

ON SEMICONDUCTOR CORPORATION
UNAUDITED CONSOLIDATED STATEMENT OF OPERATIONS

(in millions, except per share data)

	Quarters Ended			Six Months Ended	
	June 28, 2019	March 29, 2019	June 29, 2018	June 28, 2019	June 29, 2018
Revenue	\$ 1,347.7	\$ 1,386.6	\$ 1,455.9	\$ 2,734.3	\$ 2,833.5
Cost of revenue (exclusive of amortization shown below)	848.7	872.9	900.9	1,721.6	1,761.1
Gross profit	499.0	513.7	555.0	1,012.7	1,072.4
Gross margin	37.0%	37.0%	38.1%	37.0%	37.8%
Operating expenses:					
Research and development	147.0	151.8	167.1	298.8	322.3
Selling and marketing	73.6	77.1	81.7	150.7	159.5
General and administrative	74.1	72.9	74.6	147.0	145.5
Amortization of acquisition-related intangible assets	27.5	25.7	27.9	53.2	55.3
Restructuring, asset impairments and other, net	18.1	5.6	3.2	23.7	3.6
Goodwill and intangible asset impairment	0.4	1.2	3.3	1.6	3.3
Total operating expenses	340.7	334.3	357.8	675.0	689.5
Operating income	158.3	179.4	197.2	337.7	382.9
Other income (expense), net:					
Interest expense	(33.7)	(31.7)	(32.6)	(65.4)	(64.1)
Interest income	3.0	2.5	1.1	5.5	2.0
Loss on debt refinancing and prepayment	(0.4)	—	(4.0)	(0.4)	(4.0)
Gain on divestiture of business	—	—	4.6	—	4.6
Licensing income	—	—	28.1	—	31.9
Other income (expense)	(1.0)	2.1	(1.0)	1.1	(3.0)
Other income (expense), net	(32.1)	(27.1)	(3.8)	(59.2)	(32.6)
Income before income taxes	126.2	152.3	193.4	278.5	350.3
Income tax provision	(23.3)	(38.2)	(37.1)	(61.5)	(53.5)
Net income	102.9	114.1	156.3	217.0	296.8
Less: Net income attributable to non-controlling interest	(1.1)	—	(1.0)	(1.1)	(1.9)
Net income attributable to ON Semiconductor Corporation	\$ 101.8	\$ 114.1	\$ 155.3	\$ 215.9	\$ 294.9
Net income per common share attributable to ON Semiconductor Corporation:					
Basic	\$ 0.25	\$ 0.28	\$ 0.36	\$ 0.52	\$ 0.69
Diluted	\$ 0.24	\$ 0.27	\$ 0.35	\$ 0.52	\$ 0.66
Weighted average common shares outstanding:					
Basic	411.9	410.6	427.0	411.3	426.5
Diluted	417.7	417.7	444.3	417.8	444.4

ON SEMICONDUCTOR CORPORATION
UNAUDITED CONSOLIDATED BALANCE SHEET

(in millions)

	June 28, 2019	March 29, 2019	December 31, 2018
Assets			
Cash and cash equivalents	\$ 885.2	\$ 939.6	\$ 1,069.6
Receivables, net	713.2	704.0	686.0
Inventories	1,273.8	1,225.2	1,225.2
Other current assets	192.0	177.9	187.0
Total current assets	3,064.2	3,046.7	3,167.8
Property, plant and equipment, net	2,620.0	2,585.0	2,549.6
Goodwill	1,552.5	932.5	932.5
Intangible assets, net	778.0	539.5	566.4
Deferred tax assets	242.0	238.2	266.2
Other assets	267.8	222.4	105.1
Total assets	<u>\$ 8,524.5</u>	<u>\$ 7,564.3</u>	<u>\$ 7,587.6</u>
Liabilities, Non-Controlling Interest and Stockholders' Equity			
Accounts payable	\$ 542.9	\$ 583.3	\$ 671.7
Accrued expenses and other current liabilities	618.2	603.4	659.1
Current portion of long-term debt	105.7	130.8	138.5
Total current liabilities	1,266.8	1,317.5	1,469.3
Long-term debt	3,550.8	2,639.0	2,627.6
Deferred tax liabilities	58.9	54.1	54.8
Other long-term liabilities	350.1	333.0	241.8
Total liabilities	5,226.6	4,343.6	4,393.5
ON Semiconductor Corporation stockholders' equity:			
Common stock	5.6	5.6	5.6
Additional paid-in capital	3,757.6	3,722.5	3,702.3
Accumulated other comprehensive loss	(53.4)	(43.7)	(37.9)
Accumulated earnings	1,195.5	1,093.7	979.6
Less: Treasury stock, at cost	(1,631.0)	(1,579.9)	(1,478.0)
Total ON Semiconductor Corporation stockholders' equity	3,274.3	3,198.2	3,171.6
Non-controlling interest	23.6	22.5	22.5
Total stockholders' equity	3,297.9	3,220.7	3,194.1
Total liabilities and stockholders' equity	<u>\$ 8,524.5</u>	<u>\$ 7,564.3</u>	<u>\$ 7,587.6</u>

ON SEMICONDUCTOR CORPORATION

UNAUDITED RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA AND

NET CASH PROVIDED BY OPERATING ACTIVITIES

(in millions)

	Quarters Ended			Six Months Ended	
	June 28, 2019	March 29, 2019	June 29, 2018	June 28, 2019	June 29, 2018
Net income	\$ 102.9	\$ 114.1	\$ 156.3	\$ 217.0	\$ 296.8
Adjusted for:					
Licensing income	—	—	(28.1)	—	(31.9)
R&D costs related to licensing income	—	—	3.7	—	6.5
Restructuring, asset impairments and other, net	18.1	5.6	3.2	23.7	3.6
Goodwill and intangible asset impairment	0.4	1.2	3.3	1.6	3.3
Interest expense	33.7	31.7	32.6	65.4	64.1
Interest income	(3.0)	(2.5)	(1.1)	(5.5)	(2.0)
Loss on debt refinancing and prepayment	0.4	—	4.0	0.4	4.0
Income tax provision	23.3	38.2	37.1	61.5	53.5
Net income attributable to non-controlling interest	(1.1)	—	(1.0)	(1.1)	(1.9)
Depreciation and amortization	144.0	135.8	125.5	279.8	245.4
Amortization of fair market value step-up of inventory	0.6	—	0.2	0.6	0.2
Gain on divestiture of business	—	—	(4.6)	—	(4.6)
Adjustment to contingent consideration	—	—	—	—	(2.1)
Third party acquisition and divestiture related costs	6.5	3.3	2.1	9.8	2.5
Indemnification gain	—	(4.9)	—	(4.9)	—
Adjusted EBITDA	<u>325.8</u>	<u>322.5</u>	<u>333.2</u>	<u>648.3</u>	<u>637.4</u>
Increase (decrease):					
Licensing income	—	—	28.1	—	31.9
R&D costs related to licensing income	—	—	(3.7)	—	(6.5)
Restructuring, asset impairments and other, net	(18.1)	(5.6)	(3.2)	(23.7)	(3.6)
Interest expense	(33.7)	(31.7)	(32.6)	(65.4)	(64.1)
Interest income	3.0	2.5	1.1	5.5	2.0
Income tax provision	(23.3)	(38.2)	(37.1)	(61.5)	(53.5)
Net income attributable to non-controlling interest	1.1	—	1.0	1.1	1.9
Amortization of fair market value step-up of inventory	(0.6)	—	(0.2)	(0.6)	(0.2)
Adjustment to contingent consideration	—	—	—	—	2.1
Third party acquisition and divestiture related costs	(6.5)	(3.3)	(2.1)	(9.8)	(2.5)
Indemnification gain	—	4.9	—	4.9	—
Loss on sale or disposal of fixed assets	—	0.4	1.1	0.4	2.4
Amortization of debt discount and issuance costs	3.4	3.2	3.4	6.6	6.7
Payments for term debt modification	—	—	(1.1)	—	(1.1)
Share-based compensation expense	27.3	19.7	23.1	47.0	41.5
Non-cash interest on convertible notes	9.3	9.1	8.9	18.4	17.6
Change in deferred taxes	3.3	29.0	35.7	32.3	43.2
Other	5.8	(4.3)	0.2	1.5	(1.0)
Changes in assets and liabilities	<u>(74.4)</u>	<u>(169.8)</u>	<u>(87.3)</u>	<u>(244.2)</u>	<u>(159.2)</u>

ON SEMICONDUCTOR CORPORATION

UNAUDITED RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA AND

NET CASH PROVIDED BY OPERATING ACTIVITIES (Continued)

(in millions)

	Quarters Ended			Six Months Ended	
	June 28, 2019	March 29, 2019	June 29, 2018	June 28, 2019	June 29, 2018
Net cash provided by operating activities	\$ 222.4	\$ 138.4	\$ 268.5	\$ 360.8	\$ 495.0
Cash flows from investing activities:					
Purchase of property, plant and equipment	\$ (153.5)	\$ (157.0)	\$ (152.9)	\$ (310.5)	\$ (252.4)
Proceeds from sales of property, plant and equipment	1.4	—	0.4	1.4	6.0
Deposits utilized (made) for purchase of property, plant and equipment	9.8	(10.1)	(2.1)	(0.3)	(13.7)
Purchase of business, net of cash acquired	(867.0)	—	(70.7)	(867.0)	(70.7)
Purchase of license and deposit made for manufacturing facility	(100.0)	—	—	(100.0)	—
Proceeds from divestiture of business and release of escrow	5.0	—	5.6	5.0	5.6
Proceeds from repayment of note receivable	—	—	10.2	—	10.2
Equity method investment	—	—	(19.8)	—	(19.8)
Net cash used in investing activities	\$ (1,104.3)	\$ (167.1)	\$ (229.3)	\$ (1,271.4)	\$ (334.8)
Cash flows from financing activities:					
Proceeds for the issuance of common stock under the ESPP	6.4	\$ 7.4	\$ 6.9	\$ 13.8	\$ 6.9
Proceeds from exercise of stock options	0.4	0.5	0.7	0.9	4.3
Payment of tax withholding for RSUs	(1.1)	(26.1)	(1.1)	(27.2)	(19.9)
Repurchase of common stock	(50.8)	(75.0)	(40.0)	(125.8)	(40.0)
Borrowings under debt agreements	900.0	4.3	2.2	904.3	7.5
Payment of debt issuance and other financing costs	(4.7)	—	—	(4.7)	—
Repayment of long-term debt	(26.4)	(12.2)	(79.5)	(38.6)	(215.4)
Payment of finance lease obligations	(0.2)	(0.2)	(2.1)	(0.4)	(3.2)
Net cash provided by (used in) financing activities	\$ 823.6	\$ (101.3)	\$ (112.9)	\$ 722.3	\$ (259.8)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	\$ 0.3	\$ —	\$ (0.9)	\$ 0.3	\$ 0.7
Net decrease in cash, cash equivalents and restricted cash	\$ (58.0)	\$ (130.0)	\$ (74.6)	\$ (188.0)	\$ (98.9)
Cash, cash equivalents and restricted cash, beginning of period	\$ 957.1	\$ 1,087.1	\$ 942.3	\$ 1,087.1	\$ 966.6
Cash, cash equivalents and restricted cash, end of period	\$ 899.1	\$ 957.1	\$ 867.7	\$ 899.1	\$ 867.7

ON SEMICONDUCTOR CORPORATION

RECONCILIATION OF GAAP VERSUS NON-GAAP DISCLOSURES

(in millions, except per share and percentage data)

	Quarters Ended			Six Months Ended	
	June 28, 2019	March 29, 2019	June 29, 2018	June 28, 2019	June 29, 2018
Reconciliation of GAAP gross profit to non-GAAP gross profit:					
GAAP gross profit	\$ 499.0	\$ 513.7	\$ 555.0	\$ 1,012.7	\$ 1,072.4
Special items:					
a) Expensing of appraised inventory at fair market value step-up	0.6	—	0.2	0.6	0.2
Total special items	0.6	—	0.2	0.6	0.2
Non-GAAP gross profit	\$ 499.6	\$ 513.7	\$ 555.2	\$ 1,013.3	\$ 1,072.6
Reconciliation of GAAP gross margin to non-GAAP gross margin:					
GAAP gross margin	37.0%	37.0%	38.1%	37.0%	37.8%
Special items:					
a) Expensing of appraised inventory at fair market value step-up	0.1%	—%	—%	—%	—%
Total special items	0.1%	—%	—%	—%	—%
Non-GAAP gross margin	37.1%	37.0%	38.1%	37.1%	37.9%
Reconciliation of GAAP operating expenses to non-GAAP operating expenses:					
GAAP operating expenses	\$ 340.7	\$ 334.3	\$ 357.8	\$ 675.0	\$ 689.5
Special items:					
a) Amortization of acquisition-related intangible assets	(27.5)	(25.7)	(27.9)	(53.2)	(55.3)
b) Restructuring, asset impairments and other, net	(18.1)	(5.6)	(3.2)	(23.7)	(3.6)
c) Goodwill and intangible asset impairment	(0.4)	(1.2)	(3.3)	(1.6)	(3.3)
d) Third party acquisition and divestiture related costs	(6.5)	(3.3)	(2.1)	(9.8)	(2.5)
e) R&D costs related to licensing income	—	—	(3.7)	—	(6.5)
Total special items	(52.5)	(35.8)	(40.2)	(88.3)	(71.2)
Non-GAAP operating expenses	\$ 288.2	\$ 298.5	\$ 317.6	\$ 586.7	\$ 618.3
Reconciliation of GAAP operating income to non-GAAP operating income:					
GAAP operating income	\$ 158.3	\$ 179.4	\$ 197.2	\$ 337.7	\$ 382.9
Special items:					
a) Expensing of appraised inventory at fair market value step-up	0.6	—	0.2	0.6	0.2
b) Amortization of acquisition-related intangible assets	27.5	25.7	27.9	53.2	55.3
c) Restructuring, asset impairments and other, net	18.1	5.6	3.2	23.7	3.6
d) Goodwill and intangible asset impairment	0.4	1.2	3.3	1.6	3.3
e) Third party acquisition and divestiture related costs	6.5	3.3	2.1	9.8	2.5
f) R&D costs related to licensing income	—	—	3.7	—	6.5
Total special items	53.1	35.8	40.4	88.9	71.4
Non-GAAP operating income	\$ 211.4	\$ 215.2	\$ 237.6	\$ 426.6	\$ 454.3
Reconciliation of GAAP operating margin to non-GAAP operating margin (operating income / revenue):					
GAAP operating margin	11.7%	12.9%	13.5%	12.4%	13.5%

ON SEMICONDUCTOR CORPORATION

RECONCILIATION OF GAAP VERSUS NON-GAAP DISCLOSURES (Continued)

(in millions, except per share and percentage data)

	Quarters Ended			Six Months Ended	
	June 28, 2019	March 29, 2019	June 29, 2018	June 28, 2019	June 29, 2018
Special items:					
a) Expensing of appraised inventory at fair market value step-up	0.1%	—%	—%	—%	—%
b) Amortization of acquisition-related intangible assets	2.0%	1.9%	1.9%	1.9%	2.0%
c) Restructuring, asset impairments and other, net	1.3%	0.4%	0.2%	0.9%	0.1%
d) Goodwill and intangible asset impairment	—%	0.1%	0.2%	0.1%	0.1%
e) Third party acquisition and divestiture related costs	0.5%	0.2%	0.1%	0.4%	0.1%
f) R&D costs related to licensing income	—%	—%	0.3%	—%	0.2%
Total special items	4.0%	2.6%	2.8%	3.2%	2.5%
Non-GAAP operating margin	15.7%	15.5%	16.3%	15.6%	16.0%
Reconciliation of GAAP income before income taxes to non-GAAP income before income taxes:					
GAAP income before income taxes	\$ 126.2	\$ 152.3	\$ 193.4	\$ 278.5	\$ 350.3
Special items:					
a) Expensing of appraised inventory at fair market value step-up	0.6	—	0.2	0.6	0.2
b) Amortization of acquisition-related intangible assets	27.5	25.7	27.9	53.2	55.3
c) Restructuring, asset impairments and other, net	18.1	5.6	3.2	23.7	3.6
d) Goodwill and intangible asset impairment	0.4	1.2	3.3	1.6	3.3
e) Third party acquisition and divestiture related costs	6.5	3.3	2.1	9.8	2.5
f) R&D costs related to licensing income	—	—	3.7	—	6.5
g) Loss on debt refinancing and prepayment	0.4	—	4.0	0.4	4.0
h) Non-cash interest on convertible notes	9.3	9.1	8.9	18.4	17.6
i) Indemnification gain	—	(4.9)	—	(4.9)	—
j) Adjustment to contingent consideration	—	—	—	—	(2.1)
k) Licensing income	—	—	(28.1)	—	(31.9)
l) Gain on divestiture of business	—	—	(4.6)	—	(4.6)
Total special items	62.8	40.0	20.6	102.8	54.4
Non-GAAP income before income taxes	\$ 189.0	\$ 192.3	\$ 214.0	\$ 381.3	\$ 404.7
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	\$ 101.8	\$ 114.1	\$ 155.3	\$ 215.9	\$ 294.9
Special items:					
a) Expensing of appraised inventory at fair market value step-up	0.6	—	0.2	0.6	0.2
b) Amortization of acquisition-related intangible assets	27.5	25.7	27.9	53.2	55.3
c) Restructuring, asset impairments and other, net	18.1	5.6	3.2	23.7	3.6
d) Goodwill and intangible asset impairment	0.4	1.2	3.3	1.6	3.3
e) Third party acquisition and divestiture related costs	6.5	3.3	2.1	9.8	2.5

ON SEMICONDUCTOR CORPORATION

RECONCILIATION OF GAAP VERSUS NON-GAAP DISCLOSURES (Continued)

(in millions, except per share and percentage data)

	Quarters Ended			Six Months Ended	
	June 28, 2019	March 29, 2019	June 29, 2018	June 28, 2019	June 29, 2018
f) R&D costs related to licensing income	—	—	3.7	—	6.5
g) Loss on debt refinancing and prepayment	0.4	—	4.0	0.4	4.0
h) Non-cash interest on convertible notes	9.3	9.1	8.9	18.4	17.6
i) Indemnification gain	—	(4.9)	—	(4.9)	—
j) Adjustment to contingent consideration	—	—	—	—	(2.1)
k) Licensing income	—	—	(28.1)	—	(31.9)
l) Gain on divestiture of business	—	—	(4.6)	—	(4.6)
m) Adjustment of income taxes	10.4	23.0	23.8	33.4	21.1
Total special items	73.2	63.0	44.4	136.2	75.5
Non-GAAP net income attributable to ON Semiconductor Corporation	\$ 175.0	\$ 177.1	\$ 199.7	\$ 352.1	\$ 370.4
Adjustment of income taxes:					
Tax adjustment for special items (1)	\$ (13.2)	\$ (8.4)	\$ (4.3)	\$ (21.6)	\$ (11.4)
Other non-GAAP tax adjustment (2)	20.0	31.0	28.1	51.0	32.5
Tax indemnified by third parties	3.6	0.4	—	4.0	—
Total adjustment of income taxes	\$ 10.4	\$ 23.0	\$ 23.8	\$ 33.4	\$ 21.1
Reconciliation of GAAP diluted share count to non-GAAP diluted share count:					
GAAP diluted share count	417.7	417.7	444.3	417.8	444.4
Special items:					
a) Dilutive share count attributable to convertible notes	(3.9)	(3.9)	(12.7)	(3.9)	(12.7)
Total special items	(3.9)	(3.9)	(12.7)	(3.9)	(12.7)
Non-GAAP diluted share count	413.8	413.8	431.6	413.9	431.7
Non-GAAP diluted earnings per share:					
Non-GAAP net income attributable to ON Semiconductor Corporation	\$ 175.0	\$ 177.1	\$ 199.7	\$ 352.1	\$ 370.4
Non-GAAP diluted share count	413.8	413.8	431.6	413.9	431.7
Non-GAAP diluted earnings per share	\$ 0.42	\$ 0.43	\$ 0.46	\$ 0.85	\$ 0.86
Reconciliation of net cash provided by operating activities to free cash flow:					
Net cash provided by operating activities	\$ 222.4	\$ 138.4	\$ 268.5	\$ 360.8	\$ 495.0
Special items:					
a) Purchase of property, plant and equipment	(153.5)	(157.0)	(152.9)	(310.5)	(252.4)
Total special items	(153.5)	(157.0)	(152.9)	(310.5)	(252.4)
Free cash flow	\$ 68.9	\$ (18.6)	\$ 115.6	\$ 50.3	\$ 242.6

- (1) Tax impact of non-GAAP special items (a-l) is calculated using the federal statutory rate of 21% for all periods presented.
- (2) 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.

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

ON SEMICONDUCTOR CORPORATION

RECONCILIATION OF GAAP VERSUS NON-GAAP DISCLOSURES (Continued)

(in millions, except per share and percentage data)

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

	Quarters Ended			Six Months Ended	
	June 28, 2019	March 29, 2019	June 29, 2018	June 28, 2019	June 29, 2018
Cost of revenue	\$ 3.5	\$ 1.9	\$ 1.8	\$ 5.4	\$ 3.4
Research and development	5.4	3.6	4.0	9.0	7.2
Selling and marketing	4.6	3.8	4.0	8.4	7.2
General and administrative	13.8	10.4	13.3	24.2	23.7
Total share-based compensation expense	\$ 27.3	\$ 19.7	\$ 23.1	\$ 47.0	\$ 41.5

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 generally accepted accounting principles. 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 the Company's revenue generation performance relative to the direct costs of revenue of ON Semiconductor's core businesses.

Non-GAAP Operating Income and Operating Margin

NON-GAAP MEASURES (Continued)

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 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 those 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 when the quarterly average stock price per share exceeds \$18.50, the non-GAAP diluted share count includes the anti-dilutive impact of the Company's hedge transactions issued concurrently with the 1.00% convertible notes. As such, at an average stock price per share between \$18.50 and \$25.96, the hedging activity offsets the potentially dilutive effect of the 1.00% convertible notes.

In periods when the quarterly average stock price per share exceeds \$20.72, the non-GAAP diluted share count includes the anti-dilutive impact of the Company's hedge transactions issued concurrently with the 1.625% convertible notes. As such, 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.