ON SEMICONDUCTOR CORPORATION

CALL SCRIPT
FOR
Q3-16 RESULTS CONFERENCE CALL

Parag Agarwal

Thank you <operator> .

Good morning and thank you for joining ON Semiconductor Corporation's third quarter 2016 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 will be available on our website approximately one hour following this live broadcast and will continue to be available for approximately 30 days following this conference call, along with our earnings release for the third quarter of 2016. 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 the Securities and Exchange Commission.

Additional factors are described in our earnings release for the third quarter of 2016. 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.

We will be holding our 2017 Analyst Day on March 10th in Scottsdale, Arizona, and we will be send invitations and additional details of the event in coming days. During the fourth quarter, we will be attending the Credit Suisse Technology, Media & Telecom Conference on November 30th.

Now, let me turn it over to Bernard Gutmann, who will provide an overview of the third quarter 2016 results. Bernard….

Bernard Gutmann

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

Let me start by updating you on recent directives from Securities and Exchange Commission on disclosure of non-GAAP financial measures. Due to new and revised Compliance & Disclosure Interpretations on the use of non-GAAP financial metrics by U.S. listed companies from the U.S. Securities and Exchange Commission, we are revising our practices with respect to guidance and use of non-GAAP measures. Please see the earnings release for additional information.

Now, let me provide you details on our third quarter 2016 results. ON Semiconductor today announced that total revenue for the third quarter of 2016 was approximately $951 million, an increase of approximately eight percent as compared to the second quarter of 2016. Third quarter revenue included contribution of approximately $53 million from our acquisition of Fairchild Semiconductor, which closed on September 19, 2016. This incremental contribution from Fairchild was partially offset by approximately $5 million of revenue we didn't see this quarter as a result of divestiture of our Ignition IGBT, TVS diodes, and Thyristor product lines.

GAAP net income for the third quarter was $0.02 per diluted share. GAAP income before income tax for the third quarter was approximately $87.3 million. Non-GAAP income before income tax for the third quarter was approximately $107.3 million. Net cash paid for taxes in the third quarter was approximately $6.5 million and diluted shares outstanding were approximately 420 million.

GAAP gross margin for the third quarter was 34.6 percent, and Non-GAAP gross margin for the third quarter was 35.9 percent. GAAP and Non-GAAP gross margin in the second quarter of 2016 was 35.1 percent.

GAAP operating margin for the third quarter of 2016 was approximately 4.9 percent, as compared to approximately 8.6 percent in the prior quarter. Our non-GAAP operating margin for the third quarter was 12.9 percent, as compared to 12.3 percent in the prior quarter.

GAAP operating expenses for the third quarter were approximately $282 million, as compared to approximately $233 million for the second quarter of 2016. Non-GAAP operating expenses for the third quarter were approximately $218 million, as compared to approximately $200 million in the second quarter. The sequential increase in operating expenses was driven by inclusion of Fairchild in our third quarter results, annual merit increases, which become effective in the third quarter every year, costs related to Fairchild integration, and increases in legal and tax consulting fees.

We had strong operating cash flow performance in the third quarter. I am very excited about the cash flow potential of ON Semiconductor, and with addition of Fairchild, we should see meaningfully improved cash flow performance in 2017. Operating cash flow for the third quarter was approximately $133 million, as compared to approximately $104 million in the second quarter. Operating cash flow for the third quarter was negatively impacted by approximately $26 million related to modification of our Term Loan B financing. During the third quarter, we spent approximately $36 million of cash for the purchase of capital equipment, and we obtained approximately $104 million from divestiture of our ignition IGBT, TVS diodes and Thyristor product lines.

We exited the third quarter of 2016 with cash, cash equivalents and short term investments of approximately $880 million, as compared to approximately $588 million in the second quarter.

At the end of the third quarter of 2016, days of inventory on hand, adjusted for 11 days of revenue contribution from Fairchild and for fair market value step-up were 113 days. ON Semiconductor days of inventory in the second quarter were 120 days. In the third quarter of 2016, distribution inventory days increased marginally as compared to the second quarter, primarily due to inclusion of Fairchild.

For the third quarter of 2016, our lead times were up quarter over quarter. Our global factory utilization for the third quarter was slightly up sequentially.

Now let me provide you an update on performance of our business units, starting with Power Solutions Group, or PSG. Revenue for PSG was approximately $408 million. Revenue for our Analog Solutions Group for the third quarter of 2016 was approximately $363 million. Revenue for Image Sensor Group was approximately $180 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 update on progress we have made thus far on integration of Fairchild, and then I will provide commentary on current business trends and on various end-markets.

We are very pleased with our acquisition of Fairchild and also with the progress we have made thus far in the integration process. As of now, we are tracking significantly ahead of our announced synergy targets. Recall that at the close of transaction, we announced that we were targeting to achieve annual synergy run-rate of $75 million six months after close of the transaction. We already have exceeded our six months post close target and we plan to implement further actions in the current quarter to realize additional synergies. We expect to start to see the impact of these measures on our operating costs in early next year.

Let me now provide additional detail on the actions we have taken to realize synergies in various functional areas.

On R&D front, we have identified redundant or uneconomical programs and we are in process of eliminating many of these programs. A sizeable portion of R&D program rationalization will likely be achieved in the current quarter. As we previously mentioned, although ON Semiconductor and Fairchild had very complementary product portfolios, both companies were investing to grow in similar areas.

In sales and marketing, we took actions on first day after close of the transaction to effectively integrate the sales team. Redundancies in account management were eliminated, and customer accounts were allocated immediately after close of the transaction. Based on inputs from our customers, we retained the best talent between the sales forces of the two companies. With addition of Fairchild's portfolio, ON Semiconductor has significantly improved its presence in the distribution channel. We intend to leverage our expanded presence to drive higher sales through the distribution channel.

In general and administrative, we are rationalizing corporate functions such as finance, IT, legal and human resources. As we integrate the systems of the two companies, we should see meaningful savings on the G&A front. The departure of Fairchild management team has contributed to savings on G&A front.

On operations front, planning is well underway, and we are beginning to execute on synergies. Our initial assessment indicates that Fairchild's facilities are in good condition, and we intend to increase loading at most of these facilities through insourcing and production transfers to drive higher margins. Fairchild's operations planning systems are very similar to ours, and we expect a seamless integration of operations of the two companies.

Our initial assessment fully validates our financial and strategic rationale behind the acquisition. The acquisition is highly complementary, and overlap and redundancies in products and customers of the two companies are lower than previously expected. Fairchild has a very strong product portfolio, and with our scale and execution rigor, we are confident that we can generate significant value from Fairchild's portfolio. As we have indicated earlier, Fairchild's expertise in mid and high voltage power management is highly complementary to our strength in low voltage power management.

Customer reception to the transaction has been very positive. Customers realize the combined strength of the two companies and they are willing to engage with us in even more meaningful manner than before. We have seen increased interest from automotive, industrial, and communications customers in our combined portfolio. Fairchild has also added a list of marquee customers in the networking and industrial end-markets, and we are very pleased to be working with these customers.

As we had indicated earlier, the combination of ON Semiconductor and Fairchild creates a new leader in discrete power management market. Given our scale, execution history, and relationships, customers now have a very credible alternative to traditional market players for discrete power management solutions. Customers across end-markets and geographies have intensified their engagement with us for mid to high voltage power management solutions.

We will provide further updates on the financial and strategic impact of the acquisition at our Analyst Day on March 10th, 2017.

Let me now comment on the business trends in the third quarter. During the third quarter, demand trends were stable and the bookings were generally steady across most end-markets and geographies. End-market trends were generally in line with expectations. Recent commentary from customers points to a steady demand environment.

Despite a stable macro-economic environment and generally benign demand environment, we continue to manage our business in a prudent manner. We continue to execute on our strategy of focusing on automotive, industrial and communications end-markets, and with the acquisition of Fairchild, we are well positioned to increase our presence in these markets in a meaningful manner. We expect that our investments should start showing concrete results in 2017 and beyond.

Now I'll provide details of the progress in our various end-markets. With inclusion of Fairchild's results for a part of the third quarter, the normal quarter-over-quarter comparison that we have historically provided is not quite as meaningful. Therefore, I will limit my remarks to qualitative summary and limited quantitative data.

The **Automotive** end-market contributed revenue of approximately $319 million and represented approximately 33 percent of our revenue in the third quarter. Third quarter automotive revenue was negatively impacted by divestiture of Ignition IGBT business, TVS diodes and Thyristor product lines.

Our automotive design funnel remains robust as semiconductor growth in light vehicles continues to outpace production. We continue to see strong demand for our image sensors for ADAS applications. We have secured wins on marquee platforms, and we are well positioned to drive strong growth in our automotive image sensors. Other applications driving growth in automotive include advanced front lighting, park assist, and DC to DC conversion. With addition of Fairchild, we are now very well positioned to benefit from the fast growing EV/HEV market.

The **Industrial** end-market, which includes military, aerospace and medical, contributed revenue of approximately $212 million and represented approximately 22 percent of our revenue in the third quarter.

Key drivers on growth in the industrial markets remain intact. In the medical market, we continue to maintain our leadership in the hearing health market, and we are preparing to launch new products in the fourth quarter. In machine vision market, we are seeing strong demand for our CMOS and CCD image sensors.

The **Communications** end-market, which includes both networking and wireless, contributed revenue of approximately $192 million and represented approximately 20 percent of our revenue in the third quarter.

Our momentum in the smartphone market remains strong, and our presence with global OEMs and China based OEMs continues to grow. We continue to increase our content on marquee platforms by virtue of our innovative power management solutions. Fairchild further improves our position with key global and China based OEMs with its wall to battery solutions, convertors, audio switches, power switches, and other analog switches.

The **Computing** end-market contributed revenue of approximately $116 million and represented approximately 12 percent of our revenue in the third quarter. We noticed a slowdown in the computing market due to inventory adjustment.

The **Consumer** end-market contributed revenue of approximately $113 million and represented approximately 12 percent of our revenue in the third quarter. We noticed greater than seasonal strength in our consumer business, primarily due to gaming consoles and white goods.

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 revenues will be approximately $1,190 million to $1,240 million in the fourth quarter of 2016. Backlog levels for the fourth quarter of 2016 represent approximately 80 to 85 percent of our anticipated fourth quarter revenues. Our guidance for the fourth quarter is in line with normal seasonality with our organic business down approximately two percent at mid-point and Fairchild down approximately seven percent at mid-point.

We expect inventory at distributors to be flat quarter over quarter on a dollar basis. We expect total capital expenditures of approximately $40 million to $50 million in the fourth quarter of 2016. For the fourth quarter of 2016, we expect GAAP gross margin in range of 27.4 percent and 29.5 percent and non-GAAP gross margin in range of approximately 33.6 percent to 35.6 percent. Factory utilization in the fourth quarter is likely to be down sequentially.

We expect total GAAP operating expenses of approximately $327 million to $359 million. Our GAAP operating expenses include the amortization of intangibles, restructuring, asset impairments, and other charges, which are expected to be approximately $54 million to $72 million. We expect total non-GAAP operating expenses of approximately $273 million to $287 million.

We anticipate GAAP net other income and expense, including interest expense will be approximately $40 million to $43 million for the fourth quarter of 2016, which include non-cash interest expense of approximately $6 million to $7 million. We anticipate our non-GAAP net other income and expense, including interest expense will be approximately $34 million to $36 million.

Cash paid for income taxes is expected to be approximately $7 million to $11 million.

We also expect share based compensation of approximately $13 million to $15 million in the fourth quarter of 2016, 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 the fourth quarter of 2016 is expected to be approximately 424 million shares, based on the 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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