Q313 Earnings Conference Call Remarks – Final
Wednesday, October 23, 2013
Carlo Bozotti, President and Chief Executive Officer

I would like to thank everyone for joining today's call.

Our financial performance in the third quarter was mixed, and was a direct reflection of the changing demand in the semiconductor market which has clearly slowed. We posted progress in the third quarter towards our business and financial goals although somewhat less than what we had envisioned.

So, let me first discuss the changes we saw in the semiconductor market environment and then move to our third quarter financial results in more detail.

In the market, on the one hand, we experienced a few negative developments in the third quarter. In Asia, there was a softening of demand specifically impacting the mass market and across many applications with the exception of automotive.

In addition, within the Asian cellular phone market, feature phones and mid-tier smartphones outpaced the high-end leading to a much less favorable product mix.

And finally, in India the demand for our cable set-top box solution was reduced due to the postponement of the country's Cable Digitalization program.

On the other hand, point of sales in distribution remained solid in all regions and our inventory position in the channel is healthy. Furthermore, automotive products demand continues to be strong across the portfolio; in powertrain, body, safety and infotainment and in all regions.

Let’s move now to our sales results, where third quarter net revenues were $2.01 billion and net revenues excluding Wireless product line totaled $1.88 billion. Based upon available WSTS market data, we believe our year over year growth of 3.9% excluding ST-Ericsson products will outperform our served market thanks to growth in Imaging, Microcontrollers, MEMS and Automotive. On a sequential basis, net revenues excluding ST-Ericsson products also slightly increased driven by the performance of the same key product families I just mentioned.

Operating income before impairment and restructuring charges in the third quarter was a $54 million profit, improving by $118 million on a sequential basis. This was due in large part to the sale of ST-Ericsson’s Global Navigation Satellite System business along with significantly lower operating expenses.

Now, let me move to our two product segments.

Within our Sense & Power and Automotive product segment, net revenues were stable quarter to quarter. Automotive and MEMS increased slightly and we anticipate further strength in the fourth quarter benefiting from both increased volume and penetration of our products. Industrial and power products experienced lower volumes than expected due to the current market dynamics. Importantly, overall in SP&A we saw a progression in the operating margin to 6.2% from 3.5% in the prior quarter on higher gross margin and lower operating expenses.

Turning to our Embedded Processing Solutions segment, revenues decreased sequentially. The decline in Wireless was significant, but lower than expected. In Set-top box, sales decreased as well, however, we are encouraged by the traction at our customers and design wins with our new products and technologies. The growth in Imaging and Microcontrollers was significant.

Embedded Processing Solutions' operating loss was negative $18 million. Excluding the $75 million gain from the sale of assets, mainly the ST-Ericsson GNSS business, EPS's operating margin improved 130 basis points to negative 11.5% on reduced operating expenses.

Turning to the gross margin, we had a sequential decrease of 40 basis points to 32.4%. This decline principally relates to a negative mix effect with a higher weight of legacy ST-Ericsson products combined with lower than expected sales of products from our core businesses.

Moving to our inventory, the total stood at $1.32 billion, a decrease of about $20 million from the second quarter. Our inventory turns remained at a good level at 4.1 turns or 88 days, so stable quarter to quarter.

With respect to our capital expenditures we invested $166 million, net in the third quarter and about $400 million year-to-date. We anticipate a much reduced level in the fourth quarter, so we are now on track to spend about $500 million in 2013, which is well within our targeted capex to sales ratio of 10% or below.

At the end of the third quarter, ST's liquidity was $1.53 billion and we had a net cash position of $739 million. Based on this solid financial position, the resolution to distribute a cash dividend of US$0.10 per outstanding common share for the fourth quarter of 2013 and first quarter of 2014 has been submitted for shareholder adoption at the Extraordinary General Meeting of Shareholders to be held in December.

We have a number of highlights to share with you this quarter which illustrate the positive momentum we continue to have with design wins and new product launches. In addition, with the completion of the transaction to split up ST-Ericsson, we are strengthening our product development in key areas where we see important customer expansion opportunities including embedded processing, RF, analog and power.

In **microcontrollers** we achieved **record billings** driven by general purpose devices. We ramped production of our STM32 for Samsung's latest wearable device and smartphone; earned a number of sockets for other wearable devices as well as a socket in a new generation of fitness products from a leading brand.

Moreover, in secure microcontrollers, we earned the Secure Element in the showcase smartphone from a major OEM and we achieved Bank-Card Test Center certification for our secure microcontroller for Dual Interface Banking in China.

In **power and smart power products** we won significant business with two new custom chips with extended lifetimes from major European automation companies, as well as another for a dedicated power supply for utilities metering.

Moving to our **imaging** business, during Q3 we started deliveries of a new dedicated Image Signal Processor to a leading consumer brand and, in our diversification effort, we sampled a new Image Signal Processor and image-sensor combo chip to a leading automotive supplier for safety applications.

In **our set-top-box and home gateway business**, we launched in Amsterdam this September at IBC our new ARM-based 28nm devices that support Ultra-HD and HEVC video-decoding. These products are ideally suited for client-box (our Cannes family) and home server (the Monaco family) applications and we have already achieved a major design win with a Tier 1 operator.

At the same time we continue to demonstrate strong momentum with our low-power, high-performance FD-SOI technology with **7 design wins to date** and a sustained high level of customer interest.

Turning now to our **analog, MEMS and sensors products,** in Q3 we started high-volume production of our latest gyroscope and digital microphone for a major consumer-electronics manufacturer. We launched a new family of gyroscopes specifically optimized for image stabilization in mobile phones and cameras, and we earned a design win for a new environmental sensor from a leading Chinese Smartphone manufacturer.

We are also working on **smart sensor systems**. In Q3 we launched mass production of one of them, – the combination of an accelerometer, a gyro, and a microprocessor – for a handheld gaming system from a major consumer manufacturer. This kind of integrated solution is something we see playing a growing role in the deployment of the Internet of Things.

We are also working on the connectivity needed by smart connected things and began sampling the industry’s most energy-efficient Bluetooth 4.0 network processor for smart applications.

Finally, let me conclude with our **Automotive business.** We won a socket in a body gateway and control system, and one within a transmission system from leading European automotive equipment manufacturers. We also earned major awards from multiple suppliers in Europe and Korea for our successful car lighting products. And in car infotainment we won the new-generation BaseBand chip for Digital Satellite Broadcasting at Sirius/XM satellite radio for North American applications.

So, to conclude on products, I believe our progress and momentum continues.

Now let me move to our fourth quarter outlook. Based on the more muted environment we saw in the third quarter, we anticipate a relatively flat sequential revenue performance.

From a gross margin perspective, we anticipate some positive sequential progression as we expect to be at about 33% at the mid-point, positively impacted by manufacturing efficiencies and negatively impacted by about 1 point for currency and unused capacity charges.

Turning to our cash flow, we expect to generate a substantially positive free cash flow in the fourth quarter and of course, it will continue to be a top priority in 2014.

We continue to aggressively pursue our objective to reach an operating margin of about 10 percent. Our initiatives to reduce costs, such as achieving our net operating expenses target, and improving our manufacturing, are on track. However, the timing for us to achieve our operating margin target will depend greatly on our level of revenues. Based on current visibility including market conditions, reaching this operating margin target is now expected in mid-2015, about six months later than originally expected.

My colleagues and I are now ready to take your questions. Thank you.