Q315 Earnings Conference Call Remarks
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Thank you for joining us on our third quarter earnings conference call. As usual, we will start with a financial and business review of the quarter and then of our two product segments in detail.

We will then share with you our view of the macro environment as we see it today and our fourth quarter outlook. Also, we will update you on DPG. So let's begin.

Our third quarter results have brought sequential improvement in gross margin, operating margin, earnings per share and free cash flow. On the other hand, on the top line we saw limited sequential growth.

Revenues totaled $1.76 billion, increasing 0.3% on a sequential basis.

Three of our five product groups delivered sequential revenue growth. Our Microcontroller Group was the strongest performer, with sales growth of 6.1%. Automotive Group sales increased 1.9% and Digital Product Group sales increased by $23 million.

In total, however, sequential revenue results came in at the low end of our outlook range, due to two principal factors. First, as we moved through the quarter, market conditions softened, affecting our Industrial and Power Discrete and Automotive groups in particular. Second, due to a specific manufacturing issue with a subcontractor, microphone sales were delayed and we are now gradually resuming shipments.

On a year over year basis, net revenues decreased 6.5%, or 3.8% excluding negative currency effects and revenues from mobile legacy products.

Distribution channel sales represented 33% of total revenues in the third quarter. The mixed Distribution results by region highlight the differing macro influences. Our point of sales -or sales to the final customer- decreased slightly on a sequential basis and was flat compared to the year-ago period. Sequentially, EMEA grew high single-digit; Japan & Korea, and the Americas were flat, while Greater China declined about 5%. On a year-over-year basis, the Americas posted the strongest results, with double-digit growth, while Greater China was weakest, declining 5%.

On a sequential basis, gross margin expanded 100 basis points to 34.8% in the third quarter. The drivers were favorable currency effects, net of hedging, manufacturing efficiencies and lower unused capacity charges.

Expenses totaled $549 million in the third quarter, well in line with our expectations. The sequential decrease reflected the usual Q3 seasonality, favorable currency effects, net of hedging, and savings from the 2014 EPS savings plan that was completed in July and whose effect is already largely visible in our Q315 financial performance.

Moving to operating margin, before impairment and restructuring charges, where, in the third quarter, we had a substantial sequential increase, up 390 basis points to 5.8%. Both the SP&A and EPS segments contributed to this improvement: however, both segments benefitted from the usual favorable seasonality in operating expenses and lower unused capacity charges in the third quarter.

Income tax included a one-time income of $14 million related to the settlement of a local tax assessment.

Our net income totaled $90 million in the third quarter, more than doubling from the second quarter.

Also, our free cash flow increased to $85 million in the third quarter and was $179 million for the first nine months of this year: a solid progression on a year-over-year basis compared to the negative $11 million recorded in the first nine months of 2014.

Now, let's discuss our two product segments. In SP&A, net revenues totaled $1.12 billion, representing a decrease of 3.6% on a sequential basis.

Despite this decrease, SP&A's operating margin improved to 9.2% from 6.6% in the second quarter, benefiting from favorable currency effects net of hedging, lower operating expenses due to seasonality, as well as manufacturing efficiencies.

Moving to our product groups, let's start with Industrial and Power Discrete. IPD's net revenues totaled $437 million, decreasing sequentially by 2.5%. This was due to distribution softness, which impacted discrete and power transistor products.

While in the short-term IPD results reflect softer GDP trends, we continue to strengthen our portfolio and are improving margins. Let me share some examples of our progress and reasons for confidence in IPD.

In power conversion, we gained a number of design-wins: for example, for digital controllers in digital-power-supply applications from several Asian manufacturers and for high-voltage IGBTs for an induction-heating application with a leading manufacturer.

In industrial and home-appliance automation, we announced 650V IGBTs that increase energy efficiency of HVAC motor drives, uninterruptible Power Supplies and solar power converters.

In portable applications, we secured sockets for AMOLED converters for Samsung Galaxy smartphones and earned a key win with a display power-management solution for a tablet platform.

Also, we maintained the growth of protection products within the smartphones, laptops, tablets, and IoT applications of numerous industry leaders.

In our fourth focus area, energy management, we captured design wins for on-board chargers in electric vehicles from leading manufacturers with our silicon-carbide, silicon MOSFET and silicon-controlled rectifier products. We also launched industry-first automotive high-side drivers with galvanic isolation ideal for vehicles with stop-start technology.

Moving to Analog, MEMS and Sensors (AMS), net revenues were $233 million in the third quarter. Sales came in $40 million lower than the second quarter, due to weaker results in distribution and due to a manufacturing issue at a subcontractor, which affected our sales of microphones.

During the quarter, we continued to pursue our diversification strategy: both by expanding our portfolio with existing customers and by working with new customers.

In low power connectivity, we started volume shipments of our next generation Bluetooth low energy solution for automotive telematics services in China and for wearable devices from a leading activity-monitoring company.

In MEMS micro-mirrors, we shipped to multiple computer manufacturers, after having been chosen at the beginning of the year by Intel.

Our automotive sensor business continued to make good progress, capturing a design-win at a major automotive tier one with a high-g accelerometer for airbag applications in China, and expanded the airbag-electronics kit offering with automotive central-airbag crash sensors.

Within smartphones, we had large volume shipments of Fingertip, Pressure Sensor, and 6-axis ultra-low-power MEMS accelerometer and gyroscope for the latest flagship model of Samsung Galaxy smartphones; we announced that the flagship OnePlus 2 smartphone in China is using an ST gyroscope for optical image stabilization and we entered with our low-noise gyroscope into a market-leading tablet.

And finally, in microphones, we expanded our presence with a top global brand, starting to ship high-end digital microphones for their new TV remote controller.

Turning to our Automotive Group (APG), net revenues in the quarter were $447 million, increasing 1.9%.

The sequential growth was lower than we had anticipated and was due to a slowdown in consumer spending in China, which affected semiconductor sales more globally and automotive in particular. On the other hand, our microcontrollers dedicated to automotive and our processors for ADAS systems recorded good performances.

At the same time, during the quarter we continued to leverage the strength of our broad-based portfolio to win strategic business.

For example, in the third quarter we made progress in radar-based ADAS applications, winning the next generation platform at 24GHz for a global leader.

In automotive microcontrollers we continued to see growth, as our design-win pipeline is increasing and progressively entering production. For example, we started shipments of a 32-bit Power Architecture technology microcontroller for the power-conversion unit in a hybrid vehicle. We also received an award from a major Chinese tier 1 for a chip set that includes smart-power actuators, analog signal processing, and a 32-bit microcontroller.

In car infotainment, we began ramping production of our Accordo car-radio-processor family for OEM and aftermarket applications with leading Chinese and Japanese car infotainment makers. We also received a major additional award with a leading Korean infotainment manufacturer for this family.

Moving now to our EPS product segment, revenues totaled $642 million, increasing 7.8% on a sequential basis. EPS operating margin was break-even in the third quarter, which is a quarter seasonally characterized by lower expenses. MMS posted record profitability while DPG continued to post substantial losses; that’s why we remain steadfast in our goal to fix the losses of DPG and to move this group to a sustainable and improved level of performance over time.

Digital Product Group revenues totaled $230 million, an increase of $23 million on a sequential basis driven by Imaging. In our specialized imaging business we continued to expand our Time-of-Flight photonic sensor business in Asia, with now more than 20 phone models available from several leading Asian smart-phone manufacturers.

MMS performed very well, growing 6.1% sequentially and 9.1% year-on-year to $412 million. Additionally, it was another record high billing quarter, thanks to the STM32 microcontroller family.

In fact, in our general purpose microcontroller business we reached the milestone of more than 1 billion STM32 microcontrollers shipped since the first product launch. During the third quarter, we further expanded the developer support around our highly successful STM32 family with the mass market launch and associated release of the ultra-low-power STM32 L4 ecosystem including development tools, software, training and online support. At the same time we started to ramp the L4 for a wearable band at a major OEM.

In addition, we began production of the STM32F0 and F4 microcontrollers for several consumer drones for a major Asian OEM and captured an F0 design-in at a major Japanese consumer OEM.

In our secure microcontroller family we qualified and certified our latest contact secure MCU for banking, ID, and pay-TV smartcards. We supported a major pay-TV smartcard roll-out for the China digital-TV market and we joined Entrust Datacard’s Card Validation Program for STPay EMV smart-card solutions.

Now, let me conclude with our fourth quarter outlook and update on DPG.

While market conditions were mixed entering the third quarter, we saw progressive deterioration as we moved through the quarter and during the month of October so far. Lower consumer spending in China is impacting the dynamics of the distribution channel in the region and the industry more globally, as I previously mentioned, particularly in automotive. We see this possibly continuing through the next couple of quarters.

As a result, we adjusted down our manufacturing plan for the fourth quarter. We expect revenues to decrease sequentially by about 6% at the midpoint and our gross margin to decrease to about 33.5% at the mid-point. We are estimating a negative impact of fab under-loading of about 2 percentage points, more than offsetting the underlying improvement in our gross margin, including favorable currency effects.

Finally, with respect to fixing the losses in our Digital Product Group, we are making progress in narrowing the options, and we have the objective to announce a final decision in early 2016.

Our goals are clear: fix DPG and continue to excel in the most promising areas we see in the industry and where we are already winning, such as the Smart Driving experience and the Internet of Things. We are investing and building our market presence in product areas where we can be leaders and where we see sustainable opportunities for profitable participation.

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