STMicroelectronics
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Q1 2019 Financial Results
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Good morning, and thank you for joining ST on our first quarter 2019 earnings call. Let me start with some opening remarks on the first quarter, our second quarter outlook and FY 2019.

First, on Q1:

- Our revenues, at $2.08 billion, and gross margin, at 39.4%, were substantially in line with our expectations amid softened market dynamics. We were lower than midpoint on revenues –I will say more on that later– and better on gross margin.
- We maintained a solid level of profitability, with an operating margin above 10% and a net income of $178 million.

Second, on Q2:

- We are still operating under soft market conditions, but today we are confirming our plan to return to sequential growth in the second quarter. At the midpoint of our guidance, we see second quarter revenues up about 2.4% on a sequential basis. And we see gross margin at about 38.5% at the midpoint.

Regarding the full year 2019:

- Our plan is for revenues to be in the range of about $9.45 to $9.85 billion.
- This means that we plan for strong sequential growth in the second half of the year across our Industrial, Automotive and Personal Electronics end markets.
- This expected level of growth is taking into account already engaged customer programs and new product introductions.
- It is also assuming improving market conditions in the second half of the year.

Indeed, our visibility of the market improved as we progressed through the first quarter.

In Industrial and Mass Market, exiting the Chinese New Year, we saw no signs of improvement in Q2 demand. However, March and April Point of Sales revenues at distributors are showing signs of recovery. This, coupled with the financial stimulus programs in China, is increasing our confidence level for improved market conditions for the second half of 2019. Automotive is still growing, although tracking at a softer pace than planned.

- While confirming our revenue dynamics for a sequential growth in Q2 and a stronger second half compared to the first half, our 2019 plan is lower than what we expected entering the year. Therefore, we have started to take actions:
    - First, on inventory. Our goal is to decrease it to a level in line with our current revenue expectations. This is an action already embedded in our Q2 gross margin guidance, which includes significant unsaturation charges.
    - Second, to adjust our capital spending. We have moderated our 2019 Capex plan to a range of $1.1 to $1.2 billion. The decrease is essentially impacting short-term capacity additions. At the same time, we are protecting our strategic programs that support our future growth.

In 2019, we will maintain a solid capital structure. Importantly, as part of the proposed Annual General Meeting Resolutions, our Supervisory Board is proposing to shareholders to declare a cash dividend of 24 cents per common share, payable to shareholders in equal quarterly installments.

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

Net revenues decreased 6.7% year-over-year, as sales of Microcontrollers and Memories, Analog and Imaging were lower. On the other hand, we had strong growth in Power Discrete and Automotive, as well as growth in Digital and MEMS.

On a sequential basis, net revenues decreased 21.6%. Compared to our midpoint target, we were lower by 90 basis points mainly due to ADG revenues below expectations in discrete and in traditional automotive products. As expected, all product groups decreased on a sequential basis.

Our gross margin was 39.4%, 40 basis points higher than the midpoint of our guidance, mainly due to the lower sales price pressure and a better than expected product mix.

On a seasonally low quarter, our net operating expenses were $607 million, within the range already shared with you in January. As anticipated, they included some catch-up of 2018 R&D grants.

As a result, we maintained a solid level of profitability as our operating margin was 10.2%; net income was $178 million and diluted earnings per share were $0.20.

Turning to cash generation – our net cash from operating activities was $341 million in the first quarter.

Our Capex in Q119 amounted to $322 million.

After the cash outflow of $76 million for the acquisition of 55% of Norstel's share capital, free cash flow was negative $67 million in the first quarter.

We paid cash dividends totaling $54 million and executed a $61 million share buy-back as part of our ongoing program.

Now, let's move to our second quarter outlook.

In Q219 we plan to return to sequential revenue growth. We expect revenues to increase about 2.4% at the midpoint. Sequential revenue drivers will include growth in Imaging and Power Discrete. On a year-over-year basis, Imaging, Automotive and Power Discrete (mainly driven by HV Mosfet and SiC Mosfet) are expected to grow, while General Purpose Microcontrollers and Analog products are expected to be the main detractors, leading to a year-over-year decrease of 6.3% at the midpoint for our total revenues.

Our gross margin guidance is 38.5% at the midpoint. This represents a decrease of 90 basis points quarter-over-quarter and 170 basis points year-over-year, respectively. The main reason for the sequential gross margin decline –about 80 basis points– is related to unsaturation charges, resulting from our actions to align inventory with our 2019 revenue expectations.

We expect net operating expenses to be in the range of $625 to $635 million in Q2 in a seasonally high quarter for this metric.

Let me now share with you some important business, market and product dynamics we saw during the first quarter, starting with Automotive.

In Q1, this part of our business grew high single-digit year-over-year. Late in March we started to see some backlog adjustment in the traditional part of this business. This was due to the decline in the number of car registrations, especially in China. We believe this trend is likely to be reversed, based also on recent market forecasts.

The demand for components supporting car electrification and digitalization (ADAS and MCUs) continued – and continues – to be strong.

In car electrification, we had a number of significant design-wins during Q1 for various electric car and charging designs. These included smart-charging controllers, smart power products for EV applications, and a 32-bit safety MCU for an EV Battery Management System for a major European player.

For Silicon Carbide, we announced the agreement to acquire the wafer manufacturer Norstel, on top of the multi-year supply agreement with Cree we already announced. In Q1, we also started to provide global carmakers with samples of our ACEPACK Drive module with SiC embedded.

In car digitalization, we continued to benefit from our close cooperation with Intel-Mobileye, who won a program for the EyeQ5 from a European carmaker. We also won a major project in Japan with our 32-bit microcontroller family.

Moving now to Industrial, we see two different trends:

- First, the ongoing inventory correction in the channel acknowledging shorter lead times. This is impacting our Analog portfolio and General Purpose Microcontrollers. However, as I mentioned earlier our business plan assumes better market conditions in the second half, with March and

April Point of Sales revenues at distributors showing signs of recovery. This, coupled with the financial stimulus programs in China, is increasing our confidence level for improved market conditions in the second half of 2019.

- Second, power device demand is still strong, with a capacity shortage worldwide, and here we have good backlog visibility.

As you know Industrial is a key area of focus for ST where we want to accelerate our growth. Progress was visible during Q1, as we continued our strong push, with new product introductions and key design wins across many applications.

For example, we announced the next step in our strategy to build a stronger leadership position in embedded processing solutions for industrial with the launch of our first STM32 Microprocessor. We also extended our already broad STM32 ecosystem for microcontrollers with further advanced Artificial Intelligence features and with USB-C support. We launched new sensors for the industrial market, including a device with an embedded Machine Learning core for machine vibration detection. We also received awards from global players for industrial-grade motion sensors in asset tracking applications. Finally, Q1 also brought many design wins in power discrete for industrial applications.

Let me conclude this product and market review sharing with you some points on Personal Electronics, where we target primarily smartphones, wearables and accessories with a selected approach. The 2019 global smartphone market is forecast to decrease slightly and foresees the introduction of first 5G devices. Our strategy is to bring more semiconductor content per device and we will benefit from existing and new programs, for smartphones as well as for wearables and accessories.

During Q1, our Imaging Sensors business was clearly impacted by the anticipated strong seasonality, but we are progressing well on all our engaged programs with major customers. Imaging products are a key component of our selective approach to Personal Electronics, together with other sensors, secure solutions, power management and analog products.

In the first quarter we brought in wins for motion and pressure sensors and Time-of-Flight products in many flagship smartphones and wearables. We also won a motor driver in a smartphone from a major Chinese customer and other designs for smart-power and analog products.

To conclude my remarks:

- During the first quarter we executed substantially in line with our expectations and we maintained a solid level of profitability.
- For the second quarter, we are confirming today our plan to return to sequential revenue growth.
- For the full year 2019:
    - We plan for strong sequential growth in the second half of the year compared with the first half and across our Industrial, Automotive and Personal Electronics end markets.
    - Our revenue expectation is based on clearer visibility since Q1; it is taking into account engaged customer programs, new product introductions and assuming improving market conditions.
    - We are aligning our production with the expected demand and moderating our capex.
    - Based upon our plans, we expect to maintain a solid capital structure.
    - Our objective in 2019 is to outperform our served market and deliver sustainable profitability.

Thank you for your attention and we look forward to seeing you at our Capital Markets Day in London on May 14th. We are now ready to take your questions.