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SCRIPT FOR
Q2-20 RESULTS CONFERENCE CALL

Parag Agarwal

Thank you <operator>.

Good morning and thank you for joining ON Semiconductor Corporation's second 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 webcast, along with our 2020 second quarter earnings release, will be available on our website approximately one hour following this conference call, and the recorded webcast 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 and 2021 fiscal calendars 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 included 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 second 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.

We plan to host our analyst day on March 5, 2021. At this time, our intent is to hold the event virtually. However, if conditions improve and risks related to COVID-19 pandemic subside substantially, we will try to hold an in-person event in Phoenix, Arizona. We will provide additional information on the event in due course.

During the third quarter, we plan to attend four virtual conferences. These include KeyBanc Capital Markets' Future of Technology Series on August 11th, Jefferies' Virtual Semiconductor, IT Hardware & Communications Infrastructure Summit on September 2nd, Citi Global Technology Conference on September 10th, and Deutsche Bank Technology Conference on September 15th.

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

Bernard Gutmann

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

During the second quarter, we saw moderate improvement in business conditions as macro-economic activity picked-up across the world. We are seeing improving order activity across most end-markets and geographies as the global community adjusts to changed business and social conditions brought about by the pandemic. The COVID-19 pandemic continues to be a significant headwind to our results. However, through strong execution and unwavering commitment from our employees, customers, and supply-chain partners, we believe that we are successfully navigating the current environment. Despite near-term challenges, long-term drivers of our business remain intact. We are seeing strong momentum in our key end-markets driven by accelerating designs wins for our power, analog and sensor products.

At this time, improving our gross margins is the primary strategic priority for the company. As evident from our most recent press releases, we have accelerated our plans to optimize our manufacturing network. In addition, we are making strong progress in ramp of our 300mm manufacturing processes at East Fishkill fab. Keith will later provide additional details regarding our progress on the manufacturing front in his remarks.

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

Total revenue for the second quarter of 2020 was $1.213 billion, a decrease of 10 percent as compared to revenue of $1.348 billion in the second quarter of 2019. The year-over-year decline in revenue was driven primarily by slowdown in global macroeconomic activity due to the COVID-19 pandemic. GAAP net loss for the second quarter was $0.00 per diluted share as compared to a net income of $0.24 per diluted share in the second quarter of 2019. Non-GAAP net income for the second quarter of 2020 was $0.12 per diluted share as compared to $0.42 per diluted share in the second quarter of 2019.

GAAP gross margin for the second quarter of 2020 was 30.8 percent as compared to 37 percent in the second quarter of 2019. Non-GAAP gross margin for the second quarter of 2020 was 30.8 percent as compared to 37.1 percent in the second quarter of 2019. The year-over-year decline in gross margin was driven primarily by lower revenue as discussed earlier, and COVID-19 related costs. Second quarter 2020 gross margin included approximately $24 million of COVID-19 related costs. These costs include approximately $13 million related to underutilization of our factory network in the first half of the second quarter. At this time, we do not expect to incur this underutilization charge in the third quarter of 2020 and beyond, and consequently we expect to see a substantial increase in our gross margin for the third quarter. Other COVID-19 related costs in the second quarter included higher logistics costs, and costs related to the implementation of enhanced health and safety protocols for our employees.

Our GAAP operating margin for the second quarter of 2020 was 3.6 percent, as compared to 11.7 percent in the second quarter of 2019. Our non-GAAP operating margin for the second quarter of 2020 was 7.4 percent, as compared to 15.7 percent in second quarter of 2019. The year-over-year decline in operating margin was driven largely by lower revenue and lower gross margin due to COVID-19 pandemic.

GAAP operating expenses for the second quarter were $331.2 million, as compared to $340.7 million in the second quarter of 2019. Second quarter GAAP operating expenses include approximately $11.8 million associated with our previously announced restructuring programs. Non-GAAP operating expenses for the second quarter were $284.6 million, as compared to $288.2 million in the second quarter of 2019. The year-over-year decrease in non-GAAP operating expenses was driven primarily by strong execution on cost front, and by restructuring and cost saving measures undertaken by the company.

Second quarter free cash flow was $81.2 million and operating cash flow was $154.5 million. Capital expenditures during the second quarter were $73.3 million, which equate to a capital intensity of six percent. Given the current macroeconomic environment, we are directing most of capital expenditures towards enabling our 300mm capabilities at East Fishkill fab. We expect total capital expenditures for 2020 to be approximately $400 million. We exited the second quarter of 2020 with cash and cash equivalents of $2.061 billion, as compared to $1.982 billion at the end of first quarter 2020. At this time, with cash balance of approximately $2 billion, we are very comfortable with our liquidity position.

At the end of the second quarter, days of inventory on hand were 140 days, up by 9 days as compared to 131 days in the first quarter of 2020. The increase in days of inventory was driven primarily by our expectations of recovery in demand in second half of the current year. In addition, we want to ensure that we have significant inventory at hand to support our customers in case of any supply disruption. In the second quarter, distribution inventory decreased marginally in terms of weeks of inventory.

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 second quarter was $618 million. Revenue for Advanced Solutions Group for the second quarter was $427 million, and revenue for our Intelligent Sensing Group was $168 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.

I will start with structural changes we are making to drive margin expansion, and then I will provide an update on current business environment.

To drive structural gross margin expansion, we have accelerated the pace of our manufacturing footprint optimization. We announced a plan to explore potential sale of our six-inch fab in Niigata, Japan. Production from Niigata fab is expected to be transitioned to other fabs in our network. This announcement comes on heels of our announcement in February regarding our plan to transition production from our six-inch automotive centric fab in Belgium. With the manufacturing optimization plans we have announced thus far, we expect to see significant improvement in our manufacturing cost structure and gross margin. Our 300mm manufacturing capability in East Fishkill fab has afforded us significant flexibility, which had enabled us to optimize our network.

During the second quarter, we started our first 300mm wafer production at East Fishkill fab. We are currently sampling our 300mm products to customers, and we expect to recognize our first 300mm revenue in the third quarter. As we have noted in our earlier calls, we are very pleased with our accelerated progress in ramping our 300mm manufacturing processes. The yields have been spectacular, and we expect to see a meaningful positive impact on our gross margin as our 300mm manufacturing ramps up in the coming years.

We have made substantial progress in key initiatives for driving gross margin expansion. We have launched new products and built a robust design win pipeline in automotive, industrial, and cloud-power end-markets to drive richer mix. We continue to optimize our portfolio to ensure healthy margins for the company. We have accelerated the optimization of our manufacturing network. In addition, we will continue to work on expanding our gross margin through operational improvements within our network. As our revenue recovers driven by global macro-economic recovery and ramp-up of our design wins, we expect to see strong operating leverage and robust gross margin expansion. Let me now comment on the current business environment.

We are beginning to see moderate recovery in the business environment. The improvement is broad-based with improving order activity across most end-markets. Unlike in the second quarter, we have not seen any meaningful pushout or cancellations of orders. Based on current outlook, we expect to see improving business trends through the rest of the year. Improvement in our business is driven not only by improving global macro-economic environment, but also by our accelerating design-wins in automotive, industrial, and cloud-power end-markets. Our customers are restarting their factories and are engaging with our teams on ongoing projects. Our factories have resumed normal operations, and at this time, we don't expect to see any meaningful supply constraints in the current quarter and beyond.

From a geographic perspective, we are seeing recovery in demand from Americas and Europe as economic activity has improved in these regions. We are very encouraged by improving PMI numbers from both Europe and the US. We are beginning to see signs of recovery in automotive demand from Europe and the US, while demand from China and Asia remains healthy.

Despite the disruption caused by COVID-19 pandemic, we continue to make progress towards our strategic and financial goals. Key secular megatrends and long-term drivers of our business remain intact. We are seeing accelerating momentum in key strategic initiatives for electric vehicles, robotics, factory and warehouse automation, cloud-power, and ADAS. Customers are increasingly relying on us to provide enabling technologies in power, analog, and sensors, and they value the differentiation in technology and quality our products offer.

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

Revenue for the **automotive** market in the second quarter was $327 million and represented 27 percent of our revenue in the second quarter. Second quarter automotive revenue declined 26 percent year-over-year. The year-over-year decline in automotive market was driven primarily by the closure of automotive production factories in various parts of the world due to COVID-19 pandemic.

Although the COVID-19 pandemic caused a temporary slowdown in our automotive revenue, key secular drivers powering our business have remained intact. Our content in fastest growing automotive applications continues to grow at a healthy pace. Based on our design-win pipeline, indications from customers, and revenue trends, we believe that we are gaining significant share in most attractive segments of the automotive semiconductor market.

We are beginning to see recovery in the automotive market in the US and in Europe. Conversations with customers indicate that we should see ongoing recovery in the third and the fourth quarter of the current year.

We are seeing strong momentum for our Silicon Carbide and Silicon products for electric vehicles. We recently won a very significant design with one of the leading global automotive OEMs for our Silicon Carbide power module for traction invertor for electric vehicles. We expect to start seeing revenue from this win a year from now. Based on our current engagement with various automotive OEMs, we expect to win multiple designs in the near to mid-term. With a broad portfolio of Silicon and Silicon Carbide products and industry leading module capabilities, we believe that we are uniquely positioned to be a strong leader in power semiconductor market for electric vehicles. We expect to see strong revenue growth in our IGBT modules for EV traction inverters as our design wins ramp in China this year.

In ADAS, we continue to win designs for our CMOS image sensors with leading global OEMs. Our competitive position in automotive CMOS image sensors remains solid, and customers value our technology leadership and breadth of product offerings in this market. We are seeing strong customer interest in our recently introduced backside illumination image sensors for automotive applications. We are making strong progress in LiDAR, and we expect to commence commercial shipments of our LiDAR products in mid to late 2021. During the second quarter, we also secured major design wins for surround vision applications, and we expect to begin seeing revenue from these wins in mid-2021. Our ability to integrate our automotive sensor products with our analog and power products, coupled with our deep automotive systems expertise has provided us with very formidable competitive advantage. Customers continue to place very high value on our ability to provide complete solutions for various automotive sensor applications.

Revenue in the third quarter of 2020 for the automotive end-market is expected to be up strongly quarter-over-quarter as we expect to see worldwide recovery in automotive production.

The **Industrial** end-market, which includes military, aerospace, and medical, contributed revenue of $348 million in the second quarter. The Industrial end-market represented 29 percent of our revenue in the second quarter. Year-over-year, our second quarter industrial revenue declined three percent. This decline was driven by reduction in global industrial activity and supply constraints due to the COVID-19 pandemic.

We are seeing strong traction for our Silicon Carbide products in industrial power applications with an expanding base of customers. Recently we announced a win with Delta for our Silicon Carbide power modules for solar invertor applications.

Demand for industrial automation continues to grow at a rapid pace. We have secured major design wins for our image sensors for industrial applications, and we expect revenue from these wins to be recognized in late 2020. We continue to secure design wins for our large format sensors in diverse industrial applications. We are engaged with leading global players on many warehouse automation and robotic delivery products. We expect that e-commerce customers will be a key driver of growth of our industrial revenue in a year's timeframe. As is the case in automotive market, we leverage our broad companywide portfolio and customer relationships to secure design wins for our sensor products in the industrial market.

We continue to make strong progress in industrial IoT space, and we are on track to launch our first industrial IoT connectivity product incorporating Wi-Fi technology from our Quantenna acquisition within a year.

Revenue in the third quarter of 2020 for the industrial end-market is expected to be down quarter-over-quarter. Geopolitical issues related to a specific customer have adversely impacted our third quarter industrial revenue. We don't expect any further meaningful decline in revenue from this customer beyond the third quarter.

The **Communications** end-market, which includes both networking and wireless, contributed revenue of $255 million in the second quarter, and represented 21 percent of our revenue during the second quarter. Second quarter communications revenue increased by three percent year-over-year. We saw strong year-over-year growth in our 5G business in the second quarter. On the smartphone front, we continue to increase our content in most popular platforms.

Revenue in the third quarter of 2020 for the communications end-market is expected to be down quarter-over-quarter. Our third quarter communications revenue has been impacted by delayed launches of certain platforms and geopolitical issues related to a specific customer. We don't expect any further meaningful decline in revenue from this customer beyond the third quarter.

The **Computing** end-market contributed revenue of $158 million in the second quarter. The computing end-market represented 13 percent of our revenue in the second quarter. Second quarter computing revenue increased by 14 percent year-over-year due to strength in both server and client businesses.

Revenue in the third 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 $126 million in the second quarter. The consumer end-market represented 10 percent of our revenue in the second quarter. Second quarter consumer revenue declined by 22 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 third quarter of 2020 for the consumer end-market is expected to be up quarter-over-quarter due to normal seasonality.

In summary, gross margin expansion is the key strategic priority for the company. We have accelerated the pace of our manufacturing footprint optimization with the goal to drive significant gross margin expansion. Ramp of our 300mm manufacturing processes at East Fishkill fab should further help in gross margin expansion. In the near term, the expected decline in COVID-19 related expenses and impact of cost realignment measures should help expand margins. We have seen moderate improvement in business conditions to date, and we expect that this improvement should continue in near-term. We are seeing broad-based recovery across most end-markets and geographies. Key secular megatrends and long-term drivers of our business remain intact, and we are excited about our medium to long-term prospects. We are seeing accelerating momentum in our key strategic initiatives for electric vehicles, robotics, factory and warehouse automation, cloud-power and ADAS. As COVID-19 related impact subsides, we expect to see meaningful improvement in revenue growth and margin expansion.

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 will be in the range of $1.2 billion to $1.33 billion in the third quarter of 2020. Our third quarter revenue has been impacted moderately by geopolitical issues related to a particular customer. At this time, near to mid-term expectations related to this customer have been de-risked to a large extent, and we don't expect to see any further meaningful decline in revenue from this customer beyond the third quarter.

For third quarter of 2020, we expect GAAP and non-GAAP gross margin between 32.0 percent to 34.0 percent. Our third quarter gross margin outlook includes COVID-19 related costs of approximately $11 million.

We expect total GAAP operating expenses of $307 million to $327 million. Our GAAP operating expenses include amortization of intangibles, restructuring, asset impairments, and other charges, which are expected to be $30 million to $34 million. We expect total non-GAAP operating expenses of $277 million to $293 million in the third quarter.

We anticipate third quarter of 2020 GAAP net other income and expense, including interest expense, will be expense of $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 expense of $33 million to $35 million.

Net cash paid for income taxes in third quarter of 2020 is expected to be $17 million to $22 million. For 2020, we expect cash paid for taxes to be in range of $54 million to $60 million. We expect total capital expenditures of $80 million to $90 million in third quarter of 2020. We are currently targeting an overwhelming proportion our capex for enabling our 300mm capability at an accelerated pace. For 2020, we expect total capital expenditures of approximately $400 million.

We also expect share based compensation of $17 million to $19 million in third 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 third quarter of 2020 is expected to be 416 million shares, based on our current stock price. Our non-GAAP diluted share count for third quarter of 2020 is expected to be 411 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.

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