Carlo Bozotti, President and Chief Executive Officer, STMicroelectronics:
Q2 2017 Earnings Results
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Thank you for joining us on our Second Quarter and First Half earnings' conference call. Our agenda today includes an overview, followed by a detailed discussion of our results by product group, our outlook for the third quarter, and our ambitions for the second half overall.

Before beginning, I want to welcome our Deputy CEO Jean-Marc Chery to his new role, which officially started on July 2nd. I look forward to working even more closely with Jean-Marc and with our strong executive team to continue to deliver sustainable and profitable growth.

Let's start now with our financial review. As you have seen, we are putting together quarters of successive improvement in our financial results. The second quarter delivered further improvement, with strong sequential and year-over-year revenue growth, and with operating income and net income following the same trajectory.

- Revenues increased 5.6% sequentially, a better than seasonal performance and 60 basis points above the mid-point of our guidance. On a year-over-year basis, revenues increased 12.9%, with growth coming from all product groups and sales channels. In the Internet of Things and smartphones, we continue to win business with our complete portfolio of microcontrollers, sensors, analog and power management, connectivity and secure solutions. In IoT, our distribution channel plays a key role, with point-of-sales in the second quarter growing 13% year-over-year. Distribution represented 34% of our revenues in Q2.

In Smart Driving, we continue to capture opportunities both with products developed in our Automotive and Discrete Group, as well as with products -such as sensors and general purpose analog- which are developed by other Groups and fit the needs of automotive customers. With our present visibility, we expect our overall automotive business to grow by about 10% in 2017.

For the first half of 2017, ST's total revenues were $3.74 billion, up 12.9%.

- Gross margin was 38.3% in the second quarter, 20 basis points above the mid-point of our range. On a sequential basis, gross margin increased by 70 basis points, positively impacted by favorable product mix and manufacturing efficiencies, partially offset by price erosion.

On a year-over-year basis, gross margin increased by 440 basis points, reflecting manufacturing efficiencies, improved fab loading and favorable product mix, partially offset by normal price pressure.

- Operating income before impairment and restructuring charges increased to $184 million, representing an operating margin of 9.6%, thanks to our product and profit initiatives driving operating leverage, better product mix and manufacturing efficiencies. On a sequential and year-over-year basis, operating income before impairment and restructuring charges increased by $50 million and $144 million, respectively.

- Net income in the second quarter was up sharply to $151 million, representing a sequential improvement of $43 million and, on a year-over-year basis, a swing of $128 million. First half 2017 net income totaled $258 million.

- Free cash flow was $52 million in the second quarter and $113 million for the First Half. This means that we can support our higher level of capital investments in 2017 from our improved cash flow from operations.

- Exiting the second quarter our net financial position was $524 million, slightly up from the first quarter and higher by $98 million compared to one year ago, after having distributed $207 million in dividends.

- To strengthen our capital structure and further enhance our financial flexibility, in July we raised $1.5 billion at an overall zero cost, through a convertible bond offering. Additionally, the combination of the net share settlement option and the on-going repurchase of the underlying shares implies substantially no dilution at conversion to shareholders. Proceeds from the issuance of the bonds will be used for general corporate purposes, including support for growth and the redemption of our 2019 and 2021 convertible bonds.

Now let's move to a detailed review of our product groups beginning with Automotive and Discrete (ADG).

ADG revenues grew 6.6% sequentially, performing better than the Company average, and grew 4.7% in comparison to the year-ago quarter. ADG's operating income and operating margin improved sequentially, driving ADG's second quarter operating margin to 8.6%.

For the first half, ADG's revenues increased 5.1%, with its operating income up slightly and the operating margin substantially stable at 7.1%.

Looking at our product portfolio for Automotive, we see the increasing silicon content of the latest generation of cars reflected in the number of ST components present in new models. For example, in the new Audi A8 we estimate that we will contribute up to 1000 components, coming from all areas of our broad automotive portfolio.

With our focus on technologies and solutions enabling greener driving, we won important design wins related to car electrification. These included wins for SiC MOSFETs, high-temperature silicon-controlled rectifiers and ultrafast diodes from OEMs as well as from key Automotive suppliers. Semiconductor content for Hybrid and Electric Vehicles is growing fast, and we see the potential for over 50 SiC dice in today's typical electric car.

We also had a number of design wins related to a more connected and safer driving experience, such as an important win for a new generation of airbag platform from a major car-safety technology leader. We also won audio-amplifier sockets with a Tier1 and we were selected as a partner by a German company for the development of a next-generation rear LED driver, targeting major global carmakers.

Moving to our power discrete business outside automotive, here we had design wins for high-voltage Super Junction devices for battery chargers with leading smartphone makers, wins with high-voltage IGBTs from many global leaders in home appliances, and wins with ultrafast series diodes at top air-conditioning makers.

In our Analog and MEMS Group (AMG), we saw strong revenue growth both sequentially and year-over-year. On a sequential basis, revenues increased 8.9%, driven by both analog and MEMS products. Year-over-year AMG's revenues were up 28.3% on sharply higher MEMS growth and strong growth in Analog. Similarly, AMG's second quarter operating margin saw strong sequential and year-over-year improvement, increasing to 14.5%, from 10.1% and 0.2% in the prior and year-ago quarters, respectively.
For the first half 2017, AMG's revenues increased 24.1%. Its operating margin saw a significant turnaround reaching 12.4%, up from break-even in the year-ago period.

Moving to AMG's products, our MEMS sensors achieved a number of important design wins across a diverse range of applications. These included motion sensors and magnetometers in PCs and tablets, motion sensors for bike applications in Asia and a 6-axis motion sensor for a top Chinese smartphone manufacturer. We also received first orders for waterproof pressure sensors for a smartwatch from a leading global brand and won sockets for pressure sensors in multiple applications, including drones and appliances. In addition, we enlarged our family of 10-year-longevity sensors with the introduction of a 6-axis module targeting Smart Industry applications.

In sensors for automotive telematics applications, we grew more than 30% year-over-year with customers across the globe.

In wireless connectivity, we launched a new System-On-Chip Bluetooth low-energy 5.0-certified and also won multiple designs for sub-GHz and Bluetooth Low Energy in a range of applications including wearable, smart home and smart building automation.

The performance of our Analog business was strong during the second quarter. We achieved record quarterly sales in Standard and High Performance Analog product families and we introduced new advanced Operational Amplifiers to reinforce our position both in Industrial and in Automotive.

Our STSPIN motor control family won numerous sockets globally for a broad range of Consumer and Industrial motor-control applications – including 3D printers, textile machines for smart factories, but also vacuum cleaners and fan controls.

Wireless charging has been an area of recent investment, and during the second quarter we landed a design win for fast, wireless-charging ICs in smartphones as well as introducing new multi-standard wireless charger ICs.

Now let me share some highlights on our Microcontrollers and Digital ICs Group (MDG), which has seen a strong overall improvement in operating results since the start of the year. On a sequential basis, MDG's revenues increased 3.3% and year-over-year were up 10% on double-digit growth of our general purpose microcontrollers, offset in part by lower digital IC sales including products undergoing a phase-out.

MDG's operating margin was 11.6% in the second quarter, showing sequential improvement and was up sharply compared to the year-ago quarter. On a year-over-year basis, this improvement reflects on the one hand our strong performance in microcontrollers, and on the other our restructuring initiatives, that have resulted in a substantial reduction of losses from digital ICs.

First half MDG results further demonstrate the significant progress we have made, with revenues increasing 10.7%, operating income up $126 million and its operating margin reaching 10.9% from 0.5% in the first half of 2016.

Our general purpose microcontrollers set another revenue record in the second quarter. To further strengthen the STM32 family product offer and ecosystem, we introduced new parts for the STM32L4 family with new features enabling advanced audio capabilities, as well as a new IoT Discovery kit to accelerate development of applications with direct connection to cloud services. We also increased our support for Smart Industry applications with a scalable industrial Ethernet platform through a cooperative effort with a German automation solution provider.

Moving to security, we started production of our latest high-performance NFC controller targeting consumer and mobile-security applications. We launched a new STPay dual-interface banking solution and announced a solution for IoT Security, based on STSAFE Trusted Platform Module, in cooperation with Security Platform Inc.

We gained wins for ST25D dynamic RFID tags in washing machines and for ST25R NFC reader ICs for point-of-sales terminals from major OEMs, while beginning production ramp of a 256k-bit EEPROM at a top sportswear brand. We also launched the ST25DV Dynamic NFC/RFID Tag expansion board for the STM32 Nucleo ecosystem.

In our custom silicon business we introduced the first European independent design platform dedicated to ASICs for space applications in low-power CMOS technology, in cooperation with the European Space Agency and the French space agency CNES. We also qualified a new FD-SOI digital ASIC for a key networking OEM and captured several design wins for optical ICs at a key sub-system manufacturer for applications in datacenters.

To complete the review of our products, let's now discuss our Imaging Product Division, which we report in "Others". As anticipated, Imaging revenues in the second quarter decreased slightly on a sequential basis to $68 million, while we prepare for the ramp of new programs.

On a year-over-year basis, Imaging revenues increased 60% in the second quarter, and for the first half 2017 rose 83% to $140 million driven by ST's innovative Time-of-Flight technology.

In the second quarter we continued to gain design-wins while delivering high volumes of our "FlightSense" Time-of-Flight proximity and ranging sensors to multiple smartphone OEMs. We now have reached cumulative shipments of over 300 million Time-of-Flight sensors and are in more than 80 smartphone models from 15 different OEMs.

Moving now to our third quarter guidance, we anticipate continued progress in revenue growth, improvement in our operating performance and higher net income. Bookings are strong across all product groups and regions and we continue to see healthy inventory levels and demand from our point-of-sales data.

Based on our current bookings activity and visibility, we expect third quarter revenues to increase about 9.0% on a sequential basis. This represents a year-over-year growth of about 16.6% at the mid-point of our guidance. We expect this growth to come from all of our businesses, regions and sales channels. For our three Product Groups, we anticipate revenue growth in the third quarter to reflect higher than normal seasonality.

In our Imaging business, we anticipate strong sequential growth, as the key new program ramps in Q3, followed by further revenue acceleration in the fourth quarter of this year.

Looking at 2017 overall and based on current visibility, we expect our revenues to be at the high-end of the range that we gave at the Capital

Markets Day (14% year-over-year revenue growth, plus or minus 1.5 percentage points).

Turning to gross margin, we anticipate further expansion in the third quarter to about 39.0% at the mid-point, leading to strong year-over-year improvement in operating and net income.

With respect to our 2017 free cash flow, we continue to anticipate it will substantially match the level of our dividend.

Additionally, let me share some more specifics on our capital investment plans for 2017. At our Capital Markets Day in May, we indicated we were reviewing our capital spending in 2017 above our initial plans of up to $1.1 billion. Based upon a combination of new products and higher customer demand, we now anticipate capital investments in 2017 to be in the range of about $1.25 billion to $1.3 billion. This investment will support both 2017 revenues and our future growth programs.

To conclude, at our Capital Markets Day we shared with you our financial performance targets for the second half of 2017. Based upon our third quarter guidance and second half ambitions overall, we believe ST is very well positioned to reach these short-term financial targets.

My colleagues and I would now be happy to answer your questions.