

[Table of Contents](#)

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with our audited historical consolidated financial statements, which are included elsewhere in this Form 10-K. Management's Discussion and Analysis of Financial Condition and Results of Operations contains statements that are forward-looking. These statements are based on current expectations and assumptions that are subject to risk, uncertainties, and other factors. Actual results could differ materially because of the factors discussed in Part I, Item 1A "Risk Factors" included elsewhere in this Form 10-K.

Executive Overview

This executive overview presents summary information regarding our industry, markets, business and operating trends only. For further information relating to the information summarized herein, see Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" in its entirety.

Industry Overview

According to WSTS (an industry research firm), worldwide semiconductor industry sales were \$335.8 billion in 2014, an increase of approximately 9.9% from \$305.6 billion in 2013. We participate in unit and revenue surveys and use data summarized by WSTS to evaluate overall semiconductor market trends and also to track our progress against the market in the areas we provide semiconductor components. The following table sets forth total worldwide semiconductor industry revenues and revenues in our Serviceable Addressable Market ("SAM") since 2010:

<u>Year Ended December 31,</u>	<u>Worldwide Semiconductor Industry Sales (1) (in billions)</u>	<u>Percentage Change</u>	<u>Serviceable Addressable Market Sales (1) (2) (in billions)</u>	<u>Percentage Change</u>
2014	\$ 335.8	9.9%	\$ 112.0	7.4%
2013	\$ 305.6	4.8%	\$ 104.3	0.6%
2012	\$ 291.6	(2.6)%	\$ 103.7	(3.4)%
2011	\$ 299.5	0.4%	\$ 107.4	(2.5)%
2010	\$ 298.3	31.8%	\$ 110.2	28.7%

- (1) Based on shipment information published by WSTS. WSTS collects this information based on product shipments, which differs from how we recognize revenue on shipments to certain distributors as described in Note 2: "Significant Accounting Policies—Revenue Recognition" in the notes to our audited consolidated financial statements contained elsewhere in this report. We believe the data provided by WSTS is reliable, but we have not independently verified it. WSTS periodically revises its information. We assume no obligation to update such information.
- (2) Our SAM comprises the following specific WSTS product categories: (a) discrete products (all discrete semiconductors other than sensors, microwave power transistors/modules, microwave diodes, and microwave transistors, power modules, logic and optoelectronics); (b) standard analog products (amplifiers, VREGs and references, comparators, ASSP consumer, ASSP communications, ASSP computer, ASSP automotive and ASSP industrial and others); (c) standard logic products (general purpose logic); (d) standard product logic (consumer other, computer other peripherals, wired / wireless communications, automotive, industrial and multipurpose); (e) CMOS and CCD image sensors; (f) memory; (g) microcontrollers and (h) motor control modules. Our SAM is derived using the most recent information available at the time of the filing of each respective period's annual report and is revised in subsequent periods to reflect final results.

Worldwide semiconductor industry sales grew 31.8% in 2010, grew 0.4% in 2011, declined 2.6% in 2012, grew 4.8% in 2013, and grew 9.9% in 2014 following a pattern associated with the financial crisis, subsequent recovery and persistent economic uncertainty. The increase of 9.9% from 2013 to 2014 is related to improved global macroeconomic conditions within the semiconductor industry affecting sales in all geographic regions.

[Table of Contents](#)

Sales in our SAM increased to \$110.2 billion in 2010, decreased to \$107.4 billion in 2011, decreased to \$103.7 billion in 2012, increased to \$104.3 billion in 2013 and increased to \$112 billion in 2014. The increase of approximately 7.4% from \$104.3 billion in 2013 to \$112 billion in 2014 is consistent with the trend in the worldwide semiconductor market. The most recently published estimates of WSTS project a compound annual growth rate in our SAM of approximately 3% for the next three years. These projections are not ours and may not be indicative of actual results.

Recent Results

Our total revenues for the year ended December 31, 2014 were \$3,161.8 million, an increase of approximately 14% from \$2,782.7 million for the year ended December 31, 2013. The majority of the increase was attributable to our acquisitions of Aptina and Truesense, along with other increases in our Application Products Group and Standard Products Group, partially offset by decreased revenue from our System Solutions Group. During 2014, we reported net income attributable to ON Semiconductor Corporation of \$189.7 million compared to net income attributable to ON Semiconductor Corporation of \$150.4 million in 2013. Our gross margin increased by approximately 90 basis points to 34.3% in 2014 from 33.4% in 2013, primarily driven by changes in volume and mix across certain of our product lines.

During 2014, the majority of our restructuring and cost saving initiatives were focused on our System Solutions Group, which included certain voluntary retirement programs and the planned closure of our KSS facility.

For further information with respect to our restructuring activity, including our other restructuring and cost savings programs initiated during 2014, see Note 6: "Restructuring, Asset Impairments, and Other, net" of the notes to the audited consolidated financial statements located elsewhere in this report.

Business Overview

We are driving innovation in energy efficient electronics. Our extensive portfolio of analog, digital and mixed signal ICs, standard products, image sensors and custom devices helps customers efficiently solve their design challenges in advanced electronic systems and products. Our power management and motor driver semiconductor components control, convert, protect and monitor the supply of power to the different elements within a wide variety of electronic devices. Our custom ASICs use analog, DSP, mixed-signal and advanced logic capabilities to act as the brain behind many of our automotive, medical, military/aerospace, consumer and industrial customers' products. Our signal management semiconductor components provide high-performance clock management and data flow management for precision computing, communications and industrial systems. Our image sensors, optical image stabilization and auto focus devices provide advanced imaging solutions for automotive, wireless, industrial and consumer applications. Our standard semiconductor components serve as "building blocks" within virtually all types of electronic devices. These various products fall into the logic, analog, discrete, image sensors and memory categories used by the WSTS group.

Our new product development efforts continue to be focused on building solutions in product areas that appeal to customers in focused market segments and across multiple high growth applications. We collaborate with our customers to identify desired innovations in electronic systems in each end-market that we serve. This enables us to participate in the fastest growing sectors of the market. We also innovate in advanced packaging technologies to support ongoing size reduction in electronic systems and in advanced thermal packaging to support high performance power conversion applications. It is our practice to regularly re-evaluate our research and development spending, to assess the deployment of resources and to review the funding of high growth technologies. We deploy people and capital with the goal of maximizing our investment in research and development in order to position ourselves for continued growth. We seek to maximize the investment of our people and capital in research and development by targeting innovative products and solutions for high growth

[Table of Contents](#)

applications that position the company to outperform the industry. Our design expertise in analog, digital, mixed signal and imaging ICs, combined with our extensive portfolio of standard products enable the company to offer comprehensive, value added solutions to our global customers for their electronics systems.

Historically, the semiconductor industry has been highly cyclical. During a down cycle, unit demand and pricing have tended to fall in tandem, resulting in revenue declines. In response to such declines, manufacturers have reduced or shut down production capacity. When new applications or other factors have caused demand to strengthen, production volumes have historically stabilized and then grown again. As market unit demand reaches levels above capacity production capabilities, shortages begin to occur, which typically causes pricing power to swing back from customers to manufacturers, thus prompting further capacity expansion. Such expansion has typically resulted in overcapacity following a decrease in demand, which has triggered another similar cycle.

Business and Macroeconomic Environment Influence on Cost Savings and Restructuring Activities

We have recognized efficiencies from implemented restructuring activities and programs and continue to implement profitability enhancement programs to improve our cost structure. However, the semiconductor industry has traditionally been highly cyclical and has often experienced significant downturns in connection with, or in anticipation of, declines in general economic conditions. While there have been recent indications of improving conditions, our business environment continues to experience significant uncertainty and volatility. We have historically reviewed, and will continue to review, our cost structure, capital investments and other expenditures to align our spending and capacity with our current sales and manufacturing projections.

We have historically taken significant actions to align our overall cost structure with our expected revenue levels. Such actions continued in 2014 within our System Solutions Group. See “Results of Operations” under the heading “Restructuring, Asset Impairments and Other, Net” below, along with Note 6: “Restructuring, Asset Impairments and Other, net” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for further details relating to our most recent cost saving actions.

Outlook

ON Semiconductor Q1 2015 Outlook

Based upon product booking trends, backlog levels, and estimated turns levels, we estimate that our revenues will be approximately \$840 million to \$880 million in the first quarter of 2015. Backlog levels for the first quarter of 2015 represent approximately 80% to 85% of our anticipated first quarter 2015 revenues. We estimate average selling prices for the first quarter of 2015 will be down approximately two percent compared to the fourth quarter of 2014. For the first quarter of 2015, we estimate that gross margin as a percentage of revenues will be approximately 33.4% to 35.4%.

Results of Operations

Our results of operations for the year ended December 31, 2014 include the operations of our acquisitions of Aptina and Truesense on August 15, 2014 and April 30, 2014, respectively.

Revision of Previously-Issued Financial Statements

During the quarter ended December 31, 2014, we revised our financial statements for 2013 and 2012 to record a deferred tax asset in a foreign subsidiary and have made adjustments in each successive period related to the foreign currency exchange rate changes associated with that item. The prior periods also include revised amounts from a change in application of an accounting convention, related to manufacturing variances, and other adjustments relating to hedging and inventory amounts. These other previously-identified errors were either uncorrected or corrected in a period subsequent to the period in which the error originated.

[Table of Contents](#)

We assessed the effect of the above errors in the aggregate on prior periods' financial statements in accordance with the SEC's Staff Accounting Bulletins No. 99 and 108 and, based on an analysis of quantitative and qualitative factors, determined that the errors were not material to any of our prior interim and annual financial statements.

All financial information contained herein has been revised to reflect the correction of these errors. See Note 1: "Background and Basis of Presentation" of the notes to our audited consolidated financial statements included elsewhere in this report for additional information.

Operating Results

The following table summarizes certain information relating to our operating results that has been derived from our audited consolidated financial statements for the years ended December 31, 2014, 2013 and 2012 (in millions):

	Year ended December 31,			Dollar Change	
	2014	2013	2012	2013 to 2014	2012 to 2013
Revenues	\$3,161.8	\$2,782.7	\$2,894.9	\$ 379.1	\$ (112.2)
Cost of revenues (exclusive of amortization shown below)	2,076.9	1,853.6	1,948.6	223.3	(95.0)
Gross profit	1,084.9	929.1	946.3	155.8	(17.2)
Operating expenses:					
Research and development	366.6	334.2	367.5	32.4	(33.3)
Selling and marketing	200.0	171.2	180.9	28.8	(9.7)
General and administrative	180.9	148.5	160.6	32.4	(12.1)
Amortization of acquisition-related intangible assets	68.4	33.1	44.4	35.3	(11.3)
Restructuring, asset impairments and other, net	30.5	33.2	163.7	(2.7)	(130.5)
Goodwill and intangible asset impairment	9.6	—	49.5	9.6	(49.5)
Total operating expenses	856.0	720.2	966.6	135.8	(246.4)
Operating income (loss)	228.9	208.9	(20.3)	20.0	229.2
Other income (expenses), net:					
Interest expense	(34.1)	(38.6)	(56.1)	4.5	17.5
Interest income	1.5	1.3	1.5	0.2	(0.2)
Other	(4.4)	1.5	5.8	(5.9)	(4.3)
Loss on debt extinguishment	—	(3.1)	(7.8)	3.1	4.7
Other income (expenses), net	(37.0)	(38.9)	(56.6)	1.9	17.7
Income (loss) before income taxes	191.9	170.0	(76.9)	21.9	246.9
Income tax benefit (provision)	0.2	(16.4)	(16.0)	16.6	(0.4)
Net income (loss)	192.1	153.6	(92.9)	38.5	246.5
Less: Net income attributable to non-controlling interest	(2.4)	(3.2)	(4.3)	0.8	1.1
Net income (loss) attributable to ON Semiconductor Corporation	\$ 189.7	\$ 150.4	\$ (97.2)	\$ 39.3	\$ 247.6

[Table of Contents](#)

Revenues

Revenues were \$3,161.8 million, \$2,782.7 million and \$2,894.9 million for 2014, 2013 and 2012, respectively. The increase from 2013 to 2014 was primarily attributed to approximately \$262.4 million of additional revenue in the Image Sensor Group provided by the acquisitions of Aptina and Truesense, along with increases from our Application Products Group and Standard Products Group, which experienced greater revenue as a result of an improved demand environment. The increase in revenue was partially offset by decreased revenue from our System Solutions Group.

For the year ended December 31, 2014, we experienced a decline in average selling prices of approximately 5%, as compared to 2013, offset by favorable changes in volume and mix, which resulted in a net increase in revenue of approximately 14%.

The decrease in revenues from 2012 to 2013 was the result of decreased revenue in our System Solutions Group from a weakened demand environment associated with a further softening of the Japanese consumer market and a devalued Yen, which was partially offset by increased revenue from our other reportable segments.

Revenues by reportable segment for each of the three years below, were as follows (dollars in millions):

	Year Ended December 31, 2014	As a % of Revenue (1)	Year Ended December 31, 2013	As a % of Revenue (1)	Year Ended December 31, 2012	As a % of Revenue (1)
Application Products Group	\$ 1,070.4	33.9%	\$ 996.8	35.8%	\$ 969.6	33.5%
Image Sensor Group	306.1	9.7%	39.5	1.4%	49.6	1.7%
Standard Products Group	1,210.4	38.3%	1,121.2	40.3%	1,104.7	38.2%
System Solutions Group	574.9	18.2%	625.2	22.5%	771.0	26.6%
Total revenues	<u>\$ 3,161.8</u>		<u>\$ 2,782.7</u>		<u>\$ 2,894.9</u>	

(1) Certain of the amounts may not total due to rounding of individual amounts.

Revenues from the Application Products Group

Revenues from the Application Products Group increased by \$73.6 million, or approximately 7%, from 2013 to 2014 and increased from 2012 to 2013 by \$27.2 million or approximately 3%.

The 2014 increase resulted from an increase in revenues from ASIC products of \$44.4 million, or approximately 9%, an increase in revenues from analog products of \$13.2 million, or approximately 3%, an increase in revenues from foundry services of \$8.8 million, or approximately 65%, and an increase in revenues from TMOS products of \$7.8 million, or approximately 20%.

The 2013 increase resulted from an increase in revenues from analog products of \$29.9 million, or approximately 8%, and an increase in revenue from TMOS products of \$5.0 million, or approximately 15%, partially offset by a decrease in revenues from ASIC products of \$10.4 million, or approximately 2%, and a decrease in revenues from ECL products, of \$6.9 million, or approximately 15%.

Revenues from the Image Sensor Group

Revenues from the Image Sensor Group increased by \$266.6 million from 2013 to 2014 and decreased from 2012 to 2013 by \$10.1 million.

This increase in 2014 is primarily attributable to revenue provided by the 2014 acquisitions of Aptina and Truesense, which generated approximately \$262.4 million, of revenue during 2014. Revenues from our existing image sensor business units also increased during 2014.

[Table of Contents](#)

Revenues from the Standard Products Group

Revenues from the Standard Products Group increased by \$89.2 million, or approximately 8%, from 2013 to 2014 and increased from 2012 to 2013 by \$16.5 million, or approximately 1%.

The 2014 increase resulted from an increase in revenues from discrete products of \$60.4 million, or approximately 14%, an increase in revenues from analog products of \$24.1 million, or approximately 8%, and an increase in revenues from memory products of \$11.3 million, or approximately 20%, partially offset by a decrease in revenues from TMOS products.

The 2013 increase resulted from an increase in revenues from discrete products of \$24.9 million, or approximately 6%, and an increase in revenues from analog products of \$8.9 million, or approximately 3%, partially offset by a decrease in revenues from TMOS products of \$13.8 million, or approximately 6%.

Revenues from the System Solutions Group

Revenues from the System Solutions Group decreased by \$50.3 million, or approximately 8%, from 2013 to 2014 and decreased from 2012 to 2013 by \$145.8 million, or approximately 19%.

The 2014 decrease resulted from a decrease in demand from the Japanese consumer market and an increase in competition in other regions, causing a decrease in revenue from LSI products of approximately \$53.8 million, or approximately 13.0%.

The 2013 decrease resulted from a softening of the Japanese consumer market, a devalued Yen, and, to a lesser extent, political tensions between Japan and China.

Revenues by Geographic Location

Revenues by geographic location, including local sales made by operations within each area, based on sales billed from the respective country, are summarized as follows (in millions):

	Year Ended December 31, 2014	As a % of Revenue	Year Ended December 31, 2013	As a % of Revenue (1)	Year Ended December 31, 2012	As a % of Revenue (1)
United States	\$ 497.0	15.7%	\$ 415.4	14.9%	\$ 452.0	15.6%
United Kingdom	497.9	15.7%	400.2	14.4%	388.3	13.4%
Hong Kong	975.3	30.8%	862.4	31.0%	874.2	30.2%
Japan	293.1	9.3%	290.2	10.4%	401.2	13.9%
Singapore	786.5	24.9%	700.6	25.2%	627.7	21.7%
Other	112.0	3.5%	113.9	4.1%	151.5	5.2%
Total	<u>\$ 3,161.8</u>		<u>\$ 2,782.7</u>		<u>\$ 2,894.9</u>	

(1) Certain of the amounts may not total due to rounding of individual amounts.

For additional information, see the table of revenues by geographic location included in Note 18: "Segment Information" of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K.

[Table of Contents](#)

Gross Profit and Gross Margin (exclusive of amortization of acquisition-related intangible assets described below)

Our gross profit by reportable segment in each of the three years below was as follows (dollars in millions):

	Year Ended December 31, 2014	As a % of Segment Revenue (2)	Year Ended December 31, 2013	As a % of Segment Revenue (2)	Year Ended December 31, 2012	As a % of Segment Revenue (2)
Application Products Group	\$ 475.0	44.4%	\$ 431.0	43.2%	\$ 430.3	44.4%
Image Sensor Group	91.1	29.8%	24.6	62.3%	28.9	58.3%
Standard Products Group	431.0	35.6%	390.7	34.8%	400.9	36.3%
System Solutions Group	117.5	20.4%	103.4	16.5%	143.1	18.6%
Gross profit by segment	\$ 1,114.6		\$ 949.7		\$ 1,003.2	
Unallocated manufacturing (1)	(29.7)	(0.9)%	(20.6)	(0.7)%	(56.9)	(2.0)%
Total gross profit	\$ 1,084.9	34.3%	\$ 929.1	33.4%	\$ 946.3	32.7%

(1) Unallocated manufacturing costs are being shown as a percentage of total revenue.

(2) Certain of the amounts may not total due to rounding of individual amounts.

Our gross profit was \$1,084.9 million, \$929.1 million and \$946.3 million for the years ended December 31, 2014, 2013 and 2012, respectively. The gross profit increase of \$155.8 million, or approximately 17%, for the year ended December 31, 2014 compared to 2013 is primarily attributable to increased revenues, along with increased capacity utilization and cost savings realized from previous restructuring activities, partially offset by decreased average selling prices and approximately \$27.0 million for the expensing of the fair market value of inventory step-up from our recent acquisitions for the year ended December 31, 2014.

The gross profit decrease from 2012 to 2013 is primarily attributable to decreases in gross profit in our System Solution Group as a result of lower revenues for the year ended December 31, 2013 as well as smaller decreases in gross profit from our other operating segments.

Gross margin increased to approximately 34.3% during 2014 compared to approximately 33.4% during 2013. This increase was primarily driven by favorable changes in volume and mix across certain product lines as well as a larger proportion of revenues generated from our Applications Products Group, Image Sensor Group and Standard Products Group which experienced higher gross margin levels than our System Solutions Group.

The increase in gross margin as a percentage of revenues from 2012 to 2013 was primarily driven by changes in volume and mix across certain product lines.

Operating Expenses

Research and Development

Research and development expenses were \$366.6 million, \$334.2 million and \$367.5 million, representing approximately 11.6%, 12.0% and 12.7% of revenues for the years ended December 31, 2014, 2013 and 2012, respectively.

The increase in research and development expenses of \$32.4 million, or approximately 10%, from 2013 to 2014 is primarily associated with approximately \$38.0 million of expenses attributable to our 2014 acquisitions of Aptina and Truesense. These expenses were further increased by greater personnel costs in our Application Products Group and Standard Products Group, along with increased performance-based compensation as a result of improved performance results for 2014 compared to 2013, partially offset by decreases in our System Solutions Group attributable to decreased payroll related expenses resulting from our restructuring and cost saving activities.

[Table of Contents](#)

The decrease in research and development expenses from 2012 to 2013 was primarily associated with decreased payroll and related expenses resulting from our 2012 and 2013 restructuring and cost saving activities in our System Solutions Group, along with the impact of a devalued Yen.

Selling and Marketing

Selling and marketing expenses were \$200.0 million, \$171.2 million and \$180.9 million, representing approximately 6.3%, 6.2% and 6.2% of revenues, for the years ended December 31, 2014, 2013 and 2012, respectively.

The increase in selling and marketing expenses of \$28.8 million, or approximately 17%, from 2013 to 2014 is primarily associated with approximately \$11.2 million of expenses attributable to our 2014 acquisitions of Aptina and Truesense, along with increased sales commissions and increased payroll related expenses associated with performance-based compensation as a result of improved performance results for 2014 compared to 2013.

The decrease in selling and marketing expenses from 2012 to 2013 was primarily attributable to decreased payroll and related expenses resulting from our 2012 and 2013 restructuring and cost saving activities in our System Solutions Group, along with the impact of a devalued Yen.

General and Administrative

General and administrative expenses were \$180.9 million, \$148.5 million and \$160.6 million, representing approximately 5.7%, 5.3% and 5.5% of revenues, for the years ended December 31, 2014, 2013 and 2012, respectively.

The increase in general and administrative expenses of \$32.4 million, or approximately 22%, from 2013 to 2014 is primarily associated with approximately \$9.6 million of expenses attributable to our 2014 acquisitions of Aptina and Truesense, along with increased payroll related expenses associated with performance-based compensation as a result of improved performance results for 2014 compared to 2013, in addition to approximately \$8.1 million in third-party acquisition-related expenses.

The decrease in general and administrative expenses from 2012 to 2013 was primarily attributable to decreased payroll and related expenses resulting from our 2012 and 2013 restructuring and cost saving activities in our System Solutions Group, along with the impact of a devalued Yen.

Amortization of Acquisition—Related Intangible Assets

Amortization of acquisition-related intangible assets was \$68.4 million, \$33.1 million and \$44.4 million for the years ended December 31, 2014, 2013 and 2012, respectively. The increase of \$35.3 million from 2013 to 2014 is attributable to the amortization of intangible assets assumed as a result of our acquisitions of Aptina and Truesense. See Note 5: “Goodwill and Intangible Assets” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

The decrease in amortization of acquisition-related intangible assets from 2012 to 2013 was primarily attributed to the impairment of certain of the System Solutions Group’s intangible assets recorded during the fourth quarter of 2012. See Note 5: “Goodwill and Intangible Assets” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

Restructuring, Asset Impairments and Other, Net

Restructuring, asset impairments and other, net was \$30.5 million, \$33.2 million and \$163.7 million for the years ended December 31, 2014, 2013 and 2012, respectively. The information below summarizes the major

[Table of Contents](#)

activities in each year. For additional information, see Note 6: “Restructuring, Asset Impairments and Other, net” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K.

2014

During the fourth quarter of 2013, we initiated a voluntary retirement program for employees of certain of our System Solutions Group subsidiaries in Japan (the “Q4 2013 Voluntary Retirement Program”). Approximately 350 employees opted to retire under the Q4 2013 Voluntary Retirement Program, of which all employees had exited by December 31, 2014. For the year ended December 31, 2014, we recognized approximately \$10.4 million of employee separation charges related to the Q4 2013 Voluntary Retirement Program.

In connection with the Q4 2013 Voluntary Retirement Program, approximately 70 contractor positions were also identified for elimination, all of which all had exited by the end of 2014. During the year ended December 31, 2014, an additional 40 positions were identified for elimination, as an extension of the Q4 2013 Voluntary Retirement Program, consisting of 20 employees and 20 contractors, substantially all of which had exited by December 31, 2014.

As a result of the Q4 2013 Voluntary Retirement Program, we recognized a pension curtailment benefit associated with the affected employees of \$4.5 million during the year ended December 31, 2014, which is recorded in Restructuring, Asset Impairments and other, Net. See Note 11: “Employee Benefit Plans” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

During the year ended December 31, 2014, we initiated further voluntary retirement activities applicable to an additional 60 to 70 positions, for certain of our System Solutions Group subsidiaries in Japan, consisting of employees and contractors. Substantially all personnel had exited under this program by December 31, 2014. We anticipate total cost savings for the Q4 2013 Voluntary Retirement Program, which includes the above headcounts, to be between the range of our previously disclosed expectations of \$36 million to \$45 million during the first year following the completion of the anticipated headcount reductions.

On October 6, 2013, we announced a plan to close KSS (the “KSS Plan”). Pursuant to the KSS Plan, a majority of the production from KSS was transferred to other of our manufacturing facilities. The KSS Plan includes the elimination of approximately 170 full time and 40 contract employees. During the year ended December 31, 2014, we recorded approximately \$7.8 million of employee separation charges and \$2.3 million of exit costs related to the KSS Plan.

As a result of the KSS facility closure, we recognized a \$2.1 million pension curtailment benefit associated with the affected employees during the year ended December 31, 2014, which is recorded in Restructuring, asset impairments and other, net. See Note 11: “Employee Benefit Plans” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

2013

During the year ended December 31, 2013, we initiated two voluntary retirement programs for certain employees of our System Solutions Group subsidiaries in Japan. Approximately 500 employees opted to retire pursuant to the first program, and substantially all employees had retired by December 31, 2013. Approximately 170 employees had retired by December 31, 2013 under the Q4 2013 Voluntary Retirement Program. As part of these restructuring activities, approximately half of the 70 contractor positions identified for elimination were terminated by the end of 2013.

We recorded net charges of approximately \$37.3 million in connection with these programs, consisting of employee severance charges of \$52.9 million, partially offset by pension and related retirement liability adjustments associated with the affected employees, which resulted in a pension curtailment benefit of \$15.6 million.

[Table of Contents](#)

During the year ended December 31, 2013, we recorded \$3.1 million of restructuring charges related to the announced closure of our Aizu facility. We also released approximately \$21.0 million of associated cumulative foreign currency translation gains related to our subsidiary that owned the Aizu facility, which utilized the Japanese Yen as its functional currency. The related amount was recorded as a benefit to restructuring, asset impairments and other, net on the our Consolidated Statements of Operations and Comprehensive Income. For additional information, see Note 16: "Changes in Accumulated Other Comprehensive Loss" of the notes to our consolidated financial statements included elsewhere in this Form 10-K.

We recorded approximately \$10.0 million of net restructuring charges related to the KSS Plan during the year ended December 31, 2013, consisting of employee severance charges of \$6.5 million and \$3.5 million of asset impairment charges associated with the KSS Plan.

2012

During the year ended December 31, 2012, we initiated a voluntary retirement program for certain employees of our System Solutions Group and certain of its subsidiaries. We recorded net charges of approximately \$35.9 million associated with this program, consisting of employee severance charges of \$47.6 million, partially offset by \$11.7 million attributed to pension plan curtailment gains.

Additionally, during the year ended December 31, 2012, we executed a global workforce reduction program. Restructuring expenses resulting from this program consisted primarily of \$11.2 million associated with employee severance charges.

We incurred additional charges related to the closure of certain of our facilities during 2012.

Indefinite and Long-Lived Asset Impairment Charges

2014

During the year ended December 31, 2014, we determined that approximately \$8.7 million in carrying value of goodwill relating to one of our reporting units in the Application Products Group was impaired resulting from a decline in estimated future cash flows. In connection with this impairment, we wrote-off approximately \$0.9 million of intangible assets and \$4.7 million of other long-lived assets. See Note 5: "Goodwill and Intangible Assets" of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

2012

During the year ended December 31, 2012, we evaluated the current period operating results of the System Solutions Group and re-assessed future projections for the segment. As a result, we determined that \$94.4 million of carrying value for certain long-lived assets associated with the System Solutions Group and \$31.6 million of related intangible assets were impaired. For additional information, see Note 5: "Goodwill and Intangible Assets" of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K.

During the year ended December 31, 2012, we further determined that approximately \$14.1 million in carrying value of goodwill relating to our 2008 acquisition of Catalyst was impaired resulting from a strategic decision to invest in other business units and the resulting decline in estimated future cash flows. As part of our annual goodwill testing, it was determined that certain intangible assets associated with the Standard Products Group were impaired. In connection with this impairment, we wrote-off approximately \$3.8 million of intangible assets. These goodwill and intangible asset impairment charges were recognized in our Standard Products Group segment. See Note 5: "Goodwill and Intangible Assets" of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

[Table of Contents](#)

Other Income and Expenses

Interest Expense

Interest expense decreased by \$4.5 million from \$38.6 million in 2013 to \$34.1 million in 2014. Additionally, interest expense decreased by \$17.5 million from \$56.1 million in 2012 to \$38.6 million in 2013. We recorded amortization of debt discount to interest expense of \$7.0 million, \$11.2 million and \$23.4 million for 2014, 2013 and 2012, respectively. Our average long-term debt balance (including current maturities and net of debt discount) during 2014, 2013 and 2012, was \$1,067.4 million, \$977.1 million and \$1,109.5 million, respectively. Our weighted average interest rate on long-term debt (including current maturities and net of debt discount) was approximately 3.2%, 3.9% and 5.1% per annum in 2014, 2013 and 2012, respectively. See “Liquidity and Capital Resources—Key Financing and Capital Events” below for a description of our refinancing activities.

Other

Other income decreased by \$5.9 million from a gain of \$1.5 million in 2013 to a loss of \$4.4 million in 2014. Other income decreased by \$4.3 million from a gain of \$5.8 million in 2012 to a gain of \$1.5 million in 2013. The change from year to year is largely attributable to fluctuations in foreign currencies against the dollar for the periods presented, net of the impact from our hedging activity.

Loss on Debt Extinguishment

2013

During the year ended December 31, 2013, we exchanged \$60.0 million in principal value (\$57.4 million of carrying value) of our 2.625% Notes for \$58.5 million in principal value of our 2.625% Notes, Series B, plus accrued and unpaid interest on the 2.625% Notes, resulting in a loss on debt repurchase of \$3.1 million. Subject to certain other terms and conditions, this transaction extended the earliest put date for the exchanged amount from December 2013 to December 2016.

See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

2012

During the year ended December 31, 2012, we exchanged \$99.9 million in par value (\$92.8 million of carrying value) of our 2.625% Notes for \$99.9 million in par value of 2.625% Notes, Series B and \$2.0 million in cash, which resulted in a loss on debt exchange of \$7.8 million. Subject to certain other terms and conditions, this exchange extended the first put date of the underlying notes, which we consider to be the earliest maturity date, from December 2013 to December 2016. See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

Provision for Income Taxes

We recorded an income tax benefit of \$0.2 million and a provision of \$16.4 million and \$16.0 million in 2014, 2013 and 2012, respectively.

The income tax benefit for the year ended December 31, 2014 consisted of the reversal of \$23.3 million of our previously established valuation allowance against our U.S. deferred tax assets as a result of a net deferred tax liability recorded as part of the Truesense acquisition and the reversal of \$4.6 million for reserves and interest for uncertain tax positions in foreign taxing jurisdictions that were effectively settled or for which the statute lapsed during the year ended December 31, 2014. This is partially offset by \$19.8 million for income and withholding taxes of certain of our foreign and domestic operations, \$4.6 million of new reserves and interest on existing reserves for uncertain tax positions in foreign taxing jurisdictions, and \$3.3 million of deferred federal income taxes associated with tax deductible goodwill.

[Table of Contents](#)

The 2013 provision of \$16.4 million included \$22.2 million for income and withholding taxes of certain of our foreign operations and \$0.9 million of interest on existing reserves for potential liabilities in foreign taxing jurisdictions and \$2.7 million of deferred federal income taxes associated with tax deductible goodwill. This is partially offset by the reversal of \$6.0 million of valuation allowances against deferred tax assets of certain foreign subsidiaries and the reversal of \$3.4 million for reserves and interest for potential liabilities in foreign taxing jurisdictions which were effectively settled or for which the statute lapsed during 2013.

The 2012 provision of \$16.0 million included \$21.7 million for income and withholding taxes of certain of our foreign operations, \$2.6 million of deferred federal income taxes associated with tax deductible goodwill, and \$0.9 million of interest on existing reserves for potential liabilities in foreign taxing jurisdictions. This is partially offset by \$7.8 million of additional tax benefit recorded and the reversal of \$1.4 million for reserves and interest for potential liabilities in foreign taxing jurisdictions which were effectively settled or for which the statute lapsed during 2012.

Our provision for income taxes is subject to volatility and could be adversely impacted by earnings being lower than anticipated in countries that have lower tax rates and earnings being higher than anticipated in countries that have higher tax rates. Our effective tax rate for the year ended December 31, 2014 was a benefit of 0.1%, which differs from the U.S. statutory federal income tax rate of 35%, due to our domestic tax losses and tax rate differential in our foreign subsidiaries. Our effective tax rate was also lower than the U.S. statutory federal income tax rate for the year ended December 31, 2013 and December 31, 2012, due to our domestic tax losses and tax rate differential in our foreign subsidiaries. We continue to maintain a full valuation allowance on all of our domestic and Japan related deferred tax assets; however, it is reasonably possible that a substantial portion of the valuation allowance on our domestic deferred tax assets will be reversed within one year of December 31, 2014, which is not expected to have a material effect on the Company's cash taxes. As of December 31, 2014, the valuation allowance on our domestic deferred tax assets was approximately \$461.9 million.

Income taxes have not been provided on approximately \$1,784.1 million of the undistributed earnings of our foreign subsidiaries at December 31, 2014 over which we have sufficient influence to control the distribution of such earnings and have determined that substantially all such earnings have been reinvested indefinitely. These earnings could become subject to either or both federal income tax and foreign withholding tax if they are remitted as dividends, if foreign earnings are loaned to any of our domestic companies, or if we sell our investment in certain subsidiaries. We estimate that repatriation of these foreign earnings would generate additional taxes of approximately \$178.7 million after the assumed utilization of our available net operating loss carryforwards and foreign tax credits.

For additional information, see Note 15: "Income Taxes" of the notes to the audited consolidated financial statements included elsewhere in this Form 10-K.

Liquidity and Capital Resources

This section includes a discussion and analysis of our cash requirements, off-balance sheet arrangements, contingencies, sources and uses of cash, operations, working capital, and long-term assets and liabilities.

[Table of Contents](#)

Contractual Obligations

Our principal outstanding contractual obligations relate to our long-term debt, capital leases, operating leases and purchase obligations. The following table summarizes our contractual obligations at December 31, 2014 and the effect such obligations are expected to have on our liquidity and cash flow in the future (in millions):

Contractual obligations (1)	Payments Due by Period						
	Total	2015	2016	2017	2018	2019	Thereafter
Long-term debt, excluding capital leases (2)	\$1,235.1	\$215.1	\$436.1	\$ 59.3	\$489.8	\$34.8	\$ —
Capital leases (2)	43.2	21.9	13.6	6.1	0.8	0.8	—
Operating leases (3)	103.6	21.0	18.0	14.0	9.5	6.9	34.2
Purchase obligations (3):							
Capital purchase obligations	42.4	38.5	1.8	0.5	0.4	0.4	0.8
Inventory and external manufacturing purchase obligations	454.9	279.3	105.1	37.7	8.1	7.8	16.9
Information technology, communication and mainframe support services	10.9	9.0	1.4	0.3	0.1	0.1	—
Other	18.7	13.6	4.1	0.4	0.4	0.2	—
Total contractual obligations	\$1,908.8	\$598.4	\$580.1	\$118.3	\$509.1	\$51.0	\$ 51.9

- (1) The table above excludes approximately \$16.0 million of liabilities related to unrecognized tax benefits because we are unable to reasonably estimate the timing of the settlement of such liabilities.
- (2) Includes interest payments at applicable rates as of December 31, 2014.
- (3) These represent our off-balance sheet arrangements (See “Liquidity and Capital Resources—Off-Balance Sheet Arrangements” for a description of our off-balance sheet arrangements).

This table also excludes our pension obligations. We expect to make cash contributions and future pension payments to comply with local funding requirements of approximately \$8.5 million in 2015. This future payment estimate assumes we continue to meet our statutory funding requirements. The timing and amount of contributions may be impacted by a number of factors, including the funded status of the plans. Beyond 2015, the actual amounts required to be contributed are dependent upon, among other things, interest rates, underlying asset returns and the impact of legislative or regulatory actions related to pension funding obligations. See Note 11: “Employee Benefit Plans” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for more information on our pension obligations.

Our balance of cash, cash equivalents and short-term investments was \$517.8 million at December 31, 2014. We believe that our cash flows from operations, coupled with our existing cash, cash equivalents and short-term investments will be adequate to fund our operating and capital needs for at least the next 12 months. Total cash and cash equivalents and short-term investments at December 31, 2014 include approximately \$203.6 million available in the United States. In addition to cash, cash equivalents and short-term investments already on hand in the United States, we have the ability to obtain cash in the United States by settling loans with our foreign subsidiaries in order to cover our domestic needs, by utilizing existing credit facilities or through new bank loans or debt obligations.

We hold a significant amount of cash and cash equivalents outside the United States in various foreign subsidiaries. As we intend to reinvest certain of our foreign earnings indefinitely, this cash held outside the United States in various foreign subsidiaries is not readily available to meet certain of our cash requirements in the United States. We require a substantial amount of cash in the United States for operating requirements, common stock and debt repurchases, payments and acquisitions. If we are unable to address our U.S. cash requirements through operations, borrowings under our current debt agreements or other sources of cash obtained

[Table of Contents](#)

at an acceptable cost, it may be necessary for us to consider repatriation of earnings that are permanently reinvested, and we may be required to pay additional taxes under current tax laws, which could have a material effect on our results of operations and financial condition.

See Note 8: “Long-Term Debt,” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for a discussion of our long-term debt.

See Part II, Item 5 “Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” included elsewhere in this report for a discussion of restrictions on our ability to pay dividends and our stock repurchase activities.

Off-Balance Sheet Arrangements

In the normal course of business, we enter into various operating leases for buildings and equipment including our mainframe computer system, desktop computers, communications, foundry equipment and service agreements relating to this equipment.

In the normal course of business, we provide standby letters of credit or other guarantee instruments to certain parties initiated by either our subsidiaries or us, as required for transactions including, but not limited to: material purchase commitments; agreements to mitigate collection risk; leases; utilities; and customs guarantees. Our senior revolving credit facility includes \$40.0 million of availability for the issuance of letters of credit. A \$0.2 million letter of credit was outstanding under our senior revolving credit facility as of December 31, 2014. We also had outstanding guarantees and letters of credit outside of our senior revolving credit facility of \$6.3 million at December 31, 2014.

As part of securing financing in the normal course of business, we issued guarantees related to our capital lease obligations, equipment financing, lines of credit and real estate mortgages, which totaled approximately \$113.3 million as of December 31, 2014. We are also a guarantor of SCI LLC’s non-collateralized loan with SMBC, which had a balance of \$235.9 million as of December 31, 2014. See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements found elsewhere in this Form 10-K for additional information.

Based on historical experience and information currently available, we believe that in the foreseeable future we will not be required to make payments under the standby letters of credit or guarantee arrangements.

For our operating leases, we expect to make cash payments and incur similar expenses totaling \$103.6 million as payments come due. We have not recorded any liability in connection with these operating leases, letters of credit and guarantee arrangements. See Note 12: “Commitments and Contingencies” of the notes to our audited consolidated financial statements found elsewhere in this Form 10-K for additional information.

Contingencies

We are a party to a variety of agreements entered into in the ordinary course of business pursuant to which we may be obligated to indemnify other parties for certain liabilities that arise out of or relate to the subject matter of the agreements. Some of the agreements entered into by us require us to indemnify the other party against losses due to IP infringement, property damage including environmental contamination, personal injury, failure to comply with applicable laws, our negligence or willful misconduct, or breach of representations and warranties and covenants related to such matters as title to sold assets.

We face risk of exposure to warranty and product liability claims in the event that our products fail to perform as expected or such failure of our products results, or is alleged to result, in economic damages, bodily injury or property damage. In addition, if any of our designed products are alleged to be defective, we may be

[Table of Contents](#)

required to participate in their recall. Depending on the significance of any particular customer and other relevant factors, we may agree to provide more favorable rights to such customer for valid defective product claims.

We and our subsidiaries provide for indemnification of directors, officers and other persons in accordance with limited liability agreements, certificates of incorporation, by-laws, articles of association or similar organizational documents, as the case may be. We maintain directors' and officers' insurance, which should enable us to recover a portion of any future amounts paid.

While our future obligations under certain agreements may contain limitations on liability for indemnification, other agreements do not contain such limitations and under such agreements it is not possible to predict the maximum potential amount of future payments due to the conditional nature of our obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by us under any of these indemnities have not had a material effect on our business, financial condition, results of operations or cash flows, and we do not believe that any amounts that we may be required to pay under these indemnities in the future will be material to our business, financial condition, results of operations or cash flows.

See Part I, Item 3 "Legal Proceedings" and Note 12: "Commitments and Contingencies" of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for possible contingencies related to legal matters. See also Part I, Item 1 "Business—Government Regulation" for information on certain environmental matters.

Sources and Uses of Cash

We require cash to fund our operating expenses and working capital requirements, including outlays for research and development, to make capital expenditures, for strategic acquisitions and investments, to repurchase our common stock and other Company securities, and to pay debt service, including principal and interest and capital lease payments. Our principal sources of liquidity are cash on hand, cash generated from operations and funds from external borrowings and equity issuances. In the near term, we expect to fund our primary cash requirements through cash generated from operations and cash and cash equivalents on hand, including short-term investments.

As part of our business strategy, we review acquisition and divestiture opportunities and proposals on a regular basis. On August 15, 2014, we completed the purchase of Aptina, for a total purchase price of approximately \$405.4 million in cash, of which approximately \$2.9 million remained unpaid and approximately \$40.0 million was held in escrow as of December 31, 2014. On April 30, 2014, we completed the purchase of Truesense, for a total purchase price of approximately \$95.7 million in cash. See Note 4: "Acquisitions" of the notes to our audited consolidated financial statements found elsewhere in this Form 10-K for additional information.

We believe that the key factors that could affect our internal and external sources of cash include:

- Factors that affect our results of operations and cash flows, including the impact on our business and operations as a result of changes in demand for our products, competitive pricing pressures, effective management of our manufacturing capacity, our ability to achieve further reductions in operating expenses, the impact of our restructuring programs on our production and cost efficiency and our ability to make the research and development expenditures required to remain competitive in our business; and
- Factors that affect our access to bank financing and the debt and equity capital markets that could impair our ability to obtain needed financing on acceptable terms or to respond to business opportunities and developments as they arise, including interest rate fluctuations, macroeconomic conditions, sudden reductions in the general availability of lending from banks or the related increase in cost to obtain bank financing, and our ability to maintain compliance with covenants under our debt agreements in effect from time to time.

[Table of Contents](#)

Our ability to service our long-term debt, including our 2.625% Notes, Series B, to remain in compliance with the various covenants contained in our debt agreements and to fund working capital, capital expenditures and business development efforts will depend on our ability to generate cash from operating activities, which is subject to, among other things, our future operating performance, as well as to general economic, financial, competitive, legislative, regulatory and other conditions, some of which may be beyond our control.

If we fail to generate sufficient cash from operations, we may need to raise additional equity or borrow additional funds to achieve our longer term objectives. There can be no assurance that such equity or borrowings will be available or, if available, will be at rates or prices acceptable to us. We believe that cash flow from operating activities coupled with existing cash and cash equivalents, short-term investments and existing credit facilities will be adequate to fund our operating and capital needs, as well as enable us to maintain compliance with our various debt agreements, through at least the next twelve months. To the extent that results or events differ from our financial projections or business plans, our liquidity may be adversely impacted.

During the ordinary course of business, we evaluate our cash requirements and, if necessary, adjust our expenditures for inventory, operating expenditures and capital expenditures to reflect the current market conditions and our projected sales and demand. During 2014, we paid \$204.3 million for capital expenditures, while in 2013 we paid \$155.2 million. Our current projection for capital expenditures in 2015 is approximately \$250 million to \$270 million, of which our current minimum commitment is approximately \$38.5 million. The capital expenditure levels can materially influence our available cash for other initiatives.

On October 10, 2013, we entered into an \$800.0 million, five-year senior revolving credit facility. The new credit agreement amended and restated our prior agreement dated as of December 23, 2011 and significantly increased our liquidity as described under “Key Financing and Capital Events—2013 Financing Events—Amended and Restated Senior Revolving Credit Facility.” We borrowed approximately \$350.0 million of the \$800.0 million available under the new facility. See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

On December 1, 2014, we announced a capital allocation policy (the “Capital Allocation Policy”) under which we intend to return approximately 80 percent of free cash flow less repayments of long-term debt to shareholders, subject to a variety of factors, including our strategic plans, market and economic conditions and the Board’s discretion. For the purposes of the Capital Allocation Policy, we define free cash flow as net cash provided by operating activities less purchases of property, plant and equipment. We also announced the 2014 Share Repurchase Program pursuant to the Capital Allocation Policy. Under the 2014 Share Repurchase Program, we intend to repurchase approximately \$1 billion of our common shares over a four year period, subject to the same factors and considerations described above. The 2014 Share Repurchase Program was effective December 1, 2014, and the \$300 million 2012 Stock Repurchase Program was terminated on that date. See Part II, Item 5. “Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” for additional information with respect to our share repurchase programs.

Cash Management

Our ability to manage cash is limited, as our primary cash inflows and outflows are dictated by the terms of our sales and supply agreements, contractual obligations, debt instruments and legal and regulatory requirements. While we have some flexibility with respect to the timing of capital equipment purchases, we must invest in capital equipment on a timely basis to allow us to maintain our manufacturing efficiency and support our platforms of new products.

[Table of Contents](#)

Primary Cash Flow Sources

Our long-term cash generation is dependent on the ability of our operations to generate cash. Our cash flows from operations is summarized as follows (in millions):

	For the year ended December 31,		
	2014	2013	2012
<i>Summarized cash flow from operating activities</i>			
Net income (loss)	\$192.1	\$153.6	\$ (92.9)
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	268.8	211.8	243.6
Write-down of excess inventories	40.6	51.9	51.9
Non-cash share-based compensation expense	45.8	32.3	20.5
Non-cash interest	7.0	11.2	23.4
Non-cash asset impairment charges	6.5	8.0	103.0
Non-cash goodwill and intangible asset impairment charges	9.6	—	49.5
Non-cash foreign currency translation gain	—	(21.0)	—
Change in deferred taxes	(18.8)	1.4	(1.9)
Other	1.8	(2.7)	(1.2)
Changes in assets and liabilities (exclusive of the impact of acquisitions):			
Receivables	20.5	(35.4)	95.4
Inventories	(59.0)	(88.3)	(1.5)
Accounts payable	(17.3)	6.6	(159.9)
Deferred income on sales to distributors	24.6	6.0	(37.5)
Other long-term liabilities	(15.5)	(48.9)	(12.4)
Other changes in assets and liabilities	(25.4)	40.8	(4.0)
Net cash provided by operating activities	<u>\$481.3</u>	<u>\$327.3</u>	<u>\$ 276.0</u>

Our cash flows provided by operating activities for the year ended December 31, 2014 increased by approximately \$154.0 million compared to the year ended December 31, 2013. The increase is primarily attributable to higher net sales, cost savings realized from our previously enacted restructuring programs and lower cash outflows from our restructuring activities.

Our ability to maintain positive operating cash flows is dependent on, among other factors, our success in achieving our revenue goals and manufacturing and operating cost targets.

Our management of our assets and liabilities, including both working capital and long-term assets and liabilities, also influences our operating cash flows, and each of these components is discussed below.

Working Capital

Working capital, calculated as total current assets less total current liabilities, fluctuates depending on end-market demand and our effective management of certain items such as receivables, inventory and payables. In times of escalating demand, our working capital requirements may be affected as we purchase additional manufacturing materials and increase production. Our working capital may also be affected by restructuring programs, which may require us to use cash for severance payments, asset transfers and contract termination costs. In addition, our working capital may be affected by acquisitions, capital activities as part of our share repurchase programs and transactions involving our convertible notes and other debt instruments. Our working capital, including cash and cash equivalents and short-term investments, was \$765.0 million at December 31, 2014 and has fluctuated between \$913.1 million and \$743.5 million over the last eight quarter-ends. Although investments made to fund working capital will reduce our cash balances, these investments are necessary to support business and operating initiatives. For the year ended December 31, 2014, our working capital was most

[Table of Contents](#)

significantly impacted by our capital expenditures, the acquisition of Aptina and Truesense, the repurchase of our common stock and the payments associated with our restructuring activities. See Note 8: “Long-Term Debt,” Note 6: “Restructuring, Asset Impairments, and Other, net” and Note 9: “Earnings Per Share and Equity” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

Long-Term Assets and Liabilities

Our long-term assets consist primarily of property, plant and equipment, intangible assets and goodwill.

Our manufacturing rationalization plans have included efforts to utilize our existing manufacturing assets and supply arrangements more efficiently. We believe that near-term access to additional manufacturing capacity, should it be required, could be readily obtained on reasonable terms through manufacturing agreements with third parties. We will continue to look for opportunities to make strategic purchases in the future for additional capacity.

Our long-term liabilities, excluding long-term debt, consist of liabilities under our foreign defined benefit pension plans and contingent tax reserves. In regard to our foreign defined benefit pension plans, generally, our annual funding of these obligations is equal to the minimum amount legally required in each jurisdiction in which the plans operate. This annual amount is dependent upon numerous actuarial assumptions. For additional information, see Note 11: “Employee Benefit Plans” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K and see Note 15: “Income Taxes” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K.

Key Financing and Capital Events

Overview

For the past several years, we have undertaken various measures to repurchase shares of our common stock, reduce our long-term debt, reduce related interest costs and, in some cases, extend a portion of our debt maturities to continue to provide us additional operating flexibility. Certain of these measures continued in 2014. Set forth below is a summary of certain key financing events affecting our capital structure during the last three years. For further discussion of our debt instruments see Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K.

2014 Financing Events

Share Repurchase Program

During the year ended December 31, 2014, we purchased approximately 13.9 million shares of our common stock pursuant to our share repurchase programs for an aggregate purchase price of approximately \$121.0 million, exclusive of fees, commissions and other expenses, at a weighted-average execution price of \$8.71 per share. See Part II, Item 5. “Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” for additional information. See also See Note 9: “Earnings Per Share and Equity” of the notes to our audited consolidated financial statements under the heading “Equity—Share Repurchase Program” included elsewhere in this Form 10-K for information on the share repurchase programs.

Amounts Drawn on Amended and Restated Senior Revolving Credit Facility

During the third quarter of 2014, we drew an incremental amount of approximately \$230.0 million to partially fund the purchase of Aptina. The outstanding balance of the facility as of December 31, 2014 was \$350.0 million. See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

[Table of Contents](#)

2013 Financing Events

Share Repurchase Program

During the year ended December 31, 2013, we purchased approximately 13.9 million shares of our common stock pursuant to our previously announced share repurchase program for an aggregate purchase price of approximately \$101.3 million, exclusive of fees, commissions and other expenses, at a weighted-average execution price per share of \$7.29. See Note 9: “Earnings Per Share and Equity” of the notes to our audited consolidated financial statements under the heading “Equity—Share Repurchase Program” included elsewhere in this Form 10-K for additional information on the share repurchase program.

Convertible Note Exchange

During the year ended December 31, 2013, we exchanged \$60.0 million in principal value (\$57.4 million of carrying value) of our 2.625% Notes for \$58.5 million in principal value of our 2.625% Notes, Series B, plus accrued and unpaid interest on the 2.625% Notes, resulting in a loss on debt repurchase of \$3.1 million. Subject to certain other terms and conditions, this exchange extended the earliest put date for the exchanged amount from December 2013 to December 2016. See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information. This exchange, along with the exchange in 2012 described below, was based on the exemption from registration in Section 3(a)(9) of the Securities Act of 1933, as amended.

Retirement of 1.875% and 2.625% Notes

On January 28, 2013, we settled the conversion obligation on the outstanding 1.875% Notes by delivering approximately \$77.5 million in cash to the holders who tendered their 1.875% Notes for conversion. The excess \$4.1 million over the \$73.4 million in aggregate outstanding principal amount of the 1.875% Notes was attributable to the conversion feature for the 1.875% Notes. The settlement of the conversion obligation on January 28, 2013 resulted in the retirement of our obligation under the 1.875% Notes.

On December 20, 2013, we exercised our option to redeem all of our outstanding 2.625% Notes. As a result, we paid the gross principal amount of \$72.6 million to the holders of the 2.625% Notes and retired the outstanding obligation.

Note Payable to SMBC

On January 31, 2013, we amended and restated our seven-year non-collateralized loan obligation with SANYO Electric. In connection with the amendment and restatement of the loan agreement, SANYO Electric assigned all of its rights under the loan agreement to SMBC.

See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

Amended and Restated Senior Revolving Credit Facility

On October 10, 2013, we entered into an \$800 million, five-year senior revolving credit facility (the “Facility”), the terms of which are set forth in an Amended and Restated Credit Agreement dated as of October 10, 2013 (the “Credit Agreement”). The Facility may be used for general corporate purposes, including working capital, stock repurchase, and/or acquisitions. The increase in amount of the Facility further enhances our profile and provides financial flexibility to support long-term business and financial objectives. Following entry into the Credit Agreement, we borrowed \$120 million of the \$800 million available under the Facility. The Facility includes \$40 million of availability for the issuance of letters of credit, \$15 million of availability for swingline loans for short-term borrowings and a foreign currency sublimit of \$75 million. See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

[Table of Contents](#)

2012 Financing Events

Share Repurchase Program

During the year ended December 31, 2012, we purchased approximately 8.8 million shares of our common stock under a share repurchase program for an aggregate purchase price of approximately \$55.3 million, exclusive of fees, commissions and other expenses, at a weighted-average price per share of \$6.26. See Note 9: “Earnings Per Share and Equity” under the heading “Equity—Share Repurchase Program” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

Convertible Note Exchange

During the year ended December 31, 2012, we exchanged \$99.9 million in par value (\$92.8 million of carrying value) of our 2.625% Notes for \$99.9 million in par value of our 2.625% Notes, Series B and \$2.0 million in cash, resulting in a loss on debt repurchase of \$7.8 million, which included the write-off of \$0.6 million of unamortized debt issuance costs. Subject to certain other terms and conditions, this exchange extended the earliest put date for the exchanged amount from December 2013 to December 2016. See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

Redemption of 1.875% Notes

During the year ended December 31, 2012, we redeemed approximately \$21.6 million in aggregate principal value of our 1.875% Notes for approximately \$21.6 million in cash.

Retirement of Zero Coupon Convertible Senior Subordinated Notes due 2024

During the year ended December 31, 2012, we exercised a call option relating to our Zero Coupon Convertible Senior Subordinated Notes due 2024. As a result, we paid the aggregate principal amount of \$96.2 million to the holders of the notes and retired the outstanding obligation.

Debt Guarantees and Related Covenants

Our 2.625% Notes, Series B are subordinated to the senior indebtedness of ON Semiconductor Corporation and its guarantor subsidiaries, as defined in Note 20: “Guarantor and Non-Guarantor Statements” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K, on the terms described in the indentures for such notes. As of December 31, 2014, we believe that we were in compliance with the indentures relating to our 2.625% Notes, Series B and with covenants relating to our senior revolving credit facility and various other debt agreements.

See Note 8: “Long-Term Debt” of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K for additional information.

Critical Accounting Policies and Estimates

The accompanying discussion and analysis of our financial condition and results of operations is based upon our audited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. We believe certain of our accounting policies are critical to understanding our financial position and results of operations. We utilize the following critical accounting policies in the preparation of our financial statements.

Use of Estimates. The preparation of financial statements in accordance with generally accepted accounting principles in the United States of America requires us to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amount of revenues and

[Table of Contents](#)

expenses during the reporting period. Significant estimates have been used by management in conjunction with the following: (i) measurement of valuation allowances relating to trade receivables, inventories and deferred tax assets; (ii) estimates of future payouts for customer incentives and allowances, warranties, and restructuring activities; (iii) assumptions surrounding future pension obligations; (iv) fair values of share-based compensation and of financial instruments (including derivative financial instruments); (v) evaluations of uncertain tax positions; (vi) estimates and assumptions used in connection with business combinations; and (vi) future cash flows used to assess and test for impairment of goodwill and long-lived assets, if applicable. Actual results could differ from these estimates.

Revenue. We generate revenue from sales of our semiconductor products to OEMs, electronic manufacturing service providers and distributors. We also generate revenue, although to a much lesser extent, from manufacturing services provided to customers. Distributor revenue is recognized in various ways within the industry, dependent on the facts and circumstances of the arrangement with distributors. Some entities recognize revenue upon sale to the distributor, while others, like us, recognize revenue when the sale is made to the end customer, where the facts and circumstances of the distributor arrangements allow for such recognition. Additionally, there can often be a lag in the data collection from distributors, which may have an effect on our revenue recognition. Due to our high distributor sales, revenue recognition is a critical accounting policy.

We recognize revenue on sales to OEMs, distributors that are not entitled to returns and allowances, and electronic manufacturing service providers, net of provisions for related sales returns and allowances, when persuasive evidence of an arrangement exists, title and risk of loss pass to the customer (which is generally upon shipment), the price is fixed or determinable and collectability is reasonably assured.

For products sold to distributors who are entitled to returns and allowances, we recognize the related revenue and cost of revenues when we are informed by the distributor that it has resold the products to the end-user. As a result of our inability to reliably estimate up front the effects of the returns and allowances with these distributors, we defer the related revenue and gross margin on sales to these distributors until we are informed by the distributor that the products have been resold to the end-user, at which point the ultimate sales price is known. Although payment terms vary, most distributor agreements require payment within 30 days.

Taxes assessed by government authorities on revenue-producing transactions, including value added and excise taxes, are presented on a net basis (excluded from revenues) in the statement of operations.

Sales returns and allowances are estimated based on historical experience. Our OEM customers do not have the right to return our products, other than pursuant to the provisions of our standard warranty. Sales to distributors, however, are typically made pursuant to agreements that provide return rights with respect to discontinued or slow-moving products. Under our general agreements, distributors are allowed to return any product that we have removed from our price book. In addition, agreements with our distributors typically contain standard stock rotation provisions permitting limited levels of product returns. However, since we defer recognition of revenue and gross profit on sales to distributors until the distributor resells the product due to our inability to reliably estimate up front the effect of the returns and allowances with these distributors, sales returns and allowances have minimal impact on our results of operations. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related revenues are recognized, and are netted against revenues. We review warranty and related claims activity and record provisions, as necessary.

We generally warrant that products sold to our customers will, at the time of shipment be free from defects in workmanship and materials and conform to our specifications. Subject to certain exceptions, our standard warranty extends for a period of two years. At the time revenue is recognized, we establish an accrual for estimated warranty expenses associated with our sales, recorded as a component of cost of revenues. In addition, we also offer cash discounts to certain customers for payments received by us within an agreed upon time, generally 10 days after shipment. We accrue reserves for cash discounts as a reduction to accounts receivable and a reduction to revenues, based on experience with each customer.

Freight and handling costs are included in the cost of revenues and are recognized as period expenses during the period in which they are incurred.

Inventories. We carry our inventories at the lower of standard cost (which approximates actual cost on a first-in, first-out basis) or market and record provisions for potential excess and obsolete inventories based upon a regular analysis of inventory on hand compared to historical and projected end-user demand. These provisions can influence our results from operations. For example, when demand falls for a given part, all or a portion of the related inventory which is considered to be in excess of anticipated demand is reserved, impacting our cost of revenues and gross profit. If demand recovers and the parts previously reserved are sold, we will generally recognize a higher than normal margin. However, the majority of product inventory that has been previously reserved is ultimately discarded. Although we do sell some products that have previously been written down, such sales have historically been relatively consistent on a quarterly basis and the related impact on our margins has not been material.

Deferred Tax Valuation Allowance. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. In determining the amount of the valuation allowance, we consider estimated future taxable income as well as feasible tax planning strategies in each taxing jurisdiction in which we operate. If we determine that it is more likely than not that we will not realize all or a portion of our remaining deferred tax assets, we will increase our valuation allowance with a charge to income tax expense. Conversely, if we determine that we will more likely than not be able to utilize all or a portion of the deferred tax assets for which a valuation allowance has been provided, the related portion of the valuation allowance will be released to income as a credit to income tax expense. We maintain a valuation allowance for our domestic deferred tax assets and most of our foreign deferred tax assets.

Impairment of Long-Lived Assets. We evaluate the recoverability of the carrying amount of our property, plant and equipment and intangible assets whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be fully recoverable. Impairment is first assessed when the undiscounted expected cash flows derived for an asset group are less than its carrying amount. Impairment losses are measured as the amount by which the carrying value of an asset group exceeds its fair value and are recognized in operating results. We continually apply our best judgment when applying these impairment rules to determine the timing of the impairment test, the undiscounted cash flows used to assess impairments and the fair value of an impaired asset group. The dynamic economic environment in which we operate and the resulting assumptions used to estimate future cash flows impact the outcome of our impairment tests. In recent years, most of our asset groups that have been impaired consist of assets that were ultimately abandoned, sold or otherwise disposed of due to cost reduction activities and the consolidation of our manufacturing facilities. In some instances, these assets have subsequently been sold for amounts higher than their impaired value with related gains recorded in the restructuring, asset impairment and other, net line item in our consolidated statement of operations and disclosed in the footnotes to the financial statements.

Goodwill. We evaluate our goodwill for potential impairment annually during the fourth quarter and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. Determining the fair value of our reporting units is subjective in nature and involves the use of significant estimates and assumptions including projected net cash flows, discount and long-term growth rates. We determine the fair value of our reporting units based on an income approach, whereby the fair value of the reporting unit is derived from the present value of estimated future cash flows. Estimates of the future cash flows associated with the businesses are critical to these assessments. The assumptions about future conditions include factors such as future revenues, gross profits, operating expenses, and industry trends. Changes in these estimates based on evolving economic conditions or business strategies could result in material impairment charges in future periods. We consider other valuation methods, such as the cost approach or market approach, if it is determined that these methods provide a more representative approximation of fair value. We base our fair value estimates on assumptions we believe to be reasonable. Actual future results may differ from those estimates. We consider historical rates and current market conditions when determining the discount and growth rates to use in our analysis.

[Table of Contents](#)

The first step of the goodwill impairment test compares the fair value of the reporting unit to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets associated with that unit, goodwill is not considered impaired and we are not required to perform further testing. If the carrying value of the net assets associated with the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the goodwill impairment test in order to determine the implied fair value of the reporting unit's goodwill. If, during this second step, we determine that the carrying value of a reporting unit's goodwill exceeds its implied fair value, we would record an impairment loss equal to the difference.

We have determined that our product families, which are components of our operating segments, constitute reporting units for purposes of allocating and testing goodwill. Our product families are one level below the operating segments, constituting individual businesses with our segment management conducting regular reviews of the operating results for each product family. As of each acquisition date, all goodwill acquired was assigned to the product families that were expected to benefit from the synergies of the respective acquisition. The amount of goodwill assigned to each reporting unit was the difference between the fair value of the acquired business included in a reporting unit and the fair value of identifiable assets and liabilities allocated to the reporting unit as of the acquisition date.

Our next annual test for impairment is expected to be performed on the first day of the fourth quarter of 2015; however, identification of a triggering event may result in the need for earlier reassessments of the recoverability of our goodwill and may result in material impairment charges in future periods.

Defined Benefit Pension Plans and Related Benefits We maintain defined benefit pension plans covering certain of our non-U.S. employees. For financial reporting purposes, net periodic pension costs and estimated withdrawal liabilities are determined based upon a number of actuarial assumptions, including discount rates for plan obligations, assumed rates of return on pension plan assets and assumed rates of compensation increase for employees participating in the plans. These assumptions are based upon management's judgment and consultation with actuaries, considering all known trends and uncertainties. Actual results that differ from these assumptions impact the expense recognition and cash funding requirements of our pension plans. As of December 31, 2014, a one percentage point change in the discount rate utilized to determine our continuing foreign pension liabilities and expense for our continuing foreign defined benefit plans would have impacted our results by approximately \$35.0 million.

Contingencies. We are involved in a variety of legal matters that arise in the normal course of business. Based on the available information, we evaluate the relevant range and likelihood of potential outcomes and we record the appropriate liability when the amount is deemed probable and reasonably estimable.

For a further listing and discussion of our accounting policies, see Note 2: "Significant Accounting Policies" of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K.

Recent Accounting Pronouncements

For a discussion of recent accounting pronouncements, see Note 3: "Recent Accounting Pronouncements" of the notes to our audited consolidated financial statements included elsewhere in this Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. To mitigate these risks, we utilize derivative financial instruments. We do not use derivative financial instruments for speculative or trading purposes.

At December 31, 2014, our long-term debt (including current maturities) totaled \$1,192.6 million. We have no interest rate exposure to rate changes on our fixed rate debt, which totaled \$446.8 million. We do have interest rate exposure with respect to the \$745.8 million balance on our variable interest rate debt outstanding as of