STMicroeloectronics Q312 Earnings Conference Call Remarks - Final
Wednesday, October 24, 2012
Carlo Bozotti, President and Chief Executive Officer

Thank you for joining us for our third quarter conference call.

Today, in addition to reviewing our third quarter, there are several important topics I would like to address. Before going into detail in each of these areas, let me share some key points.

First, looking at our financial results both revenue and gross margin were within our guidance range. The demand environment remains weak at the macro level since June. But, importantly, in spite of this, three of ST's five product segments showed sequential revenue growth again this quarter: Analog, MEMS & Microcontrollers; Power Discretes, and Wireless, highlighting the traction of our new product portfolio.

Second, there is a major positive dynamic underway at ST as our innovative product portfolio is driving an expansion of our strategic relationships with market leaders. For example, in automotive we just announced a strategic partnership with Audi to co-develop semiconductor solutions in three key areas of automotive design: reduction of CO_2 emissions, safety and security, infotainment and comfort.

Third, we are taking steps to improve our net financial position in the fourth quarter with a strong focus on containing capital spending and a major inventory reduction plan.

Fourth, in our earnings release last evening we announced a new $150 million annualized savings plan in ST's digital sector to be completed by the end of 2013.

Fifth, third quarter restructuring and impairment charges significantly increased to $713 million. As part of our annual impairment test and based upon our assessment of the Wireless segment plan, updated in Q3 2012, and the evolving dynamics of the smartphone industry, we posted a non-cash charge of $690 million. This charge reflects our current best estimate of the fair market value of our Wireless business.

Turning now to the third quarter in detail:

The market environment was weak throughout the quarter, tracking generally to what we had been seeing since June when the recovery started to deflate, uncertainty in customers' demand increased and visibility decreased.

Our third quarter revenue and gross margin results were within the outlook we shared with you in July. Our wholly-owned businesses were relatively flat to the second quarter. Nonetheless, new product momentum was clearly evident, as anticipated, with MEMS, Microcontrollers, Power MOSFET and IGBT demonstrating sequential progression. Wireless revenue grew 4% including revenues from IP licensing of $35 million.

In a weak semiconductor environment globally, we were able to show progress in key areas: with margin improvement, significantly lower operating expenses, lower losses and progression towards returning to a cash flow positive situation in the fourth quarter. Overall, I think this is a positive statement about our new product trajectories and traction.

So as I said earlier, three of our five product groups reported sequential revenue growth.

- First, Analog, MEMS and Microcontrollers (AMM) revenue increased about 4% sequentially. Our MEMS and sensors business continued its outstanding traction. ST won the accelerometer and gyroscope sockets for a new smartphone from a leading consumer electronics manufacturer and was awarded the dual-core gyroscope by a major mobile vendor. Our microphones earned a socket in a popular tablet from a major US corporation and our pressure sensors started shipping in a high-profile smartphone.

- Second, Power Discrete (PDP) saw revenue growth of over 5%, here due to higher demand for Power MOSFET and IGBT.

- And third, wireless revenue increased around 4%, from the ramp of Nova-Thor platforms and IP licensing. ST-Ericsson continues to expand its relationship with Samsung and just recently announced that Samsung is using the NovaThor platform for its new Galaxy S3 mini smartphone.

Digital revenue was lower mainly due to a sharp decrease in revenues from certain imaging customers but it still managed to reduce losses despite revenues being down 8% sequentially.

Automotive revenue reflected market weakness. However, we are very well positioned in the automotive market with more opportunities over the mid-term with customers including Audi, a new strategic partner.

So, let's look at how we are doing in some product areas:

In **healthcare and wellness**, among our life improving successes, we won a slot with a leading Asian healthcare equipment manufacturer for a respiratory aid system. In addition, we helped one of our partners earn U.S. FDA approval for a patient Remote Monitoring System containing our MEMS, STM32 Microcontrollers, analog components and sophisticated algorithms. This will be used to detect and monitor cardiac arrhythmias.

- We also announced our efforts to accelerate health and fitness monitoring by supplying the low-power STM32 microcontroller and our MEMS technology to a fitness monitor offered by one of the leading consumer brands.

In **power-management and energy-saving**, our MOSFETs were qualified by a major Japanese car maker for a DC/DC converter in their hybrid electric vehicles and one of the world's largest automotive players awarded us a design win in the power supply for an Engine Management System. We also introduced the world's first and only automotive-specific surge-protection devices. In the home, we won a socket for Intelligent Power Modules at a leading European household appliance provider for high-end appliances and we announced our first 900V and 950V SuperMESH™5 Power MOSFETs, which deliver the industry's best efficiency and highest voltage rating for enhanced application reliability.

In **smart consumer devices,** we earned an important design win for first ever for our 'FingerTip' multi-touch sensing technology with a leading mobile handset brand. We also announced a tiny chip that offers consumers the prospect of smaller, cheaper portable set-top-boxes capable of delivering broadcast and Over-The-Top multimedia services on the go.

Moving on to our gross margin, our third quarter results were on track at 34.8% thanks to improved manufacturing efficiencies and helped by currency with unsaturation charges similar to those of the second quarter.

Slightly better than anticipated, our operating expenses decreased 6% sequentially, in part seasonal and currency, but also reflecting the cost-realignment actions underway at ST-Ericsson. Looking forward, we expect to see a modest increase in operating expenses sequentially and we remain focused on ongoing improvements in reducing spending levels.

At the beginning of my remarks I indicated that one of the key priorities for the year is to improve our net financial position.

Turning first to our capital spending, here we had tightened the range for the year to $500 to $600 million last quarter. Year to date we have invested $398 million and I can now confirm that for the full year we expect to spend about $500 million. While early, we would anticipate a modest level of capital expenditures in 2013 as we believe our current manufacturing capacity is more than adequate.

It will be challenging but I want to reiterate our goal to be positive free cash flow on a consolidated basis for 2012 in order to maintain a stable net financial position, adjusted to account for our 50% investment in ST-Ericsson, compared to the end of 2011.

Let me turn to our new savings plan:

- This is designed to achieve $150 million in annual savings at the ST level upon completion by the end of 2013.

- A portion of the savings coming from the initiatives will leverage the synergies from our Unified Processing Platform approach by integrating the development of the System-On-Chip for digital TV.

- The plan also involves other new initiatives, such as efficiencies in our process technology development model and expenses related to design outsourcing.

In combination with the savings to be realized through the restructuring plan announced in April 2012 underway at ST-Ericsson, we expect a total of $220 million in annualized savings benefiting operating income attributable to ST by the end of 2013. These savings are based on Q4 2011 cost base.

Let us turn now to the fourth quarter.

Looking first at market conditions, as you have read from a number of semiconductor companies, the environment continues to be weak. For ST this has translated into a decline in our bookings levels. Consequently, we expect revenues in the fourth quarter to be relatively flat on a sequential basis, within the range of minus 5% to +2%.

We do, however, anticipate strong revenue growth in our motion MEMS and environmental sensors and continued progress in microcontrollers.

Now, to manage through this period and maintain our key priorities, we have put in place aggressive actions to align our manufacturing. Our plans include temporarily closing fabs by offering extended holidays, repatriating activities from subcontractors and taking other cost-reduction initiatives.

With respect to our gross margin, given this high level of unsaturation of our manufacturing, we are projecting 32%, plus or minus two points. The gross margin is absorbing about 3.8 points of unsaturation impact.

These actions in turn should allow us to bring down our inventory level by about $150 million based upon our fourth quarter revenue expectation and manufacturing initiatives and bring us back to our target turns level of around 4.5 times.

We are also taking further action with respect to ensuring a turnaround of our cash flow for the year, by reducing further our capital expenditure plans as we have outlined.

And while we have had quarter to quarter variations, we expect to see an improvement in the fourth quarter in our net financial position attributable to ST and to end the year at a level similar to the end of 2011.

To conclude, let me share a few points.

In the fourth quarter of 2011 we started a strategic review, based on the changes in our industry and changes at our former largest customer.

Since then we have already taken **four** important steps.

- First, with ST-Ericsson's strategic plan in April, benefiting ST as consolidated by the Group;
- Second, again in April with the application processor agreement with ST-Ericsson that forms the basis of our Unified Processing Platform approach
- Third, with the closing of this agreement in July
- Fourth, with our new $150 million savings plan

We have now entered our last quarter of the year. This quarter will be important to us as we will conclude our strategic review which we will announce in December.

Our main principles remain unchanged: we want to continue to accelerate our roadmap towards our already announced financial model, taking into account the changed market environment and some specific customer dynamics, and we will continue to ensure the future success of our company in total, with the two pillars, Analog and Digital, both being sustainable segments of ST from a financial point of view.

And with that, my colleagues and I are now ready to take your questions.