

ON Semiconductor (ON)

\$21.15 (As of 02/05/20)

Price Target (6-12 Months): **\$17.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 02/04/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: B

Summary

ON Semiconductor reported mixed fourth-quarter results, wherein revenues beat the Zacks Consensus Estimate, while earnings lagged the same. Moreover, both earnings and revenues declined year over year. Soft demand from industrial, automotive and consumer end-markets impacted results. Further, sluggishness in smartphone and 5G infrastructure verticals affected the top line. Markedly, unanticipated high demand for a lower-margined product in consumer segment weighed on margins. Moreover, significant China exposure amid coronavirus crisis and Huawei ban remain major concerns. Further, increasing investments on portfolio expansion and product enhancements is anticipated to weigh on the bottom line at least in the near term. Notably, shares of ON Semiconductor have underperformed the industry in the past year.

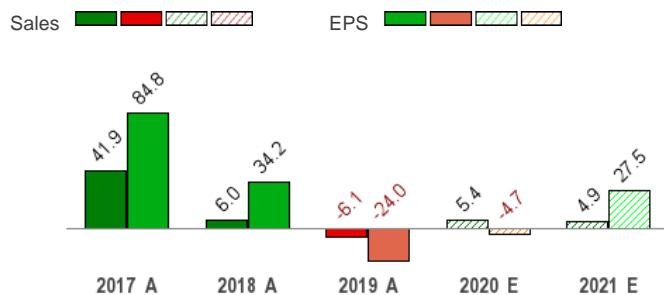
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$25.92 - \$16.65
20 Day Average Volume (sh)	8,594,438
Market Cap	\$8.7 B
YTD Price Change	-13.3%
Beta	2.27
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Semiconductor - Analog and Mixed
Zacks Industry Rank	Top 9% (24 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-9.1%
Last Sales Surprise	1.9%
EPS F1 Est- 4 week change	-13.4%
Expected Report Date	04/24/2020
Earnings ESP	0.0%
P/E TTM	14.3
P/E F1	14.9
PEG F1	2.1
P/S TTM	1.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,457 E	1,509 E	1,574 E	1,572 E	6,100 E
2020	1,381 E	1,435 E	1,504 E	1,500 E	5,815 E
2019	1,387 A	1,348 A	1,382 A	1,402 A	5,518 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.37 E	\$0.43 E	\$0.49 E	\$0.49 E	\$1.81 E
2020	\$0.23 E	\$0.32 E	\$0.41 E	\$0.42 E	\$1.42 E
2019	\$0.43 A	\$0.42 A	\$0.33 A	\$0.30 A	\$1.49 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/05/2020. The reports text is as of 02/06/2020.

Overview

Phoenix, AZ-based ON Semiconductor Corporation is an original equipment manufacturer (OEM) of a broad range of discrete and embedded semiconductor components.

The company was spun off from Motorola in Aug 1999, and went public through an IPO in May 2000.

ON Semi's product lines include discretes, such as bipolar transistors, diodes, filters, FETs, rectifiers and thyristors.

ON Semi's acquisition of Fairchild Semiconductor International makes it a leader in the power semiconductor space. Moreover, the company's acquisitions of Cypress Semiconductor's CMOS Image Sensor Business Unit, SANYO Semiconductor, AMI Semiconductor, Analog Devices' power PC controller business, CMD, Catalyst, and SoundDesign gave it new technical capabilities, some custom ASIC products, higher-margin products, exposure to new end markets and greater product breadth.

The **power management** product line includes AC-DC controllers and regulators, DC-DC converters and regulators, drivers, thermal managers, and voltage controllers, references and supervisors.

The **logic** product line includes clocking, memory, differential logic and standard logic products.

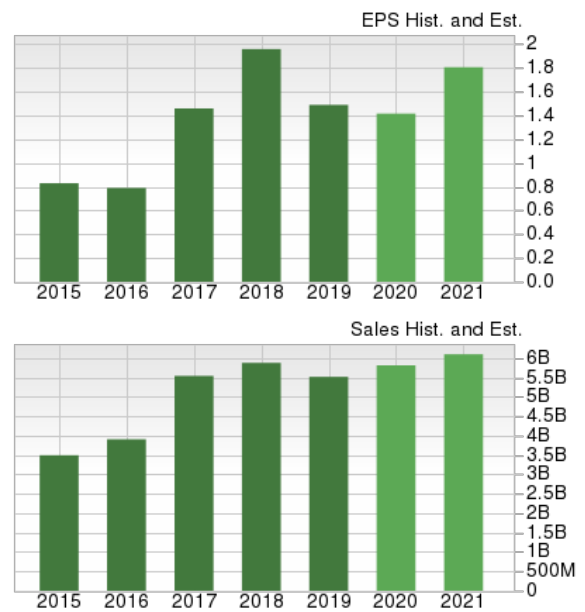
Signal processing products include amplifiers and comparators, analog switches, digital potentiometers, DSP systems and interfaces.

The company also offers **custom** application specific integrated circuits (ASICs), foundry services and memory products.

Customers include OEMs, electronic manufacturing service (EMS) providers and distributors. Top OEM customers include Motorola, Delta, Hewlett-Packard, Samsung, Siemens, Apple, Dell, Nokia, Intel, Sony, Continental Automotive Systems, DaimlerChrysler, Delphi, TRW and Visteon.

Top distributor customers include Arrow, Avnet, EBV Elektronik, Future, Solomon Enterprise and World Peace. Top EMS customers are Flextronics, Jabil and Celestica.

In 2019, revenues declined 6.1% over 2018 tally to \$5.518 billion. Non-GAAP earnings of \$1.49 per share declined almost 24% year over year. Non-GAAP gross margin of 36.1% contracted 200 bps on a year-over-year basis.



Reasons To Sell:

- ▼ ON Semi has a significant debt burden, but management has been dealing with the difficult situation through consistent repayments and refinancing actions. The acquisition of Fairchild will add more debt that the company will again have to bring down. Interest payments will continue to have a significant impact on net earnings. The company exited the fourth quarter with net debt balance amounting to \$2.72 billion. A high debt position increases the risk profile of the business.
- ▼ ON Semi has made a number of acquisitions in the past, but the two acquisitions that were completed in 2008 were perhaps the most significant. Integration of AMIS continued right up to 2010, even after years from the date the acquisition was completed. SANYO Semiconductor was another difficult acquisition and while it recently turned incremental to earnings, the margin impact may not be positive, given that it is a lagging edge facility. Consistent acquisition of companies is a distraction for management until the integration activities are completed. Moreover, we note that the buyouts negatively impacted the company's balance sheet in the form of high level of goodwill and net intangible assets, which comprised of 26.7% of total assets as of Dec 27, 2019.
- ▼ ON Semi faces significant competition in all of the served markets. Being a maker of building block components of a general purpose nature, competition comes from every kind of integrated circuit manufacturer. The automotive market in Japan is particularly competitive, where the company has to get designed in at an early stage. This is mainly because Japanese automotive customers have a preference for local makers that sometimes makes it difficult to operate.
- ▼ ON Semi's restructuring actions will likely have a positive impact on margins over the next year or so. Further, its recent acquisitions have increased its exposure to industrial, automotive and consumer markets that have helped it diversify away from a sluggish computing market. Some of these markets can generate higher margins than the traditional business, which is a positive. The company also stands to benefit from share gains within the computing business, considering the increasing dollar content at Intel's new process architecture. However, the company is considering cutting down utilization, as broader markets are witnessing weaker demand trends. This will invariably lead to poorer fixed cost absorption, thus eroding margins.
- ▼ ON Semi derives significant proportion of revenues from outside the United States (almost 85.3% of total revenues in fiscal 2018), subjecting the company to exchange rate volatility. Unfavorable movement in exchange rates of foreign currencies like Hong Kong dollar, euro, pound sterling, and Singapore Dollar, among others, related to the U.S. dollar can adversely impact results and undermine its growth potential to some extent. Further, imposition of tariffs owing to trade war between the United States and China is anticipated to negatively impact growth prospects. The macroeconomic uncertainty has impacted investors' confidence and is likely to weigh on the company's performance.

The significant debt position, integration risks from acquisitions, rising spend on restructuring initiatives and ever-increasing competition remain major headwinds.

Risks

- ON Semi is seeing strengthening demand across most end markets as evident from its bookings trends over the last few quarters. The company's backlog grew in each of the last four quarters and since it generates just a fifth of sales from turns, backlog growth is a good indicator of sustained demand. Also, increasing distributor inventories and strong resales is a positive. The design win momentum that the company is seeing also remained encouraging.
 - ON Semi's automotive segment is a strong growth driver for the company. Unit growth, share gains, attractive product offerings, rising content along with decreasing oil prices contribute to revenues. During the fourth quarter, the automotive segment registered a few impressive design wins for ADAS and rear view cameras with leading OEMs in the Americas, Europe and South Korea. Also the company is focused on investing in growth areas such as ADAS and wireless charging in the automotive business to broaden its exposure. This will further enhance its performance and help it deliver strong results. Given rising demand, ON Semi launched three new image sensors for ADAS and rear view applications. Also demand for image sensors, MOSFET's, Smart FET's, led drivers, wireless battery free sensing solution, parking sensor interface and power supply products is strong. The product launches in the automotive end market for next generation automobile designs augur well for the top line.
 - ON Semi is active on the M&A front. The company's acquisitions of Cypress Semiconductor's CMOS Image Sensor Business Unit, SANYO Semiconductor, AMI Semiconductor, Analog Devices' power PC controller business, CMD, Catalyst, and SoundDesign gave it new technical capabilities, some custom ASIC products, higher-margin products, exposure to new end markets and greater product breadth. ON Semi's acquisition of Fairchild Semiconductor International makes it a leader in the power semiconductor space. The deal will help the company diversify across many markets with a planned focus on smartphone, automotive and industrial end markets. ON Semi has also acquired Quantenna Communications (June 2019), which is engaged in providing high performance Wi-Fi solutions. The transaction is anticipated to strengthen the company's connectivity portfolio and enable it to better address Industrial and Automotive end markets.
 - ON Semi has successfully integrated big acquisitions like AMIS in the past, so it shouldn't have trouble with the integration. Management expects Fairchild acquisition to be immediately accretive to non GAAP earnings and free cash flow. Further gains are expected within a few quarters of close. Annual cost savings of at least \$150 million are expected within 18 months of closing. We believe that ON Semi can drive new socket opportunities by leveraging these acquisitions, thus generating top-line growth.
 - ON Semi has a very well diversified business. The company generates a significant percentage of revenues from each of the computing, consumer, industrial, communications and automotive markets. This mitigates the impact of seasonality typical of any of the markets, resulting in balanced growth through the year. Moreover, this diversity also helps the company to offset any weakness in a particular market by growth in others.
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Last Earnings Report

ON Semiconductor Q4 Earnings Miss, Revenues Top Estimates

ON Semiconductor Corporation reported fourth-quarter 2019 non-GAAP earnings of 30 cents per share, which lagged the Zacks Consensus Estimate by 9.1%. Notably, the figure declined 43% from the year-ago quarter's level.

Revenues of \$1.402 billion beat the Zacks Consensus Estimate of \$1.376 billion. However, the top line declined 7% on a year-over-year basis. Soft demand from industrial and consumer end-markets led to revenue decline. Nevertheless, the figure was above the higher end of management's guidance of \$1.350-\$1.400 billion.

The company intends to expand margins by enhancing manufacturing footprint and accelerate the timeline for production with the acquisition of 300mm East Fishkill fab. Moreover, the company also announced plans of selling its six-inch manufacturing facility in Oudenaarde, Belgium.

Top-Line Details

Business Units Metrics:

ON Semiconductor has three business units — Power Solutions Group (revenues of \$695.3 million), Analog Solutions Group (revenues of \$507.3 million) and Image Sensor Group (revenues of \$199.2 million).

End-Market Metrics:

Automotive (33% of revenues) end-market revenues were approximately \$462.1 million, down 3.5% year over year. The decline can be attributed to broad-based softness in automotive market.

Nonetheless, management noted strength in China. Further, the company is banking on strong demand for its image sensors, ADAS, power management products, LiDAR, radar and Silicon Carbide (SiC) products. Continued growth in ADAS and vehicle electrification design wins are likely to be a tailwind going ahead. Management is optimistic on improving demand for IGBT modules across Asia and Europe.

Notably, the company holds a competitive edge over its peers when it comes to delivering a comprehensive image sensor solution for autonomous driving applications and ADAS. The solution features exhaustive range of pixel densities which include 1, 2, and 8 megapixels on a single platform.

Industrial/Medical/Mil-Aero (24.6%) end-market revenues declined 11.5% year over year to \$344.3 million on broad-based soft demand.

Nevertheless, the company is witnessing strong demand for SiC modules, which holds promise.

Moreover, robust pipeline for the company's CMOS image sensors across e-commerce vertical for warehouse automation systems and delivery robots is expected to be a key catalyst in the days ahead.

Communications (20.6%) end-market revenues declined 3.2% year over year to \$289 million on sluggishness in demand from smartphone and 5G infrastructure verticals.

Computing (10.9%) declined 7.6% year over year to \$153.4 million. Notably, strength in server solutions domain failed to negate the downside. Management noted that improving supply of Intel's processors facilitated sequential growth in client computing business.

Consumer (10.9%) end-market revenues came in at \$152.9 million. The figure declined 10.4% from the year-ago quarter's level, primarily due to softness in consumer electronics.

Margins in Detail

Non-GAAP gross margin of 34.6% contracted 330 basis points (bps) on a year-over-year basis. For the fourth quarter, non-GAAP gross margin was anticipated in the range of 35.7-36.7%. Management attributes the decline to unanticipated high demand for a lower-margined product in consumer segment.

Non-GAAP operating expenses fell 1.2% from the year-ago quarter's figure to \$313.6 million. However, as a percentage of revenues, the figure expanded 130 bps on a year-over-year basis to 22.4%.

Non-GAAP operating margin contracted 450 bps on a year-over-year basis to 12.3%, owing to lower gross margin.

Balance Sheet & Cash Flow

As of Dec 31, 2019, ON Semiconductor had cash and cash equivalents of \$894.2 million, compared with \$928.7 million as of Sep 27 2019.

The company exited the fourth quarter with total debt (including current portion) amounting to \$3.613 billion, down from \$3.615 billion in the last reported quarter.

During the reported quarter, cash from operations came in at \$91.7 million compared with the prior-quarter figure of \$242.2 million.

Free cash flow came in at negative \$130.5 million compared with \$130.5 million generated in the previous quarter.

Quarter Ending **12/2019**

Report Date	Feb 03, 2020
Sales Surprise	1.90%
EPS Surprise	-9.09%
Quarterly EPS	0.30
Annual EPS (TTM)	1.48

Guidance

For first-quarter 2020, ON Semiconductor forecasts revenues in the range of \$1.355-\$1.405 billion.

Management expects revenues from Automotive end-market to improve sequentially in the first quarter. Revenues from Industrial end-market are anticipated to remain flat to decline slightly on a quarter-over-quarter basis. Meanwhile, Communications, Computing and Consumer end-markets are anticipated to decline sequentially in the first quarter.

For the first quarter, non-GAAP gross margin is projected in the range of 33.7-34.7%. Non-GAAP operating expenses are expected in the range of \$327-\$343 million.

Recent News

On Feb 4, 2020, ON Semiconductor introduced two LED drivers and two current controllers to power advanced vehicle lighting applications and improve road safety.

On Feb 3, 2020, ON Semiconductor announced intention to expand margins by enhancing manufacturing footprint and accelerate the timeline for production with the acquisition of 300mm East Fishkill fab. Moreover, the company also announced plans of selling its six-inch manufacturing facility in Oudenaarde, Belgium.

On Oct 20, 2019, ON Semiconductor announced that shipments of its AR0132AT image sensors, which are utilized to enhance performance of driver assistance applications, has crossed over 100 million units. The sensors have been implemented by SUBARU CORPORATION, to power its robust driver support system, EyeSight.

On Oct 15, 2019, ON Semiconductor announced collaboration with Almotive to build prototype sensor fusion platforms to power automotive applications.

On Oct 10, 2019, ON Semiconductor announced that its Wi-Fi chipset from Quantenna Connectivity Solutions division has been implemented by Europe-based broadband service provider, Orange France in its latest gateway— Livebox 5.

Valuation

ON Semiconductor shares are up 20.4% in the past six-month period, but down 5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 18.2% and 21.8% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and sector are up 26.7% and 30.9%, respectively.

The S&P 500 index is up 17.1% in the past six-month period and 22.7% in the past year.

The stock is currently trading at 13.03X forward 12-month earnings, which compares to 22.58X for the Zacks sub-industry, 22.62X for the Zacks sector and 19.09X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.62X and as low as 7.52X, with a 5-year median of 11.25X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$17 price target reflects 10.47X forward 12-month earnings.

The table below shows summary valuation data for ON

Valuation Multiples -ON					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.03	22.58	22.62	19.09
	5-Year High	16.62	22.79	22.62	19.34
	5-Year Low	7.52	13.42	16.87	15.18
	5-Year Median	11.25	18.14	19.28	17.46
P/S F12M	Current	1.52	4.68	3.70	3.54
	5-Year High	2.00	4.68	3.70	3.54
	5-Year Low	0.82	2.81	2.30	2.54
	5-Year Median	1.30	3.69	3.02	3
EV/Sales TTM	Current	1.89	5.20	4.40	3.35
	5-Year High	2.37	5.20	4.40	3.35
	5-Year Low	0.90	3.13	2.57	2.12
	5-Year Median	1.83	4.35	3.48	2.79

As of 02/05/2020

Industry Analysis Zacks Industry Rank: Top 9% (24 out of 255)



Top Peers

STMicroelectronics N.V. (STM)	Outperform
Analog Devices, Inc. (ADI)	Neutral
Broadcom Inc. (AVGO)	Neutral
Diodes Incorporated (DIOD)	Neutral
Infineon Technologies AG (IFNNY)	Neutral
Monolithic Power Systems, Inc. (MPWR)	Neutral
Texas Instruments Incorporated (TXN)	Neutral
Vishay Intertechnology, Inc. (VSH)	Neutral

Industry Comparison Industry: Semiconductor - Analog And Mixed				Industry Peers		
	ON Underperform	X Industry	S&P 500	ADI Neutral	AVGO Neutral	DIOD Neutral
VGM Score	C	-	-	D	B	A
Market Cap	8.69 B	6.40 B	24.26 B	43.05 B	126.25 B	2.65 B
# of Analysts	11	7	13	12	13	1
Dividend Yield	0.00%	0.00%	1.75%	1.85%	4.10%	0.00%
Value Score	B	-	-	D	C	B
Cash/Price	0.10	0.10	0.04	0.02	0.04	0.09
EV/EBITDA	7.53	19.43	14.19	18.84	18.60	9.47
PEG Ratio	2.09	1.95	2.04	1.97	1.28	NA
Price/Book (P/B)	2.68	4.63	3.31	3.67	NA	2.46
Price/Cash Flow (P/CF)	6.52	19.05	13.70	15.72	9.34	11.48
P/E (F1)	14.89	26.07	19.17	24.43	13.72	17.90
Price/Sales (P/S)	1.57	5.26	2.67	7.19	5.59	2.10
Earnings Yield	6.71%	3.85%	5.22%	4.10%	7.29%	5.59%
Debt/Equity	0.89	0.56	0.71	0.44	-214.36	0.08
Cash Flow (\$/share)	3.25	2.86	6.92	7.42	33.97	4.52
Growth Score	D	-	-	C	B	A
Hist. EPS Growth (3-5 yrs)	25.92%	13.72%	10.80%	21.84%	28.58%	24.92%
Proj. EPS Growth (F1/F0)	-4.94%	13.11%	7.35%	-7.27%	8.70%	0.00%
Curr. Cash Flow Growth	20.30%	-12.10%	10.12%	-9.88%	8.07%	36.97%
Hist. Cash Flow Growth (3-5 yrs)	24.07%	25.11%	8.55%	24.75%	48.32%	11.81%
Current Ratio	1.54	3.48	1.20	1.32	1.44	2.56
Debt/Capital	47.05%	36.52%	42.91%	30.72%	54.64%	7.55%
Net Margin	3.84%	3.29%	11.79%	22.75%	12.06%	10.74%
Return on Equity	18.85%	13.04%	17.21%	16.39%	46.16%	14.60%
Sales/Assets	0.67	0.47	0.54	0.28	0.32	0.79
Proj. Sales Growth (F1/F0)	5.39%	4.39%	4.15%	-5.46%	10.72%	-0.67%
Momentum Score	B	-	-	D	A	B
Daily Price Chg	6.71%	3.06%	1.40%	3.75%	1.85%	3.61%
1 Week Price Chg	-7.36%	-7.80%	-2.60%	-6.65%	-5.81%	-9.26%
4 Week Price Chg	-14.79%	1.27%	1.96%	-3.30%	2.80%	-9.82%
12 Week Price Chg	-1.81%	10.41%	6.04%	2.20%	1.18%	13.19%
52 Week Price Chg	-7.32%	23.85%	16.68%	13.93%	14.90%	41.92%
20 Day Average Volume	8,594,438	770,985	1,966,046	2,049,908	2,700,550	372,721
(F1) EPS Est 1 week change	-13.41%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-13.41%	0.00%	0.00%	0.00%	0.43%	0.00%
(F1) EPS Est 12 week change	-13.63%	-0.15%	-0.08%	-9.58%	-1.41%	0.00%
(Q1) EPS Est Mthly Chg	-25.53%	0.00%	0.00%	0.00%	0.46%	0.00%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	D
Momentum Score	B
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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