



ON Semiconductor®

ON SEMICONDUCTOR CORPORATION

SCRIPT FOR
Q3-20 RESULTS CONFERENCE CALL

Parag Agarwal

Thank you <operator>.

Good morning and thank you for joining ON Semiconductor Corporation's third 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 third 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 third 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 events that may occur, except as required by law.

During the fourth quarter, we plan to attend two virtual conferences. These include Nasdaq's 43rd Virtual Investor Conference on December 1st and Wells Fargo TMT Summit 2020 on December 2nd.

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

Bernard Gutmann

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

During the third quarter, we saw strong recovery in business conditions due to sharp acceleration in global economic activity, especially in the automotive market. Order activity has picked-up meaningfully across end-markets and geographies. Manufacturers are striving to meet the upsurge in demand, which was previously disrupted by COVID-19 pandemic. Along with the strong macro driven recovery in our business, momentum in our key strategic growth areas in industrial, automotive, and cloud-power end-markets is accelerating. Our design wins are accelerating and design funnel is expanding at a rapid pace.

As we stated earlier, gross margin improvement is the primary strategic priority for the company. We are on track with our manufacturing consolidation plans, and discussions are ongoing with various parties regarding the previously announced intended sale of our fabs in Belgium and Niigata, Japan. In the near-term, revenue tailwinds from the ongoing recovery in business conditions and favorable end-market mix shift should help drive margin expansion.

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

Total revenue for the third quarter of 2020 was \$1.317 billion, a decrease of five percent as compared to revenue of \$1.382 billion in the third quarter of 2019. The year-over-year decline in revenue was driven primarily by a slowdown in global macroeconomic activity due to the COVID-19 pandemic. GAAP net income for the third quarter was \$0.38 per diluted share as compared to a net loss of \$0.15 per diluted share in the third quarter of 2019. Non-GAAP net income for the third quarter of 2020 was \$0.27 per diluted share as compared to \$0.33 per diluted share in the third quarter of 2019.

GAAP gross margin for the third quarter of 2020 was 33.5 percent as compared to 34.4 percent in the third quarter of 2019. Non-GAAP gross margin for the third quarter of 2020 was 33.5 percent as compared to 35.8 percent in the third 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.

Our GAAP operating margin for the third quarter of 2020 was 9.0 percent, as compared to negative 3.2 percent in the third quarter of 2019. Third quarter 2019 GAAP operating margin included an impact of \$169.5 million related to the intellectual property settlement with Power Integrations. Our non-GAAP operating margin for the third quarter of 2020 was 12.0 percent, as compared to 13.0 percent in third quarter of 2019. The year-over-year decline in operating margin was driven largely by lower revenue and impact on gross margin due to COVID-19 pandemic.

GAAP operating expenses for the third quarter were \$322.2 million, as compared to \$519.1 million in the third quarter of 2019. Third quarter 2019 GAAP operating expenses included \$169.5 million related to the intellectual property settlement with Power Integrations. Non-GAAP operating expenses for the third quarter were \$283.6 million, as compared to \$314.3 million in the third quarter of 2019. The year-over-year decrease in non-GAAP operating expenses was driven primarily by strong execution on the cost front, and by restructuring and cost saving measures undertaken by the company.

Third quarter free cash flow was \$101.8 million and operating cash flow was \$163.4 million. Capital expenditures during the third quarter were \$61.6 million, which equate to a capital intensity of 4.7 percent. As we indicated previously, we are directing most of our capital expenditures towards enabling our 300mm capabilities at East Fishkill fab. We expect total capital expenditures for 2020 to be in the range of \$370 million to \$390 million. We exited the third quarter of 2020 with cash and cash equivalents of \$1.654 billion, as compared to \$2.06 billion at the end of second quarter of 2020. The decline in cash balance was primarily due to pay down of amounts drawn under our revolving debt facility as a precautionary measure in response to the COVID-19 pandemic. At this time, with cash balance of approximately \$1.6 billion, we are very comfortable with our liquidity position. In the fourth quarter, we expect to use approximately \$690 million to pay-off our 2020 convertible note principal at maturity.

At the end of the third quarter, days of inventory on hand were 133 days, down 7 days as compared to 140 days in the second quarter of 2020. In the fourth quarter, we intend to continue to reduce our balance sheet inventories. Therefore, we plan to run our factories at current level of utilization, despite expected higher level of revenue in the fourth quarter.

In the third quarter, distribution inventory decreased by approximately two weeks as sales through the distribution channel increased significantly quarter-over-quarter. Instead of shipping products in the distributor channel for revenue, we brought down channel inventory, even though it was within our comfort zone.

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 third quarter was \$647.4 million. Revenue for Advanced Solutions Group, or ASG, for the third quarter was \$494.6 million, and revenue for our Intelligent Sensing Group, or ISG, was \$175.3 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.

Let me first update you on our manufacturing optimization plans, and I will then provide an update on the current business environment.

We are in discussions with various parties regarding the planned sale of our Belgium and Niigata fabs. We are working diligently to get quick resolution on these fabs, but we do not have an announcement to make at this time. The process for ceasing operations of our fab in Rochester, New York, is progressing as per plan, and we expect to begin seeing annual savings of \$15 million starting in the first quarter of 2021.

We achieved a major milestone in the third quarter as we recognized our first revenue from our 300mm products. We continue to make solid progress in our manufacturing transition to 300mm fab in East Fishkill, New York. As I have indicated earlier, yields for our 300mm manufacturing processes have been spectacular, and we expect to see a meaningful positive impact on our gross margin as our 300mm manufacturing ramps in the coming years. Additionally, our 300mm manufacturing capability in East Fishkill fab has afforded us significant flexibility, which has enabled us to optimize our network.

We continue to make substantial progress in our key initiatives to expand gross margins. We are driving shift towards higher margin products by aggressively winning designs in automotive,

industrial, and cloud-power end-markets. At the same time, we continue to optimize our portfolio to drive margin expansion.

The fundamentals of our cost structure remain unchanged. With ongoing recovery, as our revenue and factory utilization increase, we expect to see meaningful increase in our gross margin. The benefits from manufacturing optimization, mix shift, and portfolio optimization should be additive to fall-through we see from incremental revenue.

Now, let me comment on the current business environment.

We have seen meaningful acceleration in order momentum in the third quarter, and we expect that business activity will continue to grow at above seasonal levels in the near term. Along with improving global macroeconomic environment, our accelerating design-wins in automotive, industrial, and cloud-power end-markets are key contributors to our momentum.

From a geographic perspective, we are seeing acceleration in demand from all regions. Economic data such as PMI and GDP point towards a strong recovery in industrial activity and in the overall business environment across the globe.

Although COVID-19 pandemic temporarily affected our business, the underlying fundamentals of our business and secular trends driving our business remain unchanged. We continue to see strong momentum in key strategic initiatives for electric vehicles, robotics, factory and warehouse automation, cloud-power, and ADAS. We are well positioned to benefit from ongoing recovery with our highly differentiated power, analog, and sensor products, which enable key secular trends in automotive, industrial, and cloud-power end-markets.

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

Revenue for the **automotive** market in the third quarter was \$419.2 million and represented 32 percent of our revenue in the third quarter. Third quarter automotive revenue declined by six percent year-over-year, primarily due to COVID-19 driven decline in automotive production.

We are seeing strong momentum for our Silicon Carbide offerings with additional design wins at leading OEMs and tier-1 customers. In addition to winning new designs, we are expanding our engagement with new customers for Silicon Carbide, and we are currently sampling products to many of these customers.

On the ADAS front, we continue to win designs with major global automotive players. We are also seeing a higher-level of attach rate for both ADAS and viewing applications. We are very well positioned to benefit from technology transition in automotive LiDAR to newer SiPM and SPAD technologies from APD technology, and we are seeing strong traction for our LiDAR products with leading customers.

Other areas of automotive were strong as well in the third quarter. We saw strong growth in our lighting, ultrasonic, and actuator solutions.

From a geographical perspective, we saw strength across all regions. Despite steep increase in automotive production, it appears that dealer inventories are low. We expect current recovery in global automotive production to continue in near-term.

Based on our outlook and third party reports, we believe that our 2020 annual automotive revenue growth rate should exceed 2020 global light vehicle annual production growth rate by a wide margin.

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

The **Industrial** end-market, which includes military, aerospace, and medical, contributed revenue of \$327.6 million in the third quarter. The Industrial end-market represented 25 percent of our revenue in the third quarter. Year-over-year, our third quarter industrial revenue declined seven percent. This decline was driven by reduction in global industrial activity due to the COVID-19 pandemic and geopolitical issues related to a specific customer.

In the industrial end-market, we are seeing strong adoption of our Silicon Carbide modules for solar power related applications, and we are rapidly expanding our customer base in the alternative energy market.

On the industrial power front, we are seeing increasing design activity for motor control and building automation. Energy efficiency regulations that are slated to be enacted in 2021 and beyond are driving power management and motor control related activity.

Our medical business grew strongly quarter over quarter in the third quarter as the pace of elective procedures picked up.

We continue to work with leading market players to design in our image sensors for automation and machine vision applications. We have secured additional design wins for large format image sensors for professional movie camera applications.

Revenue in the fourth quarter of 2020 for the industrial end-market is expected to be up quarter-over-quarter.

The **Communications** end-market, which includes both networking and wireless, contributed revenue of \$255.4 million in the third quarter, and represented 19 percent of our revenue during the third quarter. Third quarter communications revenue declined by seven percent year-over-year.

We saw strong year-over-year growth in our 5G infrastructure business in the third quarter. Our smartphone business declined year-over-year, in part due to geopolitical factors related to a customer.

Revenue in the fourth quarter of 2020 for the communications end-market is expected to be flat to down quarter-over-quarter, due to expected revenue decline from customer specific geopolitical factors.

The **Computing** end-market contributed revenue of \$172.2 million in the third quarter. The computing end-market represented 13 percent of our revenue in the third quarter. Third quarter computing revenue increased by 12 percent year-over-year due to strength in both server and client businesses.

We are seeing strength in our server power business with increasing content in new server platforms and share gains. Most leading processor makers are projecting higher current requirements in their next generation products. We expect this trajectory to continue in the near to mid-term due to increasing demand for computational capabilities, driven primarily by artificial intelligence.

Revenue in the fourth quarter of 2020 for the computing end-market is expected to be up quarter-over-quarter.

The **Consumer** end-market contributed revenue of \$142.9 million in the third quarter. The consumer end-market represented 11 percent of our revenue in the third quarter. Third quarter consumer revenue declined by nine percent year-over-year. The year-over-year decline was due to broad-based weakness in the consumer electronics market due to COVID-19 pandemic and our selective participation in this market.

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

In summary, we are accelerating our efforts to drive margin expansion. We are rationalizing our fixed cost footprint. At the same time, we are also aggressively winning designs to drive mix shift towards automotive, industrial, and cloud-power end-markets, which have higher margins. Ramp-up of our 300mm manufacturing processes at East Fishkill fab should further help in gross margin expansion. In the near term, strong revenue growth driven by ongoing recovery in our business, should contribute to margin expansion. Business conditions have improved meaningfully and we expect the improvement to continue in the 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.

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 \$1.3 billion to \$1.4 billion in the fourth quarter of 2020.

For fourth quarter of 2020, we expect GAAP and non-GAAP gross margin between 32.9 percent to 34.9 percent.

We expect total GAAP operating expenses of \$315 million to \$333 million. Our GAAP operating expenses include amortization of intangibles, restructuring, asset impairments, and other charges, which are expected to be \$32 million to \$36 million. We expect total non-GAAP operating expenses of \$283 million to \$297 million in the fourth quarter. The expected increase in our fourth quarter operating expenses as compared to those in the third quarter is driven by the planned reinstatement of salaries and benefits that were reduced due to decline in our business resulting from COVID-19 pandemic.

In our 2020 operating expenses, the variable component of compensation was not significant. However, as we enter 2021, we plan to accrue meaningful variable compensation with the expectation that 2021 will be a strong year. Consequently, we expect an increase of about \$25 million to \$30 million quarter over quarter in our operating expenses in first quarter of 2021.

We anticipate fourth quarter of 2020 GAAP net other income and expense, including interest expense, will be an expense of \$41 million to \$44 million, which includes the 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 an expense of \$32 million to \$34 million.

Net cash paid for income taxes in fourth quarter of 2020 is expected to be \$22 million to \$28 million. For 2020, we expect cash paid for taxes to be in the range of \$52 million to \$58 million. We expect total capital expenditures of \$100 million to \$120 million in fourth quarter of 2020. We are currently targeting an overwhelming proportion of our capex for enabling our 300mm capability at an accelerated pace.

We expect share based compensation of \$16 million to \$18 million in fourth quarter of 2020, of which approximately \$3 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 fourth quarter of 2020 is expected to be 425 million to 426 shares, based on our current stock price. Our non-GAAP diluted share count for fourth 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.

###