

## Sensata Technologies Holdings NV

NYSE:ST

**Analyst:** Audrey Barrucand

**Sector:** Technology

**BUY**

Price Target: \$46

### Key Statistics as of 11/04/16

Market Price: \$35.81  
 Industry: Technical Instruments  
 Market Cap: \$6.167 B  
 52-Week Range: \$29.92 - \$49.73  
 Beta: 1.37

### Catalysts:

- Mergers and Acquisitions
- New revenue stream from new business or clients
- Q4 2016 earnings announcement

### Company Description:

Sensata Technologies Holdings is a technology company that develops, manufactures, and sells sensors and controls, used in the automotive and electronic industries. Market-leading products include pressure sensors, speed and position sensors, temperature sensors, pressure switches, as well as, bimetal electromechanical controls, thermal and magnetic-hydraulic circuit breakers, and industrial sensors. Sensata markets its products worldwide, especially in the United States, Europe including the Netherlands, China, Korea and Japan. Sensata is a holdings company with less than 10 companies, each specialized in different segments of the business, which allows Sensata to gain exposure to many parts of the technology industry.

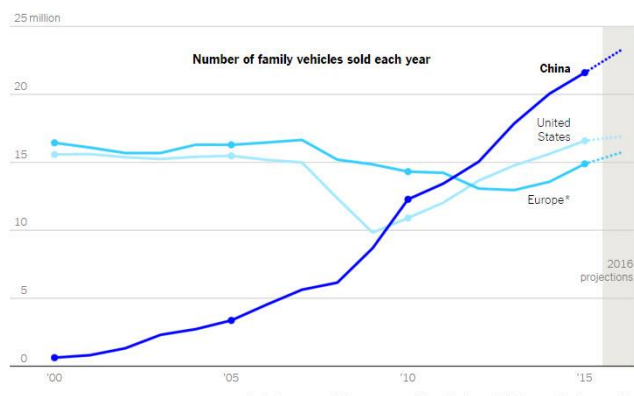


## Thesis

- Sensata is a growth company with leadership positions in automotive sensors, which is a growing market. It has been delivering strong constant growth and has the ability to make more acquisitions to bring more growth.
- There are increasing regulations relating to safety and emissions that drive the demand for energy efficient electronic products.
- Sensata focuses on R&D to develop complex products with applications to the automotive industry.
- Unappreciated earnings will increase when the company achieves its long-term targets.

## Industry Outlook

Sensata provides technical instruments products mainly used in the automotive and electrical industries. Because its stock price depends on revenues, it also depends on the demand for automotive products i.e. cars. Looking at 2016, the number of vehicles sold in China, Europe and the United States, will keep increasing, and will allow Sensata to sell more of its products worldwide.



As for the electronic industry, there is an increasing demand for electric vehicles and for hydraulic circuits that Sensata can take advantage of. As well, worldwide vehicles are changing as manufacturers are trying to meet government regulations and improvements regarding safety, carbon-monoxide emissions, and fuel efficiency. This change in the industry will impact Sensata's product offerings and will differentiate its products from its competitors'.

## Acquisitions & Their Impact on Sensata

In the past 10 years, Sensata has bought 9 companies in order to develop its range of products and applications. Each acquisition allows the company to expand its reach

geographically and to become more and more present in the sensing business.

The company's last acquisition was in December 2015. The acquired company, CST, is a technology company with sensing content used beyond the automotive industry, which will expand and double Sensata's reach into the aerospace business. CST also has products that will be incorporated into each of Sensata's segments.

Each acquisition increases the company's debt and impacts its margins. In fact, these acquisitions initially reduce the company's margins due to their lower profitability and because of the interest burden the new debt brings. But these acquisitions also bring new revenues. For example, the last three acquisitions (DeltaTech, Schrader, and CST) have brought at least \$1.05 B of acquired revenue. CST is also expected to bring new revenue stream in aerospace within the next year.

These acquisitions make Sensata a highly levered company, with new debt issued for most acquisitions, the last debt issuance being for CST in December 2015. From then, the company has been rapidly paying its debt thanks to its strong free cash flow. Sensata is expected to increase its FCF by 29.3% for FY 2016, considering the 11% year-on-year increase for Q3 2016. The increase in FCF is due to strong adjusted net income and to low capital expenditures. The company forecasted a decrease in its leverage ratio to below 3.8 by the end of the year 2016, to become a less risky company, and be more attractive to investors.



## NET LEVERAGE RATIO

LEVERAGE RATIO OF ~3.0X BY END OF 2017\*



Assuming the company will not buy other companies before Q4 2017, it will be able to reduce its leverage ratio to 3.0 times and become a much less risky company.

## Segments Wins & Future Revenues

Through its acquisitions, Sensata has been able to develop two main segments: performance sensing and sensing solutions. Performance sensing includes applications in automotive and in heavy vehicle & off-road business (HVOR), with a goal of improving performance, safety, and efficiency. The company has been a market leader in this segment for 25 years, with 9 global automotive OEM manufacturers as their clients, such as Volkswagen. As for the sensing solutions segment, it includes applications in the automotive industry as well but with a goal of preventing damage from heat and fire for vehicles, with electrical protection products.

For those segments, Sensata also has products in development focusing on next generation electric cars. In Q3 2016, Sensata won a large order with one of the leading electric vehicle manufacturers, with its just developed sensor for complex thermal management systems. This new contract will bring its first revenues to the company beginning next year. It also has other sensors in development in electrification and the company is expected to increase its investments in those types of sensors, since the products have an increasing popularity and demand.

As for HVOR growth, there are currently greenhouse gas regulations in development and Sensata is already looking at solutions for those through R&D. There is also an interest in tire pressure sensing for the heavy vehicle market, which would bring new revenues for the company within a couple years.

As well, for its performance sensing business, Sensata won two key gas direct injection (GDI) contracts against competitors which will bring \$10M per year in new revenues beginning next year.

Overall, Sensata invests more and more in R&D because of the beneficial effects it has on its revenues and on its stock price. The company invest 9% of its revenues in R&D to create future value, an increasing amount year to year to support new technology developments in acquired and existing business, in order to drive future revenue growth.

## Value Creation for Investors

Sensata has been focusing on creating value for its investors. To do so, they continue to invest in long-term growth by gaining contracts towards energy efficiency and a clean environment, like the previously mentioned new contract for electric cars.

To increase profitability, Sensata is also going through a restructuring of the companies it bought, in order to remove the inefficient parts of the companies. To do so, the company is in the process of closing two production facilities brought on by the CST acquisition with a focus on improving margins to elevate the profitability of the acquired businesses.

Another growth opportunity for Sensata is the Tire Pressure Monitoring Sensors (TPMS) leadership opportunities in China. TPMS is expected to be adopted in Chinese regulations next year, because of the important mandate just passed in China in Q3 2016. This will allow the company to move its business in China and will bring new revenues and allow for further growth in Asia. Considering the outlook on the automotive business, revenue growth will be driven by China, and Asia in general.

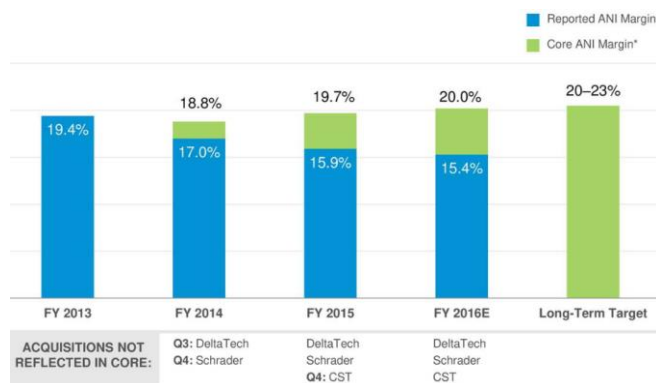
Looking at the longer term, this year, Sensata created a partnership with Quanergy to create sensors to be used in the autonomous driving market. Research is going smoothly and both companies are expecting the final product delivered by 2020, which would be revolutionary to the industry and would bring new revenues to both companies.

Overall, Sensata is committed to create value for its shareholders through acquisitions, long-term revenue and earnings growth, strong cash generation, and increasing margins in growth markets.

## Financials

As previously stated, Sensata is a highly levered company with a D/E ratio of 198. This high debt gives them exposure to changes in interest rates. Though its current tax rate is around 6%, it is expected to remain between 6% and 7% next year, lowering the risk of increasing interest expenses. Since the company has made a commitment to rapidly pay back its debt in order to become a less risky company for investors, this exposure should decrease within the next year.

Looking at the company's revenues, they increased by 9% from 2014 to 2015 and are expected to grow at a faster pace in the coming years. For its Q3 2016 earnings, the company reported an organic revenue growth of +1.7% and a net margin of 16%. The company also has a long-term net margin target of 20-23%. The reason why this was never achieved is because of the lower margins on acquisitions, as seen in the below graph.



As for ROIC/WACC, Sensata is at 1.35 compared to 1.30 for its competitors, showing invested capital is being used effectively.

ROIC			WACC		
	History	LFY		History	LFY
ST	11.6%	9.1%	ST	8.6%	8.6%
Competitors	12.9%	11.3%	Competitors	10.0%	8.5%

ROIC /WACC		
	History	LFY
ST	1.35	1.07
Competitors	1.30	1.33

Looking at the segments, performance sensing is expected to see its revenues increase from \$585 M in Q3 2016 to \$785 M in Q4 2016. Its organic revenue growth is at +1.5%. The automotive market for both segments is the largest market for the company and is expected to have an organic revenue growth of 5% for 2016.

The company is financially healthy, except for its high amount of debt, which should be remedied by end of next year.

## Risks

There are always risks involving when investing in a technology company. But for Sensata, the main risks surround new acquisitions and currency transactions. In fact, in the past, Sensata has seen its stock price drop because of new acquisitions. The uncertainty of the outcome scares investors and the price drops. As for the currency transaction risk, Sensata has seen a slight decrease in revenues last year because of the euro devaluation against the dollar, which also scared investors. But looking at organic EPS growth, excluding acquisitions and currency effects, it was at 11% last year and should keep growing.

## Important Dates and Catalysts

Important events to look at and to consider as catalysts for the stock price would be potential new acquisitions, though none are expected before end of 2017.

As well, new revenues and contracts would drive the price of the stock up and would reassure investors as to the future of the company.

## Summary

Sensata is a BUY because it delivers strong organic EPS growth and makes good progress on its margin expansions and the integration of its acquisitions. With a focus on paying its debt and strengthening its balance sheet, the company is on the path of becoming a less risky company for investors. It is also on track to deliver the FY 2016 earnings guidance which would drive the price up.

Sensata has a long period of potential growth ahead of them and is currently undervalued because of the risk it currently represents.



**Sensata Technologies  
Holding NV (ST)**

**CENTER FOR GLOBAL FINANCIAL STUDIES**

**NEUTRAL**

Analysis by Audrey Barrucand

Current Price:

\$35.49

Intrinsic Value

\$33.99

11/3/2016

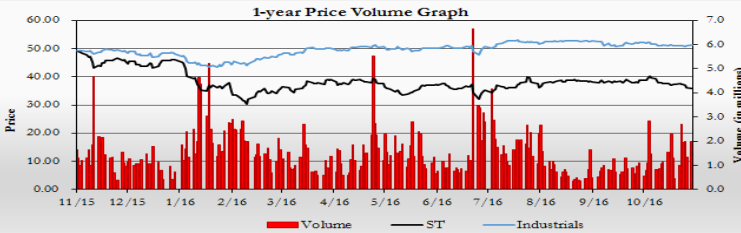
Divident Yield:

0.0%

Target Price

\$38.43

Target 1 year Return: 8.28%  
Probability of Price Increase: 77.4%



**Description**  
Sensata Technologies Holding N.V., through its subsidiaries, develops, manufactures, and sells sensors and controls.

Market Data	
Market Capitalization	\$6,063.83
Daily volume (mil)	1.45
Shares outstanding (mil)	170.86
Diluted shares outstanding (mil)	171.40
% shares held by institutions	104%
% shares held by investments Managers	78%
% shares held by hedge funds	22%
% shares held by insiders	0.39%
Short interest	5.59%
Days to cover short interest	9.12
52 week high	\$49.19
52-week low	\$29.92
Levered Beta	1.33
Volatility	25.96%

General Information	
Sector	Industrials
Industry	Electrical Equipment
Last Guidance	November 3, 2015
Next earnings date	February 3, 2017
Estimated Country Risk Premium	5.13%
Effective Tax rate	28%
Effective Operating Tax rate	27%

**Peers**

TE Connectivity Ltd.  
Rockwell Automation Inc.  
Emerson Electric Co.  
Eaton Corporation plc

Past Earning Surprises	
Quarter ending	Revenue
9/30/2015	-2.10%
12/31/2015	-1.16%
3/31/2016	0.08%
6/30/2016	-1.13%
9/30/2016	-2.13%
Mean	-1.29%
Standard error	0.4%

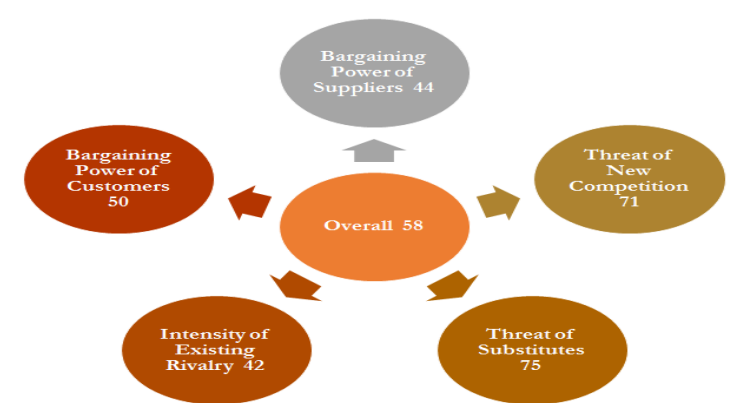
Management	
Sullivan, Martha	Chief Executive Officer, Pre
Vasington, Paul	Chief Financial Officer, Chi
Cote, Jeffrey	Chief Operating Officer and
Beringhouse, Steven	Chief Technology Officer and
Stefanic, Rob	Chief Information Officer an
Young, Joshua	Vice President of Investor R

Profitability	
ST (LTM)	ST (5 years historical average)
ROIC	23.4%
NOPAT Margin	17%
Revenue/Invested Capital	1.35
ROE	-31.5%
Adjusted net margin	13%
Revenue/Adjusted Book Value	-2.34

Invested Funds	
ST (LTM)	ST (5 years historical average)
Total Cash/Total Capital	4.5%
Estimated Operating Cash/Total Capital	4.5%
Non-cash working Capital/Total Capital	5.8%
Invested Capital/Total Capital	38.8%

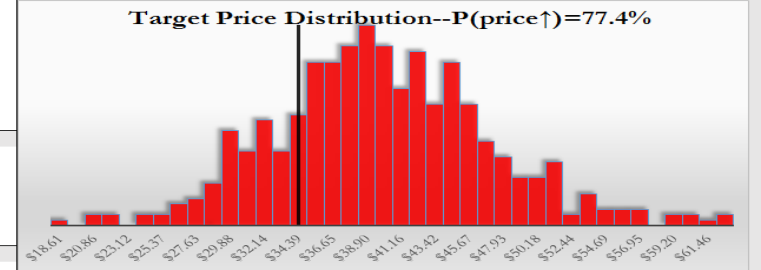
Capital Structure	
ST (LTM)	ST (5 years historical average)
Total Debt/Common Equity (LTM)	0.51
Cost of Existing Debt	4.97%
Estimated Cost of new Borrowing	3.72%
CGFS Risk Rating	BB
Unlevered Beta (LTM)	1.00
WACC	8.55%

**Porter's 5 forces (scores are out of 100)**



Revenue growth	
Period	Revenue growth
Base Year	6.3%
9/30/2017	2.9%
9/30/2018	2.7%
9/30/2019	2.9%
9/30/2020	3.0%
9/30/2021	3.2%
9/30/2022	3.3%
9/30/2023	3.5%
9/30/2024	3.6%
9/30/2025	3.8%
9/30/2026	3.9%
Continuing Period	4.1%

Invested Capital	
Period	Invested Capital
Base Year	\$904.68
9/30/2017	\$1,153.89
9/30/2018	\$1,358.75
9/30/2019	\$1,856.68
9/30/2020	\$2,325.19
9/30/2021	\$2,611.44
9/30/2022	\$2,753.32
9/30/2023	\$2,798.86
9/30/2024	\$2,840.69
9/30/2025	\$2,882.60
9/30/2026	\$2,922.97
Continuing Period	



Sensitivity Attribution Analysis	
Revenue	62.1%
Operating Expenses	30.5%
Dividends	0.0%
NWC	0.6%
CAPEX	0.4%
Operating Cash	0.5%

Valuation	
NOPAT margin	ROIC/WACC
17.3%	2.73
14.6%	2.15
15.1%	2.20
14.8%	2.21
14.5%	2.22
14.1%	2.24
13.8%	2.26
13.5%	2.30
13.2%	2.33
13.0%	2.37
12.7%	2.42
12.4%	2.45

Net Claims	
Price per share	
\$3,411.59	\$34.43
\$3,155.20	\$38.57
\$2,771.91	\$42.86
\$2,444.77	\$46.89
\$2,162.00	\$50.75
\$1,906.17	\$54.51
\$1,659.92	\$58.30
\$1,409.61	\$62.17
\$1,149.77	\$66.16
\$855.54	\$70.40
\$511.08	\$75.00