ON SEMICONDUCTOR CORPORATION

SCRIPT FOR
Q1-20 RESULTS CONFERENCE CALL

Parag Agarwal

Thank you <operator>.

Good morning and thank you for joining ON Semiconductor Corporation's first quarter 2020 quarterly results conference call. I'm joined today by Keith Jackson, our President and CEO, and Bernard Gutmann, our CFO. This call is being webcast on the "Investor Relations" section of our website, at www.onsemi.com. A replay of this broadcast, along with our 2020 first quarter earnings release, will be available on our website approximately one hour following this conference call, and the recorded broadcast will be available for approximately 30 days following this conference call. The script for today's call and additional information related to our end-markets, business segments, geographies, channels, share count, and 2020 fiscal calendar are also posted on our website.

Our earnings release and this presentation include certain non-GAAP financial measures. Reconciliations of these non-GAAP financial measures to the most directly comparable measures under GAAP are in our earnings release, which is posted separately on our website in the "Investor Relations" section.

During the course of this conference call, we will make projections or other forward-looking statements regarding future events or the future financial performance of the company. The words "believe," "estimate," “project,” "anticipate," "intend," “may,” "expect,” “will,” "plan," "should" or similar expressions are intended to identify forward-looking statements. We wish to caution that such statements are subject to risks and uncertainties that could cause actual events or results to differ materially from projections. Important factors which can affect our business, including factors that could cause actual results to differ from our forward-looking statements, are described in our Form 10-K, Form 10-Qs and other filings with Securities and Exchange Commission.

Additional factors are described in our earnings release for first quarter of 2020. Our estimates, or other forward-looking statements may change, and the company assumes no obligation to update forward-looking statements to reflect actual results, changed assumptions, or other factors, except as required by law.

Given the current restrictions on travel and gatherings due to COVID-19 pandemic, the previously announced Strategic Business Update scheduled for August 18 in New York has been postponed. We will provide you new date and location for the event as we get further clarity.

Now, let me turn it over to Bernard Gutmann, who will provide an overview of our first quarter 2020 results. Bernard….

Bernard Gutmann

Thank you Parag, and thank you everyone for joining us today.

As is the case with most of our peers, our results for the first quarter 2020, and outlook for the second quarter have been meaningfully impacted by COVID-19. Although our near term results have been impacted by the pandemic, we believe that long term drivers of our business remain intact. We expect to show progress towards our target financial model as global macroeconomic environment recovers, and we continue to implement structural changes to drive margin expansion and higher free cash flow.

In face of challenging business conditions, we have taken measures that should strengthen our balance sheet and free cash flow. These steps include the drawdown of approximately $1.17 billion from our revolving line of credit. This step was taken out of abundance of caution to ensure that we have an adequate level of liquidity should the global macroeconomic conditions unexpectedly and sharply deteriorate due to the COVID-19 pandemic. Furthermore, we have taken certain tactical and temporary actions, which should result in cost savings of approximately $50 million through the rest of the year. These measures include reduction in executive salaries and compensation for board members, suspension of our 401K company match program in the US, deferral of merit salary and wage increases, and staggered furloughs of certain employees for three weeks during the year. The cost savings of $50 million through rest of 2020 are in addition to those from our $115 million restructuring programs announced earlier. We anticipate that our capital expenditure for 2020 will be largely focused on enabling our 300mm fab in East Fishkill. At this time, we expect capital expenditure of approximately $425 million in 2020. Furthermore, to preserve our balance sheet strength, we do not intend to buyback our shares until business conditions improve.

Now, let me provide you additional details on our first quarter 2020 results.

Total revenue for the first quarter of 2020 was $1,278 million, a decrease of eight percent as compared to revenue of $1,387 million in the first quarter of 2019. The year-over-year decline in revenue was primarily driven by slowdown in global macroeconomic activity and supply constraints resulting from COVID related government mandated lockdown measures around the world. We drastically curtailed operations at few of our factories to ensure safety of our employees and to comply with local regulations. GAAP net loss for the first quarter was $0.03 per diluted share as compared to a net income of $0.27 per diluted share in the first quarter of 2019. Non-GAAP net income for first quarter of 2020 was $0.10 per diluted share as compared to $0.43 per diluted share in first quarter of 2019.

GAAP and non-GAAP gross margin for first quarter of 2020 was 31.5 percent as compared to 37 percent in first quarter of 2019. The year-over-year decline in gross margin was primarily driven by lower revenue and significantly lower level of factory utilization, as mentioned earlier. As required by GAAP, we recorded a period charge of approximately $19 million due to significant underutilization of our factory network in the first quarter. This charge also includes the impact of a short strike at our Belgium fab. This strike was related to our announced plan to divest the fab. As utilization of our factory network improves with expected improvement in business conditions potentially in second half of the year, we will not be required to take underutilization related period charge. As a result, we could see a step-function increase in our gross margin. First quarter 2020 gross margin was further impacted by approximately $3 million charge as a result of higher logistics and freight costs.

Our GAAP operating margin for the first quarter of 2020 was 1.5 percent, as compared to 12.9 percent in the first quarter of 2019. Our non-GAAP operating margin for the first quarter of 2020 was 6.6 percent, as compared to 15.5 percent in first quarter of 2019. The year-over-year decline in operating margin was largely driven by lower revenue and gross margin.

GAAP operating expenses for the first quarter were $384 million, as compared to $334 million in the first quarter of 2019. First quarter GAAP operating expenses include approximately $31 million associated with restructuring programs announced earlier. Non-GAAP operating expenses for the first quarter were $319 million, as compared to $299 million in the first quarter of 2019. The year-over-year increase in non-GAAP operating expenses was primarily due to acquisition of Quantenna.

First quarter free cash flow was $34 million and operating cash flow was $166 million. During the first quarter, we used approximately $65 million to repurchase 3.6 million shares of our common stock. Capital expenditures during the first quarter were $132 million, which equate to a capital intensity of 10.3 percent. Given the current macroeconomic environment, we are directing most of our capital expenditures towards enabling our 300mm fab at East Fishkill. As indicated earlier, we expect capital expenditure for 2020 to be approximately $425 million. We exited the first quarter of 2020 with cash and cash equivalents of $1,982 million, as compared to $894 million at the end of fourth quarter 2019. At this time, with cash balance of approximately $2 billion, we are very comfortable with our liquidity position.

At the end of the first quarter, days of inventory on hand were 131 days, up by 8 days as compared to 123 days in the fourth quarter of 2019. The increase in days of inventory was driven primarily by lower than expected revenue. Distribution inventory increased slightly in terms of weeks of inventory due to lower resales. In terms of dollars, distribution inventory declined quarter over quarter.

Now let me provide you an update on performance of our business units, starting with Power Solutions Group, or PSG. Revenue for PSG for the first quarter was $624 million. Revenue for Advanced Solutions Group, previously known as Analog Solutions Group, for the first quarter was $467 million, and revenue for our Intelligent Sensing Group was $187 million.

Now, I would like to turn the call over to Keith Jackson for additional comments on the business environment. Keith …..

Keith Jackson

Thanks, Bernard.

At the outset, I thank all of our employees for their dedication in supporting our first responders and customers in face of very challenging conditions. Our employees went well beyond what is required of them to ensure supply of critical components for ventilators and other medical equipment. In countries where governments instituted lockdown measures to control the spread of the virus, many of our manufacturing and support teams stayed at factories to ensure supply of critical components to our customers.

Safety of our employees is of paramount importance to us. Consistent with that commitment, we have suspended all non-essential travel. Globally, the teams are working remotely in compliance with local rules and are following strict social distancing guidelines in case they are required to visit a work facility. Our IT organization has done an outstanding job of enabling thousands of our employees to work remotely.

We are actively supporting local communities by donating medical supplies and personal protective equipment, and matching employee donations. We continue to step up on short notice. When state of California requested one of our customers for a quick turnaround on ventilators, our supply chain and manufacturing teams responded with extreme urgency to provide critical components immediately. These teams, like many others in ON Semiconductor, exemplify the spirit of collaboration and being a good corporate citizen.

Despite the current challenges, key secular megatrends and long-term drivers of our business remain intact. In automotive, we expect that key secular trends, such as ADAS, vehicle electrification, and fuel efficiency will continue along a steep upward trajectory. In industrial, we expect to see acceleration in factory and warehouse automation, robotics, energy efficiency, and personal medical devices. In cloud-power, along with growth in data-centric applications, we expect to see increased spending on servers and communications infrastructure as companies put in place a robust infrastructure to enable a remote and distributed workforce.

We believe that the global community should be able to overcome the current public health crisis in a timely manner, and we expect business activity to improve soon thereafter. While we are taking measures to mitigate the impact of soft business conditions, our long-term goals and strategy remain unchanged. We are aggressively working to enable our 300mm manufacturing capability. Our product development programs and customer engagement on key strategic projects are continuing as planned. We continue to strengthen our leadership by investing in the fastest growing segments of automotive, industrial and cloud-power end-markets. We expect that our content in these applications will continue to grow at a healthy pace despite the current crisis. Along with continued execution on our key strategic initiatives, we are making structural and tactical changes to align our business with current conditions, and to drive long-term growth in profitability and free cash flow.

Our business realignment programs remain on track. We have taken actions to complete the previously announced restructuring programs. These programs should result in cost savings of approximately $115 million per year. As announced earlier, we should be able to achieve these savings by the fourth quarter of 2020 on run rate basis. We believe that with these actions, the company is well positioned for accelerated progress towards our target model as the global macroeconomic environment recovers from the COVID-19 pandemic.

As mentioned during the previous results conference call, we are making strong progress towards ramping production at our 300mm fab at East Fishkill. At this point, we are tracking significantly ahead of schedule, and we now expect to begin initial production in middle of 2020. The results and yields of initial wafer runs have been spectacular. Based on our experience thus far with the East Fishkill fab, we are even more confident that transition of production to this fab will be a major inflection point for our manufacturing cost structure as we consolidate our front end-network.

Let me now comment on the current business environment.

On the demand front, it is a mixed picture. Demand from automotive end-market has been impacted severely due to closure of manufacturing plants and extremely challenging global macroeconomic conditions. We expect automotive weakness to continue till automotive manufacturing plants reopen and global production restarts at least at a moderate pace. We are seeing good strength in a few end-markets in the second quarter. Most notably, activity in industrial end-market demand appears to be strong across most geographies. Server and 5G infrastructure related demand continues to grow at a healthy pace. Demand from smartphone and consumer end-markets continues to be soft due to massive slowdown in global macroeconomic activity.

From a geographic perspective, after slowdown early in the first quarter, demand from China has improved meaningfully. Japan is another area of moderate strength. Demand from the US and Europe has significantly softened due to pause in most economic activities because of government mandated quarantines and other regulatory action aimed at reducing the spread of COVID-19. Both in US and Europe, automotive is an area of conspicuous weakness.

It appears that customers are preparing for a recovery in the second half, and are placing orders to ensure supply. At this time, we are seeing significantly higher order activity for the second half of the year as compared to that in the first half of the year. The orders are broad-based in terms of end-markets, geographies, and channels.

During the first quarter, the COVID-19 pandemic significantly affected our operations, and impacted our ability to supply products to many of our customers. These disruptions have continued into the current quarter, and we expect them to resolve by the end of this week. Early in the first quarter, our manufacturing facilities in China were closed for longer than planned for Lunar New Year holidays in compliance with government mandates. Following the extended shutdown, our China factories resumed production, and are now running at close to full utilization. Subsequently, in March, our facilities in Malaysia and Philippines, where a sizeable part of our back-end operations are located, were severely impacted due to lockdown mandates issued by various governments. Our Malaysia and Philippines manufacturing plants ran significantly below capacity for most of March. Underutilization of these facilities continued in April, and into May. Most of our facilities worldwide are expected to be running at required level of utilization by end of this week.

Now I'll provide details of the progress in our various end-markets for first quarter of 2020.

Revenue for the **automotive** market in the first quarter was $439 million and represented 34 percent of our revenue in the first quarter. First quarter automotive revenue declined six percent year-over-year. The year-over-year decline in automotive market was primarily driven by closure of automotive production factories in various parts of the world and supply constraints driven by reduced level of operations at our and our partners' manufacturing facilities.

We saw weakness in China automotive and industrial markets earlier in the first quarter, but business activity has since picked up as factories have reopened in China. Currently, we are seeing significant weakness in US and European automotive markets due to closure of automotive factories. Based on comments by major automakers, it appears that many European factories are now gradually restarting. In the US, automakers are planning to reopen factories starting in latter half of May.

Based on third party reports, we expect global light vehicle production units to decline by approximately 20 to 25 percent year-over-year in 2020. Despite a massive decline in light vehicle production units, we expect semiconductor content in automotive applications to continue to increase at a healthy pace. Key secular megatrends driving increased semiconductor content in automotive applications such as vehicle electrification, ADAS, fuel efficiency and LED lighting remain intact, and we are well positioned through our technology leadership and customer relationships to capitalize on these trends.

During the first quarter, we secured a major design win for ADAS image sensors with a Japanese OEM. This OEM is one of the largest automakers in the world. This win underscores our global leadership in ADAS image sensors, and highlights customer confidence in our technology in a highly safety critical application.

Our momentum for our Silicon Carbide and silicon power products for electric vehicles continues to increase at a rapid pace. With a solid product portfolio of Silicon Carbide devices and modules, we are seeing a strong growth in revenue from electric vehicles. At the same time, the breadth and depth of our engagement with leading participants in electric vehicle ecosystem is expanding very significantly. We expect to see strong revenue growth in our IGBT modules for EV traction inverters as our design wins ramp in China this year. Extension of subsidies for electric vehicles in China till 2022 is likely to be a significant boost for our Silicon Carbide and IGBT business in China.

Our power products continue to grow in many automotive applications. Electrification of various vehicle systems to conserve energy and improve performance is key driver of increasing content of power devices in vehicles. During the first quarter, we also secured a major design win for our mid-voltage MOSFETs for 48V systems.

Revenue in the second quarter of 2020 for the automotive end-market is expected to be down steeply quarter-over-quarter due to closure of most US and European automotive factories for a significant part of the quarter.

The **Industrial** end-market, which includes military, aerospace, and medical, contributed revenue of $315 million in the first quarter. The Industrial end-market represented 25 percent of our revenue in the first quarter. Year-over-year, our first quarter industrial revenue declined 12 percent. This decline was driven by a swift and sharp decline in global industrial activity and supply constraints due to the COVID-19 pandemic.

Despite challenging macroeconomic conditions, we continue to make progress towards our key strategic initiatives. In industrial power segment, momentum for our Silicon Carbide and silicon devices remains robust. We are seeing strong customer interest for our Silicon Carbide devices for fast charging stations for electric vehicles. During the first quarter, we secured an important design win for our high-voltage super-junction MOSFETs for electric vehicle charging stations.

On the medical front, our teams are working very hard to support the medical community in the fight against COVID-19. The entire organization is focused on supporting increased demand for components for critical medical equipment such as ventilators, infusion pumps, patient monitoring systems, cardiac assist systems, and medical imaging equipment.

Our engagement with e-commerce customers is growing at a rapid pace, and we expect e-commerce related applications will be a strong driver of our industrial image sensor business. We believe that growth in our e-commerce related business will be driven by increasing e-commerce volumes, increasing warehouse automation, and adoption of delivery robots. Through our early engagement with industry leaders in e-commerce, we have built a strong design win pipeline for our CMOS image sensors for warehouse automation and delivery robots.

Revenue in the second quarter of 2020 for the industrial end-market is expected to be up quarter-over-quarter, driven by strong recovery in demand from all regions.

The **Communications** end-market, which includes both networking and wireless, contributed revenue of $254 million in the first quarter, and represented 20 percent of our revenue during the first quarter. First quarter communications revenue declined one percent year-over-year. The decline was primarily due to weakness in our smartphone related business. We saw solid year-over-year growth in our infrastructure business, driven largely by 5G. We further solidified our position in the 5G-infrastructure market by winning new designs for medium voltage MOSFETs.

Revenue in the second quarter of 2020 for the communications end-market is expected to be down quarter-over-quarter, primarily due to softness in smartphone market. We expect our 5G infrastructure to grow at a robust pace quarter over quarter in the second quarter.

The **Computing** end-market contributed revenue of $136 million in the first quarter. The computing end-market represented 11 percent of our revenue in the first quarter. First quarter computing revenue declined seven percent year-over-year, primarily due to our selective participation in the client related business. Our server business grew at a very impressive rate year-over-year.

We experienced better than expected results in our server business as corporations rushed to augment their IT infrastructure to support remote workforce. Our power management products for server processors and IGBTs for uninterruptable power supplies were key driver of strength in our server business.

Revenue in the second quarter of 2020 for the computing end-market is expected to be up quarter-over-quarter. We expect growth in both server and client parts of our computing business.

The **Consumer** end-market contributed revenue of $134 million in the first quarter. The consumer end-market represented 10 percent of our revenue in the first quarter. First quarter consumer revenue declined by 17 percent year-over-year. The year-over-year decline was due to broad-based weakness in consumer electronics market due to COVID-19 pandemic and our selective participation in this market.

Revenue in the second quarter of 2020 for the consumer end-market is expected to be down quarter-over-quarter.

In summary, COVID-19 had a sizable impact on both demand for our products and our ability to supply. We expect that during the second quarter, by the end of this week, our supply capabilities will improve significantly. Based on order patterns, it appears that our customers are planning for a recovery in the second half of the year, and we are encouraged by gradual resumption of economic activity globally. Despite current challenges due to COVID-19 pandemic, our long-term goals and strategy remains unchanged. We have taken previously announced restructuring actions to optimize our investments and cost structure, and we are well positioned to make accelerated progress towards our target model as the global macroeconomic environment recovers. We continue to work aggressively to enable our 300mm fab in East Fishkill, and we remain on track to start our 300mm production by middle of this year. Despite the current macroeconomic disruptions, key secular megatrends driving our business remain intact, and we are upbeat about our medium to long-term prospects. We are focused on the fastest growing end-markets of semiconductor industry, and with our design wins, we expect that our content in automotive, industrial, and cloud-power applications will continue to grow.

Now, I would like to turn it back over to Bernard for forward-looking guidance. Bernard…..

Bernard Gutmann

Thank you, Keith.

Before I get into the details, let me highlight the key drivers of the guidance for the second quarter. Our guidance for the second quarter is based on the assumption that the global macroeconomic environment will not further deteriorate due to the COVID-19 pandemic. We will likely continue to face operational and logistical challenges due to government mandates. Also, this is a period of extreme uncertainty and volatility, and future results of our business will not only depend on the course of the pandemic, but also on government actions and pace of recovery in global macroeconomic activity. Therefore, our ability to forecast our business performance is limited, and the range of our guidance for various financial metrics for the second quarter is wider than what we have provided historically.

Based on product booking trends, backlog levels, and estimated turn levels, we anticipate that total ON Semiconductor revenue is expected to be in the range of $1,100 million to $1,260 million in second quarter of 2020. As noted earlier, we will likely continue to face operational and logistical challenges due to government mandates in the second quarter.

For second quarter of 2020, we expect GAAP and non-GAAP gross margin between 29 percent to 31 percent. Lower revenue in the second quarter as compared to that in the first quarter is the primary driver of quarter over quarter decline in gross margin for the second quarter. We expect to record marginally lower period underutilization charge in the second quarter as compared to that in the first quarter.

We expect total GAAP operating expenses of $340 million to $360 million. Our GAAP operating expenses include amortization of intangibles, restructuring, asset impairments, and other charges, which are expected to be $43 million to $47 million. We expect total non-GAAP operating expenses of $297 million to $313 million in the second quarter.

We anticipate second quarter of 2020 GAAP net other income and expense, including interest expense, will be $42 million to $45 million, which includes non-cash interest expense of $9 million to $10 million. We anticipate our non-GAAP net other income and expense, including interest expense, will be $33 million to $35 million.

Net cash paid for income taxes in second quarter of 2020 is expected to be $10 million to $13 million. For 2020, we expect cash paid for taxes to be in range of $50 million to $60 million. We expect total capital expenditures of $80 million to $100 million in second quarter of 2020. We are currently targeting an overwhelming proportion our capex for enabling our 300mm fab at an accelerated pace. For 2020, we expect total capital expenditures of approximately $425 million.

We also expect share based compensation of $19 million to $21 million in second quarter of 2020, of which approximately $2 million is expected to be in cost of goods sold, and the remaining amount is expected to be in operating expenses. This expense is included in our non-GAAP financial measures.

Our GAAP diluted share count for second quarter of 2020 is expected to be 413 million shares, based on our current stock price. Further details on share count and earnings per share calculations are provided regularly in our quarterly and annual reports on Form 10-Q and Form 10-K, respectively.

With that, I would like to start the Q&A session. Thank you, and <operator> please open the line for questions.

###