STMicroelectronics
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Q3 2020 Financial Results
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Good morning and thank you for joining ST on our third quarter 2020 earnings conference call.

Let me begin with some opening comments.

Starting with Q3:

- As announced on October 1st, 2020, net revenues were $2.67 billion, up 27.8% on a sequential basis, above the high-end of our outlook range. This revenue performance was due to significantly better than expected market conditions throughout the quarter. Demand for Automotive products, our engaged customer programs in Personal Electronics, as well as Microcontrollers, were the main factors that contributed to this result.
- Gross margin, at 36.0%, included about 140 basis points of unsaturation charges.
- Our operating margin was 12.3% and our net income was $242 million.

For the first nine months:

- Net revenues grew 2.7% year-over-year to $6.98 billion, with an operating margin of 9.5% and a net income of $525 million.

Looking at Q4 2020:

- At the mid-point of our guidance, we expect net revenues to be about $2.99 billion, representing sequential growth of about 12.0% and gross margin to be about 38.5%, including about 70 basis points of unsaturation charges.

For the full year 2020:

- We now expect net revenues of about $9.97 billion at the mid-point of our Q420 guidance, translating into 4.3% year-over-year growth, and with a double-digit operating margin performance.
- Our CAPEX plan for 2020 is unchanged at $1.2 billion. Year-to-date we have invested $897 million.

Now, let's move to a detailed financial review of the third quarter.

During Q3 market conditions improved progressively versus expectations. In early September we communicated that net revenues would come in above the mid-point of our Q3 guidance and, as we pre-announced on October 1st, net revenues came in 690 basis points above the high end of our outlook range.

Net revenues increased 4.4% year-over-year, with higher sales in Microcontrollers, RF Communications, MEMS and Analog, partially offset by lower sales of Automotive, Imaging and Power Discrete. Year-over-year sales to OEMs increased 7.5% and sales to Distribution decreased 3.4%.

On a sequential basis, net revenues increased 27.8% and all product groups grew revenues double-digit.

Our gross profit was $959 million, a decrease of 0.8% year-over-year.

Our third quarter gross margin at 36% came in at the mid-point of our guidance, decreasing 190 basis points year-over-year mainly due to price pressure and unsaturation charges. Unsaturation charges were about 140 basis points.

Moving to operating expenses, we continued to manage them. In parallel, we continued to execute on our R&D, sales and marketing programs and transformation initiatives. Net operating expenses, at $628 million, were below what we anticipated when entering the quarter.

Our third quarter operating margin was 12.3%, decreasing 80 basis points on a year-over-year basis. Both ADG and AMS operating margins decreased, while MDG operating margin improved.

Our net income decreased to $242 million and EPS to $0.26 compared to $302 million and $0.34 per share, respectively, in the year-ago quarter.

Turning now to the revenue performance of the product groups on a year-over-year basis:

- ADG revenues decreased 4.9% on weaker demand in legacy Automotive and in Power Discrete;
  while
- AMS revenues increased 3.0%, with MEMS and Analog higher, while Imaging sales were lower.
- MDG revenues increased 18.6%, reflecting double-digit growth in both Microcontrollers and RF Communications.

In terms of operating margin by product group on a year-over-year basis:

- MDG operating margin increased to 17.4% compared to 15.7%; while
- ADG operating margin decreased to 5.8% from 8.5%.
- and AMS operating margin decreased to 17.5% compared to 20.5%.

Net cash from operating activities decreased 10.3% to $385 million in Q3, compared to $429 million in the year-ago period.

CAPEX was $319 million in the quarter, compared to $244 million in the year-ago period.

After the cash outflow of $76 million for acquisitions to further strengthen the Company's wireless connectivity capabilities, and $33 million of accreted interest paid to settle the 2022 Tranche A of the convertible bond issued in 2017, free cash flow was negative $25 million in the third quarter, compared to positive $170 million in the year-ago quarter.

In Q3 we paid cash dividends totaling $38 million.

During the quarter, ST exercised the call option for the early redemption of its $750 million 2022 Tranche A of the convertible bond issued in 2017. Simultaneously with the exercise of the call option, ST issued a new $1.5 billion dual-tranche senior unsecured convertible bond due 2025 and 2027.

Let's now discuss the market and business dynamics.

In Automotive, global demand picked up faster than what we were expecting in July. This acceleration was driven by car production volumes, which continued to increase in China and South Korea and restarting faster than expected in Europe and in the US.

Importantly, during Q3 we saw a progressive acceleration of key trends driving the increase in semiconductor content per car: electrification and digitalization, our strategic focus areas.

In car electrification, the latest 2020 market estimates for hybrid and electric vehicle production are for about 7 million and 2 million vehicles, respectively. Also, in car digitalization the trend is positive, although with a different mix: the pandemic may delay Level 4 and Level 5 ADAS deployment, but demand is clearly accelerating on Level 2 and Level 2+.

These dynamics are visible in our achievements during the quarter.

In car electrification, we had again a number of new design wins for Silicon Carbide MOSFETs – in applications such as on-board chargers for electric vehicles. We also won a number of sockets with complementary technologies such as our MDmesh™ MOSFETs for a Battery Management System, low-voltage transistors in an Integrated Belt Starter Generator, VIPower™ products for a body-electrification platform and with Ultrafast and Silicon Carbide Diodes.

Overall, our Silicon Carbide engagement with customers has increased again during the quarter. As of today, we are engaged with 60 customers in 68 ongoing programs. We are extending our reach with EV carmakers, with important production starts in Asia during the quarter.

You will hear more during the ADG session of our Capital Markets Day on November 6th.

In car digitalization, we are focused on technologies and solutions for driver assistance and autonomous driving, V2X communications, and embedded processing solutions supporting new car architectures.

Here we won a power-supply platform designed for ADAS applications with multiple Asian manufacturers, and a design for a digital output tuner for a software defined radio. As mentioned, we are seeing an acceleration trend on Level 2 and Level 2+, where we have already delivered, together with our partner Intel-Mobileye, over 50 million vision processing chips to the market in the past 5 years.

With our 32-bit Automotive MCU embedded processing solutions we won designs in a keyless access-control application and in an integrated communication solution. We also had additional awards for our 28nm Phase Change Memory microcontrollers (Stellar) which support the evolution of car architectures. We recently announced further details on our Stellar MCUs to show how the devices ensure execution of multiple independent real-time applications. ST has developed this new technology with Bosch to meet future OEM integration demands.

To conclude this automotive overview, I would like to mention that we also expanded our sensor business with automotive-grade motion sensors and accelerometers for key fob applications.

Moving now to Industrial.

The industrial market dynamics remained mixed but gradually improved during the quarter. This trend was visible across all geographies. Demand was strong for power tools and home appliance applications. We continued to see positive dynamics in power-related applications, motion control and factory automation -all of which are focus areas for ST.

Distribution is an important element of our go-to-market strategy in Industrial. Here, the improvement of the situation in the channel is accelerating. In Asia, point-of-sales trends remained strong, up sequentially and year-over-year, with healthy levels of inventory in our distribution channel across all product families. In the Americas and Europe, recovery is ongoing with point-of-sales up sequentially. Here also inventory is back to healthy levels across all product families.

We address the industrial end market with our general purpose and secure MCUs, analog and sensors, power and energy management solutions.

One of our strategic objectives in Industrial is leadership in embedded processing solutions. Last month we held the first module of our 2020 Capital Markets Day covering MDG. In the presentation we detailed how we are strengthening our embedded processing offer around the STM32 family in terms of wireless connectivity, security, and artificial intelligence.

During the quarter we had several announcements supporting this strategy, including acquisitions of Riot Micro and BeSpoon to further strengthen wireless connectivity, machine learning tools from a partner to support AI deployment, and higher performance top end microcontrollers.

In addition, last week we announced the acquisition of SOMOS Semiconductor, a power amplifier and RF Front-End-Module specialist. With this latest move, we are reinforcing our ability to play a major role in RF Front-End Modules for the IoT connectivity market and we strengthen our RF front-end roadmap for 5G.

Another strategic objective is to accelerate our growth in analog and sensors for industrial. In Q3, we won several new designs with our analog products for industrial applications. For example, we received awards for a new smart metering platform, as well as in motion control and automation with our STSPIN product which integrates an STM32 microcontroller. We also continued to expand our business in industrial sensors with wins for our inclinometer with a number of large players.

A third objective for us is expansion in industrial power and energy management. Here we captured many wins with our power discrete products: Silicon Carbide and high voltage silicon MOSFETs, IGBT, triacs, diodes and Intelligent Power Modules.

These wins were for customers in applications such as power supplies, air conditioning, metering, home appliance, power tools, solar pumps, and motor control.

Moving now to the Personal Electronics market. In Q3, there was a strong restart of consumer demand for smartphones accompanied by steady growth in wearables, tablets, hearables and game consoles. This was driven in part by the “stay-at-home” effect and by consumer demand for health and fitness devices.

In Personal Electronics we have two strategic objectives. First, to lead in selected high-volume smartphone applications with differentiated products or custom solutions. Here we continued to have success with multiple wins in flagship devices with Time-of-Flight ranging sensors, motion sensors for image stabilization, wireless charging products, touch display controllers, and secure solutions such as eSIM and secure elements with Near Field Communication.

I would like to give you more detail on one win I mentioned last quarter. I can now confirm it is the Samsung Galaxy Note20 Ultra smartphone which uses ST’s multi-zone direct Time-of-Flight sensor. Also, both the Note 20 and Note 20 Ultra include our MEMS pressure sensors, inertial measurement units, and EEPROMs.

Our second objective is to leverage our broad portfolio to address high-volume applications such as True Wireless Stereo headsets, smart watches, bracelets and gaming devices. Here we had wins for sensors, analog and power products as well as microcontrollers. It is worth mentioning that we shipped a record number of MEMS sensors during the quarter.

We also launched the Laser Scanning for Augmented Reality (LaSAR) Alliance as an ecosystem to accelerate the development of augmented-reality eyewear applications. We see this as another potential high-volume application.

In Communications Equipment and Computer Peripherals, during the quarter we continued to see growing demand for homeworking-related products, while the demand for hard-disk drives was softer.

Our approach to this end market has three objectives. One is to address selected applications in cellular and satellite communication infrastructure. Here I would like to mention a win we had with a new Gallium Nitride (GaN) based-product in a communication infrastructure application. This was based on our new MasterGaN smart power product which combines a driver and GaN FETs.

In this area we also captured multiple RF-CMOS ASICs awards, an award for our new STM32 Microprocessor and awards for our STM32 microcontrollers for 5G infrastructure.

Our other objectives are to address selected high-volume applications with differentiated products or custom solutions, while leveraging our broad portfolio. Here I would like to mention wins with our FlightSense™ products, motion sensors and electronic fuses in personal computers and hard disks.

Now, let’s move to a discussion of the fourth quarter and brief comments on the full year 2020.

In the fourth quarter we expect net revenues to be about $2.99 billion. This sequential revenue growth of about 12.0% at the mid-point is expected to be driven by all product groups, except the RF Communications sub-group. Gross margin is expected to be about 38.5%, including about 70 basis points of unsaturation charges.

For the full year, we now expect net revenues at the mid-point to be about $9.97 billion, translating into 4.3% year-over-year growth. Based upon this updated plan, we expect to report a double-digit operating margin performance. We are maintaining our CAPEX plan for 2020 at about $1.2 billion.

Before concluding let me remind you of the upcoming Virtual Capital Markets Day which we are conducting through four modules. We held our first module, on MDG, on September 15th. Thank you for attending that session.

The three upcoming modules are:

- ADG – November 6th
- AMS – November 20th
- Overall Strategic update – December 9th

To conclude, I would like to reinforce two key points:

First, in response to the global COVID-19 pandemic, we will continue to ensure both the ongoing health and safety of our employees and continuity of our business operations for our customers. These priorities remain of upmost importance for us.

Second, ST fundamentals are solid. The strategic decisions which we made years ago stem from secular, growing market trends addressing key societal needs. The underlying principles of our strategy have not changed, and we remain determined to continue to make ST stronger, executing our sales and operating plan and outperforming the markets we serve.

Thank you, and we are now ready to answer your questions.