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ST.N - Q3 2023 Sensata Technologies Holding PLC Earnings Call

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Company Summary

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PRESENTATION

Operator

Good day, and welcome to the Sensata Technologies Q3 2023 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 of Finance. Please go ahead, sir.

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

Thank you, Rocco, and good morning, everyone. I'd like to welcome you to Sensata's Third Quarter 2023 Earnings Conference Call. Joining me on today's call are Jeff Cote, Sensata's CEO and President; Paul Vasington, Sensata's Chief Financial Officer; and Brian Roberts, Sensata's incoming 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'll post a replay 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 the future events or financial performance of the company and these statements 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.

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We encourage you to 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 business.

Jeff will begin today with highlights of our business results during the third quarter. He will then provide a few updates on new launches and exciting applications that we've discussed on prior calls and then provide an update on our progress in electrification. Paul will cover our detailed financials for the third quarter, updates on capital deployment, and he will discuss our financial guidance for the fourth 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. Thank you very much, Jacob, and welcome, everyone. I'm very pleased to introduce Brian Roberts. As announced this morning, Brian will be joining Sensata and taking over the CFO responsibilities after the filing of our Form 10-Q next week.

Brian is a seasoned financial executive with extensive public and private company executive experience. Brian most recently served as CEO of Tarveda Therapeutics, rising to the President and CEO spot from the CFO role. Brian previously served as a public company CFO at both Insulet and Digitas. He also brings significant public board experience, including 8 years serving as Audit Committee Chair at ViewRay, Inc. The depth of his experience is described in the press release we issued this morning. We welcome Brian to Sensata and look forward to working with him.

I'd like to thank Paul for his nearly 10 years of service to Sensata and wish him well in his upcoming retirement. Paul has been instrumental in guiding Sensata through a significant strategic shift and navigating through the pandemic. We appreciate that Paul will be continuing as an adviser to me and Brian for the next several months to ensure a smooth transition of this very important role.

Now I'd like to move to some summary thoughts on our performance during the third quarter, as outlined on Slide 3. During the third quarter, we produced $1,001 million revenue, down 1.7% from the prior year period and in line with our guidance range.

Market outgrowth for the last 12 months remained within our target range at approximately 460 basis points and 660 basis points over the past 3 years. Strong recent business wins, new product development activities and the upcoming launch schedules gives us confidence that our revenue growth will accelerate in the coming years.

Adjusted operating income was $192 million or 19.1%, down 30 basis points compared to prior year on a reported basis and up 90 basis points on a constant currency basis. Adjusted net income moved higher by 5.5% to $138 million, and adjusted earnings per share grew 7% on a reported basis and 16.5% on a constant currency basis to $0.91 from the prior year period.

During the quarter, we took a $21 million charge for our recently announced restructuring program. This program is expected to generate $40 million to $50 million in savings in 2024. As we continue to focus our strategy on Electrification, harvest of the investments of the past few years and actively manage our cost structure, we expect to see the benefit drop to the bottom line.

At the beginning of 2023, we shared with investors a shift in our capital deployment strategy, based upon our confidence in our capabilities to effectively intersect the Electrification growth vector and deliver innovative solutions to our customers without the need for significant new acquisitions. We continue to execute that strategy during the third quarter, returning capital to shareholders through our dividend and share repurchases.

Our capital allocation strategy reduces risk in our capital structure, lowers interest expense and improves adjusted net income and earnings per share as well as return on invested capital. Paul will detail this information shortly.

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On Slide 4, I want to provide an update on 2 exciting applications that we've mentioned in the past earnings calls. Recent government regulations implemented to reduce greenhouse gases and improve the environment require HVAC manufacturers to switch to new coolants with lower global warming impact known as A2L or A3 refrigerants. Sensata has leveraged its leadership position in HVAC pressure sensing to create a new category of gas detection sensors that detect refrigerant leaks.

Since we announced this application this past spring, we have already secured new business totaling $55 million in annual revenue from customers for sensors that we'll be launching later this quarter.

Sensata was the first supplier to be awarded UL certification for our solution, which provides a critical benefit to customers in [catapulting] Sensata into a leadership position in this very fast-growing sensor category with a $500 million addressable market expected in the next 5 years.

Another exciting area is electromechanical braking. During the third quarter, we were awarded a large win with a second major brake system provider to support a leading global EV manufacturer. We are already a leader in brake pressure sensors, and these new wins secure a total of $30 million in future annual revenue as well as our leadership position in 4 sensors for the next generation of braking solutions used on electric vehicles.

Sensata is focused on continually innovating to help customers solve their mission-critical, hard-to-do engineering challenges on their path toward Electrification.

As shown on Slide 5, I'd like to share some thoughts on how we intend to reach our revenue goals within automotive electrification. We expect the combination of rapid EV adoption and the increased content on electrified vehicles to drive more than $1.2 billion in automotive electrification revenue for Sensata by 2026, up from approximately $380 million this year. Approximately 90% of this total is already booked either through expected market growth as forecasted by IHS or incremental business wins already awarded.

Our progress in North America is being realized where we currently have approximately 1.5x the revenue per vehicle on an EV compared to an ICE platform.

China and Europe remain as opportunities for us. In China, we currently have approximately 1.25 the revenue per vehicle on a local OEM EV compared to an ICE platform. However, the revenue per vehicle on the local OEM EV is about half that of a multinational ICE sold into that market. Therefore, in share shifts to local OEMs from multinationals, Sensata will experience a headwind. This share appears to have stabilized at around 55% for local OEMs, and we will continue to monitor this closely. We have been increasing our pace of new business wins with local OEMs across many product categories, including the development of country-specific contactors, through our joint venture with Churod.

In Europe, we currently have approximately half the revenue per vehicle on EVs compared to the same ICE EV platforms. This will improve as one opportunities launch, and we continue to win new EV-specific opportunities in Europe. Sensata has established strong customer relationships across the e-mobility market. We supply almost every major automotive OEM and tier across the globe. We have also developed strong relationships with the emerging automakers.

As we have shared, we think about the opportunity around Electrification holistically. The opportunity does not stop with components to enable electrified equipment. It also covers the infrastructure needed to power all this equipment. In renewable power generation, energy developers and others are poised to benefit from global initiatives to decarbonize sources of energy, including last year's Inflation Reduction Act in the United States, which provides significant long-term funding to this industry.

By addressing key needs for this important industry, Sensata revenues from its inverters, converters and rectifiers are growing rapidly and in line with the investment case we laid out when we acquired Dynapower in mid-2022. Revenue in this area is growing by more than 30% per year. We are confident in this continued growth given accelerated business bookings related to new projects, such as missile defense systems provided by General Dynamics, hydrogen separation and storage at sites being developed by Plug Power and renewable energy materials development from Freeport McMoRan, for example.

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Year-to-date, new business bookings in this area have been strong with a book-to-bill ratio of 1.2 and improving. We remain bullish regarding our opportunities in this sector.

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 [$1,001 million] a decrease of 1.7% from the third quarter of 2022. Adjusted operating income was $192 million, a decrease of 2.9% compared to the third quarter of 2022, primarily due to unfavorable movements and foreign currency, partially offset by pricing and productivity improvements.

Adjusted operating margins improved 90 basis points from the prior year period on a constant currency basis due to operational improvements within the business. Adjusted earnings per share of $0.91 in the third quarter grew 7% from the prior year quarter driven by our focus on cash flow, debt reduction and return on capital to shareholders.

On a constant currency basis, adjusted earnings per share would have been $0.99, representing 16.5% growth from the prior year period.

Now I'd like to comment on the results of our 2 business segments in the third quarter of 2023, starting with Performance Sensing on Slide 9. Our Performance Sensing business reported revenues of $754 million, an increase of 2% compared to the same quarter last year. Automotive revenue increased due to content launches and higher pricing, partially offset by unfavorable revenue mix in foreign currency. A decline in heavy vehicle off-road revenue reflects market contraction and unfavorable foreign currency, partially offset by content launches.

Performance Sensing operating income was $186 million, with operating margins of 24.7%. Segment operating margins increased year-over-year largely due to higher pricing, volume and productivity, partially offset by unfavorable foreign currency. Excluding the foreign currency impact, Performance Sensing operating margin would have been 25.8%.

As shown on Slide 10, Sensing Solutions reported revenues of $247.3 million in the third quarter, a decrease of 11.3% as compared to the same quarter last year. Industrial revenue decreased due to weaker markets, especially in HVAC, appliance and IT Mobile, industry de-stocking and unfavorable foreign currency. Aerospace revenue increased strongly in the quarter due to market, pricing, and content growth.

Sensing Solutions operating income was $71.3 million with operating margins of 28.8%. Segment operating margin was flat, primarily due to the decrease in industrial revenue and unfavorable foreign currency, offset by the growth in aerospace. Excluding the foreign currency impact, Sensing Solutions' operating margin would have been 29%.

On Slide 11, Corporate and Other operating expenses not included in segment operating income were $75.1 million in the third quarter of 2023. Adjusted for charges excluded from our non-GAAP results, Corporate and Other costs were $64.2 million, a slight increase from the prior year quarter, primarily reflecting higher employee costs.

During the quarter, we announced the structuring plan to better align our cost base with a weaker market environment we are seeing, to narrow our areas of investment, to focus on Electrification, and to accelerate our margin recovery. We recorded a charge of $21 million in the third quarter in relation to this restructuring program. We expect savings of $4 million to $6 million in Q4 as part of our guide and savings of $40 million to $50 million in 2024. These actions are designed to help the company reach its stated goal of 20% to 21% adjusted operating margins in 2024.

Moving to Slide 12. The capital deployment strategy we shared at the beginning of 2023 is already providing steady returns to shareholders as underscored by our improving return on invested capital of 9.8%, up 50 basis points from the end of 2022. We generated $87 million in free cash flow during the third quarter, up substantially from the prior year period and $401 million in free cash flow over the last 12 months, representing 70% conversion of adjusted net income. We are targeting free cash flow conversion to be approximately 75% to 80% of adjusted net income by 2026, above Sensata's long-term average, reflecting improvements in working capital. Capital expenditures are expected to remain in the range of $170 million to $180 million for 2023.

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Our net leverage ratio was 3.1x at the end of September 2023, and we expect this metric to continue to decrease to a level below 2x by the end of 2026, primarily through strong free cash flow generation. We also intend to repay the notes maturing late next year from cash on hand. During the quarter, we returned $35 million to shareholders in the form of share repurchases. In addition, we recently announced that we reset our share repurchase authorization to $500 million as well as our Q4 quarterly dividend of $0.12 per share as expected to be paid on November 22 to shareholders of record on November 8.

We are updating our financial guidance for the fourth quarter of 2023, as shown on Slide 13 to reflect the latest IHS automotive production estimates given UAW strike activity. This impact is expected to be temporary. Our expectations are based upon the end market growth outlook shown on the right side of the page. We are aligned with IHS estimates for automotive production on a Sensata revenue-weighted basis. While currently, UAW has reached tentative agreements with the D3, which now need to be ratified by membership. The ultimate outcome in process to restart production remains somewhat uncertain.

Based on IHS production estimates, we estimate the impact on Sensata's revenue as $35 million to $40 million this quarter with a 60 basis point impact to adjusted operating margin. Foreign exchange represents an expected $11 million headwind to revenue, 60 basis point headwind to adjusted operating margin and a $0.09 headwind to adjusted EPS in the fourth quarter. Excluding the impact of foreign currency, adjusted operating income margin expectations for the fourth quarter represent a 50 basis point decline from the prior year period, largely driven by the UAW strike.

Our current fill rate is approximately 91% of the revenue guidance midpoint for the fourth quarter.

Slide 14 contains a view of the implied full year 2023 outlook based on actual to date in the fourth quarter guidance. A few notable observations. Organically, adjusted operating margin is expected to increase 100 basis points during the year, and 60 basis points on a constant currency basis. Adjusted net income and earnings per share are benefiting from our capital deployment strategy of reducing leverage and buying back stock opportunistically. We now expect foreign exchange to be a $58 million headwind to revenue for the full year and a $0.26 headwind to adjusted earnings per share given current exchange rates.

I want to recognize the senior leadership team at Sensata for their support over the nearly 10 years I've served as CFO. I also appreciate the insights and support I received from so many in the investment community. I look forward to passing the baton to Brian to ensure a smooth transition.

Now I'd like to turn the call back over to Jeff for closing comments.

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

Thanks very much, Paul. And let me wrap up with a few key messages as shown on Slide 15. A replay of our Investor event from late September is available on our Investor Relations website, and I encourage you to watch it if you have not done so already.

During the event, we laid out the reasons why we believe Sensata represents a compelling investment opportunity. We have a 100-year plus history of innovation and deep customer relationships. The core of our business, whose success has been driven by trends in safety and efficiency, is vital, innovative and very profitable.

We are addressing an unprecedented opportunity in Electrification, supported by record new business wins and we remain on track to achieve our goal of $2 billion in Electrification revenue by 2026.

Together, this is expected to drive our long-term financial performance for the benefit of our stakeholders. We are committed as a management team to continue to focus our strategy in Electrification and prioritize our investments to enable us to monetize the opportunities we have invested in to enable growth and drive higher margins.

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

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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. Rocco, would you please introduce the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Today's first question comes from Mark Delaney with Goldman Sachs.

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

Paul, let me thank you for all of your help over the years. And Brian, wishing you a best of luck in your new role.

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

Thanks, Mark.

Brian Roberts

Thank you.

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

Jeff, I was hoping to dig a little bit deeper into the Electrification target for 2026. You reiterated the $2 billion target, even since your Investor Day in September, some of the major auto OEMs have talked about slowing down their EV ramp rate. So maybe help us better understand what you're seeing and what's giving you the confidence to reiterate the $2 billion target despite some of the volatility and wrap plans that we were announced here pretty recently.

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

Yes, absolutely, Mark. So just to set the context, we set that goal back in April of 2021 when we did an Electrification teach-in. At the time, it was a little bit of an ambitious goal, but we saw the line of sight, the accelerated trend of new business wins and engagement we were experiencing with our customers. And at that point in time, over the last -- the 3 years prior to that, we had seen trends toward greater EV penetration right now. So that moves around, it ebbs and flows a little bit. But based upon the engagement with customers, the NBO wins we've seen third-party estimates regarding EV penetration, we feel very comfortable with the $1.2 billion of revenue in automotive. The balance of that will come from HVOR and the Industrial business. And again, 90% of that auto target is booked at this point.

Now to address your very specific question regarding customers' view on EV penetration. We're clearly seeing an accelerated trend associated with Electrification, right? So back in 2020, 3% of North America was electric. In 2023, it's expected to be 11%. In Europe, back in '20, it was 4%. In '23, it's expected to be 17%. And in China, there was a 6% new energy vehicle penetration in '20. And in 2023, it's expected to be 36%. So there may be puts and takes in terms of estimates based upon customer take rate, but it's very clear that the technology exists, there is demand for these vehicles. The infrastructure is being built. And so we're preparing for that.

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The last comment I would make on this is that we -- clearly, we've invested in this trend toward electrification. But to the extent it slows. We have a very strong core business that will continue to prosper. And in fact, if OEMs slow down their EV penetration, they have to meet greenhouse gas emissions reductions in other ways, which would benefit Sensata.

So the slowing does not worry us. It's also in a category of our business, which today enjoys much higher margins. So to the extent that slows, it will be good for Sensata either way. It might be a little bit slower top line growth going forward, but more achievable and more certain bottom line growth in terms of the overall company. So we're prepared for both. I think that there will be ebbs and flows on individual customer forecast associated with it, but we believe in this as being a long-term trend in the industry.

Operator

And our next question today comes from Wamsi Mohan with Bank of America.

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

And I'd echo Mark's comments on both Brian and Paul. If I could, Jeff, maybe on the UAW impact being transitory, can you flesh that out a little bit in terms of how that's going to work into calendar Q1?

Did you see any inventory or are you expecting inventory build up into Q4 and your guide is net of that? Or is there no real inventory buildup and you should see about seasonal trends heading into Q1?

And if I could, on the incremental restructuring, it seems like that's going to drive about 100 basis points of operating margin upside. If auto volumes were to go down, can you still get to 20% to 21% operating margin in 2024? Just trying to calibrate what kind of revenue estimate you would need to get to that 20% to 21% operating margin?

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

Great. Wamsi, why don't I address the UAW piece of it and then maybe Paul can address the margin question, given restructuring and volumes and so forth. So as we had anticipated, the UAW strike did not have any meaningful impact on the third quarter. We landed essentially where we thought we were going to land. We knew it was going to be a fourth quarter issue.

At the time of our Investor Day, we used IHS estimates in terms of the impact associated with the strike to develop our guide for $1 billion. We also look to what we had indicated as more normalized seasonal patterns in the business, which from Q3 to Q4 typically would be flat or maybe up a percentage point or so. So we use those data points to help us figure out where we needed to be.

Obviously, things have changed, and they've been very dynamic over the last several years. Based on IHS forecast of production, we believe that there's about a $40 million fourth quarter impact, very specific to the D3 based upon production schedules that aligns pretty tightly to what our order patterns have been from those customers.

Recall that the D3 entered the fourth quarter or exited the third -- September 30 vehicle lot, and numbers were back to the 60% range on average, some were a little bit higher than others, but I think they were preparing the vehicle lot inventory to deal with the potential issues associated with the strike going into that. So I would expect that, that might be down a little bit and will present an opportunity for us.

So the startup, the restart up, I think, will be different by individual customer, but we're there to work with them. We've had calls with all of those customers regarding what that startup will look like and making sure that we can be there to deliver the parts when they need them. And at this point, my sense would be, it will be a little choppy in the fourth quarter, but it looks as though -- as we go into the first quarter, things will normalize.

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One more comment that I would make on impact of UAW. As I commented on a $40 million revenue impact in the fourth quarter associated with the UAW strike. That obviously falls through a pretty significant decremental margins. So it's a 60 basis point impact, given that we know we felt strongly. That it was temporary, so we did not adjust cost structure for that decline in revenue because we wanted to make sure that our teams in our sites were prepared to be able to respond when it ended, and that's turning out to be a good thing in terms of the preparedness on our side, but it does have a negative impact on fourth quarter margins to the tune of 60 basis points. So Paul, do you want to...

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

Yes. So quickly, Wamsi, going back to Investor Day and the 3-year growth model on the top line. The revenue profile that we had in the model there was more back-end loaded, just given the launches of Electrification, and most of the growth in the model is around Electrification and given the long cycle nature of the business, the back end period of that 3-year period is where the growth is higher. So we were expecting lower growth in 2024. We're obviously giving more specifics when we guide in the beginning of 2024.

The restructuring was done to strengthen our cost position and our margin recovery plan. And so that drives a lot of the improvement year-over-year in margin. So we're not relying on volume to solve the problem of improving margins. We're going to focus on cost control, focusing our investment dollars in the area of Electrification, we're having a great success. And so revenue will contribute, but it's not what we're relying on to deliver the margin improvement.

Operator

And our next question today comes from Samik Chatterjee with JPMorgan.

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

Paul, congrats on the -- Brian, best of luck. On the outgrowth to the market, if I look at the last 12 months number at 460 basis points and last quarter, I think, the last 12-month number was around 535. So that's been moderating here. I'm just curious, when you sort of piece out the drivers there, why the outgrowth to the market is moderating. How much of that is the share shift in relation to China automotive market versus maybe lapping some of the pricing increases that you had taken, which was probably helping our performance. If you can piece out sort of what the drivers are and why that's moderating. That will be helpful.

And a quick one for Paul. Paul, FX is always tough to model for you guys. Can you just give us some guidance for next year, based on where or how should we think about FX?

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

Yes. So let me hit on the outgrowth and we're broadly the secular growth story that you're commenting on and the impact to that and then Paul can touch on the other topic. So if you look at the full year 2023, on a reported basis, the company will be about flat on revenue. On a constant currency basis, we'll be up 1.5%. While the global markets that we serve are down about 1%, so there is a secular growth story. We are growing faster than markets.

When you break that down, Automotive is up about 2%, heavy vehicle off-road is up about 1%, Aerospace is up 28%, and the Industrial market is down 9%. So the big impact in terms of 2023 is really the industrial business in terms of that being down 9%.

When you look at the auto market specifically because that tends to be the market that we talk about when we talk about secular growth. But the reality is there's secular growth in all of the markets that we serve. If you look at the IHS forecast for the full year right now, it's about 3% auto growth. We're at 1.5% when you consider constant currency, we're at 4%. So we are growing faster than the production growth rate as forecasted by IHS.

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There are a lot of moving parts in here, okay? But I think part of the challenge is we get into all of the details on it, which are many, but they are really -- there are 2 structural things that are impacting outgrowth to market in auto and there are 2 temporary things. The structural items are the shift in China from multinational to local. That's a significant impact to Sensata, right?

Now that 5 percentage point share shift occurred during 2023. But as I had mentioned in my prepared comments, we believe that stabilized now, but we will watch that very closely. And the way that we will address it is by accelerating our new business opportunities with the local OEMs, not only on internal combustion engines, but on the EV platforms. And we're making progress on that, with 35% of their production during '23 being EVs and us being higher revenue per vehicle on EVs, that demonstrates the progress that we're making there.

But in order to become more equivalent, multinational and local, we've got a lot of work to do. But that is our strategic focus.

The second is the EV shift in Europe. So if you -- and again, in my prepared comments, I talked about the fact that because we were behind on the original sourcing associated with launches in Europe around EVs, we're about half the content or the half the revenue per vehicle in Europe on EVs versus internal combustion. We've got a number of wins that we've had that will materialize over the next several years, that will address that issue, and we're not done.

We are continuing to work with those customers to get more revenue per vehicle on the EV platforms as that take rate accelerates. So those are the 2 structural, very strategic issues. There's a lot of other noise in the system associated with things that are going on, but those are the 2 things that are having the biggest impact in terms of structural.

The 2 more transitory or temporary items are the launch delays that we've talked about. So there's a significant amount of launch delays that have happened during 2023 that we were counting on our revenue, that would have changed that out growth rate. And again, we're working with customers around creating more certainty around those to make sure that they and we are ready to launch when we've intended. And the second is around the D3 impact in the fourth quarter. So we have more revenue per vehicle with the D3. When that revenue goes down, it creates a mix problem for us. But those last 2 items will fix themselves with more engagement with our customers and the resolution on the UAW strike.

So the other 2, we'll keep you posted on it. We've got to make sure that we continue to drive the strategy to address those issues. Hopefully, that gives you more color on that.

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

And on the FX, I mean, FX will continue to be a headwind next year. I would estimate somewhere around 50 basis points impact to operating income and operating income margin, which is in line with what we -- I think we shared on Investor Day, just given, and that's based on the current rates. So how we exit the year will stay the same. That's what I would expect.

Operator

And our next question comes from Amit Daryanani with Evercore.

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

I just have 2 as well. First, on the auto, on your December quarter expectations for automotive revenues to be down 10%. Can you just talk about how do you think that stacks up across the various geographies for you? And then any initial sense of what calendar '24 production could look like across the key geos?

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

Yes. So on -- again, I spoke to the auto production versus what our market rate was for the full year. If I remember correctly, in the first quarter, we were growing faster than the market that the IHS market. In the second quarter, we were behind. Third quarter, we were about equivalent and then fourth quarter, we are behind. So -- and that's due to primarily the mix associated with D3. So the expected drop in production on D3 has a revenue impact to us, that's causing our adjusted market in auto. But across the year, Amit, we're pretty much on top of the IHS forecast. So mix will move around based upon OEMs that produce cars and the platforms that are produced, but across the market, across the year, it's pretty -- it seems to be pretty stable.

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

And to clear up in case there's any confusion, Amit, the numbers that are on that slide are meant to be market growth numbers, not our revenue growth. Obviously, they are weighted for our revenue across OEMs and geographies. They line up the auto number at least it lines up with the IHS forecast for production.

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

Got it. And then Jeff, if I just go back to the discussion you had around the impact from the UAW strike and I totally understand why you have an outsized impact on your operating profit line in the December quarter. Is it fair to think that, that should reverse back, i.e., the incremental margins should be much stronger as those revenues potentially come back in the first half of the year?

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

Yes, definitely. So as that revenue comes back, it will absorb the overhead we have associated with that, and we would expect the incrementals to come back just like they would go down in the fourth quarter. So without -- we're guiding to around 19%, midpoint of guidance. On operating income, we'd be at or slightly above what we had originally guided, if not for the UAW strike. So yes, we're very focused on making sure we show continued progress toward our operating income index target.

Operator

And our next question comes from Steven Fox with Fox Advisors.

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

I had 2 questions as well. First of all, with regard to sort of the EV supply chain. There also seems to be concern, especially on the semiconductor front with the level of inventories that some of the OEMs were sitting on as EV demand has kind of slowed a little bit here. Can you talk about how you inventory OEMs and how you think maybe your inventories sit there? And then I had a follow-up.

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

Yes. So let me address it on our supply side and then on how we deal with the demand from our customer side. So I'm hesitant to claim the end of supply chain challenges. It's been a very challenging couple of years, but clearly, things have abated considerably in terms of the overall availability of parts. That's not a universal message because I think when you talk about electronics, there are certain types of electronics that are still scarce and short on supply versus other, but generally, we're in a much better place and we feel as though the inflationary pressures that were driven by that supply-demand dynamics are starting to balance out a little bit. So that's on the supply side.

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On the customer side, as we've talked about, we're -- we make to the order, right? We're a just-in-time inventory model. There was a point in time when customers would quite literally take anything that we could produce to make sure that they had parts available to them. We feel as though that's reversed pretty dramatically due to changes in the market, but also because we feel as though we've been there for customers. So we have a proven track record of being able to deliver when they say they need it.

So we -- I think we had estimated, it's very difficult to estimate, but I think we had estimated there's still maybe $15 million to $20 million of inventory. Our parts in warehouses or in partially completed vehicles, but it's not a meaningful number anymore in terms of the long-cycle OEM market, where we have more visibility, given the just-in-time inventory modeling that our customers have.

On the Industrial side, more short-cycle business, it's much harder to get a really good beat on that. And clearly, some of the decline that we've experienced during 2023 in that market is not only market but destocking that's happening, but that will have a -- the positive impact when restocking does occur. It's been a tough year for that market. But specific to EVs, we don't see customers cutting orders because they have components specific to our -- their EV production with Sensata, I think that we've stabilized in terms of shipping the parts they need to make the product for their customers.

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

That's really helpful. And that leads me into my second question, which was on industrial markets. It seems like these markets are getting worse, but everyone defines industrial differently across the supply chain. So can you sort of talk about off of these year-over-year declines that you're seeing, like what is sort of a path to recovery or whether we're not even in the recovery phase yet?

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

Yes. So we do a lot of modeling. We have a long history in these markets that we serve to understand based up on PMI metrics and other third-party metrics that have a pretty good correlation to the demand for our product globally across the individual regions.

Clearly, we've gone through a destocking periods, Steve and so we've had order rates lower than where the market is. And when you look at the 20-year history of that, it snaps back when there is a recovery. The fourth quarter is down 19% market-wise, industrial quarter-over-quarter, that's accelerated from where it was in the third quarter. So I'm not claiming that the bottom has been achieved on that. But it will hit at some point. My hope would be that the fourth quarter would be the bottom of that and then going into 2024, we'd start to see that recover.

From a revenue basis standpoint, our Industrial business is pretty flat. Q3 to Q4. So from a sequential standpoint, it looks like it's stabilized, and then we'll start to see a recovery on that.

Last point I'd make there is the -- it might be the obvious, but that's a very hard margin business for us relative to our auto and HVOR business. So when that comes back, that will create some leverage in terms of incremental margin for the company as well.

Operator

And our next question comes from Luke Junk with Baird.

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

Paul best wishes, in your retirement as well.

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

Than you.

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

Jeff, bigger picture, you cited an increased pace of new business wins with local OEMs in China, including country-specific contactors. I was just hoping you can expand on the increased traction that you're seeing there, specifically, I guess, within contactors, especially -- and what -- as we look out a few years from now, what a reasonable target might be for local EV content versus what your historical content has been with the multinationals on ICE platforms in China?

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

So some of you may remember that 2022 -- no, it was '21, late '21, we entered into the JV with Churod, right? Because what we had observed was that the vast majority of the vehicles in China, the electric vehicles in China that were being produced were lower voltage. So let me quantify. Under 400-volt systems, whereas a lot of the newer systems in Europe and North America are above 400-volt. We didn't -- we had not invested in it. We didn't have a great solution at the below 400-volt. So we partnered with our -- this JV with Churod. We've seen accelerated progress there around specifically contactors.

Now we've made some progress on that as evidenced by the fact that when you look at a local maker, a local OEM, we have 1.25x the revenue per vehicle on electric vehicle versus on a combustion engine. But a lot more work to do to get that to the equivalent in the United States. But progress being made. It's not only going to be contactors, right? So there are other applications that we're serving that are EV-specific. As you know, around braking, around tire pressure, around environmental control that represent opportunities for us.

Good progress there -- our goal, as we've talked about is to have double the EV content by 2026 on a global basis. When you look across the globe, by 2026, based upon where we are today, North America will be above that 2x.

China will be approaching the 2x. And then Europe, I think, will be the one that will be not far behind, but we'll be accelerating to get there to create the average of 2x across the company. So continued progress, more to come in terms of specific NBO wins in that area.

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

And just a follow-up in the near term, if I looked back to strike impacts from the business in 2019, I think you said about $10 million in lost revenue in North America. Just hoping you could bridge that to the $40 million or so you're expecting this year, just trying to see if there is something in terms of what's going on in the channel or just generally how this strike is different from the Sensata's standpoint, given unit impacts aren't as meaningfully differently?

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

You're trying to reference back to the prior -- the UAW that struck in 2021? Is that the question, Luke?

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

Yes. The 2019 strike, you had cited about $10 million in lost revenue -- China square the average $35 million to $40 million right now, given that the number of units are pretty similar, Yes.

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

Yes. So listen, I mean we're -- in our $40 million impact, we're looking at what IHS says ultimately the impact will be. As I'd mentioned, that ties pretty closely what the order rates are and where we are in a fill rate. I think we're 90%, 91% filled against the forecasting we have. That's pretty typical and that too is normalizing. So I feel as though it's a pretty good estimate. I think that how -- I mean, I think the union has dealt with this one under Shawn Fain's leadership has been anything consistent with the past. And so we're following based upon the production rates.

The fact that they have tentative agreements, obviously very positive. But we'll watch closely the start-up to see whether or not we have that full $40 million impact or how that transitions as we go throughout the year. So -- but yes, that's the math on the production rates, which is about -- remember, we had talked about $7 million to $8 million per week if everything shut downs. So we're at the point where it's a little less than half the full quarter impact, if everything had been shut down for the full quarter.

Operator

Our next question today comes from William Stein with Truist.

William Stein - *Truist Securities, Inc., Research Division - MD*

Great. Thanks specifically to Paul. It's been great working with you over the last few years. And I have a question for Brian.

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

You're welcome. Thanks.

William Stein - *Truist Securities, Inc., Research Division - MD*

Yes. I do have a question for Brian. I'm wondering if you can share with us any initial thoughts you have on the company and specifically, what you think your priorities are likely to be in the near and longer term?

Brian Roberts

So I'm about 1.5 hours in. So a little bit more time to be able to truly digest. But I guess, I would say what brought me to Sensata is I'm certainly very excited about the core business and the Electrification trend that exists.

Watching the Investor Day back in September, certainly thinking that those targets that were laid out are achievable. And really, Paul has developed a great team and there's a great management team here that I get to work with. So more to come over the coming months, but I'm excited to be here.

William Stein - *Truist Securities, Inc., Research Division - MD*

Great. And I think this question was just asked, perhaps in a slightly different way, but I'm hoping Jeff, perhaps you can discuss the variability of your position across the local China EV companies. It's one thing about 1.25x the content of a local ICE, but where we, as investors, can often get into trouble is you quote the statistics and they may be very correct relative to where you have design wins, but there is an issue relative to the breadth sometimes, where maybe you're not making an explicit bet but where you wind up getting bigger content wins, those OEMs might not achieve the same growth or the growth they aspire to and others where you don't have as much position might wind up ramping. And so I'm hoping you can address the variability from OEM to OEM in China. Maybe what percentage of them you're working with? And how that 1.25x content varies from OEM to OEM?

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

Yes. So you're absolutely right that the mix of the business matters and engaging with the winners matters. And that's candidly never been more challenging given the disruption that is occurring in the automotive market. And so from an EV specific standpoint, it's very clear right now, that the 2 global leaders are Tesla and BYD. We're very well positioned with Tesla for very broadly. And they're above our average net revenue per vehicle. So that's a very good thing. BYD, I feel as though we're very well positioned also, but the challenge with BYD is they are vertically integrated from an Electrification-specific component standpoint. We're working with them very closely.

To your broader question regarding China OEMs -- we've casting it very wide in terms of who we're working with. I think clearly, we could say the top 5 local Chinese OEMs, we have good relationships with, but there are a lot of Chinese OEMs. So I can't definitively say that we're working with all of them, but I feel as though we're well positioned with the ones that are gaining market share. And the big question that we're grappling with as it relates specifically to China, is when will that consolidation happen and where will the consolidation happen. And so I personally don't think that's going to happen anytime soon. But the evidence of who the winners will be not only in the Chinese market, but potentially in the global market is starting to develop in terms of share that's being accumulated. And that's where we're focused.

As we continue to focus the strategy and making sure that we're working with the folks that we know will be the winners, that's where we're making sure that we continue to win with the players that have experience behind them that demonstrates that.

To the specific point of the 1.2x, that's year-to-date in 2023, when you look at collectively all of our revenue with local Chinese makers and you split that between combustion engine platforms and EV platforms, that's the mix. When you look at the content or the revenue per vehicle on ICE, it's about 20% and you look at the EV makers, it's 1.25x that. But we will continue to monitor it and our goal would be to make sure we accelerate that, given 35% of the vehicles produced in China this year are going to be new energy vehicles.

Operator

And our next question comes from Shreyas Patil with Wolfe Research.

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

And thanks, Paul, for all the help over the years. Maybe coming back to the EV targets. So you've talked about strong content on North American OEMs. But the ones we are -- but they are the ones where we are seeing planned pushouts and where prior expectations appear to be evolving are really the biggest with the North American automakers.

For example, GM previously talked about adding 600,000 units of EV large truck capacity by next year and the entire industry seems to have been targeting something like 1.5 million units in that area by 2026. The entire market for large trucks is about 2.7 million. So it does appear that there could be changes to those expectations. I guess what I'm asking is, if that were to happen, would that create an outsized headwind to Sensata?

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

Yes. So the point is taken. I really watching closely to understand what their forecasts look like as we continue to progress forward, right? There's some outside dynamics that are causing some of the changes in their estimates right now in terms of negotiation with the UAW and other things. Certainly, consumer demand for electric vehicles, specifically as it relates to the truck market, causing our customers to think about that. But I'll go back to the comments I had made earlier, which is, clearly, if EV penetration in the North American market, which is where we have the greatest revenue per vehicle slows, that will be -- that will create a challenge in terms of achieving the $1.2 billion of revenue.

But the OEMs will need to do other things on those combustion engines to get to the emissions requirements over the next 3, 5 years. And we're well suited to go after that, right? So they had stalled and paused all of their combustion engine development. If they change direction, they'll

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need to restart some of those, and that will represent opportunity for us and on an accelerated basis to make sure that we're addressing those issues. And as I've also mentioned, that is an area where we have demonstrated margin profile that's superior to the electric vehicle component here.

Now we have a road map on the electric vehicle-specific components to get to company margins, but there's a lot of work that we need to do to get there. So there's a put and take. The delay we're slowing of it will maybe have a little bit of impact on revenue, but it will have a positive bottom line impact. Hopefully, that addresses your concerns.

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

Okay. Great. And just one last quick one. I mean anything that you're seeing on the Tier 2 supply chain, especially as the industry is starting to ramp back up following the UAW strike, how confident are you that you can -- that the Tier 2 supply base can ramp up as well?

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

Yes. So all of our OEM customers have been very -- they've communicated a lot with us and with all of their suppliers regarding readiness. I can't speak to what others have done in terms of making sure they're idling, ready to go when that demand comes back. But I can tell you that we're ready to go. And if some Tiers miss it, it's not from a lack of communication or their part of their customers regarding being ready for their response. So -- and I would also mention where we are directed by or where we serve those tiers, we're having open dialogue with them as well. So we feel as though this -- although we'll -- the restart will have some bumps associated with that, I feel it's been well planned, where we'll able to restart pretty effectively.

Operator

And our next question comes from Joe Giordano with TD Cowen.

Joseph Craig Giordano - *TD Cowen, Research Division - MD & Senior Analyst*

A problem -- I'm juggling a bunch of calls, so apologies if this was asked. I'm just curious on the guide, right? So like in Investor Day, you just talk about the thought process and kind of going out of your way and giving a 4Q guide when there was already kind of like an uncertain market right now. And then it almost compounds having to cut it here. So what was the thought process kind of going into that event as to like why you felt compelled to put it up then when there was still like the strike going on?

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

Well, we obviously felt good about Q3, which we delivered. And so -- and we felt we should give expectations on Q4, which we had pretty good confidence at the time based on our fill. And we obviously put out a 3-year guide that would be underpinned based on our 2023 estimate. So it all made sense to put that out. We were clear that our guide for Q4 was based on IHS estimates at the time, which had about $15 million of either lower production because of the strike or that they had built inventory that they would consume and we felt that was a prudent assumption to use, which underpins the guide. And now we're seeing the strike go on longer. And we're using IHS' current estimate, which gives us about a $40 million -- $35 million to $40 million revenue impact.

So we were using the third party as a way of developing the guide, and we're updating it based on new information. I think that's appropriate, and I felt it helped integrate performance in Q3 with the full year '23 and then our 3-year expectation that we provided. So I think it was the right thing to do. And I think what's driving our lower guide is, in fact, the UAW activity and how it's progressing. No one's going to be able to know the number, right? I mean whatever we put out there, it's a best estimate based on the best estimators out there to provide that. But when we get to the end of the quarter, we'll know for sure. But we feel confident that this is the best estimate that we can put out there for Q4 at this time.

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Operator

And our next question today comes from Matt Sheerin at Stifel.

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

Jeff, I'm hoping you can give us more color on what you're seeing in the HVOR market. That was down sequentially and year-over-year for you. And I know that market has been weak, but you've also been talking about in recent quarters about continued market outgrowth. So could you share us what you're seeing in terms of outlook from customers and by region? And are you expecting it to recover any time next year?

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

Yes. So in the third quarter, the market was up a little bit, call it, 2% third quarter versus third quarter of last year. When you look at what we're guiding to, it's down 1% or 2% versus the fourth quarter of last year.

And then on a sequential basis, it's a decline, but it's a typical seasonal decline third to fourth quarter in the HVOR market. To your broader question regarding that overall market, it's disproportionately impacted by China on-road. There is some strength in some of the other markets that we serve. And again, much like the comments that I've provided on the Industrial market, it's been declining for 12 to 18 months at this point. And the expectation would be that it will come back. The seasonality of that business tends to be in that sort of 12 to 24 months time frame.

Operator

And our next question comes from Chris Snyder at UBS.

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

I wanted to ask on auto, up 6% organic versus between bit flattish production year-on-year. But I mean, if you guys see that difference. So pretty solid outgrowth, probably one of the better outgrowth quarters we had in the while. Is that just a function of comps? So maybe just kind of talk about why the outgrowth came in better from where it's been?

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

Yes. I mean we've talked about the fact that our growth is a measure that we really should be looking at over a longer period of time rather than in quarter because mix of what our customers actually make matters in terms of what that looks like. Ideally, we would have the exact same amount of revenue per vehicle across the globe, we know that's not possible based upon the relationships, the individual relationships we have. So I would say there are a number of things that we know drive outgrowth in the automotive business in terms of not only EV penetration, but the fan out of other applications that we serve as there were many, but I really would encourage folks to look at outgrowth across a longer period of time than a quarter because a lot can change the dynamics in an individual quarter.

Operator

And ladies and gentlemen, this does conclude our question-and-answer session. I'd like to turn the conference back over to the management team for any final remarks.

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

Thank you, Rocco. I'd like to thank everyone for joining us this morning. We'll be participating in a few investor conferences later during the quarter in Q4. New York Stock Exchange is sponsoring an Industrial Virtual Conference on November 14 that we'll participate in. We'll Also join Alliance Bernstein Industrial Investor Conference down in New York on the 28th of November, Melius Industrial Investor Conference in New York, again, December 7 and Oppenheimer is sponsoring a Technology Investor Virtual Conference on December 14 where we'll be presenting. We look forward to seeing you at one of these events or on our fourth quarter earnings call in late January 2024.

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

Operator

Thank you. We thank you all for attending today's presentation. You may now disconnect your lines, and have a wonderful day.

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