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PRESENTATION

Operator

Good day, and welcome to the Sensata Technologies Q4 2017 Earnings Call. (Operator Instructions) Please note, this event is being recorded. I would now like to turn the conference over to Mr. Joshua Young, Vice President, Investor Relations. Please go ahead.

Joshua S. Young - *Sensata Technologies Holding N.V. - VP of IR*

Thank you, Rocco, and good morning, everybody. I'd like to welcome you to Sensata's Fourth Quarter and Full Year 2017 Earnings Conference Call. Joining me on today's call are Martha Sullivan, Sensata's President and CEO; and Paul Vasington, Sensata's Chief Financial Officer. In addition to the earnings release that we issued 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. We will also post a replay of today's webcast shortly after conclusion of today's call.

Before we begin, I'd like to reference Sensata's safe harbor statement on Slide #2. During the course of this conference call, we will make forward-looking statements regarding future events or the financial performance of the company that involve risks and uncertainties. The company's actual results may differ materially from the projections described in such statements. Factors that might cause such differences include, but are not limited to, those discussed in our Forms 10-Q and 10-K as well as other subsequent SEC filings.

On Slide #3, we show Sensata's GAAP results for the full year 2017. We encourage you to review our GAAP financial statements in addition to today's presentation.

One part of the GAAP P&L that I would like to highlight this quarter is our GAAP tax rate. As a result of the recently enacted U.S. Tax Cuts and Jobs Act of 2017, Sensata recognized a $73.7 million income tax benefit in the fourth quarter of 2017, principally related to the reduction in the U.S. corporate income tax rate to 21%.

Most of the subsequent information that we discuss during today's call will be related to our non-GAAP financial measures. Reconciliations of our GAAP to our non-GAAP financial measures are included in our earnings release and in our webcast presentation. Additionally, the company provides details of its segment performance on Slides 9 and 10, which are the primary measures that management uses to evaluate the business.

Martha will begin today's call with an overview -- an overall business summary. Paul will then cover our financials for the fourth quarter and full year 2017 and provide guidance for the first quarter and full year 2018. We will then take your questions after our prepared remarks.

Now I'd like to turn the call over to Sensata's President and CEO, Martha Sullivan.

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Thank you, Joshua, and thank you all for joining us this morning. Sensata finished the year strong in the fourth quarter, capping off a year in which we accelerated our organic revenue growth, expanded our adjusted EBIT margins, delivered double-digit adjusted EPS growth and strengthened our balance sheet. We continued to perform to promise as the fourth quarter marks the eighth straight quarter we have met or exceeded our guidance for revenue and earnings growth.

I will briefly touch on our fourth quarter performance before summarizing our full year financials shown on the slides. We reported revenues of [$840.5 million] (corrected by company after the call) in the fourth quarter of 2017, representing organic revenue growth of 5.2%, exceeding the high end of our guidance. Our heavy vehicle off-road and automotive businesses were the strongest drivers of revenue growth. During the fourth quarter, we expanded our adjusted EBIT margins by 110 basis points and delivered adjusted EPS growth of 14%. So overall, we delivered strong operational performance to close out the year.

On Slide 4, I summarized Sensata's performance for the full year 2017. Throughout each quarter of this year, our performance has been characterized by the consistent themes you see reflected on this slide. First, we are accelerating our organic growth rate. We generated organic revenue growth of 4% for the full year 2017, which was well above our initial guidance of 1% to 3% and more than double the organic growth rate we generated in 2016. This acceleration was driven by our HVOR and industrial businesses as well as strong growth in China.

Next, we are generating robust adjusted EBIT margin expansion. We expanded our adjusted EBIT margins by 100 basis points in 2017. This level of margin expansion is well above the performance of our peer group and is the result of M&A cost synergies and net productivity gains. I'd also point out that we expect to sustain this level of margin expansion in 2018 as the midpoint of our guidance reflects an additional 110 basis points of adjusted EBIT margin expansion in the coming year.

On the bottom line, we delivered double-digit organic growth in adjusted EPS for the third consecutive year. We believe this is an important point for our investors to appreciate. Despite significant changes to our markets, our portfolio and our balance sheet in the past 3 years, Sensata has consistently delivered double-digit organic EPS growth. This demonstrates the multiple leverage we have as a management team to consistently deliver attractive earnings growth for shareholders. We significantly strengthened our balance sheet in 2017, lowering our net leverage ratio to 3x, which is the target we committed to -- we communicated to investors at the beginning of the year. A stronger balance sheet, combined with our proposed redomicile to the U.K., will increase our optionality to execute value-creating capital deployment initiatives in 2018 and beyond.

Finally, 2017 was yet another strong year of new design wins. We secured approximately $530 million of new business wins in 2017, which exceeded our expectations, due in part to an acceleration of customer decisions from 2018 into 2017 as well as some key wins that helped us to gain market share. These wins are being driven by the secular trends that we spoke about at our Investor Day, such as the need for cleaner and more efficient products as well as mandates for electrified products. Due to the long cycle nature of our business, most of the revenue associated with these wins will start to materialize 3 to 5 years from now.

Slide 5 shows our organic revenue growth by end market for full year 2017 starting with our fastest-growing businesses at the top of the slide. HVOR once again outpaced the end market growth, posting organic revenue growth of 13.5% for full year 2017, which reflected strong market and content growth. Within HVOR, all markets were strong with particular strength in our North American on-road and our construction and agricultural off-road segments. As we project 2018, we expect underlying production in the HVOR market will grow 4% to 5% for the full year 2018.

As a result, we expect that Sensata's organic revenue growth in these markets will continue to outpace production, which reflects the strong content gains we are making with our expanded portfolio.

Next, I want to turn to industrial, HVAC and other end markets, which are served by our Sensing Solutions segment and represents approximately 26% of Sensata's total revenues. For the full year 2017, we generated 4.1% organic revenue growth in this segment of our business. The key drivers of this growth were strength in China, along with healthy global demand in many industrial markets, particularly a stronger HVAC market. We are also seeing an acceleration of wins for our pressure sensors as our industrial customers seek to create cleaner and more efficient products. For example, we are seeing this trend play out with the transition from coal to electric heat, which is driving higher demand for sensors on heat and water pumps.

We have talked in the past about how Sensata's strategy is to expand our content growth opportunities in the broader industrial market. Our CST acquisition was a key part of executing that strategy, and our broader presence in the industrial markets drove attractive growth in our portfolio in 2017. This higher growth is reflected in the performance of our industrial sensing business, which has generated 9% organic revenue growth and 6% content growth in 2017. We expect to continue to expand our content growth opportunities in the industrial markets during 2018.

Our automotive business posted organic revenue growth of 1.9% in 2017. As a reminder, back in February, we forecasted the global auto market to be flat, and our forecasts proved to be accurate despite continued volatility in the market. Our 190 basis points of outgrowth, relative to underlying automotive production, was primarily driven by content growth in China, which had a strong year despite lower tax incentives available in the region when compared to 2016. With a strong growth in China, Asia is now our second largest automotive region in terms of revenue, surpassing North America for full year 2017.

Our North America and European automotive businesses largely performed in line with our expectations for full year 2017. In spite of concerns many investors had about the global auto market 12 to 18 months ago, we successfully grew our auto business and accelerated the overall organic growth rate of the company during 2017. This speaks to the better balance we have strategically built into the portfolio and the breadth of our secular growth opportunities.

Our redomicile to the United Kingdom was an important initiative we began implementing in 2017 in order to provide more optionality for future capital deployment initiatives as well as provide additional corporate governance and administrative benefits. On Slide 6, I provide an update on our efforts to complete this move. We filed our definitive proxy statement for the transaction on January 19 and set the date of our special shareholder meeting for February 16. This proxy has been mailed to all our shareholders of record as of January 19, and the process of soliciting votes for the meeting has now officially begun. If we receive shareholder approval, the next step will be for us to gain approval from the U.K. High Court, which we expect will occur in late March. We expect to have the transaction completed by the end of the first quarter 2018.

Turning to Slide 7. Let me wrap up with a few closing thoughts. Sensata continues to deliver solid execution and financial performance, and this was reflected in our results, both for the fourth quarter and full year 2017. Our higher organic revenue growth reflects our ability to intersect attractive secular growth opportunities, and our ability to capitalize on these trends can be seen in the strength of our new business wins, which reached record levels in 2017. Additionally, core near-term opportunities are being augmented by longer-term opportunities resulting from megatrends, such as electrification, autonomy and smart connected products.

We are expanding our adjusted EBIT margins faster than our peers, increasing our adjusted EBIT margins by 100 basis points in 2017. This margin expansion demonstrates that we are capturing significant value from past acquisitions through higher M&A cost synergies while also generating solid underlying operating leverage in our business. We expect this robust margin expansion will continue in 2018.

We are consistently delivering double-digit adjusted earnings per share growth. In 2017, we delivered organic adjusted EPS growth of 10%, our third consecutive year of double-digit adjusted EPS growth, and we expect to deliver 11% organic EPS growth in 2018. This attractive earnings growth does not reflect any potential benefit from future M&A and assumes a relatively flat diluted share count.

We are accelerating our free cash flow and increasing our optionality to pursue value-creating capital deployment. Our free cash flow increased 61% year-over-year in the fourth quarter and our guidance for 2018 assumes a nearly 30% increase in free cash flow. The combination of our higher free cash flow, increased optionality and track record of delivering high returns puts us in a strong position to create future value for our shareholders.

So to sum it all up, Sensata is a company that is poised to extend our leadership position and deliver strong financial performance, not only in 2018 but over the next 3 years and beyond. We expect to deliver mid-single organic revenue growth, increase our industrial-leading margins, drive double-digit adjusted earnings per share growth and effectively deploy capital for our shareholders.

I'd now like to turn the call over to Paul to review our fourth quarter results in more detail and to provide financial guidance for the first quarter and full year 2018. Paul?

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

Thank you, Martha. Key highlights for the fourth quarter, as shown on Slide 8 include, revenue of $840.5 million in the quarter, an increase of 6.6% from the fourth quarter of 2016. Of this growth, changes in foreign exchange rate increased revenue by 1.4%. The net result was 5.2% organic revenue growth in the quarter. Adjusted EBIT grew by 11.7%, and adjusted EBIT margins increased by 110 basis points compared to the fourth quarter of 2016. On an organic basis, adjusted EBIT grew by 7.8% in the quarter. Adjusted net income was $149.4 million or 17.8% of revenue, a margin increase of 120 basis points compared to the fourth quarter of 2016, and adjusted net income grew 8.7% organically. Adjusted EPS was $0.87 in the fourth quarter of 2017, an $0.11 increase from the prior year quarter. Of this increase, $0.04 reflects tailwind for foreign exchange rate. Excluding the impact of foreign exchange rates, adjusted EPS grew 9.2% organically primarily due to higher volume and acquisition cost synergies.

Now I'd like to comment on our 2 business segments. I will start with Performance Sensing on Slide 9. Our Performance Sensing business reported revenues of $634.7 million for the fourth quarter of 2017, an increase of 7.9% compared to the fourth quarter of 2016. Performance Sensing reported organic revenue growth of 6.2% in the fourth quarter of 2017. As Martha mentioned earlier, this performance was driven by strong results in our HVOR business, which rose approximately 21% organically, and the strong performance of our automotive business in China. Performance Sensing profit was $180.7 million or 28.5% of revenue for the fourth quarter of 2017. Excluding the impact of foreign exchange rates, Performance Sensing profit as a percent of revenue was 28.6%, up 110 basis points from the year-ago quarter. This improvement from the prior year reflects the benefit of growing acquisition synergies, net productivity gains and lower integration costs, probably offset by higher designs and development efforts to support accelerating new business wins.

As shown on Slide 10, Sensing Solutions reported revenues of $205.8 million in the fourth quarter of 2017, up 2.7% for the prior year quarter. Sensing Solutions reported organic revenue growth of 2.3%, reflecting continued positive momentum in many of the end markets we serve as well as continued above-market growth in our industrial sensing business unit. For the full year 2017, Sensing Solutions has posted 4.1% organic revenue growth. Sensing Solutions profit was $67.5 million in the fourth quarter of 2017, an increase of 6.9% from the same quarter last year. Excluding foreign exchange rates, Sensing Solutions profit as a percentage of revenue was 32.7%, a 120 basis point increase year-over-year due to benefit of growing acquisition synergies and operating leverage.

Corporate and other costs not included in segment operating income were $56.5 million in the fourth quarter of 2017, up approximately $10 million year-over-year due primarily to higher compensation and other employee-related costs, expenses related to our proposed redomicile transaction and foreign currency exchange rate headwinds included in corporate costs. Excluding charges added back to our non-GAAP results, corporate costs reflected in our non-GAAP EBIT were approximately $48 million in the fourth quarter and $179 million for the full year 2017.

Slide 11 shows Sensata's fourth quarter 2017 non-GAAP results. Adjusted gross profit margins were 36.3%, up slightly versus the same period in the prior year. The higher R&D expense this quarter reflects increased design and development efforts to support accelerating new business wins. The higher SG&A expense this quarter reflects higher compensation and employee-related costs and foreign currency exchange rate headwinds, partially offset by lower integration expense within SG&A. Our higher tax rate of 140 basis points in the fourth quarter of 2017 compared to the prior year is in line with our expectations. For the full year 2017, our adjusted cash tax rate was 6.6% in line with the guidance we gave for the end of the year. On the bottom line, adjusted net income margins improved by 120 basis points, and adjusted EPS increased by 14.5% in the fourth quarter of 2017 compared to the year-ago quarter. Organically, adjusted EPS increased by 9.2% in the fourth quarter of 2017.

Slide 12 shows that we delivered on the target to reduce our net leverage that we first communicated to investors nearly 18 months ago. Since the end of 2015, our net debt position has declined by approximately $758 million and our net leverage ratio has declined from 4.6 to 3.0x. This slide demonstrates that Sensata leverages and strong balance sheet to pursue initiatives that create shareholder value. Now we have the confidence and the ability to delever quickly through our strong free cash flow.

Martha mentioned earlier that we are well positioned to create shareholder value through capital deployment. Slide 13 is a slide that we shared at our Investor Day as a reminder of Sensata's balanced, returns-driven approach to capital deployment. With our strong balance sheet and free cash flow, we are well positioned to deploy capital to high-return outcomes. As a result, we expect to balance high-return M&A opportunities with economic-driven share repurchases. The key message is our strong cash flow and the pending redomicile to the U.K., we will have more flexibility to deploy capital in the best way possible to maximize shareholder value.

On Slide 14, I show our financial guidance for the first quarter of 2018. We expect to report revenues between $849 million and $873 million, representing reported growth of 5% to 8%. At the midpoint of our guidance, we expect that foreign exchange rates will increase revenues by approximately 2% to 3% in the first quarter of 2018. Excluding the effect of foreign exchange rate differences, we expect to report organic revenue growth of 3% to 5% in the first quarter of 2018. Our current bill rate is approximately 89% of the revenue guidance midpoint for the first quarter of 2018. We expect to report adjusted EBIT between $191 million and $197 million, which would represent organic growth of 8% to 11%. On the bottom line, we expect to report adjusted net income between $141 million and $147 million and adjusted EPS between $0.81 and $0.85, which would represent organic growth of 10% to 14%. Changes in foreign exchange rates are expected to increase adjusted EPS by approximately $0.03 to $0.04.

Now let me turn to our guidance for the full year 2018, as shown on Slide 15. We're forecasting revenues to be in the range of $3.442 billion to $3.542 billion for the full year 2018, a 4% to 7% increase on a reported basis. We expect foreign exchange rates to increase our revenues by 1% to 2%. Excluding foreign exchange, we expect organic revenue growth of 3% to 5% in 2018. From a market perspective, we expect the HVOR market to grow 4% to 5% and for the global automotive market to be flat to down slightly in full year 2018.

As we stated at the Investor Day, we are increasingly tracking and managing our auto business on a global basis, to match the way our auto customers are managing their global supply chains. As a result, regional breakouts of our auto business are becoming increasingly less useful, particularly on a quarterly basis. Therefore, our commentary disclosure will focus on the global trends of auto, which will also be consistent with the way we describe our other businesses, such as HVOR.

For the full year, we expect EBIT to be between $818 million and $846 million, which would represent organic growth of 7% to 10%. On the bottom line, we expect adjusted net income to be between $617 million and $645 million and adjusted earnings per share to be between $3.57 and $3.73 for the full year 2018, which would represent organic growth of 9% to 13%. We expect to generate free cash flow between $519 million and $547 million in 2018, which assumes capital expenditures of approximately $150 million to $160 million. I would note that our guidance assumes no M&A and a diluted share count of approximately 172.8 million shares.

I will conclude my remarks with Sensata's investment summary on Slide 16. Sensata is a leader in the opportunity rich sensing market, where we provide mission-critical differentiated solutions. When we combine these solutions with our low-cost global supply chain, we deliver industry-leading margins, strong free cash flow and consistent double-digit adjusted earnings per share growth. Our revenue growth is accelerating, and we are well positioned to benefit from underlying industry megatrends. Additionally, we're in the process of assessing flexibility and optionality for future capital deployment. With a strong balance sheet and our expectations to grow our free cash flow nearly 30% in 2018, we are in an excellent position to provide attractive returns for our shareholders. This is an exciting time for Sensata, and we believe we offer compelling investment opportunity for investors.

Now I'd like to turn the call back to Josh.

Joshua S. Young - *Sensata Technologies Holding N.V. - VP of IR*

Thank you very much. Rocco, please assemble the Q&A roster.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Today's first question comes from Wamsi Mohan of Bank of America Merrill Lynch.

Wamsi Mohan - *BofA Merrill Lynch, Research Division - Director*

Martha, you saw a fairly strong quarter-on-quarter growth in Asia auto, much stronger than last year and also on a year-on-year basis on somewhat of a tougher compare. Is this largely a function of incentives that will stop to be a tailwind in '18? Or would you attribute this to more sustainable content growth? And did I hear Paul right that you won't be giving regional disclosure around autos? Given the concerns around auto cycle, don't you think it's important to sort of continue giving this? And I have a follow-up.

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Yes. So recognizing our overall business in China grew over 18% in 2017 is clearly outpacing the market. And so some of the strength that we saw in China, a little bit of demand acceleration in the fourth quarter, but way -- far and away, what is driving our overall growth in China is strong content growth, and we do expect that to persist. Yes, the commentary you heard from Paul is that as we go forward, we will make sure you understand what's happening in the global automotive production rates as it impacts Sensata. On an annual basis, we'll give you a sense for what is happening in the regional breakout, but we're finding it just not very meaningful on a quarterly basis.

Wamsi Mohan - *BofA Merrill Lynch, Research Division - Director*

Okay, Martha. And Paul, when we look at the EBITDA margins, if you exclude other OpEx and other gains and losses, that was down slightly on a year-on-year basis. How do we reconcile that with the strong synergies that you're realizing? And your expectation that you're actually going to see an acceleration up to 110 bps of margin improvement next year?

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

Sure, Wamsi. I would first start with -- we shared with you a couple of things on Investor Day I think are critical. One is that the integrations are coming to -- largely coming to an end this year. So there's very little integration spend in '18 compared to '17. That will help drive margins going forward. Also -- we also provided the significant synergy growth that we're seeing in the business, which is about $12 million in 2018. So those 2 are important drivers of margin expansion next year. We continue to optimize our manufacturing. We continue to drive cost out of the business, just from pure productivity gains that we continue to get. When you exclude the other income and expense, there's 2 things I would comment. The first is that we are -- we do have commodity expense. Those commodity costs rates are reflected in our cost of revenue. In the other income expense that you -- or we call other net you commented on, that's where we have the commodity hedges, which we -- which offset those changes that occur up in the cost revenue. So you have to look at those together. I'd also say that we give guidance on a foreign exchange, we look at -- we have a comprehensive foreign exchange hedging program. We hedge cash flows. We hedge the balance sheet. And we provide the impact to foreign exchange, we're giving you that comprehensive look. So it includes all parts of the P&L. We talked about the increase or decrease that the currency could have on our earnings per share year-over-year. You really need to look at the whole P&L to get a full picture of Sensata's performance.

Operator

Our next question comes from Shawn Harrison of Longbow Research.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

Paul, just wanted to be clear on the comment that you expect global auto production to be flat to down for 2018. Did that change from the Analyst Day? And the reason I ask is with TE Connectivity on its call, what is it, 2 weeks ago, they took up their global view of auto production on China and Europe strength. So maybe just trying to figure out the difference between your view and their view, if anything.

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

Well, our view at the Analyst Day was that the global automotive market would be flat with a 3-year period. Our guide here in '18 is consistent with that view.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

Okay. So I guess the follow-up to that is you're not seeing that incremental strength they saw. Or are you just holding a more conservative view of the world?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Yes. I'm not sure we're going to comment on anybody else's view of the overall production market. These are markets that are pretty well documented by third-party forecasters. So you guys can also form your own perspective. I'll remind you, we call the overall automotive production market flat in 2017. Many did not. Many were more optimistic. I think our call is the right one if you look at where it landed at the end of the day.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

That's fair, Martha. And then just on the kind of moderate or I guess the mid-single-digit growth you see in the HVOR market for 2018. It looks like industry forecasters have been also taking up their views, particularly of North America. That 4% to 5%, did that come up over the -- relative to the Analyst Day? Or is that where you were 45 days ago?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Again, when we gave our guide for Analyst Day, it was really on the 3-year perspective. We're calling the end market in 2018 stronger than the overall guide we gave for the 3 year. So we do think that there's some rebounding that's happening. That is consistent with what we put together in the 2018 guide. That was our thinking when we provided that guide at Analyst Day.

Operator

And our next question comes from Amit Daryanani of RBC Capital Markets.

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

I guess 2 for me as well. Paul, may be let's start with the 100 basis points of 2018 EBIT margin expansion you guys are talking about. Can you just help me understand how much of that do you think will be from the gross margin side versus OpEx side? And beyond that, I guess, how much of this is just going to be from the fact that you have less integration charge in '18 versus '17? I think it was a bit more integration-heavy year for you guys.

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

That's correct. So a significant part of our margin expansion in 2018 will come at the gross margin line. We expect R&D to increase as we continue to invest in our -- supporting our new business design wins. We would expect to get leverage on our SG&A costs. If you think about integration, we said $20 million of integration is where we ended the year this year. We're expecting about $5 million next year, which we communicated on Investor Day. So that's going to be the $15 million tailwind. We also talked about $12 million tailwind related to growing synergies. So those will contribute to the expanding gross margins as well as some of the leverage we'll get around SG&A.

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

Got it. And I just -- if I could just follow up, the core automotive segment saw some nice revenue acceleration, I think, in the December quarter after being somewhat flattish organically for a few quarters. I'm curious, what are some of the reasons that enabled this uptick in growth for you guys over there organically? Was it content? Was it production trends? Just some clarity, that would be great.

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

I want to make sure I heard the question. You're asking about what's driving the strength in the fourth quarter in auto. Was that question?

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

Yes, that there was more content versus production trends that's helping you.

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Yes. Clearly, content for us. So we're seeing the momentum of our past year's NBO wins, what we've already secured and that's now coming through and leading to stronger content growth for us in auto in 2018.

Operator

And our next question today comes from William Stein at SunTrust.

William Shalom Stein - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

First, I just want to clarify the discussion around global auto production being flat for the next 3 years. Periodically, you add the sort of qualifier that this relates to your exposure to global auto production. Can you confirm that, that understanding is correct? And then remind us please where you're under or overexposed. Maybe it's one OEM or one region. I seem to forget.

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Yes. The only significant correction for us is that we're not well represented in Toyota. So we take the Toyota production out of our overall rates. That is the correction that we make. Beyond that, not a lot of change there. We're looking at major automotive markets, so Japan, Korea, North America, China, Europe. And I think that's consistent with others. We do some work to understand at the beginning of period where inventories lie and look to how that normalizes over time. I think that's pretty consistent with how folks think about the market.

William Shalom Stein - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

One other, if I can. Your HVOR growth is very robust now. And I'm hoping you can comment on the areas where you expect that to moderate and maybe the timing. It's likely not to remain at this very robust level for an extended period of time. Any comment on what the fate might look like?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Well, I'll just start by pointing out, we've talked about what the overall growth rate is. You understand what the end production rate. So we are significantly outperforming the end market in heavy vehicle and off-road, and we expect to continue to do that over the long term. We've provided that commentary at our Investor Day, for example. So while we're probably in a period, I would say, in 2017 and into '18 where there is faster end market rebound, that's not what's driving most of our growth. And we expect heavy vehicle and off-road to be a good double-digit performer for Sensata over the long run.

Operator

And our next question comes from Brian Johnson of Barclays.

Brian Arthur Johnson - *Barclays PLC, Research Division - MD & Senior Equity Analyst*

I think we are all kind of circling around the same question around Performance Sensing HVOR versus automotive. But if you were to separate out the growth in your customers' production schedule from the net growth in your content with new forms of sensing and so forth, how would you do that? What would be roughly direction in each of those growth -- each of the growth numbers in each of those 2 subsegments?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

I think that way we've tried to do that, again, I'll go back to the Investor Day, all the materials available, is to point to you what our assumptions have been on end market and what our expectation is for overall organic growth. So I think that was fairly transparent. As we go into 2018, aside from the heavy vehicle and off-road business, we're not seeing a lot of end market help. And so you can see the difference there reflected in our organic growth rate.

Brian Arthur Johnson - *Barclays PLC, Research Division - MD & Senior Equity Analyst*

Okay. So in the fourth quarter, was there anything different than long-term trends in terms of the organic content growth above and below production?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Every quarter, there's something different, and so every quarter has its perturbations. I would look at trends. I think that's more helpful than looking at the very specifics on any particular quarter. So what you saw in the fourth quarter that is important to recognize is accelerating organic growth in our auto business, and that really is a reflection of our content gains.

Brian Arthur Johnson - *Barclays PLC, Research Division - MD & Senior Equity Analyst*

Okay. Second question, can you give us an update on Quanergy and your LiDAR, either new business discussions, the feedback Quanergy got out at CES where they were very active in some point?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Generally, we don't comment about what's happening inside of Quanergy. We're very pleased with the partnership. We continue to hear from customers on the importance and the specifics of what they're looking for on a LiDAR sensor for autonomous applications, really, level 4 and level 5 in the light vehicle market, and we're pleased with the overall progress we're making. As we've talked about it before, this is a very long-term play for us, and so a lot of development that still remains to be done. We're seeing good performance in the generation of product that we're developing now, but it will be some time before that actually converts to revenue. We're seeing well beyond the 2020 time frame.

Operator

(Operator Instructions) Today's next question comes from Mark Delaney of Goldman Sachs.

Timothy G. Sweetnam - *Goldman Sachs Group Inc., Research Division - Research Analyst*

This is Timothy Sweetnam on for Mark Delaney. So my first question is relative to the 3% to 5% organic revenue growth outlook for 2018. How does China compare to that? As I think it was an important driver for the company's comments at its Analyst Day due to rising content. And how do the higher purchase tax rates in China for cars this year play into that?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

So strong performance in China across-the-board. Now light vehicle represents about 70% of our China revenues, just to give you a sense for it. And China represents about 14.5% of overall Sensata's revenue, and we're seeing very consistent, very strong double-digit growth rates. As we look ahead to 2018, we do think there'll be some impact on the overall production rates in China because of the dropping off of tax incentives. But we're still projecting very strong double-digit growth for Sensata in China.

Operator

And our next question comes from Rich Kwas of Wells Fargo Securities.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

This is -- as we think about the outlook, the revenue outlook for the year, comps are pretty similar across both segments. Is there a business that we should weight a little more heavily in terms of growth rate, organic revenue growth rate for 2018?

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

Well, Rich, I guess if you're asking between Performance Sensing and Sensing Solutions, we're going to expect Performance Sensing to have higher growth year-over-year than the Sensing Solutions business, principally driven by the content growth in automotive and the strong growth in HVOR, both in market and content.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Okay, all right. So -- and then within the Performance Sensing on -- as it goes back to auto. So China was up 18%. That's roughly -- China auto is about 10% of your revenue. So that really constituted, really, all your organic growth in 2017. Should we think about -- when we think about the business for '18, what's the content growth or organic revenue outperformance that you're assuming versus underlying production for 2018? So production is going to be flat to down. Should we think of content being 200, 300 basis points better overall? Or can you get to close to that mid-single-digit organic growth rate for auto for '18?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Yes. We think we'll get closer to that, Rich, and you could start to see that in the fourth quarter. So we've said now, we're not going to get help. We actually may have a little bit of a headwind on overall production rate. So we're expecting stronger growth in auto in Performance Sensing and the kind of growth that we've seen in the heavy vehicle and off-road business. So yes, we think we're getting now in line with the model that we shared at the Analyst Day.

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

Remember we said the 5% automotive growth at Investor Day over the 3-year period on flat global market, so that should help you start to close in on what the content would be.

Richard Michael Kwas - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Yes. I just wanted to clarify whether '18 really gets into that level or if it was going to be more of a back-end weighted, '19, '20 sort of framework, so.

Operator

And our next question comes from Craig Hettenbach of Morgan Stanley.

Craig Matthew Hettenbach - *Morgan Stanley, Research Division - VP*

Just want to follow up on the comments on M&A, Martha, in terms of the core business starting to perform a little better. You evaluate the portfolio. Do you look at things like adjacencies, CST-type opportunities? Anything you can kind of share in terms of how you see the landscape?

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Sure. One of the things that we've been conveying is that when we look at our pipeline, I will tell you it is active, but it is much more biased ex-auto. And as a result, given the footprint we now have because of the CST acquisition, we see a lot of more fragmented bite-sized opportunities in these vertical markets. And so that's more the nature of what is in the pipeline today. I would say bias is more ex-auto than and more modest bite-sized acquisitions than some of the more recent ones we've done.

Craig Matthew Hettenbach - *Morgan Stanley, Research Division - VP*

Got it. That's helpful. And just a follow-up question for Paul, just on margin. As we think through this year and maybe even heading into 2019, can you kind of frame just some of the gross margin improvements and, as some of the synergies still come into play, how you're thinking about trajectory and gross margins?

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

So like I said earlier, the things that are going to drive gross margins are going to be the completion of the integration. The synergies that are being realized, which we laid out for '18, '19 on Investor Day. It's the continued improvement in driving cost out of the business and the optimization of our manufacturing footprint, and it's the operating leverage that we get on our fixed cost base. Those are the things that are going to drive margin expansion over the next few years, for sure.

Operator

And our next question comes from Joe Giordano of Cowen.

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

Paul, you touched on this earlier, I just want to make sure I understand. When we look at the year-on-year kind of EBITDA comparison when you've -- with considering that $8 million swing in other and the synergies that we're talking about and a little bit less depreciation, like -- so are you -- were you trying to say that the commodity pressure is kind of offsetting a lot of the synergies that you're getting like right now? And is that fair?

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

No, no, no. When you think of commodities, it's...

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

Just to be clear, no, that's -- I want to make sure you hear that Joe. That is not what we're looking at.

Paul S. Vasington - *Sensata Technologies Holding N.V. - CFO, CAO and EVP*

Just trying to explain that when you look at commodities, we don't get hedge accounting for commodities. So we're going to get a little technical. And so when -- if commodities are a headwind in cost of revenue, which they have been, we hedge those exposures. And so to lock in the hedge price of the commodity, we had contracts. And those 4 contracts results in gains and losses, and they offset whatever happens in cost of revenues. So what you're seeing in part year-over-year is that the benefit we're getting in other net is gains on commodity contracts are offsetting losses on the underlying commodity and cost of revenue. So those materials work.

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

So then what accounts -- so shouldn't the synergies then be pushing like EBITDA, like it was basically kind of like -- okay, okay. So you're saying it's just all staying there. It just seems like -- okay, that's fair. At Investor Day, you guys had on display some stuff, some wireless sensing for EVs. And when I was talking to your people, it sounded like there's still a lot of discussions going on about, like who's going to like ultimately make this stuff, is it going to be OEM, is it going to be wireless. How are those discussions kind of progressing? Like I know it's very like engineer to engineer kind of level. But I'm just curious as to how people are thinking about those kind of designs going forward and how far out those discussion are taking place.

Martha N. Sullivan - *Sensata Technologies Holding N.V. - CEO, President and Executive Director*

The conversation is good. I think what you may have heard is that if you look very broadly at battery management, there's a lot of functionality there that we're not pursuing with our solution, and we want to make sure we're providing what we think is the most important thing. And that is really rich embedded information in the overall battery as opposed to logic on battery management, and that hypothesis is playing out with our customers.

Operator

That's all the time we have allotted for question and answers on today's call. I would now like to turn the conference back over to Joshua Young for any closing remarks.

Joshua S. Young - *Sensata Technologies Holding N.V. - VP of IR*

Thank you. I'd like to thank everybody for joining us this morning. Sensata will be attending the following investor conferences in the first quarter, the Goldman Sachs Tech Conference and the Barclays, Citi and JPMorgan Industrial Conferences. We hope to see you at these conferences, and we invite you to visit us at our headquarters in Attleboro, Massachusetts.

We appreciate your continued interest in Sensata. Thank you, and good day.

Operator

The conference has now concluded. We thank you all for attending today's presentation. You may now disconnect your lines.
