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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good afternoon, everyone, and welcome to the Sensata Technologies Q2 2025 earnings eall. Please also note, today's event is being recorded.

At this time, I'd like to turn the floor over to Mr. James Entwistle, Senior Director of Investor Relations. Sir, please go ahead.

James Entwistle - *Sensata Technologies Holding PLC - Senior Director of Investor Relations*

Thank you, Jamie, 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 Second Quarter 2025 Earnings Conference Call. Joining me on today's call are Stephan Von Schuckmann, Sensata's Chief Executive Officer; and Andrew Lynch, Sensata's Chief Financial Officer.

In addition to the financial results press release we issued earlier today, we will be referencing a slide presentation during today's conference call. The PDF of this presentation can be downloaded from Sensata's Investor Relations website. This conference call is being recorded, and we will post a replay 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 make forward-looking statements regarding future events or the future financial performance of the company that 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.

Much 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 in the appendices of our presentation materials and in our SEC filings.

Stephan will begin the call today with comments on the overall business. Andrew will cover our detailed results for the second quarter of 2025 and our financial outlook for the third quarter of 2025. Stephan will then return for closing remarks. We will then take your questions.

Now I would like to turn the call over to Sensata's Chief Executive Officer, Stephan von Schuckmann.

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

Thank you, James, and good afternoon, everyone. Before I begin discussing our results for the second quarter, I'd like to take a moment to congratulate Andrew Lynch, who was named our Chief Financial Officer last week.

Andrew has been a valuable partner to me since I joined Sensata, and the Board and I have full confidence in him. Andrew's extensive financial and operational experience at Sensata have prepared well for this role. I'm excited to have him as a partner on Sensata's transformation journey.

Now let's begin on slide 3. We delivered a strong quarter of 2025 with revenue, adjusted operating income and adjusted earnings per share all exceeding the high end of our guidance for the second consecutive quarter. This is an important proof point for the resilience of our business and our team's determination to execute in the face of challenges, such as volatile end markets, geopolitical uncertainty, and the cybersecurity incident that we disclosed in April.

When I first spoke to you in February, I introduced three key pillars, which would serve as my initial focal points for shareholder value creation. Improving operational performance, optimizing capital allocation and returning to growth.

At our May call, I provided an update on some of the specific work we are doing on each of these pillars and much of the focus of the update was operational excellence. Today, I'll go a bit deeper on capital allocation and growth drivers.

Before we get to capital allocation and growth, I'll share a brief update on operational excellence. We rolled out a number of initiatives over the last six months, and I'm pleased with our recent accomplishment on this journey. Our cash conversion rate in the second quarter was 91%, a significant step-up from our first quarter 2025 conversion rate of 74%. This improvement reflects our focus on [unlocking] cash to execute our capital allocation strategy. With operational excellence initiatives, we are optimizing our working capital and creating margin resilience in our business, enabling us to deliver on our earnings commitments.

Now I'd like to go deeper on our next pillar, optimizing our capital allocation. Simply put, we will deploy capital in a manner designed to maximize shareholder returns. In the first quarter, we seized the opportunity to repurchase $100 million of shares.

In the second quarter, we repurchased another $20 million of shares and funded our dividend while also accumulating an additional $74 million of incremental cash. In turn, we reduced our net leverage ratio from 3.1 times traveling 12-month adjusted EBITDA at the end of the first quarter to 3.0 times at the end of the second quarter. This further strengthened our already strong balance sheet.

In the past, you've heard me talk a lot about benchmarking as we look to drive operational excellence. We are using external benchmarks for each of our key pillars. As we look at comparable companies across the market, our differentiated margins stand out and our cash conversion is improving. However, our capital structure and net leverage is a bit of an outlier. For the balance of this year and into 2026, you can expect us to continue to prioritize deleveraging.

Now I'm excited to share our progress on our growth pillar. Just like capital allocation, growth is enabled by operational excellence. Over my decades of experience in industry, I have learned that the right to win is earned by consistently serving customers on time at the lowest possible cost with high-quality products. Operational initiatives will ensure that we do exactly that. It's equally important that we're disciplined about the new business we pursue. We need to win with the right technologies on the right platforms with the right customers.

Over the last several months, I've worked with the inside team to study our past business wins a bit deeper and to identify the characteristics of our most successful programs. We're using those learnings to be more selective about how and where we invest and what business opportunities we pursue. For us, it means the following: first, stick to our core product technologies, pressure, temperature and electrical protection and certain specialty sensing such as force, position, flow and leak.

Next, prioritized platform-driven applications where high switching costs favor incumbency with an emphasis on regulated or mission-critical sockets. And finally, focus on the right end markets with exposure to key secular tailwinds and appropriate diversification. As we apply these criteria, our priorities become clear.

In our Sensing Solutions segment, (inaudible) gas leak detection is a recent example of a business opportunity that checked all the boxes for us. We were able to leverage our core sensing capabilities to win the regulated sensor socket by air conditioning system platforms. We established a market leadership position in the US, which we are continuing to grow.

In 2025, this business is on track to deliver approximately $70 million of revenue and we continue to increase our market share with a goal of well over $100 million of revenue next year. We look forward to leveraging our incumbency with key OEMs to win globally with similar regulatory requirements on the horizon in both Europe and Asia.

In our Performance Sensing segment, we've spoken a lot about the content opportunities on both ICE and EV platforms as well as the rapidly evolving new energy vehicle or NEV market in China. It is clear and we need to win in China to maintain and grow our global market share. The China market is opportunity-rich with a rapid adoption of NEVs and growth of local OEMs. The high-voltage applications on NAVs offer incremental content opportunities for us compared to the traditional ICE business.

Our China team is actively driving business development with local OEMs in China to support their growth ambitions, both in China and beyond. We have significantly increased our pace of new business wins in China, primarily on NEVs. Our customers are placing value on our product performance, proven field quality in the local market, cost competitiveness and well-established production scale. More than 90% of these wins are with top local OEMs and leading an EV players.

Due to shorter design cycles in the China market, we expect many of these business wins to materialize into revenue later this year and serve as the foundation for a return to more consistent market outgrowth in 2026. The content wins we are securing include NEV specific electrical protection as well as powertrain agnostic content such as tire pressure monitoring systems or TPMS.

One of these recent TPMS wins featured new tire birth detection technology, and we are excited to share that we were the first to bring this technology to market for an active safety application. [Tire birth] detection enables the vehicle to activate its stability control features at the first sign of a tire rupture event, dramatically improving occupant safety. This is exactly the type of technological differentiation that gives us an edge in the market.

Now that we've spoken about our key pillars, I'd like to talk a little bit more about what we are seeing in our end markets today. Let's turn to slide 4. I will start with tariffs and trade policy. Through a combination of reimbursement agreements with our customers and modifications to our supply chain, we have now successfully mitigated all of our tariff costs in the second quarter. Compared to approximately 95% when we spoke to you in May.

Since our last update, we've also seen a reduction to our exposures in connection with the deescalation of tariff rates between the United States and China. Additionally, we are pleased to report that we have not seen significant impact from recent tariff escalations on commodities go from export controls on reverse materials. More broadly, in our end markets, we're seeing a mix of volatility, resilience and growth. I'll see a few highlights now, and then Andrew will provide more specifics as he walks you through our results and guidance.

On the performance sensing side, we are pleased with automotive production holding up stronger than initially expected when trade tensions escalated. (inaudible) production has grown in the first half as the market in China has been very strong. HVOR markets have been soft, particularly with on-road trucks, and we're starting to see off-road production slowdown as well. As a result, we're managing our costs accordingly.

In our Sensing Solutions segment, we're seeing more growth which highlights the advantages of our end market diversification. Our industrials business grew over 9% in the second quarter as markets have stabilized and our new leak detection product is delivering meaningful outgrowth.

In Aerospace, we saw over 5% revenue growth in the second quarter against the market that grew roughly 3%. Our market outlook for both industrial and aerospace in the second half is largely consistent with what we saw in the second quarter.

In summary, I am happy with what we have achieved so far this year. and our Q2 results demonstrate the progress we are making on our transformation plan built upon the three pillars. As we progress through the balance of 2025 and into the new year, we will maintain our focus and rigor on these initiatives to drive shareholder value.

With that, I will turn the call over to Andrew to provide greater detail on Q2 financial results and our guidance for the third quarter.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Thank you, Stephan, and good afternoon, everyone. I want to begin today by extending my gratitude to Stephan and our Board of Directors for placing their confidence in me as Sensata's Chief Financial Officer. I would also like to thank the Sensata team and our finance organization for their support over the last several months.

Let me start on slide 6. We delivered another strong quarter in Q2 with results above our expectations across all of our key metrics. We reported revenue of approximately $943 million for the second quarter of 2025 as compared to revenue of $1.36 billion in the second quarter of 2024. While revenues were lower year over year primarily due to the previously discussed divestitures, we saw $32 million of top line growth sequentially from the first quarter of 2025 and exceeded the top end of our guidance range, reflecting our rapid recovery from the cybersecurity incident in April, and general resilience in our end markets.

Adjusted operating income was approximately $179 million or a margin of 19.0%, and included approximately $12 million of 0 margin pass-through revenues related to tariff recovery, which were 20 basis points dilutive to our adjusted operating margins. Adjusted operating margins improved 70 basis points sequentially from 18.3% in the first quarter of 2025. Adjusted operating margins were consistent with prior year quarter at 19.6% and increased 20 basis points year over year, excluding the dilutive impact of tariff pass-through.

Adjusted earnings per share of $0.87 in the second quarter of 2025 represents an increase of $0.09 sequentially from the first quarter of 2025 and as we delivered on our margin expansion plans and a decrease of $0.05 as compared to the second quarter of 2024 due to divestitures. We achieved robust free cash flow of $116 million in the second quarter, an increase of 17% year-over-year. This represents a conversion rate of 91% of adjusted net income an increase of 17 percentage points compared to the first quarter of 2025 and 20 percentage points compared to the second quarter of 2024.

As Stephan mentioned, free cash flow is a key focus for us, and our improvements accelerate our ability to execute our capital allocation strategy.

Now let's turn to slide 7, and I will discuss capital deployment. In the second quarter, we executed share repurchases totaling $20 million and returned $18 million to shareholders through our regular quarterly dividend. We reduced our net leverage to 3.0 times trailing 12 months adjusted EBITDA compared to 3.1x at the end of March. With our capital allocation strategy, we delivered ROIC of 10.1%, and up 30 basis points compared to the second quarter of 2024.

Looking ahead, you can expect us to continue to deploy capital in a manner designed to maximize shareholder returns with an emphasis on deleveraging in the near term.

Turning to slide 8. I'll talk through the results for our segments as well as provide more color on what we are seeing in our end markets. Let's start with the segment results. Performance Sensing revenue in the second quarter of 2025 was approximately $652 million, a decrease of approximately 10% year over year primarily due to product divestitures and lower on-road truck production in North America and Europe.

Performance Sensing adjusted operating income was approximately $147 million or 22.5% of performance sensing revenue, representing year-over-year margin expansion of 20 basis points, inclusive of any dilutive impact from tariffs.

Sensing Solutions revenue in the second quarter of 2025 was approximately $291 million, an increase of approximately 9% year over year. This marks our second straight quarter of year-over-year growth driven by new content in our Industrials business and market outgrowth in our aerospace business. Sensing Solutions adjusted operating income was approximately $88 million or 30.2% of Sensing Solutions revenue, representing year-over-year margin expansion of 50 basis points, again, inclusive of any dilutive impact from tariffs.

As a reminder, corporate and other costs have been recast to exclude certain costs previously referred to as megatrend spend, which are now presented within the two reporting segments. Corporate and other adjusted operating expenses were up $4 million versus the second quarter of 2024, primarily driven by higher variable compensation due to better underlying performance.

Now I'll provide color on what we are seeing in our end markets. In our automotive business, production estimates have been volatile and trade policy has evolved throughout the year. We have seen double-digit market growth in China in the first half, partially offset by market weakness in North America and Europe. Looking ahead to Q3, we see auto production moderating to roughly flat year over year and down about 1 million vehicle units sequentially from the second quarter on typical seasonality.

In our heavy vehicle and off-road business, we have seen softness throughout the year with on-road truck production down more than 20% in the first half across North America and Europe, and we expect this softness to persist in the second half of the year. Global off-road markets have seen modest growth in the first half, but we are now experiencing a significant slowdown in Q3.

In our Sensing Solutions segment, we are seeing market strength. Both Industrials and aerospace are seeing low single-digit market growth, and we are seeing high single-digit outgrowth in industrial as our gas leak detection business has ramped nicely. The market outlook I just discussed is reflected in our guidance, which I will take you through in a moment.

Looking a bit further ahead to Q4, we are monitoring third-party forecasts and customer demand signals and we expect more clarity as trade policy develops in the days and weeks ahead. Lastly, before we get to our guidance, I'd like to give just a brief update on tariffs.

Let's turn to slide 9. When we guided the second quarter, we estimated that we would incur $20 million of tariff costs, which we expected to fully recover on a dollar basis based on reimbursement agreements, we were able to secure in partnership with our customers. At this level of cost and pass-through revenue, we expected 40 basis points of adjusted operating margin dilution. Subsequent to our second quarter guide, we saw a de-escalation of tariff rates between the United States and China.

Additionally, we continue to work on our supply chain to manage our exposures. The net result of this was that we incurred approximately $12 million of tariff costs in the quarter and recorded $12 million of pass-through revenues. Accordingly, tariff pass-throughs were approximately 20 basis points dilutive to our adjusted operating margins.

With that, let's turn to slide 10, and I will walk through our expectations for the third quarter of 2025. We expect third quarter revenue of $900 million to $930 million, adjusted operating income of $171 million to $179 million, adjusted operating margins of 19.0% to 19.2% and adjusted earnings per share of $0.81 to $0.87. At the midpoint of our guidance range, we see approximately 10 basis points of sequential margin expansion. However, we have assumed $15 million of tariff costs and associated pass-through revenues in our third quarter guide slightly higher than the $12 million we reported in the second quarter due to business mix.

On a pre-tariff basis, we expect approximately 20 basis points of sequential adjusted operating margin expansion compared to the second quarter in line with the margin expansion targets we talked about last quarter. As noted in our press release and earnings materials, our guidance and tariff assumptions are based on trade policies and tariff rates in effect as of July 28.

Earlier this month, we announced our third quarter dividend of $0.12 per share payable on August 27 to shareholders of record as of August 13.

Finally, before I turn the call back to Stephan, just a brief update on the cybersecurity incident that we disclosed in April. In connection with this incident, we experienced an approximately two-week disruption in our business. Thanks to our team's preparation and resiliency, our business has fully recovered. We are grateful to have this incident behind us without any significant disruption to our customers and without material financial impact.

With that, I will now turn the call back to Stephane.

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

Thank you, Andrew. I said this last quarter, but it warrants repeating, there is a significant transformation underway at Sensata. The foundation of this transformation is the key pillars that I've discussed on each of our earnings calls since I joined Sensata at the beginning of the year.

I would like to conclude today's remarks by sharing a bit more why these are key to our vision and what you can continue to expect from us. Operational excellence is about stabilizing our core business to serve as an enabler to both our capital allocation and growth pillars. Our capital allocation strategy is to utilize our cash flow improvements to deploy capital in a manner designed to create shareholder value in the short term and long term with an emphasis on deleveraging.

And finally, our return to growth will be supported by a focused product strategy and a clear evaluation criteria for growth opportunities. Success on our key pillars will be apparent in phases. Today, consistent execution with adjusted operating margins at or above 19% and free cash flow conversion at or above 80%. The next several quarters, net leverage continues to improve and in the years ahead, a return to more consistent growth. I'm excited about what the future holds, and I look forward to continuing to update you on our progress moving forward.

I will now turn the call back to James for Q&A.

James Entwistle - *Sensata Technologies Holding PLC - Senior Director of Investor Relations*

Thank you, Stephan and Andrew. We will now move to Q&A. Jamie, please introduce the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Mark Delaney, Goldman Sachs.

Mark Delaney - *Goldman Sachs Group Inc - Analyst*

Nice to see the free cash flow conversion pick up. And Andrew, congratulations on the expanded role.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Thank you.

Mark Delaney - *Goldman Sachs Group Inc - Analyst*

I wanted to start with EBIT margins. They expanded 20 bps year-over-year, excluding tariffs, as organic revenue was down, I think, about 2%, and you expect sequential margin improvement again in 3Q. Can you go into more detail on what's driving that margin improvement both in 2Q and 3Q? And I guess as you look longer term, do you see a path to 20%-plus EBIT margins?

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

Look, Mark, thanks for the question. So first of all, as mentioned in the call, we're undergoing quite a significant transformation at Sensata. And we've basically designed a number of initiatives that we're focusing on. So we didn't start a huge amount of initiatives. It's basically six initiatives that we're focusing on.

And just to mention a few, some of these initiatives are focused on pure operational excellence, something I've been speaking about frequently now in the quarter in the past. So that's improving plant performance. And what we're doing is we're benchmarking our plants against each other, where we have so-called similar products.

So for example, TPMS. And we try to improve the plants that are weaker than the best benchmark within Sensata as one example. Another example is we're working on commercial excellence. So we have a much stronger rigor around that. And like I said, there are other examples of we're working, for example, on improving our procurement and gaining effects from that.

And that's basically the effect that you see with other initiatives that you could see the margin improvement. But for more details, let me pass on to Andrew.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Thanks, Stephan. Mark, I think to summarize, so it's primarily operational productivity that's driving the sequential margin expansion. And we feel pretty good about our margin levels in the 19% range in the near term here. In terms of longer-term margin expansion opportunity, we've not established any targets at this time. We're really focused on short-term and margin resilience.

We'll provide more clarity on sort of what the longer-term outlook looks like as we get into sort of the 26% guide period. But for now, we're focused on just margin resilience at the current level and sequential margin expansion quarter on quarter.

Mark Delaney - *Goldman Sachs Group Inc - Analyst*

That's helpful. My follow-up is also around EBIT margins and how mix may or may not that, you talked about diverging trends you're seeing in some of these end markets, industrial picking up. You said HVOR seen times of weakness. And you see those sorts of divergent trends by end markets, what might that mean, if anything, for EBIT margin? Is that a potential headwind or a tailwind from mix that investors should potentially expect?

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

Yes. Good question, Mark. So mix definitely matters in our business. I think as we've highlighted before, our lowest margin business is our automotive business, our highest margin is our aerospace business, HVOR and Industrial are kind of in between. And as we look at the -- what we're seeing in the current quarter and Q3, we've seen softness in the HVOR business and strength in industrial.

And so we've basically been able to offset any mix headwind from the view or softness with the outgrowth that we're driving in industrial. And we feel good that the business mix kind of moving forward throughout the balance of the year will support the margin expansion that we've committed to.

Operator

Joe Giordano, TD Cowen.

Joe Giordano - *Cowen and Company LLC - Analyst*

Stephan, as you've kind of gone through the portfolio now for a little bit longer, where do you think you stand on more product rationalization, SKU reduction that you need to do, scrubbing of backlog that you'd won kind of a long time ago that's been pushed out? Like where do you think you stand on those things?

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

Sorry, can you just repeat the question on the last one?

Joe Giordano - *Cowen and Company LLC - Analyst*

So I'm just curious on where you stand as you like evaluate the portfolio now that you've been here a little while, like how much more SKU reduction is necessary or small divestments and things like scrubbing of the backlog to see like how realistic delivery is on things that were won maybe a long time ago and when markets were different?

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

Well, look, I think a lot of the SKU reduction or let's call it, portfolio cleansing has been done in the last year. So there's been significant work done by the team and around the interim CEO matter. And look, it's a continuous process. So I'm looking at all types of SKUs being in automotive, be it an HVOR but also industrial. And anything that we don't feel that doesn't fit to our portfolio at this point in time.

We will cleanse of our overall SKUs. So it's a continuous process. It's not something that is finished after we've gone through all of them. It's something that we follow through month-for-month actually, yes. So nothing significant at this point in time, but something I'll keep a focus on it.

Joe Giordano - *Cowen and Company LLC - Analyst*

And on the backlog, like the recoverability of stuff that you won a while ago?

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

Joe, so yes, I think you're probably referring to some of the EV wins and program wins from years back. mean as the market shifts on that, we work with our customers to make sure that we're securing offsets, whether it's new opportunity to quote on new business, whether it's kind of commercial recovery pricing discussions.

So we factor all that in as we negotiate with our customers moving forward. But I think the driver there is pretty clear. It's at the time horizon of certain EV programs has moved to the right, and we're just focused on supporting the market as it is today.

Joe Giordano - *Cowen and Company LLC - Analyst*

And then the follow-up, I know it's still early, but just anything incremental. Stephan, you can give us on the China positioning. I know this is a big priority of yours to evolve how Sensata is positioned in China with the local OEMs. So maybe any updates there?

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

Yes. Of course, I can. So look, I think generally, we need to say there's been quite an extreme shift from multinational to local OEMs. We see that the market is roughly at 70% local now. And -- we see that government incentives benefited 2024, and they basically continue to drive 2025. On the other hand, it's still encouraging, obviously, to see that multinational OEMs are continuing to make meaningful investments in China.

So what does that mean for Sensata? I would say it's a return to outgrowth. So 90% of all the business of the year-to-date new business wins are now with top -- basically with the top five local OEMs and with leading so-called new energy vehicle players. And around that, if I break that down to more products to more product focus, a high concentration on high-voltage and powertrain-agnostic content.

So look, we basically expect modest outgrowth in the back half based on third-party forecasted production mix. And we're also pretty confident that it's going to be more consistent outgrowth in the beginning of 2026.

Operator

Wamsi Mohan, Bank of America.

Unidentified Participant

This is [Ashley] on the call for Wamsi. Just one question for me. We were wondering if you saw any pull forward of demand that impacted the 2Q time period, specifically in autos? Just any color you could give us here.

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

Sure. Happy to answer that. So the short answer is no. I think a few dynamics at play here. So in the second quarter, the early part of the quarter, the supply chain was coming up the curve on USMCA compliance, particularly in April. And so I think what we saw there was the OEMs consuming inventory earlier in the quarter and then replenishing it in the back half of the quarter.

But effectively, Q2 was basically normal. And then looking ahead to the third quarter, our order book is pretty solid and filled to where we would expect it to be relative to where we guided the quarter. And certainly, as we talk to our channel partners on the industrial business and other end markets, we're not seeing any pull ahead in our business.

I mean, that may be more of a dynamic further down the supply chain, but where we said, it's pretty much business as usual in terms of order book correlation to production.

Operator

Kosta Tasoulis, Wells Fargo.

Kosta Tasoulis - *Wells Fargo Securities LLC - Equity Analyst*

Andrew, congratulations. My first question is for you. So you've been at (inaudible), think, for a majority of all your professional career. You've been there a while you've probably seen a lot of the maybe archaic processes that have been in place as you move up the ranks. But now you're literally a chief decision maker. So I just want to see like what are your -- what are some of the things you're looking to improve within Sensata?

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Thanks, Kosta, and thanks for the question. My primary focus here is on enabling the transformation that Stephan has outlined here in his key pillars. I think we've got the right priorities to drive performance. There's a lot of work behind the scenes that goes into enabling these key pillars. As Stephan mentioned, there's a bunch of initiatives that underpin the operational excellence pillar.

And a lot of that comes down to making sure that we've got the right analytics and the right data to drive the right decision making. And so that's part of the role of the finance org from a tactical standpoint. And so certainly focused on enabling that. And then the other piece around capital allocation and growth, ensuring that we're applying the right rigor to our growth investments. and ensuring that we're allocating capital in a way that creates shareholder returns.

So I think I'd just reiterate the pillars that Stephan has outlined, and I'm fully on board with enabling those.

Kosta Tasoulis - *Wells Fargo Securities LLC - Equity Analyst*

Great. I'll dig in on free cash flow a bit. How should we think about like cost optimistic cost optimization efforts impacting your inventories, right? So it sounds like part of the strategy is like standardization, right? So are you bringing in like a single component across your products that reduce cost and ability and therefore, you got to keep a high stock of that component and that kind of reduces the working capital tailwind?

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

I think as we think about inventory, it's two levers. So certainly, focusing on productivity and working unit cost reduction to drive inventory costs down and drive product cost down, ultimately frees up more working capital. The other piece is just the amount of inventory that we carry.

And one of the things we talked about on past calls about a potential driver for that is better integration of our supply chain planning and demand planning and making sure that we're using our systems and the data that's available in the end market to optimize our lead times, optimize our demand signal and optimize our production planning, all of that culminates in an inventory reduction opportunity. And that I would categorize as sort of a go-forward lever to continue to drive higher levels of free cash flow conversion.

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

And if I may add, Andrew, what we still -- what we do is something I mentioned initially is that we're benchmarking our inventory levels planned for plant on the one hand, benchmarking plants amongst each other with similar products to try and figure out who is the best inventory level and what can other plants strive for. But then on the other hand, is also looking outside of Sensata and looking at who is the best in class in inventory levels and measuring ourselves against them and redefining our measures and to drive inventory levels down.

Operator

Joe Spak, UBS.

Joseph Spak - *UBS AG - Equity Analyst*

I actually want to pick up on the free cash flow theme and how you're thinking about it for the second half. I think I heard a 80% sort of conversion, I'm not sure if that's a long-term target midterm target. And then also just on CapEx and maybe this is obviously part of free cash flow. It looks like you're at 3% of sales in the first half. I think that's below historical, but maybe this is sort of the new normal for Sensata. So maybe just some help there on how you're thinking about that.

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

Thanks for the question. Look, generally, we've set ourselves an ambition to strive for a cash conversion rate at 80% or more.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Yes. And I would just add to that. So a good point on the lower level of CapEx in the second quarter. Some of the dynamic there was candidly just as we were looking at uncertainty in the end markets, and we saw production forecasts dropped dramatically early in Q2 following the trade policy tariff rate escalations. We throttled back some of our CapEx to respond to potentially lower revenue levels. Obviously, that didn't materialize. We saw that demand get restored.

And so we'd expect an uptick in CapEx in the back half of the year. That said, I expect to be able to maintain pretty high levels of free cash flow conversion going forward and 80% really is the floor. We have plenty of levers available to us to maintain reasonably solid cash flow conversion here moving forward. Inventory hasn't come down dramatically yet. There's still opportunity there.

While it may not be as low as it was in the second quarter, we still have the opportunity to underspend or spend at a level consistent with depreciation. And so I don't see that as a meaningful headwind.

Joseph Spak - *UBS AG - Equity Analyst*

Okay. So even with depreciation it is a good guide. Is that -- and I guess, like versus I think in the past, it's sort of been like a 4% level, do you think going forward, it can be a little bit below that?

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

I think 4% is probably a good proxy for what sort of normalized run rate CapEx looks like. It can vary in any given quarter. And certainly, we adjust it up or down based on kind of our view on market certainty. The investment opportunities ahead of us, whether those are sort of near-term automation opportunities to drive productivity or longer-term opportunities around growth investment. We try to keep that all in balance.

Joseph Spak - *UBS AG - Equity Analyst*

Okay. And then just on the deleveraging comment. I guess I want to confirm how you're really thinking about this because you mentioned sort of net leverage going high, which, to me, sort of implies like the EBIT that's really coming from higher EBITDA? Or are you also planning to say sort of gross debt down? And are there any sort of leverage targets? Or how should we think about minimum cash just so we understand how investors can think about what's available for dividend, share repurchase or debt repayment?

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

Yes. In the short term, we'll look to reduce net leverage by accumulating cash on the balance sheet. That's just a function of where our debt maturities sit and what the current interest rate environment looks like. We don't have any debt maturities until 2029. That doesn't mean that we're going to wait until 2029 to address gross debt. There will be opportunities here in the coming quarters to potentially take some action there.

But in the immediate term, our focus is going to be on accumulating cash on the balance sheet. And then, of course, we still have a share repurchase program. We didn't execute Q2 at the same level we did in Q1, but we'll still maintain the flexibility to opportunistically repurchase shares as we see fit and keep that in balance with our net leverage targets. Certainly, we'd like to be below 3 times levered in the near term and moving towards 2.5 times relatively soon.

Operator

Shreyas Patil, Wolfe Research.

Shreyas Patil - *Wolfe Research LLC - Equity Analyst*

Maybe just coming back to the China auto piece. Can you just help level set how big this is for you today? And just to clarify, how much of an uplift could we see from the new launches that you mentioned, Stephan, that are starting later this year. And then just to put a finer point on it, how do you see the competitive landscape in China, specifically on the auto business?

In the past, the sense was that the mid- to low end of the China market was very difficult to penetrate either given vertical integration or price competition among some of the local suppliers. I'm just curious if that is still how you see it? Or have there been changes in the market.

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

Look, it's pretty much the same. It's obviously a very competitive region, a very competitive country. As you know, there is -- amongst the OEMs, there's price was going on. Which obviously trickles as an effect down to the Tier 1 level. And that leads us to, obviously, us being extremely focused on cost. That's something that we have reinitiated sites a strong history of being very cost focused is something that we've been focusing even more in China.

And following through on that in a very stringent way to stay competitive within the market. So what we do is we take our products, we go back into the design and we take out as much cost as we can in order to be competitive. And on the other hand, some of the products, as I mentioned in my earnings in my script, just early on, come with certain level of technical differentiation, take the divest systematic, and that allows us to enter the market first and gain market share in comparison to others that do not have these functionalities yet. So that's how we tackle the competitiveness in the market.

Again, it's a very important market for us as you can imagine that some of the Chinese OEMs that are hungry for market growth are stepping outside of the country and trying to gain market share in Europe, in Southeast Asia, [Vietnam], Thailand in Malaysia and so on. So a high dynamic there, and that makes it interesting for us as a growth opportunity because if we went with the with the right players like we have.

I mentioned that we won or 90% of our year-to-date new business with the top five local OEMs. So it's really with leading so-called new energy vehicle players. And why do I state that because those are the players that will most probably also show growth outside of China, and that what gives us other the opportunity to benefit from that additional growth in, for example, Southeast Asia or in Europe or wherever else they're growing.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

And, just to give you clarity on the numbers. So the China market is about 1/4 of our automotive business, so about 12% or so of overall Sensata's revenue, obviously varying depending on business mix within any given quarter. The growth opportunities that we've highlighted would be sufficient to return us to kind of the low to mid-single digits outgrowth that we've targeted in our auto business. So that will give you a little bit of context on the size. We're not talking about specific platforms or programs yet, but that's sort of the magnitude.

Shreyas Patil - *Wolfe Research LLC - Equity Analyst*

Okay. That's helpful. And then maybe pivoting to HBO you talked about meaningful weakness in the end market there. Curious how you're thinking about outgrowth in that business, both near term and long term. In the past, you've talked about 3 to 6 points of outgrowth as a target for auto. I'm wondering if there's a similar target for HVOR?

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

Well, Shreya. Let me expand it. Let me first start with the end market with the end markets, and let me give you our perspective, and then I'll give you an outlook on how business is developing for Sensata. So on the end markets, for on-road trucks, we see that obviously for the entire year of 2025, production is down. And you need to look at that from a regional perspective.

So taking North America, onroad trucks we projected really quite a strong downturn of roughly 24% year over year for this financial year of 25%. And in Europe, on-road trucks were soft in the first half, which is roughly 6% down, but projected to be up in the second half of this year. And looking at agriculture and construction, so it's expected to be down in a high single-digit percentage.

And then the second half more positive than the first half. And then if you look at what are the actual slowdown drivers that are pushing that. So for On-Road, we're saying in North America, there's been no buyer on P27 and general macro uncertainty, and operators are not renewing their fleets, and that's what we're seeing in our numbers.

In Europe, we saw a soft quarter two on macro uncertainty, but we see that Q3 is pretty much normalizing on a year-over-year basis.

Now what does that mean for Sensata's business or from a business perspective? We undergrew the market in the first half -- and the reason for that is as Western production was down, while tile production was up -- our content is generally higher on Western OEMs. But we expect -- and we actually expect this to continue in our HR segment through the balance of the year given the softness that we've seen in this Western production forecast.

Operator

Christopher Glynn, Oppenheimer.

Christopher Glynn - *Oppenheimer & Co Inc - Analyst*

Just give a little orienting question to start on the guide. Third quarter is down about $30 million sequentially at the midpoint. Is that vast majority impact that performance sensing?

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Yes, that's right. We see auto production down about 1 million units sequentially. And then we see some softness in the off-road space accelerating in the third quarter, so all performance sensing.

Christopher Glynn - *Oppenheimer & Co Inc - Analyst*

Okay. Great. And then just a couple content and outgrowth dynamics that might be in play. Curious how you see Europe phasing with some of the relaxation of the mandates for EVs, if that's a CPV mix shift that progresses as well in European auto through the back half of the year?

And then you've talked a lot about the gains with local OEMs in China and starting to lap somewhat the share loss from multinationals. Have you indicated a time frame when our growth crossover might be expected for China?

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Sure. Let me start with Europe. So the relaxation of the mandates may ultimately lead to a slowdown in EV production in Europe. If it does, that would be a content tailwind for us. We haven't seen that yet. We've seen EV production continue to grow in the first half of the year in Europe, but that is -- that was a dynamic that played out last year for us.

And so if you see that mix shift again, that would be a potential outgrowth driver, just a reminder there, we're about half the content per vehicle on an EV in Europe compared to as we move to next gens, we get above parity there. But on the current gen, that's where the content mix sits. And then on the China question.

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

Okay. Let me ask something about EV, so basically to add that, Christopher, on the content side, even if growth is not as strong as predicted due to softening regulations. As we know, for example, in Europe, the combustion in Japan might be softened.

Then we'd have probably a shift towards hybrids and mainly plug-in hybrids in the market. And Sensata has a broad portfolio mix, which we could serve as well as we can also obviously serve the EV market. So it's not a down for us. It's actually as beneficial for us.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

And then Chris, I think your question on China is when the wins start to show up in outgrowth. So there's really two dynamics here around outgrowth in China. The first is the rapid share shift that we saw last year were multinationals lost share to locals, largely played out in the back half of last year. So we'll start to lap those comps into the third quarter.

And so that outgrowth headwind starts to go away here in the back half of '25, and we'd expect to perform more or less in line with market. in China in the back half. And then as these new businesses launch, which have design cycles and lead times that are less than a year that will start to show up in revenue late in '25 and early into '26 and set the foundation for outgrowth in China in 2026.

Operator

Samik Chatterjee, JPMorgan.

Samik Chatterjee - *JPMorgan Chase & Co - Analyst*

Andrew, congrats on the new role as well. Maybe if I can sort of go back to the China renewed pace of wins that you're discussing here. And thanks for all the color till now, but maybe if you can sort of discuss how you're thinking about content per vehicle where in the -- as you mentioned, the content per vehicle there can sometimes be lower than the Western OEMs.

But in the new sort of win activity that you're seeing on that front? What are you finding out in relation to content per vehicle opportunity? And do you see a road map here as you continue to drive those wins? Is there a sort of more compression between the difference between the content on Western OEMs versus Chinese local OEMs on that front? And I have a quick follow-up for that.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

(inaudible), you are setting to the point. So basically, as I mentioned in one of the previous calls, we've shifted our focus in China. So it's very important -- of course, we want to win with the winners in China, and we want to win with the right new energy vehicle producers in China. And that's what we've been doing these last couple of months. And that has enabled us to win significant new business in the Chinese market. From a content point of view, yes.

For content in China, what really matters for us is you can look at it, whether it's EV versus ICE or you can look at it from a perspective of locals versus multinationals. Either way, it's about the same, which is that our content historically on EVs or on multinationals was much lower -- sorry, EVs or locals was much lower than with multinationals. And that's what we're starting to change.

So these new wins will bring that content imbalance up to parity such that we don't have a headwind from the shift to local players as they continue to grow in the market.

Samik Chatterjee - *JPMorgan Chase & Co - Analyst*

Okay. Helpful. And just in terms of -- Stephan, your earlier comments about the portfolio, more curious about how you're thinking about where the incremental R&D dollars go, particularly if we do see a shift in the automotive industry towards more hybrids relative to EVs, that is beneficial for your content overall. How you're thinking about where the incremental R&D dollars are being dedicated in terms of platform strategy from your end?

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

Yes. So we're obviously being very selective on where we put our dollars in R&D. And one good example is to your question -- to your earlier question, that's basically placing the dollars into applications for Chinese new energy vehicles. So that's the one side of it. That's what we're focusing on. On the other hand, we're putting more and more of our R&D dollars in the industrial area.

We've got our gas leak detection products. and A3. We're just ramping up. Some of them are still in the development phase, and we're really thinking about certain follow-up versions, so improvements on these products. So we put a certain level of R&D in these products. And then on the Aerospace side, there's also significant growth opportunities there. And selectively, we've been putting more and more R&D dollars in that area as well, so that we can tap that growth in the market that we see at least for the future.

Operator

William Stein, Truist Securities.

William Stein - *Truist Securities - Analyst*

First, Andrew, congrats on the promotion. Stephan, I think -- and Stephan, I think analysts and investors have sort of been waiting for a new mantra to understand the long-term growth potential either for free cash flow per share or earnings per share. And I think what you're communicating, I just -- it's sort of a clarifying question is that your priorities are to maintain the 19% operating margin sort of bogey stabilize it but not necessarily have such a hard focus on expanding it.

Second is to improve free cash flow conversion and third, to decrease leverage. Do we have that right? And is there -- and maybe the connection to this is, I've heard a couple of analysts refer to outgrowth, but I think those are targets that were set by prior managers of this business, do you have an outgrowth target or mantra that you want to guide us towards for the long term?

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

So thanks for the question, and let me reiterate and bring some charges more clarity into that. So first of all, again, we're going through an entire transformation. And by the way, this transformation is working for us. And we've also implemented a lot more focus and rigor in our organization. And like I've said now, we're (inaudible) benchmarking, we're working on consistency and we're working on topics like standardization. And we consistently and proactively improving our operations.

So we're working on an icing free cash flow -- and then we're setting ourselves up like the discussion around China for growth in the future. And let me not be more specific. What does that mean in numbers? So to be precise, what we said is -- and Andrew actually mentioned it's the floor of 80% cash conversion rate or more. So that is basically the bottom end of it. the floor of 19% margin or more.

So as you can see in Q3 and in Q4 of this year, we're looking at expanding margins by 20 basis points. And then we also said -- so there is a margin expansion included in that -- to be precise on your question. And then we also said, it's important that Sensata gets back to an organic growth rate by winning business in the market by winning business in automotive with the right players that we're back on track in HVOR that we're making progress in industrial and in the aerospace area.

And overall, we said, okay, let's target a growth rate, an organic growth rate of somewhere between to 4%. And that's sort of the kind of the frame that I've given the company that we're focusing on now. And that is the partner for the next 12 to 18 months, and that's what we're focusing on, and we'll see where that takes us.

Operator

Robert Jamieson, Vertical Research.

Robert Jamieson - *Vertical Research Partners LLC - Equity Analyst*

Stephan, I appreciate your color that you've provided over the last few conference calls on your strategic initiatives. But I want to ask about the global sales team. Having spent some time with them, have you seen anything in their process that needed to be changed to enable them to more effectively target the right types of customers in the right regions that you've spoken about? I'm just curious if anything has been implemented there that's driven the year-to-date wins you mentioned in China with the locals and then also in Japan year to date.

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

Can you just repeat the first sentence of your question? I didn't hear it. It was a bit not clear for me.

Robert Jamieson - *Vertical Research Partners LLC - Equity Analyst*

It's just about the global sales team and just having in like has anything been implemented to make them more effective in terms of targeting the key regions that you mentioned, like winning with the right customers, et cetera.

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

Yes, we have -- look, we've entirely changed the focus. So take the electrification market and the opportunities that are emerging within this market, and they differ very much per region. So I think it's very important to be extremely selective when choosing who you want to grow with. This is really important because as we know, unfortunately, not everybody is growing in the market.

And with some of them actually you could face a potential risk, especially in China, we know that there is a consolidation going on in the market or an accelerated consolidation amongst. So yes, the team in China is very much focused, not -- if I may say, the more blunt way, we're not running after every business. but trying to choose very selectively the right customers that we believe are going to be future strong outgrowers in the Chinese market.

And that's been challenging. And it's difficult to obviously choose the right customers, but we have a good level, we've built up, and that's also a change of good level of intelligence around that and again, being very selective. And obviously, let me explain a bit more on China is not just predicting the -- or trying to predict the consolidation game in China, but it's also trying to understand who which of these future customers are going to grow outside of China.

And as you probably know, there's a huge dynamic out there. So a lot of the big customers are entering European countries, they're entering Southeast Asia and they're hungry for growth. And so for us, as a team, as a sales team, it's very important that we try and determine who are going to be the winners outside of China so that we can grow with them when we win business with them. So it's a different type of type of focus.

And then again, in the mix of the applications, so around hybrid applications around combustion engine applications. I think we've basically broadened the scope a bit more. So we said, look, there's also very good opportunities around the combustion engine applications that we still go for. We have the assets, we have the products, and we'll also try and win in that sector.

Why do we do that? Why does the sales team graft that because that somewhat balances off the risk that you might have on the EV side trying to predict who are going to be the winner. So yes, it's a total -- it's a different focus. And I feel we have a lot more clarity around that.

Robert Jamieson - *Vertical Research Partners LLC - Equity Analyst*

That's very helpful. I appreciate that. And then just pivoting to the leak detection business. Just curious if you could elaborate on the total addressable market there, what's that size -- and then what's the margin profile versus the legacy industrial sensors business? I'm also curious what's embedded in your guidance for this business for -- is it still high single-digit outgrowth versus the market, just given some of the things that we've heard about the resi demand environment from some of the pure-play HVAC names today?

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

So on the gas in context, the overall market size in North America is roughly $150 million. And as I just mentioned in the call, we won a significant market share in this market. And if you then convert that to Europe, where we're now going to attack that market with our so-called product range. That overall, Europe is a similar sized market as what we have in North America with roughly $50 million in market size.

And there's more markets beyond that, that are actually emerging, and this is the interesting thing. The as soon as stronger or tighter regulations come out in South Korea, for example, or in Japan, we'll be ready with our product. We're busy scaling up ATL, and hopefully, we'll be ready by then with A3. And then we'll selectively tackle those markets, and that's an additional opportunity where we can gain market share and gain additional revenues. Around the margin of the product, I'm going to pass over to Andrew he'll explain that to you.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Yes. We've been coming up the curve on margin, but at the level that we're at today, sort of $70 million or so of annualized revenue, we're basically at or very close to normalized industrial margins. So scale has certainly helped there, but I think we're over the hump on where we need to be on margin scale.

And then in terms of our growth in the third quarter, so you're right, the resi dynamic has changed a bit. We're still expecting outgrowth in the third quarter. We were high single digits in Q2, probably low to mid-single digits in the third quarter and then similar kind of for the balance of the year.

Operator

Luke Junk, Baird.

Luke Junk - *Robert W. Baird & Co Inc - Analyst*

Maybe just one for me, Stephan, and really tapping into what you're just talking about leak detection, but maybe broadening that out in Sensing Solutions. It seems like tapping into non-auto markets could be a pretty interesting opportunity here. Just hoping to get your sense of urgency prioritizing that, including the message pretty loud and clear around China on the Performance Sensing side of the portfolio, but how should we think bigger sure about reinvigorating growth in Sensing Solutions, maybe even beyond the leak detection product and potentially even offsetting some of the cyclicality and performance sensing?

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

Luke, thanks for the question. Yes, certainly, part of our strategy is looking at opportunities to diversify our end market exposure, and we're weighing that in as we evaluate the new business opportunities for investment. Beyond ATL and Industrial, certainly, we're looking thematically at things like broader demand for electrification and the electrical protection opportunities that come with that.

We're looking at grid hardening and grid opportunities and the electrical protection opportunities that come with that. But I think those are all sort of longer-term secular opportunities. The clear near-term winner is the ATL product at various derivatives of that for other end markets. And so while we'll continue to look at secular opportunities longer term, the focus in the short term is on taking the business that we've already won, expanding margin share and bringing it to other end markets.

Operator

And ladies and gentlemen, with that, we'll conclude today's question-and-answer session. I'd like to turn the floor back over to Andrew Lynch for any closing remarks.

Andrew Lynch - *Sensata Technologies Holding PLC - Interim Chief Financial Officer, Vice President*

Thank you all for joining today's presentation. We look forward to seeing you at various investor events later this quarter. We currently expect to participate in the following events: Evercore ISI Semiconductor IT Hardware and Networking Conference in Chicago on August 26; Jefferies Industrial Conference in New York on September 3; and Goldman Sachs Technology Investors Conference in San Francisco on September 9. That concludes our second quarter earnings conference call.

Operator, you may now end the call.

Operator

Ladies and gentlemen, we do thank you for joining today's conference call and presentation has now concluded. You may now disconnect your lines.