STMicroelectronics
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Q2 2018 Financial Results
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Thank you for joining us on our call today. I am very pleased to be here to talk with you, together with my colleagues, in my first earnings results call leading ST.

So let's begin with an overview of our Q2 performance.

Our second quarter results were solid and in line with our expectations.

We had another quarter of double-digit, year-over-year revenue growth, balanced across all product groups, regions and end markets. And we drove another quarter of improved performance across key financial metrics.

Looking at our Q2 business results, both revenues and gross margin were above the mid-point of the Company's outlook.

- We grew revenues 18%: our seventh consecutive quarter of year-over-year, double-digit sales growth.
- The revenue growth was broad and balanced. This is important to achieving sustainable revenue growth. From an end market viewpoint, Industrial was particularly strong during the quarter.
- Our gross profit increased substantially: $911 million, up 24% year over year.
- Our gross margin was 40.2%: increasing 190 basis points year-over-year, largely driven by improved manufacturing efficiency and by a favorable mix shift toward higher value products.

- Operating expenses were $622 million: above our expectations mainly due to one-time, non-recurrent items that were not embedded in our Q2 expected range.
- Importantly, our sales growth translated into operating leverage, driving expansion of our operating income, margin and net income. ST's operating income increased 60% to $289 million, our operating margin improved 330 basis points to 12.7% and our net income increased 73% to $261 million.

Turning to our cash and investments, our profitable growth is driving improvements in our net cash from operating activities, with an increase of over 36% on a trailing twelve months' basis. For the quarter, net cash from operating activities was $360 million.

Free cash flow was negative $40 million in Q2 mainly due to:

- A high level of capex in the quarter above the annual run-rate of our expected 2018 CAPEX range of between $1.2 and $1.3 billion.
- Change in working capital mainly due to inventory increase to support demand in Q3.

We expect to return to a positive free cash flow for the third and fourth quarters and, for 2018, to generate free cash flow well above the dividend paid during the year. Our goal is to exit 2018 with a higher net cash position compared to 2017.

Let's move to our Product Groups' performance, starting with Automotive and Discrete.

During the second quarter, ADG revenues increased 15.2% year-over-year on double-digit growth for both Automotive and Power Discrete. Operating profit increased by 28.8% to $84 million and operating margin increased to 9.7% from 8.7%.

On a sequential basis, ADG revenues increased 6.5%. Revenue growth did not immediately translate into an improvement in operating profit and margin during the second quarter. This is mainly due to some temporary manufacturing inefficiencies and extra costs in the supply chain.

In terms of ADG's operating margin looking forward, we confirm that these will be in the low teens for the second half of 2018.

Turning to the Microcontrollers and Digital ICs Group, MDG posted a strong year-over-year increase, with revenues up almost 28%. This double-digit sales growth came from both microcontrollers and digital ICs. In terms of profitability, MDG's operating margin increased sharply year-over-year to 20.3% from 11.7%.

On a sequential basis, MDG's revenues increased 4.3% and its operating margin also expanded.

Our Microcontroller business remained the main driver of operating profitability. The Digital business contributed to the operating margin improvements on a sequential and year-over-year basis.

We confirm that MDG's operating margin will be about 20% for the second half of 2018.

Finally, Analog, MEMS and Sensors. AMS revenues increased 10.7% year-over-year on double-digit growth for both Imaging and Analog. In terms of profitability, AMS operating margin increased to 10.5% from 9.4%.

On a sequential basis, AMS revenues decreased 6.4%, as anticipated, on lower smartphone activity. Analog and MEMS revenues posted sequential increases. The improved product mix led to sequential operating margin progression.

For AMS we anticipate second half operating margins to move into the mid-teens as we benefit from revenue leverage, specifically from smartphone applications.

Let’s now discuss how this performance translated in new business and product leadership across the end markets we serve.

In Automotive we serve most of the electronic applications in the car, with a particular focus on car electrification and autonomous driving. In car electrification, during Q2 we continued to expand the design win pipeline for our Silicon Carbide products and we achieved an important galvanic isolation technology design win for an electric vehicle. Galvanic isolation is one of the focus areas for us in expanding our portfolio of differentiated, high-value products for Industrial and Automotive.

We also continued to win business in more traditional automotive application areas like braking, engine management and body control.

Industrial is a very broad area for us with many customers and many different applications. Here we focus on Smart Industry, where we build on our leading position in general purpose 32-bit microcontrollers and on our portfolio of power, analog, sensors and connectivity products. We also deploy our system solution expertise to deliver multiple products and complete solutions. Some examples this quarter include awards for a satellite tolling module and a custom powerline modem.

Moving to Personal Electronics. Our main focus here is on smartphones. In Q2, we expanded our reach with customers in particular in Asia. We had design wins for time of flight sensors, touchscreen controllers, motion sensors, and protection devices. We also won a design with our STM32 microcontrollers at a key Japanese OEM for high definition televisions. This is an expansion for us into a new market that was traditionally difficult to penetrate.

In Communications Equipment, Computers & Peripherals we are leveraging our in-house processes in a number of focused application areas. Examples this quarter are a design for fiber optics infrastructure with our BiCMOS process, that is optimized for high-frequency communications applications, and an ASIC design for 5G infrastructure with a Silicon-On-Insulator process that meets the latest cellular RF requirements.

Let’s conclude with our Q3 guidance: we expect revenues to increase about 10% at the mid-point on a sequential basis. This would represent year-over-year growth of about 16.8%.

By End Market, in Q3 we expect sequential strong growth in Personal Electronics. We also anticipate solid growth in Automotive, despite the fact that we would normally see some seasonality here. We are expecting normal seasonality for Industrial.

By Products, we expect sequential revenue growth to be driven by Imaging, Automotive and Power Discrete. We anticipate normal seasonality in Analog and Microcontrollers.

We anticipate a third quarter gross margin at about 40.0%. This is in line with our communication at our Capital Markets Day that in the second half of 2018, we see revenue growth as the main positive driver for the gross margin substantially offset by the product mix evolution.

As a result, we expect to maintain our current level of gross margin, which will drive gross profit increases in line with revenue growth.

Adding together the different ingredients, including OPEX discipline, we expect to continue to make steady year-over-year progress at the gross profit, operating profit and net income levels.

So, I would like to re-confirm our top priority: deliver our 2018 objective of making another step forward in terms of year-over-year revenue growth and profitability.

Overall, we are on track with the goals set at our Capital Markets Day in May:

- Grow 2018 revenues between about 14% to 17% versus 2017.
- And in the second half of 2018:
  - ADG operating margin to be in the low-teens
  - AMS operating margin to be in the mid-teens
  - MDG operating margin to be about 20%

We are also on track with our longer term goal of sustainable, profitable growth, to continue to create shareholder value and to make ST an even stronger player in the semiconductor industry.

We are now happy to answer your questions.