Q214 Earnings Conference Call Remarks – FINAL
Carlo Bozotti, President and Chief Executive Officer,
STMicroelectronics - Wednesday, July 23, 2014

Welcome to our second quarter earnings conference call. For the benefit of all, the agenda today includes a review of our financial highlights and of our two product segments, further details on our product groups within the segments and then our outlook for the third quarter. So let us begin.

Our quarterly results were well aligned with our guidance. Revenue came in at the midpoint of our outlook of 2% sequential growth. Gross margin of 34% was above the 33.6% mid-point of our range, improving both quarter-to-quarter and year-over-year. Operating expenses were again well on track with our financial model. And we returned to a net profit at the bottom-line.

We also further strengthened our capital structure -and significantly enhanced our financial flexibility to boost growth- with the $1 billion convertible debt offering completed in July which will be visible in our third quarter balance sheet.

ST simultaneously launched a buy-back program for 20 million shares in order to meet the Company’s obligations in relation to its employee stock award plans.

Moreover, we returned capital to our shareholders, with the payment of a quarterly dividend of 10 cents per share, or $90 million in the aggregate.

Turning to second quarter results in more depth, revenues came in at $1.86 billion – up 2.1% sequentially. Excluding legacy ST-Ericsson products and one-time licensing revenue in the first quarter, this represents a sequential progression of 4.7%.

In our **Sense & Power and Automotive** product segment (“SP&A”) the key drivers of our top-line growth were the Industrial and Power Discrete and Automotive product groups. IPD and APG increased 7.4% and 4.2% sequentially, respectively. And in our Embedded Processing Solutions segment (“EPS”), our Microcontrollers, Memory & Secure MCUs grew 14.5% sequentially. So, all three of our largest groups performed very well.

Our customer diversification across market channels continued. **Distribution** represented 31% of total sales in the second quarter, up from 26% at this time last year and slightly increasing from the first quarter.

Gross margin improved sequentially – up 120 basis points, thanks to manufacturing efficiencies, a favorable product mix and product pruning. So we continue to move towards our target range of 36% to 38%.

Turning to **operating expenses**, we are well aligned with our objective. Combined R&D and SG&A totaled $626 million in the second quarter, with the sequential increase mainly due to a higher number of days in the quarter. Year-over-year our operating costs are significantly lower, due to the exit of ST-Ericsson and our cost reduction programs.

Also in the second quarter, the European Union approved the funding of 400 million Euros for the **Nano2017** R&D program. This funding, granted by the French authorities to ST for the development of new technologies in the Nanoelectronics sector, is for the period 2013 to 2017. Apart from the catch-up of the Nano2017 program recorded in the second quarter, going forward, and in combination with other smaller programs, R&D grants are expected to total about $30 million per quarter. This is helping us to keep our net operating expenses at the lower end of our target range.

We also posted a significant improvement in our operating income before restructuring, of about $52 million year-over-year on a comparable basis, excluding the impact of the Nano2017 grants catch-up in the second quarter this year and the Ericsson portion of ST-Ericsson's results during the second quarter of 2013.

Now let's move to our product segment results, starting with **Embedded Processing Solutions.**

With the second quarter, we have begun what we anticipate being a positive growth trajectory for EPS. EPS revenues increased 4.6% on a sequential basis. This is mainly due to growth in MMS and DCG –the latter, when excluding legacy ST-Ericsson products. As expected, legacy ST-Ericsson revenues decreased to $34 million in Q2 compared to $63 million in Q1.

Our **digital consumer and ASIC** business grew 4.2% sequentially after reaching an inflection point in the first quarter, although not yet at the pace we are expecting for the forthcoming quarters.

In the set-top Box business, we expanded our ecosystem around 4K Ultra-High Definition TV; this is the right place to be, since the industry expects 4K TV sets to account for 5% of the global TV market this year and to rise to 42% by 2018. Overall, in the connected client/server and home gateway families we now have about 30 designs with major customers and operators. During the quarter, we also secured wins for cable chipsets in new-generation HD zappers from several operators.

Interest and momentum in next-generation ASICs is also continuing, with two major design wins, one for computer peripherals and one for communication infrastructure in FD-SOI.

Turning to **IBP**, our photonic sensors for proximity sensing applications, based on our FlightSense™ technology, are well suited to a wide range of applications. During the quarter we began volume shipments of our “time-of-flight proximity sensor” for the widely acclaimed LG G3 smartphone -that began its global rollout from the second quarter of 2014. We also started volume shipments for the mass market, driven by Internet of Things and robotics applications.

In **MMS**, this was another record revenue quarter for our general purpose microcontrollers - the fifth in a row. These strong results reflect our success in the mass market, which represented in the quarter about 70% of total general purpose microcontroller sales, and with key OEMs. For example, we ramped production of our STM32 for a new Samsung smartphone that was launched in the second quarter of 2014.

We also captured STM32 design wins in a mobile phone accessory at another major OEM and in a new platform for a major actor in the metering industry.

Finally, we sampled our latest Secure MCUs to ID and Banking customers and revealed our latest STPay (dual interface) product line for US EMV banking-card migration.

From an operating margin perspective, EPS saw an improvement both sequentially and year-over-year, largely reflecting the catch-up of funding for the Nano2017 R&D program.

Let's now cover the **Sense & Power and Automotive** segment, starting with our Automotive Product Group -APG.

APG increased 4.2% sequentially and 11.3% year-over-year, and it achieved a record quarter in terms of billing - the highest ever in ST's history, benefitting from solid execution of our strategy combined with healthy market conditions.

In fact, during the first half of the year, light vehicle sales were up almost 4% versus the first half of 2013, driven by China but showing also improved conditions in Europe.

Let me share some of the highlights for automotive in the quarter:

First, we saw continued expansion in infotainment –where we are either number 1 or 2 in each of the main sub-segments. Here, our latest generation car-radio processor earned its first important design win at a major Chinese customer, as well as wins in Europe and the US.

Second, our strategy of partnerships with car makers to address radical innovation is progressing. In Q2 we announced a partnership with Changan, the fastest growing Chinese car maker with over 40% car sales growth year-to-date.

We also signed another significant partnership with a European premium car brand, in addition to those partnerships that we had already disclosed with Audi, Hyundai Autron and Great Wall.

Third, I would like to mention some wins in automotive microcontrollers for parking assistance and transmission applications for European customers, as well as our continued expansion overall in the US market for car body, with design wins at a large American Tier1 supplier.

Industrial and Power Discrete Products –IPD- increased 7.4% on a sequential basis and 1.9% year-over-year. Here we are seeing improving market conditions and are benefiting from our marketing efforts in the mass market and distribution.

We captured a number of design wins in some of our focus areas. For example, we landed a design win with IGBTs for an air-conditioner application with a leading manufacturer in Asia; we won sockets in server power-supply applications from a global leader for ultra-high-performance silicon carbide diodes; we earned a design win for a fully integrated motor driver in a new project for textile equipment; and we qualified high-voltage MOSFETs for power supplies and LED lighting applications with numerous top-tier vendors around the world.

Results for **Analog, MEMS and Sensors** reflect the diversification phase we are in, as we ramp up new promising products, we expand our offering towards a broader set of customers and applications and prune low-margin products.

Our new products, including microphones, touch controllers, 6-axis gyroscopes and pressure sensors, have been recently selected in different combinations for forthcoming flagship smartphone models.

In terms of market diversification, we expanded our business in China and Taiwan, supplying MEMS products to ASUS, Lenovo, Oppo, Meizu among others. We also enjoyed high-volume ramp-up of our 6-axis MEMS combo in Huawei's Ascend P7 phone and started to ramp our 6-axis smart sensor with Xiaomi.

In our Analog business, we are seeing good traction with our Bluetooth low energy solution, with over 700 design registrations since we started sampling the product during Q1. This broad interest and success in the mass market will deliver revenues in the second half of this year, alongside our other low power RF solutions for the Internet of Things.

Overall, SP&A's operating margin performance improved again this quarter, to 10.5% from 8.7% in the first quarter and was up substantially from the year-ago quarter level of 3.5%. This is in line with our previously communicated expectation of margin improvement, thanks to increased revenues from new products, a favorable product mix, low margin product pruning and manufacturing efficiencies.

Let me now comment on our **outlook** for the third quarter.

The general macro-economic environment has been improving and is strong in certain areas such as automotive and industrial. So we begin with a favorable backdrop.

From ST's perspective we see sequential revenue growth in all areas of our product portfolio.

MMS, which has led the way with record revenues quarter after quarter, will temporarily slow in Q3, although we are still expecting sequential growth.

IPD and APG will perform better than seasonal thanks to both favorable industry trends and solid market positions. Importantly, AMS and DCG will become again significant contributors to ST's growth.

Looking at our specific guidance for the third quarter, we expect net revenues to grow by about 3% at the mid-point.

Based upon our revenue growth outlook, as well as product mix between analog and digital, we anticipate that our third quarter gross margin will increase to about 34.4% at the midpoint, despite a higher level of unused capacity charges as our manufacturing capacity in digital technology is not yet fully utilized.

Excluding the second quarter one-time effect related to Nano2017, we anticipate further improvement in our operating margin in the third quarter.

Last but not least, in the third quarter we expect to return to positive free cash-flow generation.

So to conclude, ST made solid progress in the second quarter from many perspectives: revenue and gross margin improvement, a solid pipeline of design wins across our products, important steps towards DCG's turnaround and AMS' renewed acceleration, a further re-focus of our portfolio and, ultimately, financial return.

But, for sure, more has to be done. This is our continued focus and commitment, in order to continue to generate value for all of our stakeholders.

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