ON SEMICONDUCTOR CORPORATION

CALL SCRIPT
FOR
Q1-19 RESULTS CONFERENCE CALL

Parag Agarwal

Thank you <operator>.

Good morning and thank you for joining ON Semiconductor Corporation's first quarter 2019 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 earnings release for first quarter of 2019, 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 and share count 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-Ks, Form 10-Qs and other filings with Securities and Exchange Commission.

Additional factors are described in our earnings release for first quarter of 2019. Our estimates 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.

During the second quarter, we will attend Bank of America Technology Conference in San Francisco on June 4th.

Now, let me turn it over to Bernard Gutmann, who will provide an overview of first quarter 2019 results. Bernard….

Bernard Gutmann

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

Our first quarter results demonstrate our solid execution on the operations front in face of slowing business conditions. Secular trends driving our business remain intact, and we are well positioned to capitalize on these secular trends to deliver strong revenue and margin performance. Mid to long-term outlook for our business remains strong, and our design win pipeline in our key strategic markets, which include automotive, industrial, and cloud-power continues to grow. Despite near-term headwinds, we remain upbeat about our future.

During the first quarter, we saw sub-seasonal trends across most geographies and end-markets, and these trends have continued into the second quarter. However, based on recent data, we expect to see improving business trends in second half of 2019. Keith will provide further details on current business trends in his prepared remarks.

We are managing our business prudently to adjust to this near-term slowdown. We have taken measures to control our operating expenses in-line with relatively soft business conditions. We believe that a highly diversified customer base, exposure to the fastest growing semiconductor end-markets, and long life cycle of many of our products should help us better navigate the current slowdown in demand as compared to broader analog and power semiconductor industry.

While we are seeing some softness in business conditions in the near-term, we are continuing to invest to strengthen and build our leadership in key strategic markets, and to improve our cost structure. In the first quarter, we entered into a definitive agreement to acquire Quantenna Communications, which we believe will strengthen our presence in connectivity applications for industrial and automotive end-markets. We also recently announced our plans to add the first 300 mm fab to our manufacturing network in a phased transaction over next four years. The addition of this fab in a staged process should accelerate our progress towards our 2022 target financial model, enable savings of approximately $1 billion in capital expenditure over next several years, and provide sufficient capacity to support our long-term growth at highly competitive cost structure.

Now, let me provide you additional details on our first quarter 2019 results.

Total revenue for the first quarter of 2019 was $1,387 million, an increase of one percent as compared to revenue of $1,378 million in the first quarter of 2018. First quarter 2019 revenue included the contribution of $18 million from ON Semiconductor Aizu Co., Ltd., also known as OSA. Excluding the impact of OSA, our first quarter 2019 revenue declined by one percent year-over-year. As we announced earlier, OSA is our manufacturing joint venture for an 8-inch wafer fab in Aizu-Wakamatsu, Japan. GAAP net income for the first quarter was $0.27 per diluted share as compared to $0.31 in the first quarter of 2018. Non-GAAP net income for the first quarter was $0.43 per diluted share as compared to $0.40 in first quarter of 2018.

GAAP and non-GAAP gross margin for the first quarter was 37 percent. On year-over-year basis, our first quarter 2019 GAAP and non-GAAP gross margin declined by 60 basis points, of which 50 basis points was due to the impact of OSA.

Our GAAP operating margin for the first quarter of 2019 was 12.9 percent, as compared to 13.5 percent in the first quarter of 2018. Our non-GAAP operating margin for the first quarter of 2019 was 15.5 percent as compared to 15.7 percent in first quarter of 2018. The year-over-year decline in operating margin was driven largely by the impact of OSA.

GAAP operating expenses for the first quarter were $334 million, as compared to $332 million for the first quarter of 2018. Non-GAAP operating expenses for the first quarter were $299 million, as compared to $301 million in the first quarter of 2018.

First quarter free cash flow was negative $19 million, and operating cash flow was $138 million. Capital expenditures during the first quarter were $157 million, which equates to a capital intensity of 11 percent. We expect capital intensity for 2019 to be approximately nine percent of revenue. We exited the first quarter of 2019 with cash and cash equivalents of $940 million, as compared to $1,070 million at the end of fourth quarter 2018. We used $75 million of cash to repurchase 4.4 million shares of our stock in the first quarter. As a result of the acquisition activity in the first quarter, we have paused our share repurchase program.

At the end of the first quarter, days of inventory on hand were 128 days, up by eight days as compared to 120 days in the fourth quarter of 2018. Distribution inventory in terms of weeks increased quarter-over-quarter in the first quarter, and is now slightly higher than our target range of 11 to 13 weeks. We expect to see reduction in our distribution inventories in the second quarter. The increase in weeks of distribution inventory in the first quarter was driven largely by softer than expected demand.

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 $704 million. Revenue for Analog Solutions Group for the first quarter of 2019 was $494 million, and revenue for Intelligent Sensing Group was $188 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.

Our execution momentum remains solid, despite relatively soft market conditions. We delivered strong margin and earnings performance, even in face of a slowdown in demand from most geographies and end-markets. With our exposure to secular megatrends in automotive, industrial and cloud-power end-markets, strong operating expense discipline, and solid execution on operations front, we are well positioned to navigate through current slowdown in market conditions. Furthermore, based on current order trends, distribution sell-through trends and macroeconomic data, we expect business conditions to improve in the second half of the year, and we remain upbeat about our mid to long-term prospects. With our planned acquisitions of Quantenna Communications and GLOBALFOUNDRIES's 300 mm fab in East Fishkill, New York, we are making prudent investments to strengthen our market leadership and significantly improve our manufacturing cost structure.

Key megatrends driving our business remain intact and our customers are increasingly relying on us as a strategic partner for key technologies to enable major disruptive trends in automotive, industrial, and cloud-power end-markets. In the automotive market, accelerating adoption of electric vehicles and active safety should drive strong growth in our power semiconductor and sensor businesses. In the industrial market, we are seeing strong traction for our power semiconductors, driven by higher power efficiency requirements for industrial systems. In cloud-power market, we are seeing robust growth for our analog power management products for servers and power semiconductors for 5G infrastructure markets.

Let me now comment on the business environment. Business conditions continue to be soft across most end-markets and geographies. However, we are seeing signs that point towards improving business trends in the second half of the year. Thus far, orders for second half of the year have shown strong recovery, and we have seen meaningful improvement in distribution sell-through in recent weeks. From geographical perspective, China, which has been source of weakness in recent quarters, appears to be improving. Business conditions in other geographies have been sub-seasonal recently, but we believe that the softness is temporary. We expect to see improving business conditions in second half of the year as customers adjust their inventory levels in line with demand outlook.

On supply side, we are seeing broad-based inventory reduction by OEMs, even though inventories at OEMs appear to be at healthy levels. We believe that much of inventory correction by OEMs should be complete in the second quarter. On distribution front, although anecdotal data and comments from distributors point to elevated semiconductor inventory levels, we believe that our inventory at distributors is at very healthy levels. As Bernard indicated earlier, our distribution inventory was slightly higher than our normal range at the end of the first quarter, but we expect to reduce our distribution inventories in the second quarter.

Now I'll provide details of the progress in our various end-markets for first quarter of 2019.

Revenue for the **automotive** market in the first quarter was $465 million and represented 34 percent of our revenue in the first quarter. First quarter automotive revenue grew by four percent year-over-year.

In the first quarter, we continued to see significant weakness in automotive market in China. We are seeing some softness in the second quarter in automotive demand from other regions, including Americas, Europe and Japan. We believe that the current softness will be short-lived as global OEMs and tier-1s adjust their inventories in-line with slowing global automotive market. We expect to see improvement in demand for our automotive products in the second half of the year.

Despite softness in automotive market conditions, our design-win pipeline in automotive market continues to grow at a solid pace. Our content in automotive applications continues to grow, and we are seeing strong adoption of our products in vehicle electrification, active safety, LED lighting, in-vehicle networking, and in various analog power management applications.

We are seeing strong momentum for our power products, especially MOSFETs, traction IGBTs, high power modules, and gate drivers in vehicle electrification with OEMs and tier-1s, worldwide. We expect start of production ramp of our design wins in multiple electric vehicle platforms in 2020. Customer response to our Silicon Carbide products has been very strong. We are also seeing strong traction for our power products in 12 volt and 48 volt electrical systems.

In ADAS applications, our momentum continues to accelerate. We are seeing strong interest from customers in our broad portfolio of automotive image sensor products. Recall that we are the only provider of automotive image sensors with complete portfolio of 1 MP, 2 MP and 8 MP image sensors. The breadth of our portfolio has enabled us to secure many design wins from leading global OEMs and tier-1s. We continue to make progress in our automotive radar development platform and we expect our first radar related revenue in 2021.

On analog power management front, we continue to make progress on our power management programs for automotive processors. We are engaged with all leading processor providers for automotive applications. We are also seeing strong traction for our LED drivers for lighting applications.

Revenue in the second quarter for the automotive end-market is expected to be slightly down, as opposed to seasonally higher sequential revenue. Weaker than seasonal growth in our automotive business is driven primarily by softness in global automotive market.

The **Industrial** end-market, which includes military, aerospace, and medical, contributed revenue of $359 million in the first quarter. The Industrial end-market represented 26 percent of our revenue in the first quarter. On year-over-year basis, our first quarter industrial revenue declined by five percent. Greater China region has been the primary source of weakness in the industrial market.

While we are seeing weakness in the industrial market, largely due to softness in China, we believe that we are well positioned to capitalize on secular trend of increased power efficiency requirements for industrial systems. We continue to see strong traction for our power semiconductor products and modules in the industrial end-market, and our customer engagements continue to expand.

Within Industrial, medical was an area of solid strength in the first quarter. We are seeing strong traction for our products in implantable devices, personal diagnostics and hearing health market.

Revenue in the second quarter for the industrial end-market is expected to be down quarter-over- quarter, as opposed to seasonally higher sequential revenue. Weaker than seasonal growth in our industrial business is driven primarily by softness in Greater China market.

The **Communications** end-market, which includes both networking and wireless, contributed revenue of $259 million in the first quarter. The communications end-market represented 19 percent of our revenue in the first quarter. First quarter communications revenue increased by 15 percent year-over-year. Much of the year-over-year increase was driven by strength in 5G ramp. Smartphone related revenue in the first quarter was also up year-over-year.

We are seeing strong ramp in our power products in 5G infrastructure market. We expect this ramp to accelerate in 2019 with increasing 5G deployments in a few parts of the world. Current indication from our customers points to better than expected rate of deployment for 5G systems in near-term. As we indicated earlier, our power content in 5G infrastructure systems is many times that in 4G systems. Furthermore, our participation in 5G systems is expected to be significantly higher than our participation in 4G systems.

On smartphone front, we saw significant decline in revenue quarter-over-quarter, although our revenue grew year-over-year.

Revenue in the second quarter for the communications end-market is expected to be up quarter-over-quarter due to continuing ramp in our 5G business.

The **Computing** end-market contributed revenue of $144 million in the first quarter. The computing end-market represented 10 percent of our revenue in the first quarter. First quarter computing revenue grew by one percent year-over-year. The year-over-year growth was driven primarily by strength in our server business.

We expect growth in our server business to continue in 2019, although we expect moderation in our growth rate as compared to that in 2018. In future generations of server platforms, we expect meaningful increase in our content.

Revenue in the second quarter for computing end-market is expected to be up quarter-over-quarter due to normal seasonality and continuing strength in our server business.

The **Consumer** end-market contributed revenue of $160 million in the first quarter. The consumer end-market represented 12 percent of our revenue in the first quarter. First quarter consumer revenue declined by 15 percent year-over-year. The year-over-year decline was due to broad based weakness in consumer electronics and white-goods segment, and our selective participation in certain areas of consumer electronics market.

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

In summary, business conditions continue to be sub-seasonal. Based on macroeconomic data from various regions of the world, we don't expect a prolonged slowdown in our business, and we expect to see growth in the second half of the current year. Despite current weakness in businesses trends across the industry, secular megatrends driving our business remain intact, and we are upbeat about our medium to long-term prospects. We have established leadership in highly differentiated power, analog, and sensor semiconductor solutions, and we believe that customers are increasingly relying on us as a key provider of enabling technologies for newly emerging and disruptive applications in automotive, industrial, and cloud-power end-markets. To adjust to slowing macroeconomic environment, we are prudently managing our business with sharp focus on controlling expenses. Our operational execution remains solid.

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

Bernard Gutmann

Thank you, Keith.

Based on product booking trends, backlog levels, and estimated turn levels, we anticipate that total ON Semiconductor revenue is expected to be in range of $1,360 million to $1,410 million in second quarter of 2019. Included in our second quarter revenue guidance is approximately $15 million revenue from manufacturing services provided by OSA.

For second quarter of 2019, we expect gross margin to be in range of 36.5 percent to 37.5 percent. Our second quarter gross margin guidance includes negative impact of 40 basis points from manufacturing services provided by OSA.

We expect total GAAP operating expenses of $322 million to $340 million. Our GAAP operating expenses include amortization of intangibles, restructuring, asset impairments, and other charges, which are expected to be $27 million to $31 million. We expect total non-GAAP operating expenses of $295 million to $309 million in the second quarter.

We anticipate second quarter of 2019 GAAP net other income and expense, including interest expense, will be $31 million to $34 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 $22 million to $24 million.

Cash paid for income taxes in second quarter of 2019 is expected to be $12 million to $16 million. We expect total capital expenditures of $140 million to $150 million in second quarter of 2019. We expect capital intensity to subside in second half of the year, and for 2019 we expect capital intensity of nine percent.

We also expect share based compensation of $26 million to $28 million in second quarter of 2019, 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 diluted share count for second quarter of 2019 is expected to be 414 million shares, based on 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.

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

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