

ON SEMICONDUCTOR CORPORATION
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Quarter Ended			Year Ended	
	December 31, 2020	October 2, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Revenue	\$ 1,446.3	\$ 1,317.3	\$ 1,401.8	\$ 5,255.0	\$ 5,517.9
Cost of revenue (exclusive of amortization shown below)	948.7	876.1	916.1	3,539.2	3,544.3
Gross profit	497.6	441.2	485.7	1,715.8	1,973.6
Gross margin	34.4 %	33.5 %	34.6 %	32.7 %	35.8 %
Operating expenses:					
Research and development	159.7	156.1	169.3	642.9	640.9
Selling and marketing	71.0	65.3	75.6	278.7	301.0
General and administrative	62.4	62.2	69.2	258.7	284.0
Litigation settlement	—	—	—	—	169.5
Amortization of acquisition-related intangible assets	29.3	29.6	32.1	120.3	115.2
Restructuring, asset impairments and other charges, net	7.2	9.0	0.6	65.2	28.7
Intangible asset impairment	—	—	—	1.3	1.6
Total operating expenses	329.6	322.2	346.8	1,367.1	1,540.9
Operating income	168.0	119.0	138.9	348.7	432.7
Other income (expense), net:					
Interest expense	(41.8)	(42.2)	(42.2)	(168.4)	(148.3)
Interest income	0.6	0.9	2.4	4.9	10.2
Loss on debt refinancing and prepayment	—	—	—	—	(6.2)
Other income (expense)	(6.3)	0.4	(16.4)	(8.6)	(11.8)
Other income (expense), net	(47.5)	(40.9)	(56.2)	(172.1)	(156.1)
Income before income taxes	120.5	78.1	82.7	176.6	276.6
Income tax (provision) benefit	(30.7)	83.1	(25.8)	59.8	(62.7)
Net income	89.8	161.2	56.9	236.4	213.9
Less: Net income attributable to non-controlling interest	(0.8)	(0.6)	(0.4)	(2.2)	(2.2)
Net income attributable to ON Semiconductor	\$ 89.0	\$ 160.6	\$ 56.5	\$ 234.2	\$ 211.7
Net income per share of common stock attributable to ON Semiconductor Corporation:					
Basic	\$ 0.22	\$ 0.39	\$ 0.14	\$ 0.57	\$ 0.52
Diluted	\$ 0.21	\$ 0.38	\$ 0.14	\$ 0.56	\$ 0.51
Weighted average common shares outstanding:					
Basic	411.3	410.8	410.8	410.7	410.9
Diluted	431.6	418.3	418.2	418.8	416.0

ON SEMICONDUCTOR CORPORATION
UNAUDITED CONSOLIDATED BALANCE SHEETS

(in millions)

	December 31, 2020	October 2, 2020	December 31, 2019
Assets			
Cash and cash equivalents	\$ 1,080.7	\$ 1,654.0	\$ 894.2
Receivables, net	676.0	728.1	705.0
Inventories	1,251.4	1,281.2	1,232.4
Other current assets	182.9	149.3	188.4
Total current assets	3,191.0	3,812.6	3,020.0
Property, plant and equipment, net	2,512.3	2,511.8	2,591.6
Goodwill	1,663.4	1,663.4	1,659.2
Intangible assets, net	469.0	498.2	590.5
Deferred tax assets	419.1	461.6	307.8
Other assets	410.2	306.4	256.4
Total assets	<u>\$ 8,665.0</u>	<u>\$ 9,254.0</u>	<u>\$ 8,425.5</u>
Liabilities, Non-Controlling Interest and Stockholders' Equity			
Accounts payable	\$ 572.9	\$ 534.2	\$ 543.6
Accrued expenses and other current liabilities	576.8	567.3	538.8
Current portion of long-term debt	531.6	701.6	736.0
Total current liabilities	1,681.3	1,803.1	1,818.4
Long-term debt	2,959.7	3,537.6	2,876.5
Deferred tax liabilities	47.5	62.6	60.2
Other long-term liabilities	418.4	403.5	346.3
Total liabilities	5,106.9	5,806.8	5,101.4
ON Semiconductor Corporation stockholders' equity:			
Common stock	5.7	5.7	5.7
Additional paid-in capital	4,133.1	3,877.6	3,809.5
Accumulated other comprehensive loss	(57.6)	(63.4)	(54.3)
Accumulated earnings	1,425.5	1,336.5	1,191.3
Less: Treasury stock, at cost	(1,968.2)	(1,733.0)	(1,650.5)
Total ON Semiconductor Corporation stockholders' equity	3,538.5	3,423.4	3,301.7
Non-controlling interest	19.6	23.8	22.4
Total stockholders' equity	3,558.1	3,447.2	3,324.1
Total liabilities and stockholders' equity	<u>\$ 8,665.0</u>	<u>\$ 9,254.0</u>	<u>\$ 8,425.5</u>

ON SEMICONDUCTOR CORPORATION

UNAUDITED RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA AND

NET CASH PROVIDED BY OPERATING ACTIVITIES

(in millions)

	Quarter Ended			Year Ended	
	December 31, 2020	October 2, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Net income	\$ 89.8	\$ 161.2	\$ 56.9	\$ 236.4	\$ 213.9
Adjusted for:					
Restructuring, asset impairments and other charges, net	7.2	9.0	0.6	65.2	28.7
Intangible asset impairment	—	—	—	1.3	1.6
Interest expense	41.8	42.2	42.2	168.4	148.3
Interest income	(0.6)	(0.9)	(2.4)	(4.9)	(10.2)
Loss on debt refinancing and prepayment	—	—	—	—	6.2
Litigation settlement	—	—	—	—	169.5
Income tax provision (benefit)	30.7	(83.1)	25.8	(59.8)	62.7
Net income attributable to non-controlling interest	(0.8)	(0.6)	(0.4)	(2.2)	(2.2)
Depreciation and amortization	153.8	156.2	162.0	625.1	593.1
Amortization of fair market value step-up of inventory	—	—	—	—	19.6
Actuarial losses on pension plans and other pension benefits	4.0	—	15.6	4.0	15.6
Third party acquisition and divestiture related costs	0.7	—	0.5	1.0	11.3
Indemnification gain	—	—	—	—	(7.8)
Adjusted EBITDA	<u>326.6</u>	<u>284.0</u>	<u>300.8</u>	<u>1,034.5</u>	<u>1,250.3</u>
Increase (decrease):					
Restructuring, asset impairments and other charges, net	(7.2)	(9.0)	(0.6)	(65.2)	(28.7)
Interest expense	(41.8)	(42.2)	(42.2)	(168.4)	(148.3)
Interest income	0.6	0.9	2.4	4.9	10.2
Litigation settlement	—	—	—	—	(169.5)
Income tax (provision) benefit	(30.7)	83.1	(25.8)	59.8	(62.7)
Net income attributable to non-controlling interest	0.8	0.6	0.4	2.2	2.2
Amortization of fair market value step-up of inventory	—	—	—	—	(19.6)
Actuarial losses on pension plans and other pension benefits	(4.0)	—	(15.6)	(4.0)	(15.6)
Third party acquisition and divestiture related costs	(0.7)	—	(0.5)	(1.0)	(11.3)
Indemnification gain	—	—	—	—	7.8
Loss (gain) on sale or disposal of fixed assets	(1.4)	1.1	1.4	(3.2)	1.9
Amortization of debt discount and issuance costs	3.0	3.1	3.1	12.1	13.0
Share-based compensation	16.5	17.5	17.7	67.7	79.4
Non-cash interest on convertible notes	8.8	10.1	9.9	38.2	37.8
Non-cash asset impairment charges	3.3	7.0	0.5	17.5	3.4
Change in deferred taxes	26.6	(136.8)	0.4	(122.5)	11.2
Other	5.2	3.5	1.4	10.5	(0.1)
Changes in assets and liabilities	94.8	(59.5)	(161.6)	1.2	(266.7)
Net cash provided by operating activities	<u>\$ 400.4</u>	<u>\$ 163.4</u>	<u>\$ 91.7</u>	<u>\$ 884.3</u>	<u>\$ 694.7</u>
Cash flows from investing activities:					
Purchase of property, plant and equipment	\$ (116.4)	\$ (61.6)	\$ (112.4)	\$ (383.6)	\$ (534.6)
Proceeds from sale of property, plant and equipment	4.8	0.6	0.4	6.3	1.9

ON SEMICONDUCTOR CORPORATION

UNAUDITED RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA AND

NET CASH PROVIDED BY OPERATING ACTIVITIES (Continued)

(in millions)

	Quarter Ended			Year Ended	
	December 31, 2020	October 2, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Deposits utilized (made) for purchases of property, plant and equipment	(0.1)	1.8	4.8	2.2	4.6
Purchase of business, net of cash acquired	—	—	—	(4.5)	(888.0)
Purchase of license and deposit made for manufacturing facility	(100.0)	—	—	(100.0)	(100.0)
Settlement of purchase price from prior acquisition	—	—	—	26.0	—
Proceeds from divestiture and escrow release	—	—	0.2	—	5.2
Net cash used in investing activities	<u>\$ (211.7)</u>	<u>\$ (59.2)</u>	<u>\$ (107.0)</u>	<u>\$ (453.6)</u>	<u>\$ (1,510.9)</u>
Cash flows from financing activities:					
Proceeds for the issuance of common stock under the employee stock purchase plan	\$ 5.8	\$ 6.4	\$ 6.6	\$ 23.6	\$ 26.2
Proceeds from exercise of stock options	—	—	0.4	—	1.7
Payment of tax withholding for restricted stock units	(2.9)	(0.5)	(1.9)	(20.0)	(33.5)
Repurchase of common stock	—	—	—	(65.4)	(139.0)
Issuance and borrowings under debt agreements	—	693.0	—	1,858.0	1,404.8
Payments of debt issuance and other financing costs	(0.2)	(2.2)	(2.1)	(2.4)	(24.0)
Repayment of borrowings under debt agreements	(759.3)	(1,204.3)	(14.3)	(2,023.9)	(594.4)
Payments related to prior acquisition	(0.6)	(2.8)	(5.2)	(8.9)	(5.2)
Release of escrow related to prior acquisition	—	—	—	—	(10.4)
Payment of finance lease obligations	—	—	(0.2)	—	(0.8)
Dividend to non-controlling shareholder	(5.0)	—	(2.3)	(5.0)	(2.3)
Net cash provided by (used in) financing activities	<u>\$ (762.2)</u>	<u>\$ (510.4)</u>	<u>\$ (19.0)</u>	<u>\$ (244.0)</u>	<u>\$ 623.1</u>
Effect of exchange rate changes on cash, cash equivalents and restricted cash	\$ 0.2	\$ 0.3	\$ (0.2)	\$ 0.6	\$ 0.2
Net increase (decrease) in cash, cash equivalents and restricted cash	<u>\$ (573.3)</u>	<u>\$ (405.9)</u>	<u>\$ (34.5)</u>	<u>\$ 187.3</u>	<u>\$ (192.9)</u>
Cash, cash equivalents and restricted cash, beginning of period	\$ 1,654.8	\$ 2,060.7	\$ 928.7	\$ 894.2	\$ 1,087.1
Cash, cash equivalents and restricted cash, end of period	<u>\$ 1,081.5</u>	<u>\$ 1,654.8</u>	<u>\$ 894.2</u>	<u>\$ 1,081.5</u>	<u>\$ 894.2</u>

ON SEMICONDUCTOR CORPORATION

RECONCILIATION OF GAAP VERSUS NON-GAAP DISCLOSURES

(in millions, except per share and percentage data)

	Quarter Ended			Year Ended	
	December 31, 2020	October 2, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Reconciliation of GAAP gross profit to non-GAAP gross profit:					
GAAP gross profit	\$ 497.6	\$ 441.2	\$ 485.7	\$ 1,715.8	\$ 1,973.6
Special items:					
a) Amortization of fair market value step-up of inventory	—	—	—	—	19.6
Total special items	—	—	—	—	19.6
Non-GAAP gross profit	\$ 497.6	\$ 441.2	\$ 485.7	\$ 1,715.8	\$ 1,993.2
Reconciliation of GAAP gross margin to non-GAAP gross margin:					
GAAP gross margin	34.4 %	33.5 %	34.6 %	32.7 %	35.8 %
Special items:					
a) Amortization of fair market value step-up of inventory	— %	— %	— %	— %	0.4 %
Total special items	— %	— %	— %	— %	0.4 %
Non-GAAP gross margin	34.4 %	33.5 %	34.6 %	32.7 %	36.1 %
Reconciliation of GAAP operating expenses to non-GAAP operating expenses:					
GAAP operating expenses	\$ 329.6	\$ 322.2	\$ 346.8	\$ 1,367.1	\$ 1,540.9
Special items:					
a) Amortization of acquisition-related intangible assets	(29.3)	(29.6)	(32.1)	(120.3)	(115.2)
b) Restructuring, asset impairments and other charges, net	(7.2)	(9.0)	(0.6)	(65.2)	(28.7)
c) Intangible asset impairment	—	—	—	(1.3)	(1.6)
d) Third party acquisition and divestiture related costs	(0.7)	—	(0.5)	(1.0)	(11.3)
e) Litigation settlement	—	—	—	—	(169.5)
Total special items	(37.2)	(38.6)	(33.2)	(187.8)	(326.3)
Non-GAAP operating expenses	\$ 292.4	\$ 283.6	\$ 313.6	\$ 1,179.3	\$ 1,214.6
Reconciliation of GAAP operating income to non-GAAP operating income:					
GAAP operating income	\$ 168.0	\$ 119.0	\$ 138.9	\$ 348.7	\$ 432.7
Special items:					
a) Amortization of fair market value step-up of inventory	—	—	—	—	19.6
b) Amortization of acquisition-related intangible assets	29.3	29.6	32.1	120.3	115.2
c) Restructuring, asset impairments and other charges, net	7.2	9.0	0.6	65.2	28.7
d) Intangible asset impairment	—	—	—	1.3	1.6
e) Third party acquisition and divestiture related costs	0.7	—	0.5	1.0	11.3
f) Litigation settlement	—	—	—	—	169.5
Total special items	37.2	38.6	33.2	187.8	345.9
Non-GAAP operating income	\$ 205.2	\$ 157.6	\$ 172.1	\$ 536.5	\$ 778.6
Reconciliation of GAAP operating margin to non-GAAP operating margin (operating income / revenue):					
GAAP operating margin	11.6 %	9.0 %	9.9 %	6.6 %	7.8 %
Special items:					
a) Amortization of fair market value step-up of inventory	— %	— %	— %	— %	0.4 %

ON SEMICONDUCTOR CORPORATION

RECONCILIATION OF GAAP VERSUS NON-GAAP DISCLOSURES (Continued)

(in millions, except per share and percentage data)

	Quarter Ended			Year Ended	
	December 31, 2020	October 2, 2020	December 31, 2019	December 31, 2020	December 31, 2019
b) Amortization of acquisition-related intangible assets	2.0 %	2.2 %	2.3 %	2.3 %	2.1 %
c) Restructuring, asset impairments and other charges, net	0.5 %	0.7 %	— %	1.2 %	0.5 %
d) Intangible asset impairment	— %	— %	— %	— %	— %
e) Third party acquisition and divestiture related costs	— %	— %	— %	— %	0.2 %
f) Litigation settlement	— %	— %	— %	— %	3.1 %
Total special items	2.6 %	3.0 %	2.4 %	3.6 %	6.3 %
Non-GAAP operating margin	14.2 %	12.0 %	12.3 %	10.2 %	14.1 %
Reconciliation of GAAP income before income taxes to non-GAAP income before income taxes:					
GAAP income before income taxes	\$ 120.5	\$ 78.1	\$ 82.7	\$ 176.6	\$ 276.6
Special items:					
a) Amortization of fair market value step-up of inventory	—	—	—	—	19.6
b) Amortization of acquisition-related intangible assets	29.3	29.6	32.1	120.3	115.2
c) Restructuring, asset impairments and other charges, net	7.2	9.0	0.6	65.2	28.7
d) Intangible asset impairment	—	—	—	1.3	1.6
e) Third party acquisition and divestiture related costs	0.7	—	0.5	1.0	11.3
f) Litigation settlement	—	—	—	—	169.5
g) Actuarial losses on pension plans and other pension benefits	4.0	—	15.6	4.0	15.6
h) Loss on debt refinancing and prepayment	—	—	—	—	6.2
i) Non-cash interest on convertible notes	8.8	10.1	9.9	38.2	37.8
j) Indemnification gain	—	—	—	—	(7.8)
Total special items	50.0	48.7	58.7	230.0	397.7
Non-GAAP income before income taxes	\$ 170.5	\$ 126.8	\$ 141.4	\$ 406.6	\$ 674.3
Reconciliation of GAAP net income attributable to ON Semiconductor Corporation to non-GAAP net income attributable to ON Semiconductor Corporation:					
GAAP net income attributable to ON Semiconductor Corporation	\$ 89.0	\$ 160.6	\$ 56.5	\$ 234.2	\$ 211.7
Special items:					
a) Amortization of fair market value step-up of inventory	—	—	—	—	19.6
b) Amortization of acquisition-related intangible assets	29.3	29.6	32.1	120.3	115.2
c) Restructuring, asset impairments and other charges, net	7.2	9.0	0.6	65.2	28.7
d) Intangible asset impairment	—	—	—	1.3	1.6
e) Third party acquisition and divestiture related costs	0.7	—	0.5	1.0	11.3
f) Litigation settlement	—	—	—	—	169.5
g) Actuarial losses on pension plans and other pension benefits	4.0	—	15.6	4.0	15.6
h) Loss on debt refinancing and prepayment	—	—	—	—	6.2
i) Non-cash interest on convertible notes	8.8	10.1	9.9	38.2	37.8
j) Indemnification gain	—	—	—	—	(7.8)
k) Adjustment of income taxes	8.1	(97.5)	9.1	(112.3)	3.7
Total special items	58.1	(48.8)	67.8	117.7	401.4

ON SEMICONDUCTOR CORPORATION

RECONCILIATION OF GAAP VERSUS NON-GAAP DISCLOSURES (Continued)

(in millions, except per share and percentage data)

	Quarter Ended			Year Ended	
	December 31, 2020	October 2, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Non-GAAP net income attributable to ON Semiconductor Corporation	\$ 147.1	\$ 111.8	\$ 124.3	\$ 351.9	\$ 613.1
Adjustment of income taxes:					
Tax adjustment for Special items (1)	\$ (10.5)	\$ (10.2)	\$ (12.3)	\$ (48.3)	\$ (83.5)
Impact of Domestication of non-U.S. IP and related (2)	(2.1)	(110.3)	—	(112.4)	—
Other non-GAAP tax adjustment (3)	20.7	23.0	21.4	48.4	83.2
Tax indemnified by third parties	—	—	—	—	4.0
Total adjustment of income taxes	\$ 8.1	\$ (97.5)	\$ 9.1	\$ (112.3)	\$ 3.7
<p>(1) Tax impact of non-GAAP Special items (a-1), calculated using the federal statutory rate of 21% for all periods presented.</p> <p>(2) The Company simplified its corporate structure by repatriating the economic rights of its non-U.S. intellectual property to the United States via domestication of certain foreign subsidiaries (the “Domestication”). The Domestication resulted in a benefit from recognizing certain deferred tax assets, net of deferred tax liabilities, of \$62.9 million. Additionally, the Domestication caused the Company to reassess the full valuation allowance recorded against its U.S. state deferred tax assets. As a result, the Company released approximately \$40.5 million of valuation allowance recorded against its U.S. state deferred tax assets.</p> <p>(3) The income tax adjustment primarily represents the use of the net operating loss, non-cash impact of not asserting indefinite reinvestment on earnings of our foreign subsidiaries, deferred tax expense not affecting taxes payable, and non-cash expense (benefit) related to uncertain tax positions.</p>					
Reconciliation of GAAP diluted shares outstanding to non-GAAP diluted shares outstanding:					
GAAP diluted shares outstanding	431.6	418.3	418.2	418.8	416.0
Special items:					
a) Less: dilutive shares attributable to convertible notes	(14.8)	(5.7)	(5.1)	(5.5)	(3.2)
Total special items	(14.8)	(5.7)	(5.1)	(5.5)	(3.2)
Non-GAAP diluted shares outstanding	416.8	412.6	413.1	413.3	412.8
Non-GAAP diluted earnings per share:					
Non-GAAP net income attributable to ON Semiconductor Corporation	\$ 147.1	\$ 111.8	\$ 124.3	\$ 351.9	\$ 613.1
Non-GAAP diluted shares outstanding	416.8	412.6	413.1	413.3	412.8
Non-GAAP diluted earnings per share	\$ 0.35	\$ 0.27	\$ 0.30	\$ 0.85	\$ 1.49
Reconciliation of net cash provided by operating activities to free cash flow:					
Net cash provided by operating activities	\$ 400.4	\$ 163.4	\$ 91.7	\$ 884.3	\$ 694.7
Special items:					
a) Purchase of property, plant and equipment	(116.4)	(61.6)	(112.4)	(383.6)	(534.6)
Total special items	(116.4)	(61.6)	(112.4)	(383.6)	(534.6)
Free cash flow	\$ 284.0	\$ 101.8	\$ (20.7)	\$ 500.7	\$ 160.1

Certain of the amounts in the above tables may not total due to rounding of individual amounts.

Total share-based compensation related to the Company’s restricted stock units, stock grant awards, and employee stock purchase plan is included below.

ON SEMICONDUCTOR CORPORATION

RECONCILIATION OF GAAP VERSUS NON-GAAP DISCLOSURES (Continued)

(in millions, except per share and percentage data)

	Quarter Ended			Year Ended	
	December 31, 2020	October 2, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Cost of revenue	\$ 3.0	\$ 3.1	\$ 2.9	\$ 11.5	\$ 10.6
Research and development	5.0	4.8	4.6	18.2	17.0
Selling and marketing	3.4	3.4	3.7	12.9	14.8
General and administrative	5.1	6.2	6.5	25.1	37.0
Total share-based compensation	<u>\$ 16.5</u>	<u>\$ 17.5</u>	<u>\$ 17.7</u>	<u>\$ 67.7</u>	<u>\$ 79.4</u>

NON-GAAP MEASURES

To supplement the consolidated financial results prepared in accordance with GAAP, ON Semiconductor uses certain non-GAAP measures, which are adjusted from the most directly comparable GAAP measures to exclude items related to the amortization of intangible assets, amortization of acquisition-related intangibles, expensing of appraised inventory fair market value step-up, inventory valuation adjustments, purchased in-process research and development expenses, restructuring, asset impairments and other, net, goodwill impairment charges, gains and losses on debt prepayment, non-cash interest expense, actuarial (gains) losses on pension plans and other pension benefits, third party acquisition and divestiture related costs, tax impact of these items, and certain other non-recurring items, as necessary. Management does not consider the effects of these items in evaluating the core operational activities of ON Semiconductor. Management uses these non-GAAP measures internally to make strategic decisions, forecast future results, and evaluate ON Semiconductor's current performance. In addition, the Company believes that most analysts covering ON Semiconductor use the non-GAAP measures to evaluate ON Semiconductor's performance. Given management's and other relevant use of these non-GAAP measures, ON Semiconductor believes these measures are important to investors in understanding ON Semiconductor's current and future operating results as seen through the eyes of management. In addition, management believes these non-GAAP measures are useful to investors in enabling them to better assess changes in ON Semiconductor's core business across different time periods. These non-GAAP measures are not prepared in accordance with, and should not be considered alternatives or necessarily superior to, GAAP financial data and may be different from non-GAAP measures used by other companies. Because non-GAAP financial measures are not standardized, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures, even if they have similar names.

Adjusted EBITDA

Adjusted EBITDA is a non-GAAP financial measure that represents net income before interest expense, interest income, provision for income taxes, depreciation, and amortization expense and special items. We use the adjusted EBITDA measure for internal managerial evaluation purposes, as a means to evaluate period-to-period comparisons and as a performance metric for the vesting and release of certain of our performance-based equity awards. SEC Regulation G and other federal securities laws regulate the use of financial measures that are not prepared in accordance with GAAP. We believe this measure provides important supplemental information to investors. However, we do not, and you should not, rely on non-GAAP financial measures alone as measures of our performance.

Non-GAAP Revenue

The use of non-GAAP revenue allows management to evaluate, among other things, the revenue from the Company's core businesses and trends across different reporting periods on a consistent basis, independent of special items. In addition, non-GAAP revenue is an important component of management's internal performance measurement and incentive and reward process as it is used to assess the current and historical financial results of the business and for strategic decision making, preparing budgets, obtaining targets and forecasting future results. Management presents this non-GAAP financial measure to enable investors and analysts to evaluate the Company's revenue generation performance relative to the direct costs of operations of ON Semiconductor's core businesses.

Non-GAAP Gross Profit and Gross Margin

The use of non-GAAP gross profit and gross margin allows management to evaluate, among other things, the gross margin and gross profit of the Company's core businesses and trends across different reporting periods on a consistent basis, independent of non-cash items including, generally speaking, expensing of appraised inventory fair market value step-up and the impact from the change in revenue recognition on distributor sales. In addition, it is an important component of management's internal performance measurement and incentive and reward process as it is used to assess the current and historical financial results of the business and for strategic decision making, preparing budgets, obtaining targets, and forecasting future results. Management presents this non-GAAP financial measure to enable investors and analysts to evaluate our revenue generation performance relative to the direct costs of revenue of ON Semiconductor's core businesses.

Non-GAAP Operating Income and Operating Margin

The use of non-GAAP operating income and operating margin allows management to evaluate, among other things, the operating margin and operating income of the Company's core businesses and trends across different reporting periods on a consistent basis, independent of non-cash items including, generally speaking, expensing of appraised inventory fair market value step-up, the impact from the change in revenue recognition on distributor sales, amortization and impairments of intangible assets, third party acquisition and divestiture related costs, restructuring charges, and certain other special items as necessary. In addition, it is an important component of management's internal performance measurement and incentive and reward process as it is used to assess the current and historical financial results of the business and for strategic decision making, preparing budgets, obtaining targets, and forecasting future results. Management presents this non-GAAP financial measure to enable investors and analysts to evaluate our revenue generation performance relative to the direct costs of operations of ON Semiconductor's core businesses.

NON-GAAP MEASURES (Continued)

Non-GAAP Net Income Attributable to ON Semiconductor and Non-GAAP Diluted Earnings Per Share

The use of non-GAAP net income attributable to ON Semiconductor and non-GAAP diluted earnings per share allows management to evaluate the operating results of ON Semiconductor's core businesses and trends across different reporting periods on a consistent basis, independent of non-cash items including, generally, the amortization and impairments of intangible assets, expensing of appraised inventory fair market value step-up, the impact from the change in revenue recognition on distributor sales, restructuring, gains and losses on debt prepayment, non-cash interest expense, actuarial (gains) losses on pension plans and other pension benefits, third party acquisition and divestiture related costs, tax indemnification by third parties, tax impact of these items and other non-GAAP adjustments, and certain other special items, as necessary. In addition, these items are important components of management's internal performance measurement and incentive and reward process, as they are used to assess the current and historical financial results of the business and for strategic decision making, preparing budgets, setting targets, and forecasting future results. Management presents these non-GAAP financial measures to enable investors and analysts to understand the results of operations of ON Semiconductor's core businesses and, to the extent comparable, to compare our results of operations on a more consistent basis against that of other companies in our industry.

Free Cash Flow

The use of free cash flow allows management to evaluate, among other things, the ability of the Company to make interest or principal payments on its debt. Free cash flow is defined as the difference between cash flow from operating activities and capital expenditures disclosed under investing activities in the consolidated statement of cash flows. Free cash flow is not an alternate to cash flow from operating activities as a measure of liquidity. It is an important component of management's internal performance measurement and incentive and reward process as it is used to assess the current and historical financial results of the business and for strategic decision making, preparing budgets, obtaining targets, and forecasting future results. Management presents this non-GAAP financial measure to enable investors and analysts to evaluate our revenue generation performance relative to the direct costs of operations of ON Semiconductor's core businesses.

Non-GAAP Diluted Share Count

The use of non-GAAP diluted share count allows management to evaluate, among other things, the potential dilution due to the outstanding stock options and restricted stock units excluding the dilution from the convertible notes that is covered by hedging activity up to a certain threshold. In periods in which the quarterly average stock price per share exceeds \$25.96, the non-GAAP diluted shares outstanding and non-GAAP net income per share include the impact of the Company's warrants issued concurrently with our 1.00% convertible notes. In periods when the quarterly average stock price per share exceeds \$20.72, the non-GAAP diluted shares outstanding and non-GAAP net income per share include the impact of the Company's hedge transactions issued concurrently with the 1.625% convertible notes. At an average stock price per share between \$20.72 and \$30.70, the hedging activity offsets the potentially dilutive effect of the 1.625% convertible notes.