Q413 Earnings Conference Call Remarks – FINAL
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I would like to thank everyone for joining today's call and to those of you who also joined us earlier today at our year-end earnings presentation in Paris.

Turning first to our fourth quarter results, revenue and gross margin were well in line with the outlook we shared with you entering the quarter. In fact, all key metrics were well in line with our expectations including a positive operating income before impairment and restructuring charges of $18 million and a substantial positive free cash flow of about $90 million in the fourth quarter.

Moving to the full year 2013, it was a year of execution. We made solid progress in executing the strategy that we announced in December 2012. Of course we still have much to accomplish but let me share a few highlights of the year.

First, with respect to ST-Ericsson, we accomplished our major goals. We exited ST-Ericsson as planned, from a timing perspective, with the split-up of the joint venture completed in August. From a cost perspective, we managed the ST-Ericsson exit at lower costs than our original and revised-down estimates. Currently, we estimate our remaining wind-down costs to be about $30 to $40 million. As a result of the split-up, we added some of their competencies and strengthened our product development teams across every product group. The transfer of resources is starting to deliver a wave of new products that I will discuss more in detail shortly.

Second, looking at the year in total, ST excluding ST-Ericsson grew 3.2% - while the market that we serve actually declined by about 1.7%. This is good news, although we must also say that the overall market declined and evolved worse than we were expecting based on industry analysis this did slow the progress at our top-line and gross margin that we had been planning.

Third, our operating expenses have come down substantially along the year. Exiting 2013, we have successfully lowered the breakeven point of the company by over $400 million compared to the fourth quarter of 2012 to a breakeven point in the range of $2 billion of revenues per quarter now. This is thanks to significantly lower operating expenses mainly due, not exclusively, to the exit from ST-Ericsson. The improvement was progressive as we generated non-GAAP profit of $18 million in the fourth quarter of 2013 compared to losses of $66 million and $100 million, in the fourth quarter of 2012 and first quarter of 2013, respectively. This represents a significant improvement when considering the material reduction of $641 million in revenue contribution from the former ST-Ericsson products in 2013.

In addition, we entered our target quarterly net operating expense model range of $600 to $650 million in the fourth quarter of 2013. So one quarter ahead of our plan. I can share that we are now targeting the lower end of this range to adjust to lower than expected revenues following the softening of our markets.

Also, we signed a key frame agreement with the French government to support our research and development work for CMOS derivative technologies called the Nano 2017 program. We anticipate the significant R&D grants to become effective during the first quarter of 2014 pending European Union clearance. As a reminder, the R&D grants are part of our net operating expense model range target.

Fourth, in 2013 we initiated gradual structural changes to our manufacturing footprint which in combination with the other execution initiatives are designed to improve progressively our gross margin to a target range of 36 to 38%. I will spend more time on this later.

As we had signaled in October, we slowed capital expenditures in the fourth quarter bringing us to a total investment level of $531 million for 2013. This represents a capital investment to sales ratio of 6.6%.

ST has maintained a strong financial position and solid capital structure, despite the poor free cash flow in 2013. Our net cash balance was $741 million exiting the year and after the distribution of 40 cents per share, or $346 million in dividends, to shareholders. At our Extraordinary meeting of shareholders in December a dividend of 10 cents per share, to be paid in the first quarter of 2014 was approved. While the dividend is subject to the decision of the Supervisory Board of ST on a semi-annual resolution, management considers the dividend as an important vehicle in returning wealth to shareholders.

Turning to our two product segments, in 2013, Sense & Power and Automotive revenues increased 3.3% year over year led by Automotive and Industrial and Power Discrete. Operating margin decreased to 5.7% compared to 8.8% in 2012 principally due to increased R&D efforts.

Moving to our Embedded Processing Solutions segment it is clear we have a steep curve ahead of us to an acceptable financial performance level as revenues decreased 14.6% compared to 2012. As I mentioned it has been a difficult challenge to replace the revenues lost due to the wind down of ST-Ericsson. However, we started to show some initial positive signs exiting the year. Excluding ST-Ericsson legacy products, revenues for EPS increased 3.4% year over year mainly thanks to the growth in Microcontrollers. While DCG sales are lower, we see the potential for a significant turnaround starting in the second half of 2014 and with substantial growth in revenues by 2015 as I will discuss later in my remarks. From an operating loss perspective, we have brought this down significantly to a negative 12.2% from negative 23.1% in 2012.

Now let's turn to a discussion of our products and key revenue drivers for 2014 and 2015 as we move quarter to quarter towards our operating performance objective.

Beginning first with Embedded Processing Solutions and our digital consumer group:

2013 has been an critical year for our **set-top-box and home gateway business**. Our revenues dropped much more than expected due to legacy products phasing out faster than expected and weakness in certain markets. During the year we put in place the foundations for a turnaround and we are encouraged by the important design wins, including the size and dimension of the projects, and traction with worldwide operators. The feedback we received from customers at the Consumer Electronics Show a couple of weeks ago was very positive and supportive of our growth goals.

First, our early investment in ARM is now paying off, allowing us to create industry leading products such as our new Client & Server portfolio for Ultra HD. We have seen strong traction and early customer adoption for this family with multiple design wins – of which 5 in Q4 alone, including the US cable market.

Second, we advanced our plans for the US market with DOCSIS 3.0 certification for cable-data gateway and interactive set-top box products.

And third, our unique FD-SOI technology is well on the way to become a significant revenue generator for 2015 with a total of 15 active designs, including multiple design wins for custom chips for networking and consumer.

These achievements give us a solid basis for the turnaround of this business, which targets to double revenues by Q4 2015 in two waves. The first wave, with high volume deployment of our 40nm chips for broadcast set-top box, and further market penetration of our custom chips for networking. Then, in the second half of 2014, with the new Client and Server and Home Gateway portfolio and the start of production for our FD-SOI design wins.

In **imaging,** we are working hard to diversify our portfolio. This year we will deploy a new generation of Image Processors and ramp up production of our proximity sensors. We also expect to continue our strong momentum in Silicon Photonics while generating business with our RF-SOI technology for cellular and WiFi systems.

In Microcontrollers our 32-bit products, including general purpose and secure MCU, almost doubled in 2013 compared to 2012 to over $600 million in sales. We will continue to pursue our successful expansion strategy by broadening the STM32 microcontroller family for both cost-effective and higher-performance and very low power applications.

In secure microcontrollers, we will ramp our products for Banking in Asia and introduce a new contactless chip with embedded memory for the ID and Banking markets.

Moving now to **MEMS and Sensors**. there is a major diversification effort in place towards applications beyond mobile.

This year we will continue to grow our business in high-performance products, ramp production of our new smart sensor family for mobile and wearable devices, and start production of high-performance touch screen controllers with hovering function.

Moving now to **power and smart power management products,** this year we expect significant growth to be supported by the overall macro economic improvement, in particular in industrial and housing.

We will benefit from the investments made during 2013 with the launch of promising new power management products, including an expansion to the server market thanks to the additional competencies we took on board from ST-Ericsson. We will also ramp up production of our design wins in smartphones & tablets.

Last but not the least, our **Automotive** business –that has contributed strongly to growth in 2013, with solid performance across all applications thanks to the continuously increasing semiconductor content in cars.

Looking to **this year,** we see two main revenue growth drivers. First, our ability to support the development of full automotive systems will enable us to reach a broader customer base. And second, we expect to continue to gain market share in 32-bit automotive-grade microcontrollers, with a doubling of our revenue.

We will also ramp up production of products in leading-edge technologies and will continue to focus on higher-margin products such as those for Infotainment, Active Safety and Positioning.

Now let me move to our 2014 expectations and our specific outlook for the first quarter.

We believe 2014 will be a year of market expansion based upon the various economic and industry data. Currently, WSTS anticipates our SAM, the market we serve, to grow by 4.2% in 2014. We are encouraged by our product leadership in Sense, Power & Automotive and Embedded Processing Solutions and we expect to capture opportunities that will enable us to grow faster than our served markets from our product portfolio as well as from our initiatives to expand our customer base and sales channels.

In the first quarter, we expect overall revenues to decrease sequentially by about 9.5% plus or minus 3.5%. First quarter revenues reflect, on top of seasonality, a substantial decrease of ST-Ericsson legacy products on the order of more than 50% compared to its sales of $133 million in the fourth quarter.

Based upon this revenue range, we expect the gross margin to be about 32.4% plus or minus 2 percentage points, and impacted by sub-optimal loading of the fabs.

Finally, let me share how we see our progress towards our target operating model goals advancing during 2014.

- First, we have already reached our quarterly net operating expense target range of $600-$650 million one quarter early. Net operating expense in the fourth quarter was $628 million, net of $28 million of R&D grants. We are now targeting the lower end of our range.
- Second, we expect to see continued solid performance across a number of product families all along the year. We reconfirm our long-term growth will be driven by the five growth drivers of Microcontrollers, MEMS and Sensors, Automotive, Digital Consumer and ASICs and Smart Power. For example, we expect two waves of new products to drive the doubling of DCG revenues from Q413 to Q415. That revenue ramp will start to show traction in the second half of 2014.
- Third, gross margin is currently at 32.9% so we need about 4 points to reach our financial model. The increase is targeted to come from:

- The phase-out of the former ST-Ericsson products will contribute over 1 point, with the revenues to be replaced by innovative products in EPS and SP&A;
- The ongoing manufacturing initiatives for another point;
- The product pruning associated with lower capacity in mature technologies of about 1 to 1.5 points;
- And finally, the technology evolution, better loading in 8" and 12" and assembly for another couple of points.

Of course we will need to manage the price erosion, net of product mix innovation, which is typical of the semiconductor industry.

While a number of parameters like the performance of the semiconductor industry and currency exchange are outside of our control, we expect to achieve our operating margin target in mid-2015. If we see changes in the environment or traction of products we are prepared to take a combination of actions to reach and to keep the track to timely deliver our financial objectives.

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