

Q314 Earnings Conference Call Remarks – Final
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Thank you for joining us on our third quarter earnings conference call. We have a lot we want to cover with you today. The agenda includes a summary financial review. We will then turn to our \$100 million cost savings plan and a discussion of our digital business organization. This will be followed by a review of our two product segments, including new designs and product highlights, on our roadmap to increasing our revenues. I will finish up with our outlook for the fourth quarter and open the call to your questions.

Let me start from our top-line. Net revenues increased 1.2% sequentially, with both SP&A and EPS segments contributing to this growth. Due to the softening of the market towards the latter part of the quarter, specifically in microcontrollers and in the mass market, we came in below the 3% midpoint of our guidance. Distribution represented 32% of revenues, up from 31% and 25% in the prior and year-ago quarter, respectively.

Moving now to the solid performance of other key metrics, gross margin was on target at 34.3%, up 30 basis points sequentially and 190 basis points year over year. As anticipated, we did have higher unused capacity charges in the third quarter which impacted our gross margin by about 70 basis points. We benefited from improved manufacturing efficiencies and, since the softness in the market came late in the quarter, it did not impact gross margin in the third quarter.

At the operating expense level, our combined R&D and SG&A decreased 3.7% sequentially to \$603 million principally due to seasonality. Including R&D grants, net operating expenses in Q3 were \$576 million: this level gives us confidence in our plan to now reduce our target net operating expense range to \$550 to \$600 million.

Operating margin excluding impairment and restructuring charges has demonstrated solid progression, reaching 4.0% of sales in the third quarter of 2014. When excluding non-recurring items such as the Nano2017 grants catch-up and the gain from the sale of assets, the operating results improved by over \$60 million sequentially and by \$90 million year over year.

We also showed progress in terms of net income and cash flow. Specifically, we posted net income of \$72 million and our free cash flow, as anticipated, turned to be positive at \$140 million.

We ended the quarter with strengthened financial resources of \$2.46 billion, following the \$1 billion of convertible debt raised in July.

Shareholders received a quarterly dividend of 10 cents per share in each of the past two quarters. The decision regarding the distribution of a dividend for the fourth quarter of 2014 and first quarter of 2015 will be decided by our Supervisory Board at their regularly scheduled meeting on December 4th. As you know, the semi-annual dividend resolution is decided by the Supervisory Board of ST upon the recommendation of the Company's management. Based upon the Company's financial resources and cash requirements, as well as our visibility of the overall economic environment, management currently intends to recommend a continuation of the current dividend level. However, as noted above, the ultimate decision remains within the discretion of our Supervisory Board.

Now let me talk about our actions to further lower our cost base. As we discussed at our investor day in May, we have flexibility to achieve our financial model, so there are several paths to reach our mid-term operating margin goal of about 10%. In the digital business, given the softness in the market, the decision to discontinue the commodity camera module products and the timing to ramp specific ASIC products, we have decided to take additional measures. Our objective is to reach \$100 million in annualized savings at the operating expense level within the third quarter of 2015.

In particular, we have now combined our DCG and IBP groups, to sharpen our focus in three principal areas: first, ASSPs addressing home gateway and set-top box, as well as digital ASICs for consumer applications; second, mixed process and digital ASICs, including silicon photonics, addressing communication infrastructure; and third, differentiated imaging products. Finally, based upon the recent announcements by our Research Alliance partners, we have initiated a review of the implications to our process technology.

Now let's move to our product segment results starting with Embedded Processing Solutions ("EPS").

EPS third quarter net revenues increased 1.0% on a sequential basis driven by set-top box products within DCG and IBP.

MMS sequential sales slowed after our record quarterly revenue in Q2, although still growing almost 5% on year-over-year basis driven by general purpose microcontrollers. In this area, we continued to keep a balanced mix between sales to key OEMs and the mass market, which again represented about 70% of total general purpose microcontroller sales in Q3.

During the quarter we enjoyed a high rate of STM32 microcontroller design wins, fueled especially by the ultra-low power and entry-range series. These designs are across the board in everything: from mobile and wearable devices to home appliances and specialized industrial applications.

To offer our customers even more choice with our STM32 family we announced and demonstrated our new STM32 F7 series, the world's first ARM Cortex-M7 processor-core microcontroller. This product redefines the performance capabilities in this segment. We also started ramping production of our STM32 L0 ultra-low-power MCU.

In digital consumer and ASIC we continued to expand our ecosystem in HEVC Set-Top Box and Home Gateways, through our Cannes/Monaco family. Here we can clearly see the progress between IBC in September last year, where we first announced these products, and IBC this year - where devices based on the family were showcased in more than 20 partners and customer booths. At the show we also demoed the latest members of this family, which will pave the way for large-scale deployment of new 4K set-top boxes.

In Imaging, our latest product announcement is in line with our sharpened focus. We launched a module based on our Time-of-Flight technology, which combines a proximity sensor, ambient-light sensor and basic gesture recognition. This module is perfectly suited for mobile devices, consumer white goods and industrial applications and it is now in volume production. As you know, LG is already utilizing our Time-of-Flight technology to assist the laser auto-focus performance of its G3 smartphone.

From an operating results perspective, EPS segment operating loss was \$27 million and excluding the \$97 million of non-recurring Nano2017 catch-up recorded in the second quarter of 2014, EPS operating losses improved by \$56 million sequentially.

Moving to the Sense & Power and Automotive segment, third quarter net revenues increased 1.3% sequentially, driven by IPD and AMS with APG flat and better than seasonality.

As anticipated, our Analog, MEMS and Sensors group ramped new MEMS products including our high-performance microphones and high-accuracy pressure sensors, and touch-screen controllers for volume markets. For example, our pressure sensor and “FingerTip” touch-screen controller are now used in Samsung’s cutting-edge “GALAXY Note4” and “GALAXY Note Edge” smartphones.

Microphones are also a growth area for us, with a large and attractive market. During the third quarter, we sold our 300 millionth MEMS microphone, and we continue to gain share in this market. Importantly, we started production of analog microphones for a recently launched smartphone for a leading consumer brand.

We also continue to lead on innovation in our established motion MEMS portfolio, where we introduced the smallest 6-axis motion sensor with industry leading performance and power consumption.

Our presence in China is growing: in the third quarter alone, 17 new mobile devices were launched in China with our MEMS inside, adding to the 27 models already launched in the first half of the year.

Last quarter, we said that we expected our Analog and MEMS group to soon become a contributor to ST's performance again and that our latest sensors such as our 6-axis gyro, analog microphone, pressure sensor and touch-screen controller, had been selected in various combinations for flagship smartphone models. AMS grew sequentially and these products are now on the market **-or coming to the market.**

In APG our position continues to strengthen. Revenues were flat on a sequential basis despite seasonality and they were up sharply year over year by 11% due to broad-based growth. We took advantage of the healthy market in the US and China and of the good momentum of premium vehicles worldwide.

Our sales in Automotive are outperforming the market growth also thanks to our product offer in active safety, mainly addressing premium vehicles. ST is definitely ready, together with our partner, to serve the needs of the autonomous driving vehicles market.

We made inroads across our focus areas: in terms of diversification, since we had a record quarter in terms of billings to distribution thanks to our dedicated microcontrollers for automotive; but we also strengthened our leadership in infotainment, with our latest generation car-radio processor earning wins at large Japanese and Chinese OEM manufacturers.

Our digital products for automotive encompassing embedded flash for microcontrollers, active safety and car-radio will contribute to loading and scale of our 300mm manufacturing in Crolles.

To conclude on Automotive, we also won important designs for our smart power products in major American, European and Korean body applications and at one of the biggest European Tier 1 suppliers for innovative engine management applications. We also expanded our success in audio power amplifiers in Japan with several design wins.

Turning to Industrial & Power Discrete (IPD), our sales increased 2.3% sequentially and are higher year over year by 6.1%. In IPD we made progress in each of the growing application areas we are focused on - portable, automation motion control and several power conversion areas.

We won business with a leading automotive supplier with our Advanced Trench Power MOS Technology and captured sockets in server power-supply applications from a leading manufacturer in the US for both high and low voltage MOSFETs.

We also won designs for an advanced family of IGBTs and half-bridge gate drivers for a household appliance with a leading global brand, achieved a number of important design wins with our 600 and 1200V Silicon Carbide diodes and we released to the market the first Silicon Carbide 1200V Mosfet transistor.

Finally, we did grow in a number of new areas through our distribution partners with our STSPIN family of motor drivers.

Turning now to SP&A operating margin performance, the operating margin was 9.4% in the quarter, compared to 10.5% in the second quarter. Normalizing for the Q2 benefit for the Nano2017 catch-up of funding, the operating margin for SP&A increased 50 basis points sequentially.

Let's now move to our outlook. Entering the third quarter, we went from a favorable macro-economic backdrop to a mixed backdrop entering the fourth quarter which we see affecting most of our product groups. As a result, for the fourth quarter we expect a sequential decrease in revenues of about 3.5% at the mid-point plus or minus 350 basis points. With respect to our gross margin, we anticipate about 33.8% at the mid-point plus or minus 200 basis points. This reflects a negative impact of about 150 to 200 basis points due to unsaturation charges principally related to digital technology.

Now, as we look further out to the second half of 2015 and considering the current soft market conditions, we are now working to drive to quarterly revenues of \$2 billion, a gross margin range of 36 to 38%, and a net operating expense range of \$550 to \$600 million. Our roadmap for our product groups is clear: within Analog, MEMS and Sensors we have the appropriate product pipeline to drive it forward both with our major accounts and across a more diversified customer base; for MMS and IPD we see the consolidation of our leadership and continuous expansion in the mass market and Internet of Things applications; for Automotive, we see continued penetration in growing areas -such as active safety- and increased customer pervasiveness thanks to our microcontrollers; and finally for Digital we see a strong and competitive product roadmap contributing to growth in spite of a slower than anticipated ramp. And with respect to our gross margin, substantial improvement in manufacturing costs will help drive us to this target range, even with some softer revenue levels. On the expense front, this is well within our control.

To conclude, ST today has a very solid product portfolio to drive growth; a sharpened focus on its digital business; and, overall, the ability to adjust to macro-economic and market dynamics: this in order to make all of our businesses self-sustainable and successful and, ultimately, to achieve our operating margin goal.

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