Carlo Bozotti, President and Chief Executive Officer, STMicroelectronics: Q1 2018 Earnings Results
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Thank you for joining us on our First Quarter 2018 earnings' conference call. Our agenda today includes a summary of the quarter, a detailed product group review, and our second quarter outlook. So let's begin.

Our objective for 2018 is to leverage the results we achieved in 2017, continuing on the path of broad-based sustainable, profitable growth. Based on our first quarter results, we have started the year well on track:

- Revenues grew 22.2% year-over-year to reach $2.23 billion and this is our 6th quarter in a row of double-digit year-over-year sales growth. Also, this quarter we posted double-digit sales growth across all product groups and regions thanks to our focus on Smart Driving and IoT applications. On a sequential basis, revenues decreased 9.8%, 20 basis points better than the mid-point of our guidance. We delivered a better than seasonal performance in two end markets: Automotive and Industrial, well balanced between large customers and distribution, which represented 37% of our revenues in the first quarter.
- Gross Margin increased 220 basis points year-over-year to 39.9%. Manufacturing efficiency was the largest contributor, followed by product mix. These two improvements were slightly offset by normal pricing adjustments at the start of the year, as well as negative currency effects of

about 80 basis points as well as some one-time negative impact specific to the quarter. On a sequential basis, our gross margin was 40 basis points above the mid-point of our guidance on better product mix.

- Operating income more than doubled to $269 million in comparison to the 2017 first quarter thanks to strong improvements across all product groups, with higher revenues, increased manufacturing efficiencies and improved product mix.
- As a result, our Operating Margin reached 12.1%, increasing 480 basis points year-over-year from 7.3%.
- Net income increased more than $131 million year-over-year to $239 million, driving diluted earnings per share to $0.26, more than double compared to the year-ago period.
- Free cash flow increased by 53% year-over-year to $95 million. In the last twelve months free cash flow was $372 million, well exceeding the level of our distributed cash dividend.
- We also strengthened our balance sheet with our Net Financial Position increasing to $522 million.

Now let’s move to a detailed review of our product groups.

Beginning with our Automotive and Discrete Group (ADG), revenues were higher year-over-year by 15.4% on double-digit growth for both Automotive and Power Discrete products. On a sequential basis, ADG revenues were substantially stable, reflecting better than seasonal performance in both areas, with a small decrease in Power Discrete products mostly offset by slight growth in Automotive. Considering all of our product groups and not only ADG, revenues to the automotive market grew 17.4% year-over-year in the first quarter.

ADG's operating margin doubled to 11.0% from 5.5% on a year-over-year basis, with significant progression for both Automotive and Power Discrete reflecting higher revenues and improved gross margin.

Moving to the product review of ADG, our proprietary technologies dedicated to automotive applications allow us to develop leading-edge products for each of the needs of the car. For example, our VIPower technology allowed us to win awards for motor control in a door-zone application with a worldwide leader and a high-end body-control module for a European premium carmaker. We also captured an award for our U-Chip power supply and drivers for engine-management and battery management systems from a major Chinese tier1, and we received multiple design wins from German tier1s for electric power trunk applications.

Our automotive-microcontroller business saw multiple wins including a design for a chassis stability control unit in Japan.

In Infotainment, we received awards for telematics solutions from European and American carmakers, and we earned multiple design wins for our Accordo processor family for mid-level car radio systems from several Asian OEMs. We were also chosen to supply class D audio amplifiers for an e-call module by a major electric-vehicle maker.

Let's now discuss Power Discretes, that are pervasive across all the end markets that we address. In Automotive, we continued to grow our Silicon Carbide business, with our Silicon Carbide MOSFETs in the traction inverter applications of two carmakers in China. We also maintained strong momentum in Silicon Carbide diodes with multiple design-wins for electric-vehicle on-board chargers.

In Industrial, our Silicon Carbide diodes and power MOSFETS were selected for high-efficiency power-conversion systems in servers, solar energy, and Hi-Fi audio systems, with both US and European customers.

In IGBT, we won sockets for intelligent power modules for washing machines and dishwashers from a market leader, and landed a win for MDmesh power MOSFETS in an implanted cardiovascular defibrillator from a top American medical player. We also won a battery-charger socket with our MOSFETs from a leading smartphone manufacturer and earned a major design win for integrated passive device filters in 5G base stations.

Moving now to our Analog, MEMS and Sensors Group (AMS), revenues increased 26.5% year-over-year on sharply higher Imaging sales, as well as double-digit growth in Analog and MEMS combined.

On a sequential basis, AMS revenues decreased by 27.4% principally reflecting the negative impact of smartphone applications to our Imaging business, while Analog and MEMS posted better than seasonal performance with lower quarter to quarter sales declines.

AMS operating margin expanded to 9.8% from 7.6% in the year-ago period on higher revenues and improved gross margin. Year-over-year margin evolution reflected, on the one hand, a strong expansion of our MEMS business operating performance as well as improvement in Analog, and, on the other hand, the unfavorable effects of smartphone sales on our Imaging business.

Moving to AMS' products, our Analog portfolio was very successful with industrial customers. Here we recorded many design wins for our high-end solutions for smart metering, motor control, solar power appliances, and power supplies. This is thanks to our portfolio of dedicated solutions that have been defined together with industry leaders, built on ST proprietary technologies and refined over the past years. Good examples include our STSPIN motor control solutions and our metering ICs.

With smartphone makers, our analog portfolio won an award for a linear regulator from a top OEM, several design wins for Analog and Smart Power products with leading OEMs and designs for touchscreen solutions with Chinese players.

In MEMS sensors and actuators for industrial, we are seeing an increasing demand in applications such as equipment condition monitoring and asset tracking. These applications often require multiple sensors and sensor fusion know-how and ST is very well positioned to target this broad industrial customer base. Also, our FlightSense™ proximity and ranging sensors achieved a number of designs in industrial applications such as robots.

In MEMS and sensors for consumer, we ramped production for the Samsung Galaxy S9 and S9+ of a full collection of sensors, including a 6-axis MEMS inertial measurement unit, a barometric sensor, and an optical-image-stabilization gyroscope. Our success in optical-image stabilization gyros is visible as six of the top ten smartphone models, as ranked by DXOMark, a leading source for independent image quality measurement, use ST OIS. We captured a number of sockets for accelerometers and pressure sensors in a top-tier wearable supplier and in a Chinese smartwatch manufacturer and we earned design wins for our Time-of-Flight proximity and ranging sensors with several leading Asian smartphone manufacturers.

Turning now to our Microcontrollers and Digital ICs Group (MDG), revenues were up 26.6% year-over-year, largely driven by a strong expansion of microcontroller sales. On a sequential basis, Microcontrollers and Digital ICs Group revenues increased 1.3%.

MDG operating margin increased to 19.5% from 10.3% in the year-ago quarter, reflecting higher revenue growth as well as improved gross margin with respect to our Microcontrollers business. We have also achieved a sustainable level of operating profitability for our Digital business.

Moving to MDG products, our general purpose STM32 microcontrollers, which are used across a very wide range of products and applications, achieved another quarter of record billings. A few of the many STM32 design-ins include devices from major OEMs in applications such as a digitally controlled Smart Home Air Vent, a new generation of electric smart plugs, insulin pumps, fast-charging for smartphones.

Our success with the STM32 builds on our broad and deep device portfolio and our continuously expanding ecosystem. In the first quarter we began sampling our STM32WB wireless System-on-Chip, which adds Bluetooth low energy and low-rate wireless connectivity to our STM32 family. We have further expanded our ecosystem with a cooperation with Sigfox to support the growing demand of connected devices to low-power wide-area network and added new Discovery Packs for the fast connection of IoT devices to Cloud services over cellular networks.

Moving to security, we earned wins for our latest Near Field Communication controllers in various smartphones from key OEMs. Here we are benefiting from the cooperation we announced last year with MediaTek to integrate our NFC Technology into their mobile platform designs. We also won sockets for our Trusted Platform Module solution from two leading PC manufacturers.

In our Tags and readers business, we captured design wins for an ST25 NFC Reader and associated NFC tags for authentication of consumable goods from a major medical equipment company.

We also ramped production for an EEPROM and a SIM card used in the Samsung Galaxy S9 and S9+.

In our custom Silicon business we earned a design win for a digital ASIC in 7nm FinFET technology from a new customer active in communications infrastructure and we won two ASIC designs in BiCMOS technology at an optical market leader.

Moving now to our second quarter outlook, based upon the expected mix of our product groups, we anticipate second quarter revenues to increase by about 1.5% on a sequential basis, plus or minus 3.5 percentage points.

As we already anticipated -and now this is well known by the industry- , the second quarter is another quarter of weak sales in smartphones, particularly for our Imaging business, while we certainly see another quarter of sequential growth and solid year-over-year growth in Automotive and Industrial for our broad range of products: Automotive ICs, Power Discrete, Analog, Microcontrollers and Digital. So, very broad.

Indeed, despite this weak demand for smartphones in the first half of 2018, we anticipate second quarter and first half revenues to grow year-over-year about 17.5% and 19.8%, respectively, at the mid-point of our guidance range. This will be driven by the continued better than seasonal sales trends in the Automotive and Industrial end markets, and in Internet of Things applications.

We see healthy demand for the second half of the year, with a backlog supporting our expectations for strong revenue growth across all our product groups, end markets -including smartphones-, and regions.

In terms of profitability, we expect the second quarter gross margin to be about 40.0% plus or minus 2 percentage points. This expected gross margin, which we have delivered in the past two quarters, results in a solid level of profitability and return on invested capital.

As part of the Annual General Meeting Resolutions issued earlier this month, 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. The Annual General Meeting of Shareholders is scheduled for May 31, 2018.

To conclude, we look forward to meeting with you at our 2018 Capital Markets Day on May 15th in London. As you know, this will be for me a special Capital Markets Day: the last one before my retirement. I will be pleased to meet with you all, and thank you in person for your support and continuous interest in ST throughout the years.

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