STMicroelectronics
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Q4& FY 2018 Financial Results
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Good morning, and thank you for joining ST on our year-end earnings call today.

Before going through a detailed review, let me start with some opening remarks:

First, on 2018:

We had solid financial results in the fourth quarter, for both revenues and profitability.

For the full year, in line with our objectives, we delivered significant revenue growth across our product groups, a strong expansion of operating profitability, net income and free cash flow, while investing to drive growth opportunities and operating efficiency over the mid-term.

Second, on 2019:

Our first quarter outlook reflects the combined impact of increased unfavorable dynamics **-**on top of first quarter seasonality- in some of the end markets we serve: smartphone applications; computer hard-disk drives; distribution in China - and also in Europe.

On the other hand, we see Automotive and Power Discrete holding well, with significant growth year-over-year.

And, for 2019, we plan to return to sequential growth in the second quarter, with an acceleration in the second half of the year.

Our key objectives for this year are to continue outperforming our served market and to balance our end market and application focus, delivering sustainable profitability and returning value to shareholders.

To support all of that and to execute on our strategic technology, R&D and manufacturing programs, we expect to invest in CAPEX. Part of this CAPEX is devoted to support three strategic initiatives that I will detail later.

Let’s now start with the detailed review.

Our financial results in the fourth quarter, for both revenues and profitability, were solid.

- Net revenues increased 7.4% year-over-year, on double-digit growth across our Automotive and Discrete Group, in Imaging and in Digital ICs. On a sequential basis, our revenues increased 5.0%, very close to our mid-point target of 5.7%. Sequential growth was driven by Imaging, Automotive and Power Discrete.
- Our gross profit totaled $1.06 billion, representing a year-over-year increase of 5.6%.
- Our gross margin was 40.0%, 20 basis points higher than the mid-point of our guidance. In comparison to the fourth quarter of 2017, our gross margin was 70 basis points lower.
- Our net operating expenses were $614 million.
- Operating income increased 7.9% year-over-year to $443 million. Our operating margin was 16.8%, 10 basis points higher than the year-ago quarter.
- Fourth quarter net income of $418 million and diluted earnings per share of $0.46 both increased about 35% year-over-year.

Now, let's look at our fourth quarter results by product group on a year-over-year basis.

ADG revenue increased 17.8% to $967 million, on double-digit revenue growth for both Automotive and Power Discrete.

ADG operating margin expanded 220 basis points to 14.6% from 12.4%. For both the third and fourth quarters, ADG's operating margin were solidly in-line or ahead of our low teens second half 2018 target.

Moving to our Analog, MEMS and Sensors group, AMS revenues totaled $988 million, an increase of 9.5% with double-digit growth in Imaging, and single-digit growth in Analog and MEMS.

AMS operating margin was 20.5%, stable with the year-ago level of 20.8%. For AMS, we had initially anticipated second half 2018 operating margins to move into the mid-teens, and we exceeded that level in both the third and fourth quarters.

Finishing our product discussion with the Microcontrollers and Digital ICs group, "MDG", the inventory correction in Microcontrollers continued, as anticipated, during the fourth quarter, due to the mass market softening in China. In total, MDG revenues decreased 6.9% year-over-year to $689 million, with growth in Digital ICs offset by Microcontrollers and Memories.

MDG operating margin was 17.7%, below the 19.7% in the year-ago quarter. For MDG, we had initially anticipated second half 2018 operating margins to be about 20%, and we came in below that level in both the third and fourth quarters. This was mainly due to a lower than expected level of revenues, and less favorable mix between Microcontrollers and other products.

Turning now to our full year results, as I said earlier, 2018 was an important year of achievement.

2018 net revenues were up by 15.8% compared to 2017, reaching $9.66 billion. So, in 2018, we achieved our objective to outpace the growth of the market we serve.

Gross margin was 40% compared to 39.2% in the prior year.

Operating margin expanded 250 basis points to reach 14.5% in 2018, on sales growth and operating efficiency leverage.

Net Income and free cash flow were up 60% and 73%, respectively, compared to 2017, while capex was slightly lower at $1.26 billion from $1.3 billion in 2017.

Also in 2018, revenues were balanced across product groups, customer types and regions of customer origin.

ST has over 100,000 customers.

By region of origin, 35% of our 2018 revenues were from the Americas, 34% from Asia Pacific and 31% from EMEA.

Sales to OEMs represented 65% of total revenues and increased 14% in 2018, with Distribution representing 35% and growing 19% for the year.

By product group, ST's total revenue growth of 15.8% was supported by all three product groups:

- ADG revenues increased 16.2%, with double-digit growth for both Automotive and Power Discrete.

  And, looking at our products across ST in total addressing the automotive market, we finished the year with a growth of about 18%, above the 17% year-over-year growth expectation that we had shared with you previously.

- AMS revenues increased 19.9%, on sharply higher Imaging sales and double-digit growth in Analog.

- MDG revenues increased 11.1% in 2018 with double-digit growth for Microcontrollers and Memories, and Digital ICs.

In parallel, all three groups delivered operating income and operating margin growth:

- ADG operating income increased by 48% to $431 million and its operating margin increased to 12.1% from 9.5% in 2017.
- AMS operating income increased 34% to $488 million and its operating margin increased to 15.5% from 13.9% in 2017.
- And MDG operating income increased by 35% to $547 million and its operating margin increased to 18.6% from 15.3% in 2017.

In 2018, our financial performance drove a 10% increase in net cash from operations for the year, reaching $1.85 billion. Our free cash flow increased 73% to $533 million, well covering our cash dividends of $216 million, as well as a $62.5 million share buy back, under the program launched during the fourth quarter.

Finally, as anticipated, we exited 2018 with a higher net cash position compared to 2017 – at $686 million compared to $489 million at December 31, 2017.

Now, let’s move to our guidance.

Our first quarter outlook is for net revenues of about $2.1 billion at the mid-point. This would represent a year-over-year decrease of about 5.7% and a sequential decrease of about 20.7%. We anticipate a gross margin of about 39.0% at the mid-point.

After Q1 2019, we plan to return to sequential revenue growth in the second quarter, with an acceleration in the second half of the year. This is in line with the objectives I stated at the beginning of my speech: continue outperforming our served market and balance our end market and application focus, delivering sustainable profitability and returning value to shareholders.

In order to support all of that and to execute on our strategic technology, R&D and manufacturing programs, we expect to invest between $1.2 to $1.3 billion in CAPEX.

Of course, this amount includes the maintenance of our manufacturing fabs and R&D required by our manufacturing operations and also capacity addition in some of our existing technologies. However, part of this CAPEX is also devoted to support three strategic initiatives:

- First, a new 300mm fab in Agrate, Italy (our site near Milan). The construction work of the first stage – to support R&D and first industrial deployment phase has already started, with the related building and facilities to be completed and ready to host some equipment for R&D in 2020. This new fab is designed to be expandable, of course according to demand, to start volume production starting from 2021. It will be focused on supporting our growth ambitions and leadership in BCD, IGBT and Power technologies.

- Second, the expansion of our installed capacity for Silicon Carbide and the start of production ramp-up for Gallium Nitride for RF devices.

  Here, our early investments in wideband gap compounds have already resulted in over $100 million of Silicon Carbide revenues in 2018, and we have over 30 active Silicon Carbide projects with many players around the globe, both in Automotive and Industrial applications. Also, earlier this month we announced a multi-year supply agreement with Cree.

- These investments support our goal to sustain an important share –about 30%- of the Silicon Carbide market, which is estimated to be over $3 billion in 2025.

- Third, our investments in the next generation of imaging sensor technologies. These will enable us to continue our leadership in our focus technologies for personal electronics, and to address selected industrial and automotive applications in the future.

These initiatives are part of our strategy to reinforce our leadership in our end markets: broad-based in Industrial and Automotive; and, with a selective approach, in Personal Electronics and in Communications Infrastructure.

We will discuss in detail our end market and product strategy at the Mobile World Congress in Barcelona on February 26, and we will provide a more in-depth overview of our company when we meet at our annual Capital Markets Day in London on May 14.

To conclude:

- In 2018 we met our objectives, with 15.8% year-over-year revenue growth across our product groups, as well as a strong expansion of profitability and cash flow from operations.

- In 2019:
  - After Q1, we plan to return to sequential growth in the second quarter, with an acceleration in the second half of the year.

- Our objective for the year is to continue outperforming our served market and to balance our end market and application focus, delivering sustainable profitability and returning value to shareholders.

We are now ready to answer your questions.