose to vertically integrate. They have their own contactor portfolio. There are opportunities there.

We'll continue to see opportunities with them as a leading automotive player and a leading battery electric vehicle player globally, in the applications that we have, but we clearly are working with them to make sure that we win in other areas. There are a number of other OEMs, obviously, that we're working with as well, NIO among them, that we continue to work with as we do with all of the disruptors, I guess, you would describe them as on a global basis. But we're continuing to narrow our focus based upon what we see in the market and who the winners will be.

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

That's helpful context. As you think about the different pieces of your business, a lot of growth coming within EVs, but perhaps some cannibalization of the internal combustion engine piece of your business. So as you think about an additional couple of billion of revenue from EVs, is any of that offset or partly offset by lower ICE sales?

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

Yes. Yes. So if you think about our content on light vehicle platforms today, about half of it -- so if you think of North America and Europe, it's about $40 of Sensata content on average in those markets, about half of that in China. But about half of that content is outside of the combustion process or outside of the drivetrain.

As I mentioned, tire pressure, braking, environmental control. And then there are a number of sockets that will go away when the combustion engine goes away. And so our goal has been over the last several years to invest in organically and through acquisition to make sure that our content on the drivetrain platform, so that means contactors, fuses, isolation motoring, sometimes it's the combination of those parts into a battery distribution unit. That will provide opportunity.

But clearly, there is cannibalization when a platform converts from internal combustion to electrified all of that internal combustion content in terms of improving the combustion process goes away. And then it's replaced with applications that we've been designed into with many of our OEMs that are part of that new powertrain.

So it's an exciting time. I would tell you what was fear 5 years ago has turned into incredible excitement, given what we're seeing in terms of our success. But when we talk about $1 billion plus of electrified light vehicle opportunity, about half of that is -- will be the result of the conversion from an internal combustion engine to an electrified platform.

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

Almost by definition, right, if we have twice the content on a battery electric vehicle as compared to an ICE if you're trading them off, then we're losing half the content from the ICE that's no longer being manufactured.

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

Yes. That's helpful, especially as we think about modeling and making sure we don't just add the EV revenue without taking internal combustion and sales out. Okay. In terms of electrification though, more broadly, right, we were talking about this a bit already. It's not just light vehicles, right? There's a broader opportunity set there. So maybe talk about some of the other opportunities Sensata has, via industrial, HVOR or other areas.

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

Yes. So we look at electrification holistically and we're not just limiting ourselves to the light vehicle market, although that's half of our revenue stream. There's a very big opportunity in terms of industrial applications and longer term in commercial vehicles, bigger trucks. Given the weight disparity and the size of the battery and the rest, commercial vehicles will electrify later than light vehicles, right?

But they're going to come eventually, the emissions requirements will force the industry to move to electrification or other kinds of new energy vehicles. And the opportunity there is really large rather than 2x the opportunity on light vehicles, given the size of the battery, the amount of current that's moving through those vehicles where it doesn't start at 400 volts, it starts at a megawatt, 1,000 volts and up.

The content opportunity for us is more like 10x on a big Class 8 truck as it electrifies in terms of the contactors and better disconnect units that we talked about. On the industrial side, there, we're looking at the infrastructure sort of all the way back up. It does us no good as a society if we're buying electric vehicles and then powering them with electricity coming from coal plants. It doesn't help us.

So we need to be electrifying all the way back up to renewable sources of energy in terms of -- and this is what the IRA is about, in terms of increasing the amount of power that comes from wind, solar, other renewable sources, time shifting that power from when the sun is shining to when we're actually needing to use the power. So having storage mechanisms in terms of hydrogen storage or battery electric storage. Those could come in the form of microgrids or elsewhere.

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And this is where the inverters, converters, that technology that we've acquired with Dynapower deal a year ago come in. So in addition to our own components and contactors that are going into DC fast chargers, where you plug in your electric vehicle, we also have the conversion capability there at the charging unit, taking the power off the grid and putting it into the DC chargers and then the inversion capability up the grid from the -- at the renewable generation sites, before that power comes on to the grid in the first place or in the intermediate stage, if a factory is using it to time shift their energy usage and storing it locally. Same thing if you're trying to store energy for emergency purposes or just the time shift. That's where the Dynapower acquisition comes in.

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

Yes. And maybe just talk a little bit more since you've acquired Dynapower, how has that business been progressing and performing. And just remind investors of the revenue scale that Dynapower brought to the company.

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

Yes. So when we acquired them, they were $100 million in revenue, about 20% operating profit. So nicely in line with the rest of Sensata from a margin perspective. They've been growing quite nicely. They're in a 20%-or-so click from a revenue growth perspective in all the areas that I've just described, renewable power generation, sites, energy, storage, either for emergency purposes or for the normal or either industrial use or the time shift energy use.

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

And have you had any revenue synergies where you can cross-sell taking some of the Dynapower products and then taking other Sensata products to be able to offer more of a full solution?

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

Yes. So those systems that they're building are a large consumer of contactors in the first place. So that's a nice product stack. The big advantage to us though comes on the knowledge side. So the engineers at Dynapower are real experts in high-voltage applications. And we're using that to sort of infuse the rest of the engineering organization all the way down to the component level to make sure we really understand that high-voltage architecture in charging stations and even in vehicle to make sure that we've got the right technology set, the right capability set.

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

And they are largely North American-based. And so what we bring in is global capability, which is very exciting in terms of being able to bring this capability as a global company to the world. And so we have some very interesting opportunities in Europe that we're pursuing. Right now, we're not pursuing the China market as strong, but clearly opportunities in Europe, given the scale of Sensata to be able to take that capability on a global basis.

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

That's helpful. Maybe taking a step back a little bit from just electrification and talking about the business more holistically. Within HVOR, could you help us understand if there's any emission standards or regulations that could be key drivers for Sensata?

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

The same regulations will eventually drive electrification. But in the near term, they're really focused around, yes, emissions control, better fuel economy. And there's a couple of areas that we're both benefiting from and that we're excited about in commercial vehicles.

One, the efficiency gained through steer-by-wire applications. So this is making the cockpit environment, starting in agriculture, moving to construction equipment much more efficient for the operator, so electrifying it, putting in very sensitive joysticks with haptic feedback and things like that. That's one of the product lines that we have.

And then the second is around tire pressure. The tire pressure is a safety feature and a fuel efficiency feature surprising to me anyway. It has not been a requirement for commercial vehicles. It has been a requirement for light vehicles for a long time. Started in North America, came to Europe in 2016, was when the requirement was launched for tire pressure for light vehicles. But only next year, will it become a requirement in Europe for commercial vehicles to have tire pressure.

So we've won quite a lot of business there that we'll begin launching later this year around tire pressure sensors and commercial vehicles in Europe. And then there are incentives that come into place for commercial vehicle manufacturers here in the U.S. and in China to start implementing tire pressure as well. Not a strict requirement here yet, but there are incentives built-in to encourage the truck makers to install them.

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

That's helpful. Another part of your business was the Insights business, and I wanted to cover that. I think Sensata had $173 million of revenue last year from Insights and that business was built up in part with M&A of companies like Xirgo and Elastic M2M and helps do things like telematics and vehicle intelligence. Could you comment on business trends and the longer-term outlook for the Insights portion of your business?

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

Yes, absolutely. So just to make sure that everybody understands it. Essentially, what we're doing is we're enabling the telematics ecosystem to make fleets and logistic channels more efficient, right? So think of a fleet management system or other tool to help fleet managers manage hundreds of thousands of assets in the field in a more efficient and safe way. What we're doing is we're bringing more data to the table given that we produced 1.3 billion sensors every year that largely feed control modules on the vehicle.

What we're doing is we're bringing that capability to the logistics and supply chain channel. We have a lot of conviction regarding this market and the opportunity for growth in this market. I believe we were looking and Samsara is speaking at the same time as us on this topic, and they obviously have a lot of conviction regarding the market.

Now we're not a Samsara, but we're helping feed this type of ecosystem in terms of the data needs to allow more efficient operation. It's also become very clear at Sensata that although the Insights opportunity is big, the electrification opportunity for Sensata is so much larger.

And so you'll hear us more frequently focus on that as being the primary trend that we're investing in. We have to make choices regarding where we invest. The Insights business will continue to get investment dollars, but we view it as being a growth lever, specifically within the HVOR market space that we're looking at, much like what Jacob mentioned around tire pressure in heavy vehicle and also our Operator Sensing technology business.

So it's another major growth vector within that ecosystem that we'll focus on, but we have to make choices regarding where we invest. The future is about electrification for Sensata and more investment dollars will be going to that to pursue those opportunities.

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

Got it. Okay. So I wanted to cover some financial and broader business topics. And maybe you can comment a bit on business trends by end market, including areas such as auto, industrial, HVAC and aerospace?

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

Okay. So I think that across those markets, where it's a little bit of a challenge in terms of where the market is right now in those spaces. So if you look at the automotive market in the third quarter, we're expecting it globally to be down about 5%. And that's pretty much aligned with where IHS is in terms of expectations. The industrial market will be down more, right? So the industrial market on a global basis, we're expecting to be down, call it, 15%, third quarter of this year versus third quarter of last year.

The HVOR market is up a couple of percentage points at the aerospace market, which is our smallest market segment is up quite nicely year-over-year. So the portfolio of businesses, we're offsetting each other a little bit. But when you look at our industrial business, down 15% and auto down 5%, it's tough from a market-only standpoint to offset that without growth in the market.

These will turn around, of course. And we'll talk maybe a little bit about it in terms of the seasonality of the business from second quarter to third. That's more like typical seasonality that we would see, but it's a market dynamic that we have to deal with that we're experiencing. And revenue second quarter, third quarter is down about $60 million, at least that's what we're forecasting it to be down. And that's the market dynamics that we're living in right now.

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

And any key differences as you think about various regions like North America, China and Europe in terms of anything stronger or weaker?

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

Yes, definitely differences. So if you break each of those end markets that we serve down by geographic exposure, China in the automotive market is way down, and I think third quarter is expected to be down 17% versus the third quarter of last year. Europe is expected to be down a couple hundred basis points versus the third quarter of last year. The North American market is the only growing market, geographically, in the automotive market right now.

So that gives you the blended, call it, 4% to 5% decline third quarter to third quarter. When you look at the HVOR market, again, the tail of -- the regions, China is down pretty dramatically. It's largely an on-road market that we're serving in China. The rest of the world is up across on-road, agriculture and construction. Industrial is down globally. I mean, down 15% in our industrial business, you're basically seeing that market being impacted on a global basis. And then our aerospace business is largely a North American aerospace business. So we see some good strength there.

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

That's helpful geographic color. And in terms of inventory dynamics, are there any end markets where you think your customers have too much or too little inventory?

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

Not really. I mean, it's hard to find that the -- to break out the difference, right? Most of the markets are in equilibrium at the moment as a result of price, right? So the automotive market, for example, inventory levels were way down. Prices got elevated dramatically. Prices are improving at the moment, and we're getting back to normal inventory days on lots.

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In North America, China has probably got a little bit too much supply in terms of -- auto in Europe is a different model altogether. They're on an order basis, order and delayed delivery. The difference would be in the industrial space, right? So the industrial market is now down 15%, but our -- the way we view it is because of the contraction that's going on in the industrial space there.

There are various markets there that are weak that we're exposed to, appliance, HVAC, datacom, mobile development they are all down, but that signal is being amplified as it goes through the supply chain to where we supply at the very beginning through distributors and the like that are amplifying that signal as it comes through. That is inventory contraction that's causing that, even though it's very hard to identify actual inventory numbers.

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

One of the items that's been dominating a lot of the media reporting on the industry recently has been a potential strike with the UAW. Curious, has Sensata seen any impact of that on its own business? Are there any differences in orders?

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

It's come up a few times. It seems very topical. We haven't seen any change in behavior yet. And we wouldn't expect to see any change in behavior until something actually triggers that change, which -- looks like it's likely to come by mid-September.

From our perspective, at Sensata, the D3 are important customers to us in North America, right? They make up the majority of our North America business. The way we calculate it, about 9%, call it, $7 million or $8 million per week, 9% of our global revenue is exposed to a D3 in North America with all of -- if you took all of their plants offline. That would be the impact to us.

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

There could be some share shift that we would get a benefit from other locations. And there are certain things we can do to prepare for this in terms of how much we'd want to build inventory during the strike period, how much our customers will continue to accept so that they can be ready when the strike -- if it happens that when it returns so they can come back quickly. We're looking at cost measures to make sure that we're prepared for it because, obviously, some of that profitability drops through pretty dramatically on that.

But we have, depending on the length of the strike, a game plan in terms of what we'll do based upon what's happening to make sure that we manage through this as carefully as we can. We've seen these before. This one feels a little bit different in terms of the rhetoric and what we hear in the marketplace. But obviously, we don't have any channels directly into the negotiations as to what's happening there. So we're just trying to stay as close as we can and respond as quickly as we can.

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

Yes. Okay. That's good context. And then in terms of the supply chain, more broadly in terms of what Sensata is manufacturing. Are there any issues that you guys are still dealing with in terms of being able to get the components or even the labor supply that you need to be able to produce? And is that gating you in any product areas?

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

It seems like there are little pockets here and there, still on the electronic side. But for the most part, the shortages seem to be behind us. And we're turning to more of the normal seasonal pattern. This is true with our customers as well in terms of being able to source components from other locations that were otherwise constraining their ability to manufacture products. So it seems like industries that we're addressing are returning to -- pretty close to normal.

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

And then as you think about what normal seasonality may be? I mean how do you think about normal seasonality for Sensata, especially if you're in an environment where supply chain constraints have fallen away?

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

Fallen away. Yes. So the quarter that we're in, Q3 is usually sequentially down 3% to 4% from Q2. That's caused by holidays in places like Europe, retooling efforts, this is on the automotive side. The HPC market begins to slow down in the third quarter. Q4 is usually flat to up a couple of points from Q3. Automotive, that's a strong quarter for China, but that's often offset by holidays elsewhere in the world and then the HVAC market continues to slow as manufacturers there slow their production.

Q1 and Q2, the first half of the year has been our strong period, right? Q1 is usually up couple of points, 1 to 3 points, and Q2 is usually up 2 to 3 points, sometimes 4 points in Q2 sequentially, as all of those markets, especially HVAC market turns around the auto production market grows. That's the normal seasonal pattern, first half stronger than second half.

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

That's helpful. Speaking of supply chain, inflation has been something that so many companies, including Sensata have been grappling with. Maybe if you can talk a little bit about what Sensata has seen on that front in areas such as labor and materials.

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

So clearly, over the last couple of years, material inflation has been a tough topic. We've seen some pretty dramatic shift in terms of material pricing globally. We've gotten a lot of that back, but not all of it from a margin standpoint, back from our customers. It seems to be plateauing a little bit.

And remember, obviously, material is the largest component of our cost structure. Next would be our engineering effort, but materials is a big component of our overall cost structure as a business. And it does appear to be plateauing, if you will, the cost curve is bending a little bit.

At the same time, inflation associated with wages is still quite strong. I mean, when you look at wage inflation on a global basis, given the market rates for employees around the world, we're continuing to see some pressure there. it's a much smaller portion of our overall cost structure. So I feel good about being able to manage through that. But dare I say that we're -- the toughest part of the cost inflation that we're experiencing as an organization is behind us. We're getting better at being able to recover all of that cost and the margin associated with that incremental cost from our customers.

But we continue to have the dialogue with them regarding how much of the pricing they want to deal with versus how much they would want to award us new business and in a long-cycle business, that's -- as you can imagine, that's a common theme that you get with the customers. They want to trade off the near-term pricing for opportunities to win in the future.

And it's a balance that I aim to strike every day as a leader in the company to make sure that I'm looking out for the best interest of the company long term in terms of new business awards, while at the same time, getting the right level of margin preservation in the near term.

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

As you think about margins, the past quarter Sensata reported a sequential and year-over-year increase in operating margins. Could you talk about the progression to what your target margin would look like of 21% and some of the key drivers?

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

Yes. So last quarter, yes, we reported 19.4% margin. We guided to 19.1% in the current quarter in Q3. So -- and we weren't happy about that. The volume has an impact on us in terms of down market sequentially, but it's also a positive to us. There are lots of other impacts, obviously, or inputs into margin and total price versus inflation is a big one.

FX, foreign exchange rates have been a big headwind over the last year plus, and that's something we need to deal with. Productivity in our own sites is something that needs to come back and hopefully with supply chain improvements that will. It is our goal to operate within the range of 21%. There are lots of -- some things that are inside of our control, lots of things outside of our control that impact us. But that's where we want to be operating the business is in the 21% we're not there at the moment. So we need to do better.

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

And maybe talk about how product mix may influence that in terms of EV margins relative to internal combustion engine margin. Where is that today? And how do you see that trending by 2026?

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

Yes. So encouragingly, on the gross margin level, a number of the electrified programs or product families have been improving margins very nicely over the course of the last year, such that they're in the range of other gross margin, for other product families, more traditional product families. So that's the good news.

We are investing a lot more R&D dollars, however, within electrification, which is what you'd expect given this is our fastest-growing area. So if you bring it down to the operating margin level, yes, our efforts in electrification are dilutive, but we expect them to be that because they are our fastest-growing areas. We're also -- some of these product families are brand new to us, with lower volumes, with manufacturing that's not fully utilized yet. So we would expect our margins to -- the gross margins to improve, over time, as that scale moves up.

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

Jeff, I think it was 2 or 3 conference calls ago, you made the point that with the new business wins momentum that the company had, you felt pretty comfortable with the product portfolio and thought that M&A might be a bit less likely to occur in the near term. Where do you feel at this point in terms of the product portfolio? And maybe talk around capital allocation, to the extent you do have the assets that you'd like to have for the most part, how do you plan on deploying capital?

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

Hopefully, the dialogue today has demonstrated. We feel very good about where the business is going. We feel quite good about the capabilities that we've built through what has been candidly, a 3-year investment cycle both by acquiring capabilities to intersect the opportunities with our customers, but also investing more heavily in our research and development to make that happen. So we feel very good about that.

I'd like to never use the word never, that we wouldn't do M&A. But clearly, our goal right now is to reap the benefits associated with that investment that we've made. Pay down debt to create a more conservative capital structure as an organization. That will naturally result in better margin profile, that would naturally result in a better return on invested capital.

And what we've said is we'll continue to listen to our customers, understand what their needs are. And if there's a need for us to intersect new market opportunities by doing M&A we would explore that, but that's not what we believe we need right now. That's not what we're hearing from our customers and the focus will be on delivering on our performance.

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

Maybe to close this out for either of you or perhaps both of you, is there anything you think could surprise industry observers or investors over the next year?

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

Well, there certainly has been over the last several years, plenty of things to surprise everybody in terms of the global economic environment and things that have changed from COVID to supply chain. I think that the more near term we talk about, right, the auto workers' strike could be something that could be quite disruptive, but I view that as being something that's a point in time as opposed to a long-term secular trend in the business that we'll deal with.

So listen, I think that we don't control these end markets and what happens. But what we can promise is that we'll do our best to respond to them more quickly. And as Jacob has mentioned, we've done our best to balance the short and long term in the business. And that has candidly resulted in some more near-term surprises for investors. And I understand that, that's frustrating to investors.

It's incredibly frustrating to us as well. And you have our commitment to make sure that we're moving more swiftly to adjust to the market dynamics that come at us, to make sure that we do optimize for that long-term performance of the business, but also to make sure we deliver on our near-term promises.

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

That's helpful. Unfortunately, we are out of time. So Jacob, and Jeff, really appreciate you both joining us.

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

Thank you, appreciate it.

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

Thanks for having us.

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