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ST.N - Q4 2024 Sensata Technologies Holding PLC Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good afternoon and welcome to the Sensata Technologies fourth-quarter and full year 2024 earnings call. All participants will be in listen-only mode (Operator Instructions)

Please note this event is being recorded and I would like now to turn the conference over to Mr. James Entwistle, Senior Director of Investor Relations. Please go ahead.

James Entwistle - *Sensata Technologies Holding PLC - Head of Investor Relations*

Thank you, Wyatt, and good afternoon, everyone. I'm James Entwistle, Senior Director of Investor Relations for Sensata, and I would like to welcome you to Sensata's Fourth Quarter and Full Year 2024 Earnings Conference Call. Joining me on today's call are Stephan Von Schuckmann, Sensata's Chief Executive Officer; and Brian Roberts, Sensata's Chief Financial Officer.

In addition to the financial results press release we issued earlier today, we will be referencing a slide presentation during today's conference call. The PDF of this presentation can be downloaded from Sensata's Investor Relations website. The conference call -- this conference call is being recorded, and we will post a replay on our Investor Relations website shortly after the conclusion of today's call.

As we begin, I would like to reference Sensata's safe harbor statement on slide 2. During this conference call, we will be making forward-looking statements regarding future events or the financial performance of the company that can involve certain 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 filings with the SEC. 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 and non-GAAP financials, including reconciliations, are included in our earnings release and in the appendices of our presentation materials. Brian will begin today by covering our detailed results for the fourth quarter and full year 2024. Next, Stephan will comment on his perspective from his first 30 days and key priorities

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moving forward. Stephan will then turn the call back over to Brian to discuss our financial guidance for the first quarter of 2025 and our high-level 2025 outlook.

We will then take your questions. Now I would like to turn the call over to Sensata's Chief Financial Officer, Brian Roberts.

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Thank you, James. Good afternoon, everyone. First, let me welcome Stephan to the team and thank Martha Sullivan for her leadership over the last several months as she stepped back into the CEO role on an interim basis. For clarity, unless noted, all amounts are denominated in US dollars.

Let me start on slide 6. We finished 2024 with a strong fourth quarter as revenue of $908 million exceeded the top end of our $870 million to $900 million guidance range. Adjusted operating margins increased sequentially for our fourth consecutive quarter, and we improved full year free cash flow conversion by 27 percentage points to 76% of adjusted net income as compared to 49% in 2023. With our improved free cash flow generation totaling $393 million for the year, we reduced net leverage to under 3x as of December 31, 2024 for the first time in three years.

Our renewed focus on our core portfolio of highly differentiated sensing and electrical protection products is driving value and improving operational efficiency. Over the last two quarters, we exited through a combination of divestitures and last time buys, approximately $370 million of annual revenue, including both the Insights business and the low-margin, low-growth product pruning efforts we described last year.

In connection with these portfolio optimization measures, we implemented restructuring activities to streamline process, reduced overhead expense and consolidate facilities. These actions to strengthen our operational foundation will prove critical as we enter 2025.

As I noted, revenue was $908 million for the fourth quarter of 2024 as compared to $992 million in the fourth quarter of 2023, a decrease of about 8%. We exceeded our guide as our top line benefited from higher-than-expected auto production in both North America and China. For the full year, revenue was $3.93 billion, representing approximately a 3% decrease from revenue of $4.05 billion in 2023.

Adjusting for the sale of Insights on September 30 and other products exited in the second half of the year, revenue would have decreased approximately 1% from 2023.

Adjusted operating income for the quarter was $175 million, representing a margin of 19.3%, an increase of 80 basis points from 18.5% in the fourth quarter of 2023. For the full year, adjusted operating income was $749 million or 19%.

Adjusted earnings per share in the fourth quarter of 2024 was at the high end of our guidance range at $0.76 as compared to adjusted earnings per share of $0.81 in the prior year period. For the full year, we reported adjusted earnings per share of $3.44 as compared to $3.61 in 2023.

Now let's turn to slide 7 to discuss our segments. Performance Sensing, which includes our auto and heavy vehicle off-road units, reported revenue of $2.74 billion in 2024, roughly flat year over year. This represents approximately 350 basis points of outgrowth against automotive and heavy vehicle end markets, which both contracted over the same time period. Our strong incumbency and recent share gains on ICE platforms enabled us to drive out growth despite the slowdown seen in EV adoption in both North America and Europe.

Performance Sensing adjusted operating margin for full year 2024 was 24.6%, representing an 80 basis point decrease year-over-year due primarily to regional revenue mix and the impact of foreign currency. For 2024, Sensing Solutions, which is comprised primarily of our industrial and aerospace businesses, reported revenue of $1.06 billion, which was a decrease of 8% year over year.

While we have not yet seen a turn in industrial end market demand, we are encouraged that the business appears to have stabilized, as fourth quarter revenues were down just a couple of percentage points as compared to the fourth quarter of 2023. Sensing Solutions operating margins for 2024 were 29.5%, representing a 30 basis point increase from 2023.

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Adjusted operating expenses of $264 million included within our Corporate and Other segment were roughly flat year-over-year. This includes approximately $62 million of expense related to programs previously referred to as megatrends spend. Beginning in the first quarter of 2025, we will reallocate these expenses to the business units, with a great majority to be included within our Performance Sensing segment. With that, let me turn the call over to Stephan for his initial thoughts on the business.

Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

Thank you, Brian, and good afternoon, everyone. I'm excited to be here as the CEO of Sensata. Let me take a moment to thank the global Sensata team, our entire Board, as well as Martha Sullivan, who continues to be a valuable adviser to me. I come to Sensata with over 20 years of global automotive, heavy vehicle and industrial experience. Most recently, with [ZF Friedrichshafen] as a member of the Management Board and as a leader of the electric mobility division with more than EUR12 billion in revenue.

The global electric mobility division included all powertrains to ensure that the growing electrification needs of its OEMs customers were met, but also to remain a strong market leader on ICE and hybrid platforms.

During my tenure, the division increased revenue by more than EUR2 billion at an average growth rate of 7% per year, improved plant level operational efficiencies and grew operating margins. Our responsibilities also included oversight of the Asia Pacific region and global procurement operations.

My prior employer and Sensata have a long history of collaborating in both automotive and heavy vehicle markets. With the reputation of being the partner of choice to meet complex sensing needs, Sensata has developed an attractive position of market leadership, underpinned by its long-lasting and deep customer relationships.

At a time when end markets are undergoing unprecedented transition and uncertainty, Sensata is well positioned across our business segments with a diverse set of high-value products and differentiated margins. This includes a robust ICE portfolio, an opportunity-rich electrification offering for our auto and our [HVOR] customers and our high-value sensing and electrical protection business serving customers in industrials and aerospace.

With our strong product [through] across end markets, our global footprint allowing us to serve customers in all regions and our deep embedded relationships, I'm confident that there is a significant opportunity to create shareholder value at Sensata.

To unlock this value opportunity, I'm focusing my efforts on three key pillars which will be critical to our long-term success. First, returning Sensata to growth; second, improving our operational performance; and third, optimizing capital allocation.

While I am only a month into my tenure, let me take a minute to discuss my initial thoughts around each of these three key priorities. Over the last few years, Sensata has struggled to deliver organic growth against the backdrop of weak end markets. Like many peers, the company responded appropriately by cutting costs.

The opportunity for growth, however, is not completely dependent on the market. It's also achieved through innovation and by winning with the right customers on the right platforms. This was paramount to the growth I helped deliver my previous employer, and I will bring similar perspectives to Sensata.

Returning to growth will take some time, as this is a long-cycle business, and our key end markets are expected to remain weak over the next several quarters. As such, our revenue expectation for 2025 is to be organically flat with 2024.

Longer term, it will be my priority to deliver top line growth, and I'm confident that Sensata is well positioned with the right product portfolio to do so.

For example, our industrials business recently launched its A2L leak protection sensor for HVAC units, and we have established a market leadership position. As production of new generation HVAC systems increases, we expect this product to be a meaningful growth driver of our industrial

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business. Additionally, we have a strong value proposition across powertrains within auto and HVOR, as we demonstrated in 2024 with approximately 350 basis points of outgrowth across these end markets.

Our ICE business is strong, as demonstrated by recent significant wins, including exhaust pressure sensing with Toyota, new emission sensing applications in North America and additional sockets across various platforms in Europe. We also continued to win in electrification, where we are focused on growing with leading EV players in North America and Europe and expanding share with local players in China. Finally, our aerospace business continues to see modest growth at operating margins well above our portfolio average.

In the near term, we're focused on operational excellence and continuous improvement as a growth enabler. I want to be clear on this point. Operational excellence is not just about cost productivity and margin percentage. It means delivering a high-quality product to our customers on time, at the lowest possible cost, while we efficiently manage production capacity and optimize inventory levels. Being operationally excellent means doing all of that well.

And that ensures we remain the supplier of choice for our customers, affording us the opportunity to win business and gain share.

Recently, I visited our plant in Aguascalientes in Mexico. I was impressed by our many product lines across our business units and the highly capable team at that site. That said, it was also clear that we have opportunities to advance towards operational excellence.

Continuing our lean manufacturing efforts, accelerating our work to identify incremental design-driven cost reductions and demanding more of our supply chain are all areas where we expect to deliver meaningful improvements.

Overall, I'm encouraged by the progress the Sensata team has made in this past year as they improve quality and customer scorecards, achieved quarterly [or] operating margin targets and refine the product portfolio. In the coming months, I'll travel to many of our locations, including Bulgaria, Malaysia and China to meet our customer-facing teams and review our operational performance. And on these visits, I have challenged our teams to accelerate their operational excellence initiatives, and I look forward to seeing that progress with an emphasis on value creation.

Finally, let me speak to cash flow generation and capital allocation. I'm pleased with the team's accomplishments in growing free cash flow in 2024. Incremental free cash flow is key to unlocking significant shareholder value as we find efficient ways to generate and deploy cash. Sensata's Board and I will continue to prioritize reducing net leverage, repurchasing shares opportunistically and maintaining our dividend.

While there are currently no plans for greater portfolio management beyond what was achieved in 2024, product life cycle management is good business practice, and I expect to continue to ensure that each of our products and businesses earns their place within our portfolio.

With that, let me turn the call back over to Brian. Thank you.

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Thank you, Stephan. On slide 8, I want to highlight our cash deployment efforts for the fourth quarter and full year 2024. As mentioned earlier, we are pleased with our improvement in free cash flow conversion as a percent of adjusted net income. We exceeded our target of 67% conversion, ending the year at 76%. We generated $393 million of free cash flow, which was a year-over-year increase of 44%.

As you can see from the chart, we've returned to pre-COVID levels of conversion as we improved working capital by reducing inventory levels and controlling capital expenditures.

Turning to slide 9. We also delivered on our commitment to reduce net leverage to below 3 times trailing 12-month EBITDA as of December 31, 2024. We retired $700 million of bonds a year early through a combination of $200 million in corporate cash and proceeds from a $500 million bond offering maturing in 2032.

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With these actions, we have improved the maturity profile of our debt stack, with the next tranche not due until 2029. Additionally, we returned $72 million of capital to shareholders through our dividend, and we repurchased nearly 2 million shares in 2024 using approximately $69 million of cash.

These capital deployment actions yielded an improvement in our return on invested capital, which increased to 10.2% for 2024 as compared to 9.7% in the prior year.

Finally, we announced last month our Q1 2025 quarterly dividend of $0.12 per share payable on February 26 to shareholders of record as of February 12. Let me now turn to slide 10, where I'll discuss our guidance for the first quarter of 2025 and provide some thoughts for the full year.

Revenue is expected to be in the range of $870 million to $890 million, with a decrease from the fourth quarter, primarily due to a return of normal seasonality as well as foreign currency headwinds. For the full year, we are expecting the business to be organically flat year over year at approximately $3.6 billion of revenue. As a reminder, approximately $300 million of 2024 revenue will not repeat in 2025.

This amount is comprised of the sale of Insights, divested products and more meaningful currency headwinds.

As we've discussed over the last couple of quarters, adjusted operating margins will decrease sequentially in Q1 to more historical pattern of margins related to the timing of pricing and productivity. Currently, we expect adjusted operating margins of 18.2% to 18.4% for the first quarter, representing a sequential decrease of about a percentage point from Q4 2024.

In comparison, the average Q4 to Q1 sequential drop in the pre-COVID period of 2015 to 2019 was 200 basis points. Our better performance compared to historical norms is a testament to the operational initiatives undertaken over the last six months to optimize our portfolio.

Importantly, and consistent with historical patterns, we expect adjusted operating margins to return to 19% or better in the second quarter, driven by ramping productivity and a seasonally stronger top line. We then expect to deliver incremental adjusted operating margin improvement in the second half of 2025.

For the full year 2025, adjusted operating margins are expected to be equivalent or slightly better than 2024. Our Q1 2025 guidance and full year 2025 outlook excludes any potential impacts from recently announced tariffs on imports into the United States. With that, I'd like to turn the call back over to James.

James Entwistle - *Sensata Technologies Holding PLC - Head of Investor Relations*

Thank you, Stephan and Brian. We will now move on to Q&A. To allow all of those who wish to ask a question, the opportunity to do so, we will limit each participant to one question at a time. Wyatt, please introduce the first question.

QUESTIONS AND ANSWERS

Operator

Joe Giordano, TD Cowen.

Joseph Giordano - *TD Cowen - Analyst*

Hey guys, thanks for taking my questions.

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Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

Hey, Joe.

Joseph Giordano - *TD Cowen - Analyst*

Hey, I want to touch on the outperformance in auto, right? It was interesting to see 300 basis points. Can you talk about what drove that? And how we should think about that in the future? I know you've made a lot of strides on US EV, and that stuff has largely been pushed out.

So like what should we -- how should we think about the driver of outperformance versus production for the portfolio for like the near term?

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Sure, absolutely. As we think about '24, obviously, first half of the year benefited a little bit from stronger ICE, especially in the European market, as we've talked about. As we've gone through the full year, if anything, it should give confidence that our ICE portfolio is very strong. And so kind of regardless of how ICE and EV penetration continue to take shape that we can do well in both.

China is obviously still the more challenging market for us in that the -- from a local versus multinational perspective, and we've talked about last quarter, that once we get into the second half of the year in 2025, we would expect to see more normal outgrowth patterns return in China as we would lap those comps. But for the full year '25, I think our expectations are that you would see us somewhere kind of in our normal range, maybe a little bit on the lower end, given where IHS is. But we should see some modest up growth in the full year.

Joseph Giordano - *TD Cowen - Analyst*

And then just a follow-on. If I think about Europe specifically, right, that was a market where you have great customer relationships historically, but we're not on like -- this generation of EVs because you didn't have the portfolio to do so back when they were being bid. Now that you've had the contactor portfolio for several years, when should we expect you guys to kind of get your fair share of that EV business in Europe?

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Yes. No, good news there is many of those wins, we've been designed into that next generation set of wins. And so really, we're awaiting those launches. And I think we all understand that the timing of those launches and then the volume of those launches may be mitigated a little bit to what initially was thought. But we're well positioned for those, and that ultimately will drive our content per value to a more equivalent range between ICE and EVs in Europe.

We'd expect that it's probably more of a '26, '27 thing than a '25 thing, but we're looking forward to those launches.

Operator

Amit Daryanani, Evercore.

Amit Daryanani - *Evercore ISI - Analyst*

Yes, good afternoon, everyone. I have two as well. I guess maybe just to start with, as I think about the operating margin expansion ramping from like 18% in Q1 to 19% plus in the back half of the year, can you just talk about how much of that is operational improvement driven versus expected revenue leverage? I'm just trying to understand how much of this expansion do you think is controllable versus perhaps a bit more revenue-driven over year?

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Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Sure, thanks for the question. I think, obviously, we're going to be organically flat as kind of the thinking for 2025, and we're obviously on a little bit of a lower revenue base than where we were in 2024. So that's what's driving the margin expectation for the full year to be, call it, 19% to slightly better than that. So I think 19% to 19.3% kind of a range.

Obviously, the volume is important for us. But we think we've taken an appropriate, I'd say, kind of level of balance around the plan, such that when that inflows of revenue, we're able to continue to generate operational productivity. And as Stephan pointed out, certainly, we believe there's different opportunities for improvement as we continue throughout '25, which hopefully benefit the second half of this year as well as start to tee up 2026.

Amit Daryanani - *Evercore ISI - Analyst*

Got it. And then Brian, you focused on very impressive free cash flow conversion in the December quarter specifically, certainly the full year December quarter really stood out. Can you touch on what enables outsized conversion in the December quarter? And then how do we think about free cash flow conversion kind of '25 at a high level? Thank you.

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

You bet. So a lot of credit to the team, especially the operational team here because they drove a lot of improvements within inventory. When you have a chance to start looking at the balance sheet, you'll see that our inventory balance is down about $100 million year over year. We still think there's more to do and to continue to kind of push on our days on hand. But we made a significant amount of progress in '24 compared to where we were probably in '22 and '23 to rightsize those balances.

Again, a lot of this is really just, I'd say, kind of as we've talked about all year, a refocus on the balance sheet and refocus on conversion, making sure we're collecting our receivables on time, doing all of that blocking and tackling that's needed to be able to generate conversion. I think for '25, we're looking for conversion levels to be, again, at least where we are here and hopefully getting into the high 70s towards 80%.

Operator

Mark Delaney, Goldman Sachs.

Mark Delaney - *Goldman Sachs - Analyst*

Yes, good afternoon. Thanks for taking my question. Stephan, congratulations on the new role. You mentioned, Stephan, that growth and capital allocation are two of your key priorities. As you think about those two areas, do you have any early thoughts about whether the growth that you're expecting and looking to drive will be more organic, driven by R&D, better focusing on customers, as you mentioned? Or do you think M&A is going to be an important component of that growth?

Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

So thanks for your question. First of all, everything around growth, I also mentioned is, of course, organically at this point of time. It's been 30-plus days, so it's still early. But if I look at the opportunities that I see at this point of time, especially around the experience that I've gained at my prior employer at ZF. I would see opportunities in Asia Pacific and especially around China.

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If I go a little bit deeper into that, what I've done in the past is I've always looked at individual OEMs. And I've tried to understand which of these OEMs will be the winners of the future. And the was it to be somewhat cautious. And what I've developed around that with my team that time at the debt is kind of an intelligence to define which customers will be growing. And I'd like to transfer this knowledge and try to implement that here at Sensata and find opportunities to grow within that region.

Mark Delaney - *Goldman Sachs - Analyst*

Very helpful. Just one other one for me. Just -- as you think about the company's exposure to tariffs, you're recognizing the guidance doesn't incorporate tariffs going into effect. But as you think about your footprint in Mexico and other regions. Can you help us understand exposure and what that may look like if tariffs do go into effect on Mexico and Canada and any steps you might be able to take to mitigate that if it does happen? Thank you.

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Sure, Mark. Happy to try to help here. So to date, the China tariffs that President Trump has announced, we don't view those to date to have any form of material impact on the business. It's probably about -- roughly about $1 million worth of exposure per quarter, so relatively small.

When we think about Mexico specifically, it's probably important to note that roughly 70%, give or take a point or two either way of our manufacturing for North America is done in Mexico. So that would be kind of the overall scope of the exposure there.

Keep in mind that the tariff itself would be more on the cost side of what we produce as compared to the sales side of what we produce. And obviously, we're watching that pretty closely. We're, as you know, a global company. We have redundant manufacturing throughout the world. It's one of our strengths of how we can be region for our customers.

And certainly, if tariffs came into play, then we would certainly do our best to be able to leverage our global footprint to minimize the exposure as much as possible. And candidly, I'm sure we, as well as every other supplier out there will be working with our customers. And unfortunately, most of that cost likely winds up being passed on to a consumer.

Operator

Christopher Glynn, Oppenheimer.

Christopher Glynn - *Oppenheimer - Analyst*

Hi, thanks, and, good to hear you, Stephan. On the pitch on the operating excellence initiative, you highlighted, I think, meaningful improvement for supply chain target. I'm just wondering what you see there in a little bit more depth. Is there sort of low-hanging fruit? Or how you see that -- those efficiencies progressing?

Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

So coming from the automotive Tier 1 world, everything revolves around operating -- at least a portion of performance revolves around operating excellence. I think part of my comment was based on my visit in Mexico, in Aguascalientes, where it was roughly two weeks ago. And I met an excellent team, a very strong team down there. I met a team that has a lot of ideas around operational excellence.

But where I see opportunities, if you scale that up, and if you concentrate more on cost, especially our costs, especially around quality, improving quality numbers, delivery performance, lowering inventories and developing that in a more systematic way over every single plant around Sensata.

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So I used Aguascalientes as an example, but doing that in a very strong systematic, stringent way so that you have a continuous year-over-year productivity improvement. That's what I see at this point of time. Of course, it's still early days, but those are the areas I'll be focusing on.

Christopher Glynn - *Oppenheimer - Analyst*

Okay. Great. And then just on the ICE share gain that's been part of the story in '24, is that something that you've kind of hit on and you've gotten that lever pulled, or is that an ongoing thing?

Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

I would say that is an ongoing thing. I would explain it like this. Take for example, the region in Europe, what we see at this point of time, especially with more conservative governments being elected that most probably, we would see a lift of the combustion engine ban, specifically around Europe. So what does that mean? That would mean that in the end, there will be a stronger, let's call it, a refocus on ICE and also predominantly on hybrid and systems.

And the idea on that is to focus or refocus more on these technologies and try to gain opportunities around them.

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Chris, obviously, we saw some of that here at '24, right? I mean with the stronger ICE business and just the amount of new opportunities coming through have been substantial, and the team has done a great job of taking advantage of that.

Christopher Glynn - *Oppenheimer - Analyst*

Sounds great. Thanks, Brian.

Operator

Luke Junk, Baird.

Luke Junk - *Robert W. Baird - Analyst*

Good afternoon. Thanks for taking the question. To start with Stephan, great to have this call with you. Just given your history at the China market and your time at your previous employer, I'd be just interested in your first impressions of Sensata's automotive business in China, maybe just some high-level strength and weakness in areas that you can lean into in the near term beyond what you've already mentioned in terms of focus on the top growing customers and platforms there? Thank you.

Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

So I think from what I've seen so far, and again, I would just like to say it's early days, 30-plus days. But I think Sensata has been very active in China, undergone extensive activities to win new business within China. If I look at it from the experience that I bring with in the past, China, especially China plus Asia Pacific 1 used to look at the complete region, is somewhat a different animal.

So I think it's important that you're very selective within the market and the OEMs that you want to win within that market. I think that is one key aspect that one needs to consider. So that's the one side of it. So you would have Chinese OEMs that are, for example, very successful in technologies around hybrids, around range extended, but they've launched EV models, and you would expect them to be successful as well, but they haven't

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been. And that's just one example that you need to be very, very selective, and that's something that I would try and bring into Sensata to understand or to let the team understand which OEMs to win with.

That's basically for the region itself. And there's another aspect I'd like to add to that. So it's not just Chinese OEMs winning within China. There's also obviously a lot of Chinese OEMs that are hungry for growth outside of China. So they want to expand into -- especially into Southeast Asia.

So we're speaking about Malaysia, Thailand and all the countries around there, and also wanting to grow in Europe. So there's a lot of effort to grow there as well. So when selecting these platforms that we would like to win with, one also needs to consider that because it gives you tremendous growth opportunity beyond just the Chinese market if these OEMs should -- are to be successful in European and Southeast Asian markets.

Luke Junk - *Robert W. Baird - Analyst*

Got it. And then for my follow-up, Brian, maybe just any segment level margin comments at a high level would be helpful, especially relative to your comment that you're going to be allocating the former megatrend to the segments, it sounds like that's going to impact Performance Sensing more than anything, is that right?

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Yes. I mean a lot of the megatrend spending or what have been called megatrend spending was really engineering expense at this point that was working on new business initiatives within the Performance Sensing business unit. So I would expect the great majority of it, probably 90% plus or minus or so, of that expense will line up in performance sensing.

On an overall basis, I think we will -- our expectation is that we probably continue to see strength in the Sensing Solutions margin, potentially see that number continuing to increase a little bit as hopefully, we see that bottoming out of industrials such that stabilize revenue, they start to grow there back of HVAC, that allows some growth in the Sensing Solutions gross margins. Performance is probably going to be somewhere where it is, right in that same range. With the -- and just have to adjust for the pricing.

Luke Junk - *Robert W. Baird - Analyst*

Understood, thank you.

Operator

(Operator Instructions)

Guy Hardwick, Freedom Capital Markets.

Guy Hardwick - *Freedom Capital Markets - Analyst*

Hi, good evening. Stephan, I wonder if you could give us your impressions on the industrial and aero businesses, potential opportunities there given that historically, they've been higher margin than the auto businesses?

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Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

Yes, thanks for the question. So again, these are just like early impressions that I have within the areas. So two areas of focus around thermal management and electrical protection. Especially in the Industrial Solutions, certain opportunities. Take for example, opportunities around the heat pump.

We are developing markets in that -- within that area. My home market where I come from, Germany, for example, very bullish on heat pumps. And I think that is one area of opportunity that we would have. And everything around leak detection, for example. So we're launching the A2L product, and this product is going to show quite some growth in the upcoming months and years.

So those are two opportunities that I would see. I'm sure there are a lot more that I haven't seen yet. And I'll dive into the industrial area step by step and get to know them a lot better. One area maybe that has been touched but we don't have any significant business in as of today is, for example, everything around data centers. It's something I'm getting my head around. I want to understand somewhat deeper, and that could also be a future opportunity looking forward.

Guy Hardwick - *Freedom Capital Markets - Analyst*

Thank you. And just a follow-up for Brian. Obviously, congrats on the excellent performance and free cash flow. And obviously, you gave encouraging guidance for this year. But is there any reason why eventually, Sensata couldn't be 100% free cash flow conversion company, similar to public peers?

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

I'd rather walk before I run, I guess, to say. There are some limitations. I mean one of the strengths, as I mentioned earlier, is that we have redundant manufacturing in multiple areas of the world. And so that's certainly a benefit when we think about how to best use our footprint to be able to effectively meet customer needs. The downside of that is it allows you to not necessarily use inventory as efficiently as you could if you were manufacturing it all in one location.

So we'll have to continue to see and evaluate that. If you look historically in this business, it's really been around 80%, a little bit better kind of a cap on cash flow conversion. But as many of you know, kind of cash flow is near and dear to my heart, and we will continue to do everything we can to drive that number higher. But for now in '25, I'm certainly going to try to push to get us to that 80% margin.

Operator

Samik Chatterjee, JPMorgan.

Samik Chatterjee - *J.P. Morgan - Analyst*

Stephan, congrats on the role. I just wanted to understand from you. I know it's early days, but relative to the outperformance related to automotive production, do you have any thoughts yet in terms of what is sort of the optimal level that Sensata should target?

And particularly, how would you think about balancing relative to growth versus margins and pursuing to that target, including, like, have you taken another look at the portfolio rationalization or the life cycle management that the team has previously done? And do you see other opportunities on that front as well to sort of have a more focused portfolio around outgrowth to automotive production?

And a quick follow-up just for Brian. Brian, I know you on the tariff question, you mentioned of the North America production being in Mexico, does all of that get carried over the border to the customer? Or does some of that get sort of overall ship to the customer in Mexico? So I just wanted to clarify that.

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Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

Sure. There is a lot there, Samik. So let me start on a couple of pieces and then let Stephan kind of jump in with his thoughts in his first 30 days or so here. So around the tariff question to start, we do use and leverage a [maquila] structure. So the majority of what is imported in the US is us effectively carrying it over the border and then effectively then dispersing it to customers.

There is some that we do within Mexico and there's a potential that we could do more if we had to, depending on exactly what happens with the -- all these potential for tariffs. And so it's one of the things that we will certainly look at with customers to see if there's a more efficient way for us to be able to deliver goods to them.

I think there's a lot there. I would comment a couple of things around outgrowth, margin profile portfolio. And again, it's early days for Stephan to let him jump in here. But I do think this business historically, and there's really no reason to think it's different, has driven outgrowth somewhere in that average of, call it, 3 to 6 percentage points per year, very kind of tried and true. I would think that there's no reason to think that's different regardless of the powertrains. And if anything, with ICE being, I think, showing good strength in ICE kind of reaffirms that range.

On the operating margin front, I would say that we're still taking this in chunks, and we certainly want to be better in '25 than where we were in '24. Again, I have a lot of confidence that in Q2, we will see that snap back to the margins that we want to be at. And the drop in margin really is just the Q1 effect and then we will recover pretty quickly on that. And so the -- those are the big drivers. And again, I think as Stephan mentioned on portfolio, just early days to determine if any other changes will happen at time.

Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

I think I could add somewhat, but I think you've answered the question, Brian. But you're asking what is the right level of market outgrowth for Sensata, maybe a bit early for me to give any number there. But from my experience, and I look at the technological mix of Sensata, I would say some from low to mid-single digits, I would say, is the right outgrowth that we should focus on.

Samik Chatterjee - *J.P. Morgan - Analyst*

Great. Thank you. Thanks for taking the questions.

Operator

Joseph Zach, UBS.

Zach Walljasper - *UBS - Analyst*

Hi, it's actually Zach Walljasper for Joe Spak today. So thanks for the question. I appreciate the color around like the margin seasonality. But when we think about the second half of the year, like how should we think about the drivers of margin expansion coming from, one, the volume leverage and two, just natural cost as a company resets for the lower like sales base? And can we expect megatrend spend to also kind of be rebased?

And then I guess second quick question is, with free cash flow conversion improving, what are your kind of early thoughts around capital allocation for the year, whether it's in buybacks or M&A potentially? Thank you.

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Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

So let me start with capital allocation. I think our view has obviously been to kind of look at both net leverage, continuing to reduce leverage and opportunistic share repurchases, kind of 1A and 1B, and you can continue to kind of alternate the order of those. I think that's probably the approach at the present time for us to be able to deploy cash. So obviously a conversation that happens with the Board every quarter. We do have our dividend as well, which we think is at an appropriate level.

So I think you'll continue to see us doing those things here in the near term. Around margin, Zach, if I heard your question right, sorry, came through a little bit kind of garbled. But in the second half of the year, certainly based off of just incremental revenue that we typically see as we go through the year, getting kind of the full effect of all of the cost initiative work that we did.

Certainly, our expectations are in the productivity improvements which compound over time that we continue to see the margin lift in both Q3 and Q4. If I had to hazard a guess, it's probably similar levels of increase as you saw here in 2024 in the back half. But obviously, we're trying to make sure we're as aggressive as we can there so that we can ensure that we will be at or up for the full year '25 as compared to '24.

Stephan von Schuckmann - *Sensata Technologies Holding PLC - Chief Executive Officer*

Great, thank you so much.

Operator

(Operator Instructions) With no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to Brian Roberts for any closing remarks.

Brian Roberts - *Sensata Technologies Holding PLC - Chief Financial Officer, Executive Vice President*

So everybody, thank you for joining today. I certainly appreciate all of your questions and your continued interest in Sensata. We look forward to speaking with you again next quarter. And operator, you can disconnect the line. That concludes the call.

Operator

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

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