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EDITED TRANSCRIPT

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q1 2020 Advanced Energy Industries Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Edwin Mok, Vice President of Strategic Marketing and Investor Relations. Thank you. Please go ahead, sir.

Yeuk-Fai Mok - *Advanced Energy Industries, Inc. - VP of Strategic Marketing & IR*

Thank you, operator. Good morning, everyone. Welcome to Advanced Energy's First Quarter 2020 Earnings Conference Call. With me today are Yuval Wasserman, our President and CEO; Paul Oldham, our Executive Vice President and CFO; and Brian Smith, our Director of Investor Relations. If you have not seen our earnings press release, you can find it on our website at ir.advanced-energy.com. There you'll also find a slide presentation to follow along our discussion today.

Before I begin, I would like to mention that AE will be participating at multiple investor conferences in the coming months, mostly virtually. As events occur, we'll make the announcements.

Let me remind you that today's call contains forward-looking statements, which are subject to risks and uncertainties that could cause actual results to differ materially and are not guarantees of future performance. Information concerning these risks and uncertainties is found on our filings with the SEC. All forward-looking statements are based on management's estimates, projections and assumptions as of today, May 6, 2020, and the company assumes no obligation to update them.

Long-term targets presented today, which include our aspirational goals and the integration targets, should not be interpreted in any respect as guidance.

Today's call also contains non-GAAP financial measures. An explanation of these measures as well as reconciliations between GAAP and non-GAAP measures are contained in our press release and the slide presentation.

With that, let me pass the call to our President and CEO, Yuval Wasserman. Yuval?

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Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

Thank you, Edwin. Good morning, everyone, and thank you for joining us on this call. Let me begin today by saying that our main efforts and focus over the last 3 months have been the safety and health of our employees, their families and our global partners. This is an extraordinary time, and I'm proud that Advanced Energy has managed to both protect our employees and deliver on our customers' commitments, which resulted in a quarter exceeding all of our expected financial metrics.

In summary, revenue of $315.5 million was above the midpoint of our guidance and non-GAAP earnings per share of $0.91 was at the higher end of our widened guidance range.

Let me first give you an update on our response and activities during this unprecedented time. As early as January, recognizing this pandemic could have global implications, we put together an executive-led rapid response team to take decisive actions to ensure everybody's health and safety, long before governments began issuing mandates. Those early preparations allowed us to safely reopen our China factories and ramp our production shortly after the Lunar New Year shutdown. We also instituted working-from-home guidelines and implemented sophisticated IT solutions, which allowed us to work virtually. In order to continue our innovation and product development projects, we provided our key innovators with home mini labs and with safe and secured access to our main labs to utilize large equipment when required. At present, all of our factories are operational, with our China factories back to full capacity while those in the Philippines and Malaysia are running at lower rates due to local government restrictions.

Within our facilities, all employees are provided with the proper protective equipment, and we have implemented our own safety protocols and physical separation structures and methods that are above and beyond local government requirements. We are proud that many of our products contribute to the effort to fight this pandemic. AE has a long history of designing and developing power supplies for use in many critical therapeutic medical products like ventilators and diagnostic equipment like CT scanners and blood analyzers. Our power supplies also power analytical instruments used in life science applications like gene sequencing and vaccine development. In addition, our power supplies are critical to the production of semiconductor devices and in the operation of data centers, which are seeing increased demand driven by the need to stay connected and the resulting increase in data usage. The key role that our products play in improving lives have never been so clear as during the past several months.

Entering this crisis in a position of strength allowed us to address both health and safety concerns as well as business continuity challenges with confidence in our ability to weather the storm. Our balance sheet at the end of the quarter is well capitalized, with an increased cash position and reduced debt, which is further improved by a lower effective fixed interest rate after we completed an interest rate swap agreement at the beginning of Q2.

Our strong backlog demonstrates the solid demand momentum from our customers and industries. While the impact of this virus on the global economy and our market is unclear, longer term we believe the growth drivers in our market verticals remain intact, and in some cases, may even be accelerated. We remain confident in our ability to serve our customers and industries that provide the essential technologies and applications that enable the data economy and the Fourth Industrial Revolution.

That said, we recognize that this crisis will put pressure on our business. Although demand in several markets further strengthened during Q1 and is continuing into Q2, government-mandated factory shutdowns and supply chain issues drove our revenue to decline sequentially in the first quarter. Further constraints in our factories could limit our ability to fully service demand during Q2.

Taking a prudent approach to the current environment, we have implemented some temporary actions to curtail discretionary spending. We also stopped our opportunistic share repurchase activity, which we initiated early in the crisis as share prices declined. At the same time, we did not delay any critical activities or programs that will drive new product introductions, design wins and future growth. Using our remote innovation capabilities allows us to continue to innovate and engage our core talent during this time.

As we navigate through this crisis, the benefits of our strategy and especially the acquisition of Artesyn Embedded Power have become evident. Our distributed world-class global manufacturing and supply chain operations were able to optimize both product and material management

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during a time of significant disruption, allowing us to deliver on our customer commitments. As we continue to integrate these 2 organizations and realize accelerated synergies, we find increasing benefits from combined operations.

Now let me turn to our business. Demand in our semiconductor markets was strong in the quarter, driven mostly by foundry/logic with some contribution from memory applications. We saw growth across most regions, with particular strength in Korea, China and Taiwan. Demand growth was augmented by key design wins across different applications. Most notably, our RF and remote plasma source products continue to gain momentum. Our RF -- our RPS won a significant new design for a chamber clean application at a top-tier equipment OEM. In addition, we shipped our first embedded power products into a wafer fab equipment customer in Q1, displacing an incumbent.

We see additional opportunity for cross-selling these products into the semi market in the future.

Looking forward, in spite of the COVID-19 impact on supply chain, we expect demand to remain strong in Q2.

During the quarter, Advanced Energy was recognized with a 2019 Supplier Excellence Award by our largest customer, Applied Materials. It is gratifying to see that our efforts and investment in industry-leading service and aftermarket products are recognized by our customers.

Turning to our Industrial & Medical market. Revenue was down significantly from last quarter. COVID-19-related limitations on multiple production sites impacted our ability to ship. However, the majority of the sequential decline was driven by a pushout by a large industrial customer, who is transitioning to a new product architecture to support a future ramp. Pending supply chain and factory capacity in the current environment, we expect to recover a portion of the pushout revenue in the current quarter.

During Q1, demand for our power supplies serving medical applications started to increase meaningfully in March as we are integral to the manufacture of diagnostic and respiratory equipment that are currently in high demand. Looking into Q2, we expect demand in Industrial & Medical applications to increase driven by continuing growth in market needs.

Our revenue from Data Center Computing applications grew sequentially on strong demand from hyperscale customers, which was up over 50% quarter-over-quarter. While we were already anticipating this hyperscale ramp going into the quarter, we saw an acceleration during Q1 to support remote work and education initiatives. This more than offset seasonal softness in enterprise computing, which was further impacted by COVID-19.

Our team did a great job delivering on the strengthened demand during Q1. At the same time, we secured multiple next-generation design wins across several hyperscale and enterprise customers, validating our technology leadership. Looking in the current quarter, we expect demand in this market to continue at elevated level on accelerated hyperscale investment and the contribution of our design wins.

As was indicated in our last earnings call, Telecom & Networking demand remains low with further delays in networking spending and 5G investment due to the uncertain environment. While we see selected spots of strength driven by our prior design wins, overall OEM market conditions are likely to remain challenging in the current quarter as well. Longer term, though, we see this market space as another key enabler of the data economy, and we expect to see resumption of growth in spending in the future.

In conclusion, our operational excellence and agility enable us to overcome significant market challenges in the quarter and to deliver solid results. The crisis brought out the best in our organization as we focused our efforts on protecting our employees and communities, serving our customers, innovating and doing our part in managing through this pandemic. We became financially stronger during the quarter, with solid profitability and higher net cash balance. The results are a strong validation of our strategic direction and initiatives. While the near-term impact of this crisis is still unknown, we are confident and committed to our long-term aspirational goal of over $1.5 billion in revenue, over $6.5 non-GAAP EPS and over 23% ROIC.

I'd like to thank our customers, shareholders, partners and our valued employees for your support, especially during these challenging times. I look forward to speaking with many of you in the upcoming quarter.

With that, let me turn the call over to Paul.

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Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Thank you, Yuval, and good morning. Let me start by wishing everyone and their family good health and safety. I would also like to echo Yuval's congratulations on our team's extraordinary efforts in ensuring safe operations while delivering results during these challenging times.

This was a good quarter for us financially as we exceeded our revenue guidance in a difficult environment, improved gross margins, delivered earnings at the high end of our range and up from last quarter, generated strong operating cash flow and realized annualized adjusted ROIC of over 16%. The company's balance sheet and liquidity are solid with $355 million in cash, positive net cash even after our debt issuance last year and the ability to access our $150 million unused line of credit. In addition, early in Q2 we converted the majority of our variable rate debt to a historically low effective fixed rate of 1.27%, locking in lower interest payments for the balance of the term. Finally, we continue to make great progress on the Artesyn integration, which was solidly accretive this quarter, putting us on track to achieve our Phase I goals ahead of our 18- to 24-month target.

Now let me turn to our Q1 financial results, and then I'll make some comments on Q2. Total revenue for the first quarter of 2020 was $315.5 million, down from $338.3 million last quarter due to COVID-19-related supply and production constraints. On a pro forma basis, including a full quarter of Artesyn revenue in prior periods, Q1 revenue grew 6.6% year-over-year, with strong growth in semi and data centers partially offset by declines in Industrial & Medical and Telecom & Networking. Excluding Artesyn, organic revenue grew about 2% sequentially and 15% year-over-year to $161.5 million. COVID-19-related government restrictions in our production facilities and the impact on our supply chain reduced our Q1 total revenue by approximately 10% as we implied during our last quarterly call.

Turning to revenue by market. Revenue in our semiconductor vertical for Q1 was $134 million, up 7% from a very strong fourth quarter and up 46% year-over-year. On an organic basis, semi revenue grew 44% year-over-year, with strong demand from foundry/logic and increased memory investment. On a product basis, semi revenue was up 10.4% sequentially and 66% year-over-year, while semi service revenue was down approximately 10% from last quarter and 11% from last year on lower fab utilization in the U.S. and Europe, combined with capacity constraints in some of our service centers due to COVID-19. Revenue from our Industrial & Medical markets was $62 million, down substantially from $97 million last quarter. On a pro forma basis, revenue declined 32% year-over-year. The results were a combination of a product transition by a large industrial customer, resulting in a pushout of orders into future quarters, continued macro weakness in several of our industrial sectors, and COVID-related government-imposed production constraints, particularly out of our Philippine facility.

Data Center Computing revenue was $86 million, up 11% from the strong results in the prior quarter. On a pro forma basis, revenues were up 63% year-over-year, driven by increased hyperscale investments and our recent design wins. Telecom & Networking revenue was $34 million, down 12.5% from the prior quarter. On a pro forma basis, revenues declined about 43% year-over-year as challenging market conditions in telecom OEM demand persisted.

Gross margin for the quarter was 35.6%. Cost of sales included approximately $5.1 million of acquisition-related charges and $1.5 million of facility expansion and relocation costs, primarily related to our strategic investment in the Malaysia factory. Most of the $5.1 million in acquisition-related costs will not continue in future quarters.

On a non-GAAP basis, gross margin was 37.8%. Gross margins benefited from favorable product mix, lower material costs and generally lower other cost of sale items. In addition, we did not experience significant COVID-related costs, as government and local benefits largely offset our incremental expenses and production disruptions in the quarter. However, we do not expect these benefits to continue into Q2. GAAP operating expenses in Q1 were $86.4 million. Expenses included $5 million of intangibles amortization, $2.8 million of acquisition-related charges, $2.8 million of stock compensation and $1 million of restructuring and transition expenses. Non-GAAP operating expenses were $74.7 million, down nearly $4 million from last quarter. We continue to execute our strategy of investing in critical R&D programs, primarily in RF technology and products with strategic customers, while controlling discretionary spending and driving synergies of the combined company.

GAAP operating margin for the quarter was 8.2%. Non-GAAP operating margin was 14.1%, up from 12.8% last quarter despite the lower revenue. Other nonoperating expense was $3.5 million, down from $3.8 million last quarter; included in other expense was $2.3 million of total interest

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expense. Given our swap transaction, we expect interest expense savings of about $1 million per quarter compared to what we paid in Q1 and total other expense to be in the $1.5 to $2 million range going forward.

We recorded GAAP tax expense of $3.9 million or 17.5%. Our non-GAAP tax expense was $6 million or 14.6% and was benefited by the mix of international income. In addition, during Q1, we made significant progress in incorporating and optimizing the impact of Artesyn on our international tax provision, resulting in lower GILTI taxes across the combined company. These actions allow us to lower our expected GAAP and non-GAAP tax rate by approximately 100 basis points to be between 15% to 17% going forward.

On a GAAP basis, earnings per diluted share from continuing operations were $0.48 compared to earnings of $0.27 last quarter and $0.40 last year. Non-GAAP earnings per share for the quarter was $0.91, up 5% from $0.87 last quarter on lower revenue and up 57% from $0.58 a year ago.

As I mentioned, the Artesyn acquisition continued to contribute to our consolidated results. As of the end of Q1, we have taken actions that we believe will result in annualized synergies of over $15 million. In addition, despite sequentially lower revenues in some of Artesyn's verticals, the acquisition remains solidly accretive in Q1, adding about $0.18 per share to non-GAAP earnings, including the interest expense of financing. While the level of accretion will fluctuate from quarter to quarter due to different revenue and product mix, we believe we are on track to achieve our earnings accretion of over $0.80 per share ahead of our 18- to 24-month target.

Turning now to the balance sheet. We ended the quarter with cash and marketable securities of $355 million, up $6 million from Q4. Receivables decreased significantly, and DSO improved 5 days to 61 days. Inventory increased by $5 million and turns were 3.5x. Payables were $167 million, representing 74 days DPO. Total days of net working capital were 91, up 2 days from last quarter.

Operating cash flow from continuing operations was $28.9 million. Capital expenditures for the quarter were $6.1 million and depreciation was $6.6 million. We ended the quarter with bank debt of $335 million after a $4.4 million principal amortization payment on the loan.

Note that our debt still has 4.5 years remaining term and is very low cost, with an effective fixed interest rate of 1.27% on 85% of the debt, as I discussed earlier. In addition, our debt covenants are based on net debt leverage, not gross debt, which gives us an extremely wide operating envelope.

During Q1, we also spent $7.2 million to repurchase 170,000 shares of our stock at an average price of $42.59 per share. Overall, we exited the quarter in a very strong financial position, which should allow us to weather the current crisis and continue to make the critical investments needed to execute our strategy. As we have demonstrated, our robust financial model and playbook should allow us to continue to generate solid non-GAAP operating margins and cash flow.

Now let me turn to guidance. In the near term, we continue to see strengthening demand in our semiconductor and data center markets, partially offset by weakness in Industrial & Telecom markets broadly. However, we expect revenue to continue to be impacted by COVID-related, government-imposed capacity constraints, particularly in our Philippine and Malaysia factories, and by ongoing supply chain challenges. As a result, we estimate revenues in Q2 to be about flat at $315 million, plus or minus $30 million, depending primarily on the level of government restrictions and the impact of supply chain constraints. We expect gross margins to be in the 35% to 37% range based on mix and increased COVID-related costs, production disruptions and higher freight and expediting expenses. Operating expenses are expected to be up slightly on increased R&D spending to accelerate strategic programs together with key customers.

As a result, we expect non-GAAP earnings at $0.80 per share, plus or minus $0.30. In summary, despite a challenging environment, we delivered strong operating and financial results in Q1. We have excellent liquidity and a robust operating model. The integration of Artesyn is on track to achieve or exceed our synergy goals ahead of schedule, and we are executing on our strategy of accelerating earnings growth. Since closing the Artesyn acquisition, our non-GAAP EPS in each of the last 2 quarters was up double digits year-over-year, and this trend is projected to continue in the current quarter.

Looking forward, the current environment with COVID-19 continues to create operating challenges, and the visibility over the next few quarters is very limited. However, near-term demand continues to be strong, and we believe we are targeted at markets and industries that support the

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data economy and will benefit from these opportunities in the long run. Despite the near-term challenges, we are confident that we have the resources, competencies and capability to achieve our aspirational goals, accelerate earnings growth over time and deliver top-tier return on invested capital.

Now we will take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Quinn Bolton from Needham & Company.

Quinn Bolton - *Needham & Company, LLC, Research Division - Senior Analyst*

Congratulations on the nice results, especially on the gross margin side. I wanted to start with the government-imposed capacity constraints you mentioned in the Philippines and Malaysia. Are those factories now back operational? And if so, what sort of utilization are you getting out of those facilities? And then I've got a couple of follow-up questions.

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

Quinn, the factories in the Philippines and Malaysia are ramping, they're not yet at full capacity. We are following government-imposed restriction related to the number of employees per factory. But we're ramping. We're not at full capacity, unlike our China factories that are at full capacity and doing great. We -- in terms of headcount and direct laborers, we don't have a limitation, it's mainly following directives by local government.

Quinn Bolton - *Needham & Company, LLC, Research Division - Senior Analyst*

And Yuval, do you think that you can get back towards sort of full capacity by the end of the quarter? Or are the government...

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

Quinn, we don't know. As you know, it is dynamic. We are working very closely with the governments, both local and general or federal governments to make sure that we have the compliance that is required by the health authorities. But at the same time, we get all the support that we need from the local governments to allow us to maximize our ability to operate. We can't predict what's going to happen. Things are dynamic. We see some places around the world that contagion is coming back, like Singapore, even though we don't have a factory there. We have limited visibility, but we are ramping in both sites; we're not at full capacity yet.

Quinn Bolton - *Needham & Company, LLC, Research Division - Senior Analyst*

Understood. And then for Paul on the gross margin, at the midpoint, looks like margins will be down about 180 basis points in the June quarter. It sounds like some of that's mix, some of that's higher COVID-related costs. Wondering if you might be able to give us some sense how that 180 basis point splits between the various factors in the second quarter.

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Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Yes. It's a good question, Quinn. Certainly, as you mentioned, COVID-related costs is part of it. And we did see some benefit in the first quarter from local support basically that offset most of our COVID costs. Those costs are both increasing a little bit in Q2 plus we don't anticipate the benefit. So that's a fair portion of that decrease. But there's a couple of other items. One is we had generally favorable other cost-of-sale items in the first quarter. You just don't expect the trees to always fall the same direction every quarter. So we expect to see some pullback there. Mix will have a small factor. And those are the primary items.

Quinn Bolton - *Needham & Company, LLC, Research Division - Senior Analyst*

Understood. And then lastly for Yuval. Data center has been, I think, much stronger than expected or at least very strong for the past couple of quarters, looks like it will be strong again in June or maintain its fairly high level of output. Are you worried at all about capacity digestion in the data center business as you look into the second half? Or is it just sort of tough to tell at this point what that data center business looks like into the second half?

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

So good question, Quinn. I think we're benefiting from 2 driving forces. The first one, which started contributing in the previous quarter, we are realizing recent design wins in hyperscale that we worked on for the last 12 to 18 months. And these design wins translated to revenue. Hyperscale right now is the fastest-growing part of the business. And not only we realized the design wins and continue to have new design wins, we saw a surge in demand, especially in hyperscale, as the working from home, relying on the Internet, the increasing usage of data right now drives acceleration of investments in data centers. And we expect to see that continuing.

Operator

Our next question comes from the line of Amanda Scarnati from Citi.

Amanda Marie Scarnati - *Citigroup Inc, Research Division - Semiconductor Consumable Analyst*

Just kind of picking up off of that data center and hyperscale question. I just want to clarify what you mean by acceleration. Do you think that that's a pull-in of demand, or do you think that this is sort of additional demand that's just happening on sort of an accelerated pace?

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

We don't believe it's pull-ins. We believe it's added capacity, some of the very large hyperscalers are seeing tremendous increase in traffic and usage of Internet applications. And we see increase in demand that, as I said earlier, will continue, Amanda. It's a significant add-on demand that, from our perspective, we're adding more capacity to fulfill the demand.

Amanda Marie Scarnati - *Citigroup Inc, Research Division - Semiconductor Consumable Analyst*

Okay. And then on the Industrial & Medical side of the business. You highlighted med-tech designs that you had that are supporting the COVID crisis. But the segment overall was down 36%, but you mentioned for a large industrial contract. How much of a benefit did you get in the quarter from that med-tech division? And do you see that demand kind of continuing on and helping to bolster growth in the second quarter?

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Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

So it's a great question, Amanda. Our medical and life science business is still small, but growing. It's above $50 million and growing. We saw what I'd call a surge in demand, specifically in power supplies that go into ventilators, and as you know, there is a huge demand for building ventilators. The question we have, we don't believe this is going to be multiyear demand. We believe that the market right now built a large inventory of ventilators that created a surge of demand from us. Another area that is increasing is the area of analytical and life science tools, more specifically gene sequencing and related technologies that are right now in high demand as more testing, more gene sequencing and what we assume could be vaccine development activities that require additional analytical tools. The area in medical that we think is going to be affected in the short term is everything that has to do with elective procedures and even cosmetic procedures, that we believe the growth there is going to be pushed out a little bit. In general, medical and life science is an area of focus for us. It has some of the business attributes we like to operate in. It's still small, but growing, and we expect it to continue to grow.

Amanda Marie Scarnati - *Citigroup Inc, Research Division - Semiconductor Consumable Analyst*

Great. And then the last question I had is you mentioned some -- that you received some benefits from government and local authorities. Can you just clarify what those benefits were, and why you don't expect them to continue in the current environment?

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Yes. A lot of them, I'll say, were from China, which was hit sort of early with the impact of the virus. And they took a variety of forms. In some cases, we saw some rent abatement, we saw some holding of some of the social cost contributions and things like that. They're time based, and so those programs have basically worked through. So that's why we don't anticipate seeing other benefits. If you look at some of the things that have been passed in the U.S., which should be coming onstream now, they largely don't benefit either large companies or large companies that aren't having massive layoffs or furloughs. So that doesn't fit us. And so we don't see any real benefit other than the timing of some tax payments, which are being deferred, as you know. So that's why we see it as temporary. Obviously, we feel fortunate that we've been able to get some relief. But the impact of this, across our worldwide operations, continues to roll through.

Operator

Our next question comes from the line of Krish Sankar from Cowen & Company.

Krish Sankar - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

I have 2 of them. Yuval, we've kind of heard the same commentary from many folks regarding supply chain constraints. Is this a function of just the geographic exposure, i.e., Malaysia and Philippines have been -- have the movement control orders? Or is there 1 or 2 key components that in the whole food chain that is actually the weakest link that is actually impacting everyone's output?

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

So Krish, it's very dynamic. At the beginning of the -- right after Chinese New Year, when everybody started slowly to go back to work, you could see that suppliers that are close to the epicenter, like in Wuhan, Hubei area, were practically shutdown. And it took them a long time to recover and go back to business. Our supply chain is broad and global. So there's no specific world region that, with the exception of Wuhan and Hubei, that we needed to address. Our combined teams, of the Artesyn supply chain team and the AE supply chain teams that are now being combining together, did a phenomenal job managing a very complex and broad supply chain network. And the addition of these 2 supply chains also help us to use each other's products because we had some redundancies, which allow us to be very flexible and nimble. The reason we managed to very quickly go back to business and deliver and exceed our commitment in terms of shipment to customers was the strength of the combined

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operation and the combined supply chain management teams. So there's no specific area or specific part. It's, I'll call it, managing day-by-day a network of suppliers that we needed to help and deliver.

Krish Sankar - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

All right. That's good insight, Yuval. And then a follow-up for Paul. I missed it. I don't know if you did give any color on how to think about semi equipment revenues in the June quarter, either sequentially or in terms of dollar numbers.

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Yes. We didn't say on the revenue side, it's difficult to predict across the business because of the supply chain issues that Yuval said. But what we did say is we expect demand to continue to strengthen and would see a healthy environment. It's just all based on our ability to deliver across the 4 markets that we're in today.

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

Krish, as I said in my remarks, the demand in semi is very strong. It's not a question of demand. It's a question of our capacity to deliver on that demand. And the demand is very strong.

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

And the supply chain, that's important.

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

And it's supply chain. Right.

Krish Sankar - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Got it. And then, Yuval, if I could just ask one last question, just to follow up on that point. I understand that visibility is limited. No one knows how the second half is going to shake out. But is there any risk that, given it's supply constrained and the demand is still pretty strong, any risk that your customers, the semi equipment OEMs, end up having excess inventory, if the downstream demand slows down in the second half? Because right now, it's a supply-constrained environment, but that could be an opposite thing when -- if demand falls off a cliff, right?

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

We don't forecast the second half. All I can tell you is that the demand is strong and continued through Q2. We have an extremely nimble and agile operation. For our perspective, we can respond very quickly to changes in volume and mix. We've done that for years. We know how to do it. We know how to do it effectively. So from our perspective, we continue to look at strong demand going through Q2, and our plan is to deliver. And if you look at our guidance, our guidance in general is very strong in comparison to peers and others.

Operator

Our next question comes from the line of Weston Twigg from KeyBanc Capital.

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Weston David Twigg - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*

Actually, I wanted to follow up on that last question because I got a little confused on the segment outlook between semi and industrial and data center and telecom, because I certainly heard demand strength was good for semi and data center, but I didn't catch which segments do you think from a revenue buildup perspective, in terms of how you get the guidance, might be up or down. And so I'm just wondering if you could walk us through, like, for example, in Industrial & Medical, I thought I heard demand would increase, but maybe offset by some supply challenges. I don't know if that means you think it's going to be up or down or maybe you don't know, but additional just directional color would help.

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

Wes, so if you look at -- so first of all, we don't have segments, right? We have market verticals that we serve with our power supplies. We see growth in semi, as I mentioned in the last answer. We see strength coming from data center, hyperscale. And with that, mainly hyperscale is growing faster than just the general data centers. We see right now, growth in medical and life sciences that is related to COVID-19. And the other aspect of industrial, if you look in general industrial, we see weakness due to largely macroeconomical forces. So if you look at solar and flat panel display, we see those not showing any strength. The area that we mentioned specifically within our industrial market was a unique case of a single large customer that decided to adopt new architecture as they prepare for continuing ramp and they pushed out revenue from Q1 to future quarters. So we don't see that as a revenue that disappeared, we see that as a pushout, right? The other area that is a decline, but not a surprise, was Telecom & Networking. And especially as we said in the last earnings call, we expect that the telecom downturn to last about 2 quarters. Does that answer your question, Wes?

Weston David Twigg - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*

Yes. That's helpful. Just kind of putting it all together.

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Wes, the main thing is we have a pretty good visibility of demand. But we didn't give specific revenue guidance by each of those markets because a lot of it comes down to customer issues at the end, who's ready to take products, who isn't, which specific supply issues we're chasing at -- towards the end. But I think broadly speaking, the areas where demand is weaker, as we talked about, we'll probably get a little less shipments. In areas where demand is a little stronger, we'll probably get a little more. But there's not going to be big swings compared to the current quarter in sort of our flat guidance. And all this stuff to move around a few million dollars right up to the end, and that's why it's difficult to kind of project. There's no one area that's up a lot and others are down a lot. It's...

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

And also the environment of the -- in general, the environment due to COVID-19 creates another uncertainty related to our ability to build and ship.

Weston David Twigg - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*

Okay. That's very helpful color, so I appreciate it. One other question that I'm just struggling with a little bit still is, I heard some reasons why you had good margin profile and good earnings. But what I didn't hear was why it was so far above your guidance midpoint. I'm wondering if you could help us understand what really surprised to the upside so strongly in Q1 to drive the EPS so high.

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Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Yes. It's a really good question. And I would say there's a couple big things. One is we expected -- I think if you recall, we talked about in our call, we thought we'd have 50 to 100 basis points of COVID cost. In the end, those were pretty much neutral, that's a straight upside to our forecast. We also had a number of items, like I said, other cost-of-sale items, none of which was material, but all of which were a little bit favorable. That contributed. And then finally, we had good mix. In general, semi was pretty good for us. And so that on balance was a contributor. And within the product areas, there's other mix positives as well. But there's one other thing that we saw. And that's why if you look at the midpoint of our guidance, it's actually higher in Q2 than the guidance in Q1 and that's because we are starting to see the benefit of some of the integration synergies. I talked about lower material costs and actually running the factories despite all the disruptions a little better than maybe we thought we could, and that's because of some of the integration activities and the ability to leverage a more global organization than we had previously.

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

So Wes, the integration of Artesyn drives additional margins growth as we realize synergies faster than planned, and that will continue. As you recall, the thesis behind this acquisition was to pursue an accelerated earnings growth, and we're pursuing it. And you saw that our earnings -- EPS growth was double digit. So that's the plan, and we're executing on the plan.

Operator

Our next question comes from the line of Pavel Molchanov from Raymond James.

Pavel S. Molchanov - *Raymond James & Associates, Inc., Research Division - Energy Analyst*

You referenced the lockdown in Luzon, the Philippines as kind of your main manufacturing headwind. Have any of your customers had lockdown-related curtailments in labor or other operations that have prevented them from accepting deliveries of your product?

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Yes. We don't talk about our customers, Pavel. But I would say in general, our customers, as we talked about in the call, have been pulling demand. They've been kind of finding a way to get product in the markets that we talked about. Obviously, Telecom & Networking is slower. But across the others, outside of some specific issues, people have generally been pulling products. So no specific comments, but in general, customers have been pulling or pushing to get products and have been very -- working with us as we try to resolve supply chain channels and where to ship things and how to be flexible in this time. Look, this turned from a China event, this quarter, to a global event. And I think broadly, in these areas, supported by the data economy, people have been working together to try to get product where it needs to be as quickly as possible.

Pavel S. Molchanov - *Raymond James & Associates, Inc., Research Division - Energy Analyst*

Okay. Understood. And then you mentioned a little bit of buyback, $7 million in the quarter, obviously, not a huge amount. But you are one of the very, very few companies, I might say, on the planet that did not have buyback 6 months ago but is repurchasing some shares now. So I'm curious what kind of stimulated that decision.

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Yes. As we went into this thing, obviously, we were through the Artesyn acquisition. We felt like we had a little better bead on where things were going. And the share price was very attractive. So it triggered an opportunistic program. However, as the environment evolved, and it evolved pretty quickly, I mean, it seems like it's been a long time, the last 2 months, but the events happening every day were easily, it felt like weeks or months in the making. And so as we saw events start to unfold more rapidly, we thought it was prudent to hold back on the repurchase and to

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stop that. We have a solid balance sheet, as you know, Pavel, but the world's changing or at least at the time was changing rapidly, and our view is let's pull back on that opportunistic program and see where things go.

Operator

Our next question comes from the line of Mehdi Hosseini from SIG.

Mehdi Hosseini - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

I apologize, I joined late, so some of my questions may be repeat. Of the $0.80 accretion that is being pulled in, it seems like $0.05 to $0.08 is due to lower taxes. So of the remaining $0.70, $0.75 accretion that is pulled in, how should I think about the cost synergies associated with Artesyn and also the revenue synergies? I remember it was announced accretion was going to come from both top line and also a big chunk of the cost synergies. And I want to better understand how those dynamics are playing? And then I have a follow-up.

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Yes. Let me see if I can answer your question, Mehdi. So we said that we expected $0.80 of accretion in that first 18 to 24 months. You're right, we have gotten some tax benefit. And out of the $0.80, you're probably right, maybe a $0.05 is from taxes. So that's obviously positive and contributes. Obviously Artesyn itself is, just on its own basis, is profitable. It's positive contribution. Last quarter, we said it was over $0.20 of accretion. This quarter, we said it was $0.18 accretion. That includes the financing cost by the way, so it's a net accretion, if you will. And if you look at that, we also talked about that we have identified and implemented annualized synergies of about $15 million. So again, we had a $20 million goal in the 18- to 24-month time frame, and we're well on our way to that. Now those are annualized synergies. So that's not $15 million a quarter right now. That's -- we're in -- we're ramping up to that run rate of $15 million a year. But the actions are taken, it's identified, those are going to happen. So I think you can kind of derive the math from those data points that says certainly Artesyn is contributing at a base level, there's clear improvements that we've made as a result of the synergies we've implemented, and we're on track to achieve those goals faster than expected. Now we did get some cross-selling. I would say that's sort of the beginning, it's not a large amount, but it's hundreds of units. And it's sort of scratching the surface of what we think is possible. We've said that that market for auxiliary power supplies is a...

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

$70 million.

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

$70 million market, and this is the very first order, kind of almost a pilot order with...

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

So Mehdi, we...

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

So there's more to come there, but it's very small at this point.

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Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

So Mehdi, during the Analyst Day, we talked about a strategy to start working on cross-selling. And we've done it before. Every acquisition we made in the history, we succeeded in taking products from one vertical and cross-sell to another vertical. In this case, in specifically in auxiliary power supplies for semiconductor wafer fab equipment applications, we managed to move much faster than our plan due to a unique specific customer need that we managed to fulfill almost immediately. And that's the first building block of having this cross-selling contribution moving forward.

Mehdi Hosseini - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Okay. Just had 2 quick follow-up. One, on the margin. Did you provide any color or detail for the June quarter gross and operating margins? And for you, Yuval, focusing on your semi cap, how do you see different end markets playing out? It seems like maybe first half is driven by foundry/logic and then some memory coming back later in the year. And I want to see if you agree or disagree, or you have any different thoughts.

Paul R. Oldham - *Advanced Energy Industries, Inc. - Executive VP & CFO*

Yes. I'll take the guidance question, and Yuval will talk about the market. So we said that we expect gross margins to be 35% to 37%. And we also noted that that's a little lower than this quarter because we do expect increased net COVID costs. Last quarter, we did see benefits that largely offset those costs. Those costs are both increasing and we don't see the benefits this quarter. As well as higher freight and expediting and other costs that just come with this environment where we're constantly trying to move things around to get product to customers.

On the operating margins. We said we expected to see $0.80 per share, plus or minus $0.30. So we didn't break it down exactly to operating margins, but you can probably derive that pretty close.

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

And maybe your assumption related to end-user market drivers is correct. That's basically the consensus. We saw front-end loaded a lot of foundry/logic with a little bit of investment in memory. As I mentioned in my prepared remarks, we saw really a lot of strength coming from Korea, China and Taiwan. And we -- and in general, the demand right now from the semi vertical is very strong, very strong. And we see that demand going through Q2. So I think I agree with your assumptions.

Operator

At this time, I'm showing no further questions. I would like to turn the call back over to Yuval for closing remarks.

Yuval Wasserman - *Advanced Energy Industries, Inc. - CEO & Director*

Well, thanks, everyone, for joining us today. We are living through interesting and challenging times. In spite of that, we delivered a really strong quarter in Q1 and expect to see the continuing of this strength through Q2. We're excited because we're making great progress to meet or exceed our aspirational strategic goals of greater than $1.5 billion in revenue, greater than $6.5 EPS, non-GAAP EPS, and more than 23% ROIC. Thanks for joining us, have a healthy and safe week.

Operator

Ladies and gentlemen, this concludes today's conference call. Thanks for participating. You may now disconnect.

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