ON Semiconductor Corporation, Q1 2022 Earnings Call, May 02, 2022 (EditedCopy)

TEXT version of Transcript

Corporate Participants

* Hassane S. El-Khoury

  ON Semiconductor Corporation - President, CEO & Director

* Parag Agarwal

  ON Semiconductor Corporation - Vice President of Investor Relations & Corporate Development

* Thad Trent

  ON Semiconductor Corporation - Executive VP, CFO & Treasurer

Conference Call Participants

* Christopher Adam Jackson Rolland

  Susquehanna Financial Group, LLLP, Research Division - Senior Analyst

* Christopher Brett Danely

  Citigroup Inc. Exchange Research - Research Analyst

* Harlan Sur

  JPMorgan Chase & Co, Research Division - Senior Analyst

* Harsh V. Kumar

  Piper Sandler & Co., Research Division - MD & Senior Research Analyst

* Joseph Lawrence Moore

  Morgan Stanley, Research Division - Executive Director

* Matthew D. Ramsay

  Cowen and Company, LLC, Research Division - MD & Senior Technology Analyst

* Rajvindra S. Gill

  Needham & Company, LLC, Research Division - Senior Analyst

* Ross Clark Seymore

  Deutsche Bank AG, Research Division - Managing Director

* Toshiya Hari

  Goldman Sachs Group, Inc., Research Division - Managing Director

* Vivek Arya

  BofA Securities, Research Division - MD in Equity Research & Research Analyst

* William Stein

Truist Securities, Inc., Research Division - Managing Director

Presentation

Operator [1]

Ladies and gentlemen, thank you for standing by, and welcome to onsemi First Quarter 2022 Earnings Conference Call. [Operator Instructions] And please be advised that today's program is being recorded.

I would now like to hand the conference over to Parag Agarwal, Vice President of Investor Relations and Corporate Development. Please go ahead.

Parag Agarwal, ON Semiconductor Corporation - Vice President of Investor Relations & Corporate Development [2]

Thank you, Carmen. Good morning, and thank you for joining onsemi's First Quarter 2022 Quarterly Results Conference Call. I'm joined today by Hassane El-Khoury, our President and CEO; and Thad Trent, our CFO. This call is being webcast on the Investor Relations section of our website at www.onsemi.com. A replay of this webcast, along with our 2022 first quarter earnings release, will be available on our website approximately 1 hour following this conference call and the recorded webcast will be available for approximately 30 days following this conference call.

Additional information related to our end markets, business segments, geographies, channels, share count and 2022 fiscal calendar is posted on the Investor Relations section of our website. Our earnings release and this presentation includes certain non-GAAP financial measures. Reconciliation of these non-GAAP financial measures to the most directly comparable measures and our GAAP are included in our earnings release, which is posted separately on our website in the Investor Relations section.

During the course of this conference call, we will make projections or other forward-looking statements regarding future events or the future financial performance of the company. The words believe, estimate, project, anticipate, intend, may, expect, will, plan, should or similar expressions are intended to identify forward-looking statements. We wish to caution that such statements are subject to risk and uncertainties that could cause actual events or results to differ materially from projections. Important factors that can affect our business, including factors that could cause actual results to differ from our forward-looking statements are described in our most recent Form 10-K, Form 10-Qs and other filings with the Securities and Exchange Commission.

Additional factors are described in our earnings release for the first quarter of 2022. Our estimates or other forward-looking statements may change, and the company assumes no obligation to update forward-looking statements to reflect actual results, change assumptions or other events that may occur except as required by law.

Now let me turn it over to Hassane. Hassane?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [3]

Thank you, Parag, and thank you, everyone, for joining us today. I will start off by saying how extremely proud I am of our team's execution in the first quarter. Our employees worldwide continue to push through challenging times, and their efforts have delivered yet another quarter of outstanding results.

We had strong revenue growth of 31% year-over-year, driven by solid performance of our Intelligent Power and Sensing Solutions in the automotive and industrial end markets. Key megatrends such as vehicle electrification, ADAS, energy infrastructure and factory automation are accelerating, and we expect to see sustained growth as we service our customers under long-term supply agreements and expand our pipeline of new Intelligent Power and Sensing products at favorable margins.

Along with our strong revenue performance in the first quarter, we achieved a gross margin of 49.4%, an increase of 1,420 basis points from a year ago. This outstanding margin performance was driven by improvements we implemented in 2021, including manufacturing efficiencies, reallocation of capacity to strategic and high-margin products to drive favorable mix shift and continued elimination of price-to-value discrepancies.

On the market environment, despite an overhang of unfavorable macroeconomics and geopolitical dynamics, demand for products in our focus end markets of automotive and industrial continues to be strong. In the first quarter, automotive and industrial grew 8% quarter-over-quarter and 42% year-over-year to 65% of our revenue, both delivering record quarters. The growth in our automotive revenue, while SAAR was revised down, highlights the strength of our portfolio and supports the content growth we expect per vehicle driven by ADAS and vehicle electrification. Lead times are flat quarter-over-quarter, and we do not see meaningful customer pushouts or increasing cancellation trends. We are fully cognizant of potential risks from inflation, higher interest rates and ongoing geopolitical tensions. We are monitoring the business environment diligently and have been managing our inventory, manufacturing and customer engagements to support our long-term financial targets and sustain our gross margin within our target range of 48% to 50%.

As of now, the COVID-related lockdowns in China have not had any meaningful impact on our business. However, there is potential risk in the second quarter if the lockdowns extend much longer, and our current guidance already accounts for a few percentage points of growth of risk we are seeing at this point. To mitigate any chance of supply disruptions to our customers due to these lockdowns, we have initiated capacity transfers to our Manila and Singapore locations to maintain supply continuity for our customers. We have been making selective investments to expand our capacity in strategic areas and relieve bottlenecks, especially in back-end factories for our imaging products. We are improving the efficiency of our factories and are reallocating capacity to strategic products and end markets, allowing us to expand our margin by driving favorable mix shift. We have been able to secure additional capacity from our external manufacturing partners and our qualifying products in our 300-millimeter fab to meet the long-term capacity needs.

In 2022, we are on track to ship more than twice the number of 300-millimeter wafers we shipped in 2021 and the continued ramp in our East Fishkill. Fab should improve the efficiency of our fab network over the next few years as we execute our fab lighter strategy by consolidating our fab footprint. We have redeployed capacity to strategic higher-margin products. And over the last 12 months, we have exited approximately $200 million in revenue at an average gross margin of 21%, of which $32 million occurred in the first quarter at an average gross margin of 22%. Some of these losses are already being offset with new product revenue, which increased 31% year-over-year at favorable gross margin and will continue to ramp through 2023 and beyond.

Our customer engagement remains strong as we see our increased customer base driving approximately 100% year-over-year growth in our design wins. This increase is driven by WINS Intelligent Power & Sensing with design wins for both doubling year-over-year. Our Intelligent Power and Sensing revenue makes up 65% of total revenue, up from 62% a year ago.

We are continuing to make progress on our silicon carbide growth and remain on track to more than double our silicon carbide revenue in 2022 as we ramp shipments to customers who have signed long-term supply agreements with us. At this pace, exiting 2023, onsemi will be on a $1 billion run rate for silicon carbide revenue.

In addition to market-leading efficiency of our products, our end-to-end vertically integrated solution in a supply-constrained environment is a compelling and differentiated competitive advantage. I'm extremely happy with the progress of our GTAT operation. And since we closed the acquisition, we have already expanded to a second building as we increased our substrate capacity and are still on track to more than quadruple exiting 2022 in support of our LTSA customers in the broader SIC market.

From the engineering side, all yields and outputs are meeting our committed production levels, and we are making fast progress on our 200-millimeter substrate development and release to production. We continue to expand our silicon carbide engagement beyond automotive traction and have made inroads into the energy infrastructure market with our power modules.

In the first quarter, our revenue for energy infrastructure grew 64% year-over-year, and we secured significant wins for our silicon carbide and silicon power modules with key market leaders. We are currently shipping to 7 of the top 10 global providers of solar inverters, and we have signed LTSAs with 3 of the top 5 players. The energy infrastructure market will be a long-term driver for our business as utility scale power plant installations are expected to grow worldwide to reduce the climate impact of fossil fuel-based power plants.

In the first quarter, our 5G cloud point-of-load revenue and design wins, both increased 33% year-over-year as we displace an incumbent to secure a design win at a leading 5G infrastructure OEM with a new product based on our superior technical performance and security of supply. In Cloud Power, we secured a major win with our high-performance power management solutions, delivering over 94% of peak energy efficiency. They were adopted by one of the largest cloud providers in the world to power their next-generation Intel servers in their data centers refresh and expansion.

Our best-in-class energy efficiency together with supply assurance and technical support, enabled us to secure this win delivering both market share gains and favorable gross margin in the second half of this year.

On the intelligent sensing front, we continue to sustain our momentum in automotive imaging with 44% revenue growth year-over-year. Our strong presence on most leading ADAS software platforms and broad ecosystem we have built over time have been a key driver of our strong market position.

We further strengthened our position in the ADAS ecosystem through a key win with a leading ADAS software platform provider in China. We expect this platform to proliferate at all OEMs in China with our content in excess of $150 per vehicle. The growth in our image sensing revenue and design wins is attributed to a doubling of the average number of cameras per vehicle over the past 5 years and a doubling again in the next 5 years. In fact, we have designed in 28 cameras per vehicle in a Level 5 autonomous vehicle already. Our industry-leading 8-megapixel camera has already been adopted by 8 car OEMs and will quadruple in revenue in '23 over '22.

In addition to ADAS applications in light vehicles, we are seeing traction for our image sensors in the industrial market for warehouse automation, autonomous delivery robot and agriculture applications. In the first quarter, we secured a win for our image sensors for use in robotic drive units in fulfillment centers with $70 of imaging content ramping in 2023 at a leading e-commerce player.

In addition, we continue to win new designs in the growing intelligent agri business segment for improving crop yields, which uses 36 image sensors per machine with revenue starting this year. Customers select our sensors based on superior imaging performance, market-leading global shutter efficiency and a strong ecosystem comprising of players that provide supportive software and hardware solutions to rapidly enable complete imaging solutions.

Our intelligent sensing products are long-lived and design wins tend to be sticky. Awarded projects typically span multiple years with lifetime in excess of 15 years as customer values the programmability and leverage their software architecture over multiple platforms and end products. This longer life cycle and sticky nature of our products gives us greater revenue stability and visibility.

Now I will turn the call over to Thad to provide additional details on our financials and guidance. Thad?

Thad Trent, ON Semiconductor Corporation - Executive VP, CFO & Treasurer [4]

Thanks, Hassane. We had another quarter of record results as we continue to execute on our transformation journey. We reported record revenue, gross and operating margins and earnings per share driven by structural changes to the business and a reallocation of investment and resources to strategic products and markets with high growth and high margins.

Vehicle electrification, ADAS, factory automation and energy infrastructure are in the early stages of adoption, and these trends will accelerate with the need for higher energy efficiency in the automotive and industrial markets. With an expanding portfolio of highly differentiated intelligent power and sensing products, long-term supply agreements and end-to-end supply chain capabilities for the fastest-growing product, we are well positioned to drive long-term revenue, earnings and free cash flow growth.

The hard work and disciplined execution of our worldwide teams are reflected in our financial transformation. Our first quarter revenue increased 31% year-over-year, gross margin improved 1,420 basis points and operating income increased 7.5x faster than revenue while free cash flow was 21% on an LTM basis. Additionally, revenue in our strategic end markets of automotive and industrial increased 42% year-over-year and now account for 65% of revenue as compared to 60% in the quarter a year ago. We also continue to make progress in our fab wider strategy, rationalizing our manufacturing footprint by exiting subscale fabs, accelerating our 300-millimeter ramp and improving operational efficiencies, all of which will double our capacity per factory over time. By transitioning production to more efficient fabs will eliminate fixed cost and lower unit costs while reducing the volatility in the P&L.

As previously announced, we closed the sale of our 6-inch fab in Belgium and expect to close the sale of our 8-inch fab in Maine to diodes in the second quarter. We are also on track to close the acquisition of the 300-millimeter fab in East Fishkill from GLOBALFOUNDRIES at year-end. As these transitions take years to fully execute and realize, we've been building bridge inventory to ensure a consistent supply of product to our customers. These structural changes, along with our differentiated portfolio, are driving momentum in our design wins, while LTSAs and the stickiness of our products are providing improved visibility into long-term revenue and profitability.

Turning to results for the first quarter. As I noted, Q1 was another quarter of record results. Total revenue was $1.95 billion, an increase of 31% over the first quarter of 2021 and 5% quarter-over-quarter. This increase was driven by favorable mix of automotive and industrial, which together grew by 8% quarter-over-quarter and 42% year-over-year.

Revenue from both Intelligent Power and Intelligent Sensing was at record levels. Intelligent Power grew by 37% year-over-year to 47% of revenue and Intelligent Sensing grew by 35% year-over-year to 17% of revenue.

Turning to the business units. Revenue for the Power Solutions Group, or PSG, was $986.7 million, an increase of 32% year-over-year. Revenue for our Advanced Solutions Group, or ASG, was $689.3 million, an increase of 30% year-over-year. Revenue for the Intelligent Sensing Group or ISG for the quarter was $269 million, an increase of 32% year-over-year.

GAAP and non-GAAP gross margin for the first quarter was 49.4%. Our non-GAAP gross margin improved 420 basis points quarter-over-quarter, driven primarily by favorable mix and pricing ahead of rising input costs.

Over the last year, we have exited approximately $200 million of noncore revenue at an average margin of 21% and reallocated this capacity to strategic products with accretive gross margins. The structural changes we have implemented give us confidence in the sustainability of the margin structure, raising the floor in all market conditions. We expect to see modest headwinds to our gross margin with increases in raw material and other input costs as well as start-up costs as we aggressively ramp our silicon carbide manufacturing offset by additional cost savings and manufacturing efficiencies. As such, we expect to maintain gross margins within the narrow range of our Q1 margin for the remainder of the year.

We also achieved record quarterly GAAP and non-GAAP operating margin of 33.3% and 33.9% respectively with our Q1 non-GAAP operating income growing quarter-over-quarter at a rate 4.5x faster than that of revenue. GAAP earnings per diluted share for the first quarter was $1.18, and non-GAAP EPS was $1.22 as compared to $0.35 in the first quarter of 2021 and $1.09 in Q4.

Now let me give you some additional numbers for your models. GAAP operating expenses for the first quarter were $314 million as compared to $395 million in the first quarter of 2021. Non-GAAP operating expenses were $302.8 million as compared to $324.7 million in the quarter a year ago and decreased $3.6 million sequentially. The decrease was primarily due to delayed hiring as we continue to reallocate resources to our focused products. We expect OpEx to trend towards our long-term model over the next several quarters as we increase investments for our long-term growth.

Our factory utilization was 81% flat as compared to the fourth quarter, and we expect utilization to be approximately 80% in the second quarter. As we guided in the past, our non-GAAP tax rate will increase in 2022 as we have substantially utilized all our NOL attributes. For the first quarter, our non-GAAP tax rate increased to 15.6% from roughly 6% in 2021. This change accounted for $0.16 of EPS dilution from the fourth quarter. Our GAAP diluted share count was 448.9 million shares, and our non-GAAP diluted share count was 442 million shares. Please note that we have an updated reference table on the Investor Relations section of our website to assist you with calculating our diluted share count at various share prices.

Turning to the Q1 balance sheet. Cash and cash equivalents was $1.6 billion, and we added $1.97 billion undrawn on our revolver. Cash from operations was $470 million and free cash flow of $305 million. Capital expenditures during the first quarter was $173.8 million, which equates to a capital intensity of 9%.

As indicated previously, we are directing a significant portion of our capital expenditures towards enabling our 300-millimeter capabilities at East Fishkill fab and the expansion of silicon carbide capacity. This increase is in line with the higher capital intensity in the near term, as mentioned at our Analyst Day.

Accounts receivable was $910.7 million, resulting in DSO of $43. Inventory increased $116.5 million sequentially to $1.5 billion as days of inventory increased by 15 days to 139. This increase was driven primarily by growth in WIP and raw material and additional build of inventory to support our fab transition and our LTSA commitments. We expect to reduce days of inventory in the second half of the year.

Distribution inventory was slightly down at 7.1 weeks. We continue to maintain distribution inventory at historically low levels to hold more inventory on our balance sheet for our customers' needs rather than building inventory in the supply chain.

Total debt was $3.2 billion, and our net leverage remains under 1.

Turning to guidance for the second quarter. The table detailing our GAAP and non-GAAP guidance is provided in the press release related to our first quarter results. Let me now provide you key elements of our non-GAAP guidance for the second quarter.

Based on current market trends, bookings and backlog levels, we believe demand will continue to outpace supply through much of 2023. We anticipate that revenue for the second quarter will be in the range of $1.965 billion to $2.065 billion. This guidance range includes the anticipated impact of the China lockdown of a couple of percentage points of revenue growth.

We expect non-GAAP gross margins between 48.5% and 50.5%. This includes share-based compensation of $3.2 million. We expect non-GAAP operating expenses of $305 million to $320 million, including share-based compensation of $23.2 million. We anticipate our non-GAAP OIE to be $20 million to $24 million. And for the remainder of 2022, we expect our non-GAAP tax rate to be in the range of 15.5% to 16.5% and non-GAAP diluted share count for the second quarter to be approximately 443 million shares.

This results in non-GAAP earnings per share to be in the range of $1.20 to $1.32. We expect capital expenditures of $240 million to $270 million in the second quarter as we ramp our silicon carbide production and invest in 300-millimeter capabilities.

In summary, we believe ON Semi's differentiated portfolio focused on the sustainable ecosystem, coupled with the structural changes in our business will continue to drive profitable long-term growth and value for our shareholders. Our worldwide teams continue to impress us with their unwavering commitment and dedication to our customers despite ongoing challenges across the globe, and I want to thank them for their outstanding results.

With that, I'll turn the call back over to Carmen to open up the line for Q&A.

Question And Answer

Operator [1]

[Operator Instructions] Your first question comes from Ross Seymore with Deutsche Bank.

Ross Clark Seymore, Deutsche Bank AG, Research Division - Managing Director [2]

Congrats on the strong results. Hassane, the first question is for you. I know you went through that you're basically not seeing any changes from the demand side of the equation. But investors clearly are having a hard time believing that that's going to persist even if you're not seeing it now. So could you go into a little more color? Any change in the demand behaviors by either end markets, geographies, just a little bit more cyclical comfort and detail on what you're seeing, so investors can kind of gauge that versus their recessionary or cyclical downturn fears?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [3]

Yes. Look, Ross, I mean, I'll comment on the automotive and industrial, which is where our highest exposure is, we don't see any changes in the demand environment or even the outlook as far as demand versus supply, like Thad said, at least through 2023. We have the engagements that we've been talking about with long-term supply agreements that we've engaged went through '21 and even in the first quarter of '22, that extend beyond '23 into some of them '24, '25. And right now, we are in a path to extend most of these long-term supply agreements beyond the original time frame that we've had of '24 average. So the fact that customers are still focusing on the supply based on a very highly credible demand and their willingness to sign up for long-term supply agreements beyond '24 and '25 sometimes gives us that visibility and comfort of the sustainability of the demand.

And just remember, our biggest exposure, and it keeps increasing, as we mentioned in Analyst Day on the auto and industrial, are driven by the megatrends that I talked about. EVs are going to happen, whether they are -- they get to 50% of total demand in '28 or '26 or '27 is irrelevant, it's still fundamentally growing as a percent of total SAAR. That's the content that's driving our growth, and that's the exposure we have where customers are highly confident of their outlook and willing to sign up for it.

Ross Clark Seymore, Deutsche Bank AG, Research Division - Managing Director [4]

Hassane, I guess just for my follow-up one for Thad or you, Hassane, if you want is to pivot on to the gross margin side of things. Obviously, you guys have done a great job, surprised to the upside, pretty much every quarter since you took over. I wanted to get into 2 parts of that, the flatness going forward for the rest of the year. That, if you could walk through the puts and takes on that. And then the confidence with keeping the higher floor, a fore handle, has that changed? Is it what used to be 40% is now 45%? Any sort of color on the gross margin sustainability there?

Thad Trent, ON Semiconductor Corporation - Executive VP, CFO & Treasurer [5]

Yes. Ross, it's Thad. Look, as I said in our prepared remarks, we're really confident with the floor, especially where we are today with the margin today. We believe the floor is definitely with the fore handle. If I kind of think about the impact to gross margin, we saw a favorable mix this quarter. We saw favorable pricing ahead of the input costs. So we saw input costs coming at us. We've always said we're going to pass on those cost increases to our customers.

So as you look forward, we've got a number of factors coming in play, right? So we've got favorability in the manufacturing side as we continue our staff lighter strategy. That's offset by increases in the input cost as well as in the second half of the year, we've got the ramping of silicon carbide, which is a headwind to margins because we don't exclude those start-up costs in our non-GAAP numbers.

And so you've got a headwind associated with that in the second half, and that's why we believe that we'll see the margins sustain in that Q1 range for the remainder of the year. Longer term, we still remain very optimistic in terms of where we're going, but we've got a lot to do between here and the end of the year.

Operator [6]

Your next question comes from Chris Barney with Citi.

Christopher Brett Danely, Citigroup Inc. Exchange Research - Research Analyst [7]

One more question on the gross margin. Can you talk about how much of the upside in Q1 was mix versus pricing and your pricing expectations for the rest of '22?

Thad Trent, ON Semiconductor Corporation - Executive VP, CFO & Treasurer [8]

Well, the mix versus pricing in Q1 to the first order, pricing was first followed by favorable mix, and that's what gave us the upside to our guidance in Q1. As we go forward, we'll continue to pass on incremental cost increases that we get in our models, either through input cost or from our external foundries. I think we continue to close the price-to-value discrepancy on those products and then we also plan on exiting the $300 million of noncore business later in the second half of the year. And as we've always said, we're basically pricing ourselves out of that market. And when supply comes online, we will exit that business.

Christopher Brett Danely, Citigroup Inc. Exchange Research - Research Analyst [9]

And for my follow-up, you said no change in lead times. So would you say that the -- I guess, the overall shortage situation for ON is about the same as it was in the last couple of quarters? And do you anticipate any improvement in the shortage/supply situation before the end of the year?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [10]

Yes. This is Hassane. Yes, I would say there's no change as far as demand versus supply to date. We don't see that changing materially over the next few quarters, call it, for the remainder of '22. We do have some manufacturing efficiencies and some supply coming online from investments we've done in '21, but not to the level to meet demand. So we'll still be supply constrained through '22 and even with the outlook we have for '23.

Operator [11]

Your next question comes from Vivek Arya with Bank of America.

Vivek Arya, BofA Securities, Research Division - MD in Equity Research & Research Analyst [12]

Hassane, I thought you mentioned that you have excluded some impact of China lockdowns in your Q2 outlook. I was hoping you could help us quantify how much is that? And is this something you can recover later in the year? Is this something that you can deliver to customers outside of the other, I believe, in Manila and Singapore distribution centers? Just how are you quantifying the impact of lockdowns? Or is this a headwind even for the second half of the year?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [13]

Yes. Look, I mean, obviously, we see -- let me give you some of the numbers. So what we have already included in our guide for Q2 is a couple of percentage point of top line. So that's kind of the impact we've included. That's based on what we see today, not knowing when a potential lift of the restriction is going to be. So that's why we put in.

We don't see that demand going away. It's still there. That's why we are trying to funnel as much of it as we can through our other distribution, but we do see that challenge in the short term. So I don't see that as a demand environment outlook -- impacting outlook, but it is a short term.

Now you can call it short term, but I don't have that visibility of when the lockdown does happen. We've engaged with all customers as far as demand. It's still there. All it does is puts us a little bit more behind on meeting that demand from a supply perspective. But I do expect that to flush out as soon as the lockdowns are done, but we thought it will be prudent to just put that in as far as the guide because the risk is out there.

Vivek Arya, BofA Securities, Research Division - MD in Equity Research & Research Analyst [14]

Got it. Hassane, longer-term silicon carbide, could you maybe give us a sense of what percentage of your sales does silicon carbide represent today? And then where do you see it going? And how do you differentiate between some of your competitors who are focused on the material side, such as Wolfspeed or II-VI and then others who are coming at it from a device incumbency perspective, such as Infineon and ST? What are ON's main differentiators in the silicon carbide market?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [15]

Yes, sure. So from -- for the first part of the question, I'm not breaking up the -- breaking out the silicon carbide. I'm just giving the ramp rates and those ramp rates, just to remind everybody we're expecting to more than double our revenue this year and puts us on track for the $1 billion run rate in '23. Those are kind of the high growth. And all of this, again, to put it in perspective, are all committed revenue and long-term supply agreements. So right now, we're building capacity to service that demand that we already have as committed revenue from -- across a wide variety of geographies and customers.

From the differentiation, you mentioned the 2 kind of -- the 2 ways of coming at it. And where onsemi sits is actually the sweet spot in the middle where we are able to support our customers with our substrate, the vertical integration and support our customers with the know-how that we've built over multiple decades of device and more importantly, packaging.

So the ability to have substrate from a supply assurance, the know-how for device, design all the way to packaging in order to get the best solution to fit the customer need is why we win and why our customers have been awarding us a lot of that business that we've been talking about over the last few quarters and more to come. But our focus right now is ramping up our supply chain, ramping up our silicon carbide substrate through the GTAT, as I mentioned. We have a heavy ramp coming, but our focus is on our LTSA commitments to our customers. And we continue to win this quarter and some of our funnel as it keeps converting to committed revenue.

Operator [16]

Your next question comes from Toshiya Hari with Goldman Sachs.

Toshiya Hari, Goldman Sachs Group, Inc., Research Division - Managing Director [17]

I had 2 as well, first on silicon carbide. Hassane, I was hoping you could give us an update on the design win funnel? Obviously, you reiterated your view on '22 and exit run rate for '23. But last quarter, I think you gave a $2.6 billion number through 2024. I was hoping to get an update on that. And if you can speak to the mix between automotive and energy infrastructure, that would be helpful.

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [18]

Yes, sure. I mean, look, I'll reiterate the committed revenue number of $2.6 billion. Obviously, we have a lot of design win in the offer that I'll be hoping to talk about over the next few quarters to '22 as we close these out. But from a -- at a high level, the highest percent of that revenue is coming from traction just because of the TAM. EV is the biggest TAM for silicon carbide. So therefore, our biggest -- I would say, 80% or so, $2 billion of that is in automotive traction. The rest of the $2.6 billion that I talked about is in nonautomotive traction. So think about it as the industrial side of alternative energy or infrastructure that I talked about, that has been ramping.

I talked about being 50% growth in 2022 from 2021 last quarter, we closed the first quarter at 65% growth. So we're growing that business nicely outside of just the automotive and that's very broad across geographies and very broad across customers. And more importantly, we are engaged with the Top 10, as I mentioned in my prepared remarks.

Toshiya Hari, Goldman Sachs Group, Inc., Research Division - Managing Director [19]

And then I've got a quick follow-up for Thad as well on the gross margin side. You talked about silicon carbide and the ramp there being the headwind later this year and, I guess, potentially into 2023. I was hoping you could quantify that for us and when you'd expect it to reverse and to be more of a tailwind for your business? Is it late '23 when you're run rating at about $1 billion? Is it beyond that? Any comment there would be helpful and the positive benefits from Belgium, Maine and, I guess, East Fishkill. I know this probably takes a couple of years, but if you can speak to that as well, that would be super helpful. .

Thad Trent, ON Semiconductor Corporation - Executive VP, CFO & Treasurer [20]

Yes. So the silicon carbide will be a headwind for us starting the second half of this year. We'll go through really be a headwind probably for the first half of next year as well and then start to be accretive. So the product margins are accretive. Obviously, it's the start-up cost as we ramp the production to support those LTSAs.

In terms of the Belgium fab over time, we will get -- let me talk about the Maine side first is about $30 million to $35 million of fixed costs that come out over time. Now we'll be buying products from that acquirer over time. So as we exit, that's when we start to see the benefit. Belgium is a lower scale fab. So it's less than that. It's roughly about $20 million of fixed costs that disappear over time as well.

Operator [21]

Your next question comes from William Stein with Truist Securities.

William Stein, Truist Securities, Inc., Research Division - Managing Director [22]

I wonder if you can remind us what the revenue level of products that you're exiting is expected to do over the next couple of quarters? And are you done with those product exits by the end of this year?

Thad Trent, ON Semiconductor Corporation - Executive VP, CFO & Treasurer [23]

Yes. So we exited about $32 million in Q1. We don't see anything meaningful in Q2. In the second half of this year, we think there's another roughly $300 million that we would exit. And you can think about that margin has been higher than what we've done in the past. What we said is, so far, we've exited, in total, $200 million, a 21% gross margin this next 300 just because of the pricing environment is higher than that but still dilutive to overall margins.

We are -- as we said at our Analyst Day back in August of last year, we said it would be 10% to 15%. So in total, we've got to get somewhere around $800 million to $900 million of losses. So we will still -- as we detailed at our Analyst Day, there's still more to come in 2023. And obviously, we moved that capacity into the higher-margin products, it allows us to free up that capacity rather than put more money in more capital into the manufacturing and move it into the higher-margin products. So favorable mix.

William Stein, Truist Securities, Inc., Research Division - Managing Director [24]

Great. And if I could follow up with any change in order patterns or point of sale through the channel. I think you said demand is still very stable and strong in the direct business. I wonder if that -- if you were including the channel in that or if there's any change there?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [25]

Yes. This is Hassane. We don't see that. We -- I include demand across whether it's direct or through distribution just to make point. Even our distribution customers, we have direct contact with them. So we have a quick touch point on the demand. We see that across the board at this point, as Thad mentioned.

We're holding inventory and maintaining the distribution inventory at a historically low level in order to maintain that visibility and be able to service the demand that we need for all of our customers. So when we make comments about demand, we include direct and distribution demand in that, and all of them are within the commentary that we set highly constrained and supply is not yet meeting the demand through '23.

Operator [26]

And the next question comes from Harsh Kumar with Piper Sandler.

Harsh V. Kumar, Piper Sandler & Co., Research Division - MD & Senior Research Analyst [27]

First of all, congratulations on implementing an amazing turnaround. What you guys have done has just been amazing so far. Hassane and Thad I'm kind of curious of the business as we go into the June quarter and look at the guidance, do you sort of expect something similar like what happened in 1Q where industrial and automotive grow to the same degree on a sequential basis. Or is there something else that we should think about? Maybe you could provide us some color on how we think of revenue breakdown?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [28]

So to a first order, the answer is yes. Our guide is driven by auto and industrial, more led by automotive in the second quarter as we see more of the strength and really, the ramps for some of our customers under the LTSAs that we talked about. So it will be about the same growth, but led by automotive.

Harsh V. Kumar, Piper Sandler & Co., Research Division - MD & Senior Research Analyst [29]

Great. And then my question was on gross margin. This incredible rise you've shown in the March quarter. I think you mentioned earlier in response to Christopher Danely's question that there was an element of price increase here. Are you specifically raising prices in the channel? Or is this just getting out of sort of cheaper stuff on legacy stuff and sort of implementing a mix change? So maybe you could clarify if there's an absolute dollar increase in ASPs that you're implementing?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [30]

Look, it's all of the above that you mentioned. So first off, it is all led by the price-to-value discrepancies that I keep talking about where we are recalibrating our complete demand across the value of our products. When we do that and as we mix -- we shift more to auto and industrial, which drive higher ASP and higher margin, that gives us that sustainable margin expansion that we've been seeing. So all of these are both increase in the value of our products and a mix shift more to these increases. That's one.

Two, we do have net price increases that we've talked about. That $200 million that we've exited so far or the $32 million we exited with 22% margin this quarter, that is in a favorable pricing environment. So there is pricing increases included in that, but that's not sustainable. As we talked about, we lost that revenue. We expect another about $300 million in '22 at dilutive margin.

So when we exit that business, our margin will have more of an expansion because of it. But that was a net price increase because we're pricing ourselves out of that market. So that's the 2 buckets you can take a look at it. One is the sustainable bucket that we see forward looking and longer term and the shorter-term bucket that was net increase from where we were historically, still dilutive, but not sustainable and that will be exited throughout this year and a little bit next year.

Operator [31]

Your next question comes at Matt Ramsay with Cowen.

Matthew D. Ramsay, Cowen and Company, LLC, Research Division - MD & Senior Technology Analyst [32]

Hassane, I wanted to ask another question about silicon carbide. And I guess the question that I get from investors most is not the demand side, it's not the visibility of design wins that you have, it's the confidence that you can scale capacity with GTAT to the levels that you're forecasting. And maybe you could give us a little bit of insight of how the operations are going and your confidence in being able to scale that revenue so quickly with internal supply at good margins?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [33]

Sure. I guess the biggest vote of confidence that I can give is we opened up another building because the first building is already full and outputting exactly what we expected it to. And I mentioned that in my prepared remarks as far as yield and capacity or how many millimeters of substrate a factory does output. So we're on track with all of those metrics. And right now, it's no longer about the engineering side or the development. It's more about the manufacturing expansion. .

We've secured another site. We are on track to quadrupling our output exiting '22 as far as, again, the number of furnaces that translate into millimeter height of substrates. High confidence, I guess, in summary, very high confidence. Our CapEx is going there. We're already generating revenue based on that material. So all in all, I'm very bullish about the prospect and we're pushing forward supporting -- in order to support our LTSA. So that would be what I would say.

Matthew D. Ramsay, Cowen and Company, LLC, Research Division - MD & Senior Technology Analyst [34]

That's really helpful. As my follow-up question, there's been a lot of back and forth on gross margin on this call. And I think it's remarkable what you guys have done. My own view was that given the barriers of entry in power semis that the margin profile of yourselves and your competitors should be sort of higher than it's been.

And we're seeing that with your results and with some of your competitors' results as well. I guess the question is, how have you seen the competitive response from the rest of the players in the space to increased pricing that you've put out there, increased margins for the group, are everyone sort of acting rationally. Do you think this is sort of sustainable for yourself and peer companies? Or do you see any kind of changes in the pricing environment from competitors that might make some of this temporary?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [35]

Sure. That's a very good question. And obviously, I can't comment on what my competitors will do in an environment today or later, especially on pricing and so on. The only thing I can't control is what our view of the market is and our view of the pricing environment is. So I'll focus my answer on that. We view this as sustainable because it's driven by value. But I will remind everybody the portion that we acknowledge is not sustainable, is on the noncore that we plan on exiting and we price ourselves out of the market.

So what does that mean? In the future where demand and supply starts to come in balance, we're not going to chase that down. our competitors may end up hashing it out amongst themselves, but you were not going to see onsemi engaging in a pricing down to keep market share. That's not what our company is about. We're going to focus on the value. Our products today that we're focusing on are strategic and our growth are based on value we provide to customers, that pricing is stable. I don't see it going anywhere else. And for the rest of the market, let them hash it out, but we're not going to chase it down.

Operator [36]

Your next question comes from Harlan Sur with JPMorgan.

Harlan Sur, JPMorgan Chase & Co, Research Division - Senior Analyst [37]

Congratulations on the strong results and execution. On the noncore low-margin businesses, as you've mentioned, you're exiting another $300 million in the second half. Previously, you thought that this exit would temper the second half and full year revenue growth profile, but drive strong margins. But the team actually continues to unlock better-than-expected manufacturing efficiencies, and it does seem like you guys are getting more external supply as well. So I guess, how should we think about the profile of second half revenues versus the first half?

Thad Trent, ON Semiconductor Corporation - Executive VP, CFO & Treasurer [38]

Well, look -- Harlan, it's Thad. What we're seeing right now is we're seeing strength out there right now, right? As we said, demand continues to outstrip supply. As we've noted, we are getting more supply from our external foundry partners. We're extracting more out of our own manufacturing footprint. So that will give us some upside in the second half. Now again, keep in mind, we've got the headwind of the $300 million that will roll off. So we don't see significant growth, but we see that the second half will actually outperform the first half if you look Q3, Q4 versus Q1 and Q2.

Harlan Sur, JPMorgan Chase & Co, Research Division - Senior Analyst [39]

Perfect. I appreciate the insights there. And then as my follow-up, despite the aggressive exit of the noncore low-margin businesses, I mean, your other segments still drove strong 15% year-over-year growth in the quarter. In this segment, you do actually have a fast-growing, high-margin end market focus, which you touched upon a little bit, but this is your cloud data center and 5G infrastructure markets, right?

You guys have a pretty strong portfolio, medium voltage MOSFETs, power management, analog products. You talked about the strong design win pipeline. But from a revenue perspective, I know you guys have targeted this market to go at about an 11% CAGR going forward. But just given strong data center compute spending trends, strong 5G non-China build-out activity, can you guys just give us a rough sense on how fast this part of the business is currently growing on a year-over-year basis?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [40]

Yes. Look, I didn't break it up specifically as far as growth, but the design win that is fueling that growth was about 33% year-over-year. This is new designs and replacing incumbents, further supporting our 11%. So the 11% we talked about, you're absolutely right. We do have growth in that other segment and that's driven by the cloud, which is key for us from a growth and margin expansion business. Our design wins, our revenue today supports a comfortable 11% growth over the next 5 years.

Operator [41]

Your next question comes from Joe Moore with Morgan Stanley.

Joseph Lawrence Moore, Morgan Stanley, Research Division - Executive Director [42]

Going back to the China potential disruption that you talked about, can you talk about how much of that is your facilities in China versus impact from your customers' manufacturing? Do you see impact from either of those? And then there were some press commentary that there was an image sensor specific supply coming out of China. Can you just talk if there's any disproportionate impact there?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [43]

Yes. Look, so it's primarily the supply disruption overall. Think about logistics, think about getting material in and out of factories and so on. So we're able to mitigate some of that by rerouting, but the lack of mobility is what is hard to judge. I don't know what commentary you're referring to on the image sensor. I can't comment on that because that did not come from ON Semi source. I don't see any specific product impacted versus just, like I said, the logistics that everybody has been commenting about. That's really their present on the ground. And like we talked about, we do see that. We put it into our guide already. So depending on how that loosens up, we'll talk about it in the second quarter.

Operator [44]

Your next question comes from Raji Gill with Needham & Company.

Rajvindra S. Gill, Needham & Company, LLC, Research Division - Senior Analyst [45]

Congratulations on the strong results across the board. Just Thad, going back to pricing, if I can, we talked about some of the impact of favorable pricing on the margins. But with respect to revenue, the auto industrial segment grew 42% year-over-year combined. Is there a way to kind of break that out between unit growth versus ASP growth? And it really speaks to the larger point about the sustainability of the pricing in the core business. As part of your LTSA agreements you have price increases. So I just want to talk a little bit about kind of price versus units?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [46]

Look, a lot of the growth in our strategic core is driven by units that we talk about the content because a lot of the price-to-value discrepancy that we talked about, that was implemented primarily in '21. So a lot of the growth moving forward is a lot of it is content. But overall, units will be down because a lot of the exits that we've done is low ASP, low margin, high volume. So we focus our unit comps to where our strategic focus has been, and that's been increasing, and I mentioned that in my prepared remarks, driven a lot by the content, not just per car, from apples-to-apples, car to car, where there's more content, whether it's imaging or power, but also as we shift more into EVs that have much more content.

So from that perspective, it's driven by units. The ASP is in the baseline to a first order. And as we ship more of the auto and industrial, we're going to benefit from the ASP reset that we've done in throughout '21, which calls it, in my view, sustainable as we move forward.

Rajvindra S. Gill, Needham & Company, LLC, Research Division - Senior Analyst [47]

Got it. That's really helpful, Thad, and just for my follow-up Hassane is that you talked about getting capacity from your external foundries as well as kind of better capacity from your internal factories and that's driving some upside in the second half. But you also kind of mentioned that the demand is going to exceed supply if I heard you correctly through much of 2023. So I just want to get a sense in terms of the demand supply conditions as you kind of look out to 2023. If we continue to be in a very kind of tight supply environment, is there a way to kind of assess the magnitude of it? Is it going to be less constrained next year but still constrained, any sense there in terms of demand, supply imbalance?

Thad Trent, ON Semiconductor Corporation - Executive VP, CFO & Treasurer [48]

Yes. Yes, that's a good -- so we are getting obviously some increases from foundry and some reducing bottlenecks internally in our manufacturing. But like I said, not enough to catch up to the demand. So if I answer the question directly, we do see increase in supply through '22 and even '23. But based on where the demand is, it's not going to get into balance. And that's where I keep talking about the supply constraint because it's the supply and demand side. Both of them increase -- demand has increased at a faster rate, which keeps us a little bit behind because it takes 18 to 24 months to add capacity these days with all of the lead times and everything. Demand has been increasing. So net-net, we're not catching up. But we have been making investments in our CapEx, but very specifically on technologies.

For example, we're not adding CapEx just across the board to increase capacity for noncore products, although that demand is still high because we plan on exiting. We're focusing our CapEx investments on EFK, on silicon carbide, on some of the mixed signal analog that all drive growth and accretive margins. But net-net, we don't see us catching up.

Operator [49]

And your next question comes from Christopher Rolland with Susquehanna.

Christopher Adam Jackson Rolland, Susquehanna Financial Group, LLLP, Research Division - Senior Analyst [50]

Congrats on the results and especially that gross margin line. Just kind of following up on that last question then. So are we to assume that East Fishkill, you guys are getting that in 2023, the full facility? Should we assume that, that fab is then filled? And then what is your external -- as you look at internal versus external, what's the plan moving forward once East Fishkill is full?

Thad Trent, ON Semiconductor Corporation - Executive VP, CFO & Treasurer [51]

Chris, it's Thad here. So we take ownership in January of 2023. There is a plan for GLOBALFOUNDRIES to exit just as we've been ramping up over the last couple of years, they'll ramp down over 3 years as we continue to move production into that facility. So we've said that our units are actually doubling this year in 2022. We'll continue to accelerate that beyond '23, but there is a 3-year period where they wind down, we wind up.

And our assumption right now is, yes, we have a full fab at that time. Now we've said this in the past, at that time, in '23, for a couple of years, we're going to be a foundry business for GLOBALFOUNDRIES, and that's at a low margin, which is a little bit of a headwind as well, but we'll be able to offset that with the cost improvements that we get across the portfolio.

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [52]

And long term, I'll confirm our -- what that will do for us long term are as we exit those other fabs that we've announced already and ramp East Fishkill up, fixed costs will be better overall like the numbers that Thad talked about for Belgium and our North America fab. But net-net, capacity will increase about to 1.3x when we have the 300-millimeter on and we exit the low-scale fabs. So net-net, we see our increase from capacity, reduced fixed costs, which gets us the growth that we'll be looking for in a much better fab lighter footprint.

Christopher Adam Jackson Rolland, Susquehanna Financial Group, LLLP, Research Division - Senior Analyst [53]

Great. And considering the 300, the fact that it's kind of spoken for, what would have to happen to consider a second 300 fab? Or are there -- is there the ability to increase capacity at East Fishkill somehow?

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [54]

Look, there is -- of course, as GLOBALFOUNDRIES exits over the next 3 years, we have a lot of headroom to go for 300-millimeter capacity within that facility. And over the next 5 years, as we look at the outlook and where we can do, then we'll address our need for additional manufacturing event.

Operator [55]

Thank you. And this concludes our Q&A session. I will turn the call back to the President and CEO, Hassane El-Khoury, for final remarks.

Hassane S. El-Khoury, ON Semiconductor Corporation - President, CEO & Director [56]

Thank you all for joining us today. I thank our worldwide teams for their hard work in accelerating our transformation and driving record results once again with leadership in intelligent power and sensing solutions and exposure to fast-growing megatrends such as vehicle electrification, ADAS, energy infrastructure and factory automation, we are well positioned to deliver sustained and profitable long-term revenue growth and margin expansion. Thank you.

Operator [57]

And with that, we conclude today's conference. Thank you for participating. You may now disconnect.