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PRESENTATION

Operator

Good day and thank you for standing by. Welcome to the Advanced Energy Industries first quarter 2021 conference call. (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. Please go ahead.

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 2021 Earnings Conference Call. With me today, I'll have Steve Kelley, 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.advancedenergy.com. There, you'll also find the Q1 slide presentation.

Before I begin, I'd like to mention that Advanced Energy will be presenting at several investor conferences in the coming months. As events occur, we will make the announcements. Let me remind you that today's call contains forward-looking statements. They are subject to risks and uncertainties that could cause actual results to differ materially and are not guaranteed or future promised. Information concerning these risks and uncertainties is in our SEC filing. All forward-looking statements are based on management's estimates as of today, May 5th, 2021, and the company assumes no obligation to update them. Long-term targets presented today, including our aspirational goals and long-term vision goals, should not be interpreted as guidance.

On today's call, our financial results will be presented on a non-GAAP financial basis, unless otherwise specified. Excluded from our non-GAAP results are amortization, stock compensation, integration and transition costs, unrealized foreign exchange gains or losses, and restructuring items. A detailed reconciliation between GAAP and non-GAAP measures can be found in today's press release. With that, let me pass the call to our President and CEO, Steve Kelley.

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Thank you, Edwin, and good morning, everyone. Thanks for joining the call today.

First quarter revenue was $352 million. We had record sales into the semiconductor market, where we are benefiting from our leadership position in process power delivery systems. We entered the second quarter with a record order backlog. Demand is increasing across all of our target markets and we continue to win new design slots at an impressive rate, as customers adopt our industry-leading products. In the short term, our most pressing tactical challenge continues to be dealing with constraints in the supply chain, particularly shortages of certain integrated circuits.

These constraints limited our upside in the first quarter as we forecasted. Our second quarter guidance also incorporates the impact of these constraints. However, given the proprietary nature of most of our products, we believe that nearly all of the demand which we can't satisfy in the second quarter will shift into the second half of the year. Also, we expect that the actions that we took in the first quarter to address choke points in the supply chain will begin to have a positive impact in the third quarter. Now I would like to provide additional color for each of our target markets.

In the semiconductor market, we generated record revenues in the first quarter, growing 35% year-on-year and 9% sequentially. This strong growth was driven by higher demand for our process power delivery systems, a key enabling technology for advanced etch and deposition processes. We've maintained our leadership position in the process power market by working closely with our customers and by continuously innovating. Advanced Energy's technology and products enable our customers to improve yields, increased throughput, reduce costs, and lower power consumption.

Over the past year, we have launched a series of next-generation products into the market. Our latest high-power RF generators are unique in most plasma system. And our back stream RPS systems are all highly differentiated and are currently being evaluated by our customers. We believe that these next-generation products will drive market share gains for Advanced Energy in the coming years. In the first quarter, we won multiple design slots and major OEMs for both etch and AOV platforms. In addition to wins and process power, our traditional area of stream, we also secured wins for Artisan brand embedded power products. To summarize, we expect that 2021 will be a record year for sales into the semiconductor market, and we are bullish about 2022 and beyond, given our strong lineup of differentiated, next-generation products.

Now that the industrial and medical markets, where our revenue was up 27% year-on-year. In industrial applications, we saw strength in flat panel display, battery production, carbon fiber manufacturing, and horticulture. In medical, demand for diagnostic and life science applications begin to improve during the quarter. Looking forward, we expect the industrial and medical markets to strengthen through the course of the year due to improving economic conditions as well as increased acceptance of our new products into a wide variety of applications. In the first quarter, we confirmed that Ascent MS platform has been designed into multiple solar cell manufacturing applications. In addition, our Thyro-A+ power controller has been incorporated into a flat panel manufacturing application.

Moving to the data center and computing market, revenues were down in the first quarter, as expected, due primarily to ongoing inventory digestion by specific hyperscale customers. Looking forward, we see increased demand in the second quarter, followed by a strong uptick in demand in the second half of the year. We continue to make good progress on new product qualifications and expect to add additional Tier 1 hyperscale customers later this year. We won another board-mounted 48-volt DC-to-DC design in the first quarter, and continue to focus on 48-volt server opportunities.

Now I'll shift to the telecom and networking market, where the first quarter revenue was down sequentially, we'd roughly planned year-by-year. Our first quarter revenue reflected the full impact of portfolio actions we executed in late 2020. Moving forward, we expect to grow revenue by targeting higher-end applications, where we can differentiate. We are focused on 5G infrastructure, and in the first quarter, won 2 critical 5G design slots, for the leading telecom OEM.

In closing, I'd like to share some personal observations. Since joining Advanced Energy in March, I've visited most of our North American manufacturing and development sites and spoken face-to-face with many members of the team. My general takeaways from those initial meetings are first, that we can have a high level of employee engagement, and second, it'd be we have some excellent engineers and scientists at Advanced Energy, and foster a culture of technical excellence.

In my first 60 days, I've also had the opportunity to meet the 2 of our largest customers in channel partners. Our customers have a genuine appreciation for Advanced Energy's technologies, products, and services. They know the company well, since our technical teams work closely together during new product development cycles. To grow our business, we will focus on continuously improving our customer value proposition. We need to deliver industry leading technologies and products in a timely fashion with best-in-class quality, reliability, and service levels. We have a strong balance sheet and we'll deploy capital where it makes strategic and financial sense for the company. The power supply industry is highly fragmented, and we think that supplier consolidation will benefit both Advanced Energy and our customers.

In conclusion, I am delighted to be part of the Advanced Energy team. We are targeting the right markets. We have a strong line of differentiated products and we have a great culture. We are focused on accelerating revenue and earnings growth and are on track to meet or exceed our aspirational goals in longer-term financial targets.

Paul will now review our financial results in providing detail and guidance.

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

Thank you, Steve. And good morning, everyone. We delivered solid financial results in the first quarter, with revenue, profitability, and cash flow up significantly year-over-year, and above the midpoints of our guidance. Overall customer demand was very strong, resulting in record backlog of over $400 million, giving us increased visibility to customer requirements over the next several quarters. We executed well to meet customer commitment. An industry-wide supply constraint limited upside in the quarter, and will be the pacing factor in our revenue outlook in the near term.

As Steve mentioned, semiconductor revenue set another record, driven by both customer demand and share gains for our full suite of semipower solutions. Overall, earnings grew 42% year-over-year, as gross margins continued to approach our long-term target of greater than 40%, partially offset by increased R and D investment to fuel future growth. Return on invested capital continues to be above 20% on solid profitability and working capital efficiency.

First quarter revenue was 352 million, up nearly 12% year-over-year, but down 5% sequentially as we had anticipated. Semiconductor sales were $181 million, up 35% from last year, and up 9% over last quarter, as our operations team was able to respond to strengthening customer's demand.

Revenue from our industrial and medical markets grew 27% from a year ago to $78 million, but declined 16% sequentially, mostly due to supply constraints.

Data center computing revenue was $59 million, down 31% from the very strong quarter a year ago, and 9% sequentially. However, demand for our products started to recover with several customers placing orders late in the quarter, signaling a return to growth in demand after just 2 quarters digestion.

Telecom and networking revenue was $33 million in the quarter, essentially flat with last year and down 28% from Q4, reflecting a new baseline going forward as we streamline our portfolios to focus on higher-value applications.

Non-GAAP gross margin for the quarter was 39.7%, up 190 basis points from a year ago on higher sales and realized synergies. Gross margins were 20 basis points higher sequentially, primarily due to improved product mix, partially offset by lower volume and some added supply chain costs. We expect the logistics and supply chain costs to continue to be a headwind to gross margin in the near term. Non-GAAP operating expenses were $79.59, up a $2.5 million from last quarter on higher R&D, hazard fund investments, and multiple new growth opportunities.

Operating margins for the quarter were 17.1%, up 300 basis points from last year reflecting improvements in gross margin and SGNA as a percentage of sales. While we expect optics to increase modestly going forward, operating margins should expand in the second half as revenue growth accelerates. Non-GAAP other expense was $2.6 million, including $1.1 million of interest expense and $1.2 million of FX losses on settlement of year-end position. We expect other expenses to be in the $1.5-2 million range going forward.

Our non-GAAP tax expense was $7.9 million or 13.8% primarily on favorable dispute items. Looking forward, we expect the GAAP and non-GAAP tax rate to remain in the 15% range. Non-GAAP earnings for the quarter were $1.29 per share, up 42% from $0.91 a year ago, but down from last quarter, due to lower revenue.

Turning now to the balance sheet, we ended the first quarter with cash and marketable securities of $513 million, up $30 million from Q4. Inventory increased by $26 million and turns where 3.75. Accounts payable rose to $163 million with associated EPO of 68 days, largely offsetting the increased level of inventory. Inventories and payables should remain at higher levels on our expectation for increased volume and as we pursue supply of critical components.

Receivables rose slightly to $237 million and DSO at 61 days. Total days of networking capital where 96, up 1 day from last quarter.

Operating cash flow from continuing operations was $54.3 million. Capital expenditures for the quarter were the $8.8 million and the depreciation was $7.3 million. We continue to expect capital expenditures to be about 2-3% of sales for the year.

During the quarter, we repaid $4.4 million of principal amortization on our debt ending with total bank debt of $318 million and the net cash of $195 million. Our trailing 12-month gross debt leverage decreased to 1.1 times. We did not repurchase any stock in Q1 and we paid $3.9 million for our first quarterly dividend of $0.10 per share.

Now let me turn to guidance. We expect demand to remain strong and improve sequentially across our markets driven by growing investment in semiconductor, improving macroeconomic conditions and strengthening orders in hyperscale. However, in the near term, industry-wide supply constraints on specific components are limiting upside to our revenue. As a result, we are guiding Q2 revenue to be $360 million, plus or minus $15 million. We expect non-GAAP gross margin to decline around 100 basis points, sequentially on less favorable product mix and higher near-term material and freight costs, which could last through the end of the year.

Operating expenses are expected to be $81-82 million as we continue to invest in R&D and see natural increase in annual costs, partially offset by synergy actions. As a result, we expect non-GAAP earnings to be $1.25 per share plus or minus $0.15.

Looking beyond Q2, we believe demand will remain strong in the second half of 2021 and into 2022. Given the current supply chain environment, we expect second half revenue to grow 5-0% over the first half with upside as conditions improve.

In conclusion, we are more excited than ever about the opportunities across our markets. We are well-positioned to continue to gain share, and obtain strong adoption of our new products. We remain focused on executing our strategy to accelerate revenue and earnings growth over time.

With that, let's take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Quinn Bolton with Needham & Company.

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

Hey guys, just trying to look through the numbers. Obviously, it sounds like you're seeing some limited upside on revenue due to capacity constraints. And I guess as I look at the June quarter, you guys were kind of $15-to maybe-20 million light of the consensus expectations for the June quarter. It that the level, that $15-20 million, is that the level of revenue you're leaving on the table because of capacity constraints? Or are there other factors going on?

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

That's a really good question, Quinn. It's hard to quantify. Exactly. Certainly, we are seeing strengthening demand, and our outlook is really based on what we believe we can get parts for and get out of the back for each quarter. Certainly, as we came into the year, we saw some supply constraints. We talked about that having some impact in Q1 and I would say, broadly speaking, in sort of a similar impact in Q2. Now that demand is still there and we'll fill as those parts become available, but it'll take a couple of quarters probably to catch it up.

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

Okay. And I guess just looking at the numbers, if you're missing some demand in Q1 and Q2, and that shifts to the second half, it almost looks like what pushes from the first half and in the second half could easily support 5-10% growth. And so I guess I'm just having difficulties reconciling that the forecast, especially if some of the demand, is shifting into the second half.

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

We looked forward and tried to give some color to the second half because it is a strong demand environment and it's really limited by availability of parts. So when you looked at what moved forward, we think it's more like half of that forecast is supportive, that move forward and that are in this year. But if the parts situation improves then we don't see upsides in numbers. That's what we believe at this point. We have line of sight too, as we go forward in the next couple of quarters. And although the parts shortage is a challenge in the near term, that's our biggest tactical challenge as Steve mentioned, we actually think that it bodes well broadly speaking. Underscores the strength of demand drivers and the fact that there's kind of an industry-wide challenge we think is, ultimately along the runway. Combine that with a stronger demand throughout the year and we think that sets us up for not only growth in the second half, but continued growth into 2022.

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

Great. And the second question I had is the VLFI market share data for Powerset Systems was out recently. Can you talk about just how you guys performed in 2020 in terms of market share in the RF power setting?

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

Yes, this is Steve. I'd like to make a comment on that one. We did take a look at the report and we were very happy to see that the AD is still the undisputed market leader in all the areas that we care about. So in the areas that are on power, on process power and some other things like RF generators, RF matching networks, DC power and remote license horsepower.

It also showed that we grew some instances of revenue faster than market last year. Certainly wasn't that surprised, we grew our revenues 52%, in semiconductor vertical in 2020. So it was a great year for the (inaudible) energy.

We're very optimistic moving forward. We've launched, over the past year, some highly differentiated products (inaudible) RPS. And in addition, excess cross-selling artisan products entering the semiconductor vertical. So we're very bullish on semiconductor moving forward.

Operator

Your next question is Krish Sankar with Cowen and Company.

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

I have 2 of them, first one for Steve. On this component [prices] that's impacting the top line, is there any risks that you might lose share to your competition? Or do you think that [issue] prevalent across the industry that you're confident also seeing the same kind of component tightness?

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

Yes. I think if you look across our portfolio, most of our portfolio is proprietary. So if you look at semiconductors, industrial medical, those are largely proprietary products. And so that's why we made the statement that most of the demand will shift into the second half, but we won't lose it. I think the only area where we risk losing some share based on lack of availability of components is probably in data center computing. That business is more of a filter print business. And so, if we can't catch up in that area in Q3, we may lose a little bit of share there. But in large part, speaking for the company as a whole, there's very little business that we think will disappear.

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

Got it. And then a follow-up, we spoke about data from the computing kind of. It was really when the dilution break started turning around in the March quarter. I'm just kind of curious what drove it? Are you seeing IT enterprise budgets improving, or what are the reasons for the dilution getting it done sooner than expected? And along the same thought, did you qualify on how much your hyperscale revenues grew in the March quarter?

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

I'll address the general question now about what Paul addressed, these more specific questions. But I think we saw increased booking activity, the data center towards the end of the quarter. And we anticipate a continued pick up in Q2, and from what we see in our forecast today, the second half is going to be quite strong, the data center. That's what we're gearing up for.

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

We didn't break out this time to change in hyperscale. Quarter over quarter (inaudible), but we did see orders start to come in and strong towards the end of the quarter. That gives us confidence that we've seen the bottom of that market from a digestion period. And we expect to see growth over the course of the year. And as Steve mentioned earlier, it's stronger growth as we go through the year. That market went through a couple of quarters of digestion and is clearing coming back now.

Operator

Next question is from Mehdi Hosseini with SIG.

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

Yes. When I look at the revenue mix by the end market, it seems to me that semis and industrial actually did better than expected. And perhaps the shortfall was in the telecom and data center. And I'm just trying to reconcile the shortages with end market. Would it be fair to say that perhaps, in the semi's you had the appropriate inventory of sub-components, so you were able to meet the demand and it was just this new market that you're trying to scale that the shortages hampered your ability to hit the targets?

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

That's a good question, Mehdi. I think, if you look across our markets, our higher volume markets added larger impact from a supply chain perspective. And look, we have some spot outages everywhere, but on balance, we were able to respond to increasing demand during the quarter in semi. Even while we had some part shortages there as well. You're broadly speaking on higher volume businesses that are more impacted by the part shortages than our semi business, or a couple of the advanced markets were.

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

Sure. Okay. And then you highlighted OPEX increasing a little bit. Could we assume that maybe OPEX is up a couple of million in the second half versus the first half, and then there could be continued increase in OPEX into '22?

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

Yes. If you look at the numbers we've been investing in an army, obviously that's where all the growth has been. You do cut some annual costs that come in as the year goes on. You can expect to see OPEX up slightly from the Q2 levels over the year. But it should be very modest growth as we go forward after Q2.

Operator

Your next question is from Amanda Scarnati with Citi.

Amanda Marie Scarnati - *Citigroup Inc. Exchange Research - Research Analyst*

Just touching in on to the data center side of the business. You talked about the expectation to add some more hyperscale customers throughout 2021. Do you need to add those customers in order to start to see an acceleration of growth? Or do you expect that the digestion that you've been seeing the last 2 quarters should roll off and you can see some growth outside of adding new customers throughout the year?

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Yes. Amanda, I think the growth is a separate issue because we see the growth from our current set of customers. As we bring on new customers, typically we start relatively low volumes and it ramps up over a period of months. We have learned the side on the growth just coming from our existing customers.

Amanda Marie Scarnati - *Citigroup Inc. Exchange Research - Research Analyst*

Okay. And then on the industrial and medical side, obviously last year was pretty strong with some of the additions related to COVID on the medical side. Could we see a step up in year-over-year growth on the industrial side, specifically on the industrial side and not the medical side of the business this year?

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Yes. I think 2020 was a down year. Industrial and medical for obvious reasons. And we're definitely seeing booking pick up in both areas, and we think those strengthen in every quarter this year. We think those 2 markets, industrial and medical, will be coming back to life over the course of 2021.

Operator

Your next question is from Scott Graham with Rosenblatt Securities.

Scott Graham - *Rosenblatt Securities Inc., Research Division - MD & Senior Equity Industrial Technology Analyst*

Yes. And Steve, welcome. Could you maybe quantify the impact on sales of your portfolio changes in the common networking segment of the revenues?

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

Yes, Scott. It's Paul. We haven't called that out specifically, but if you recall, we'd expect it to be down in Q1, and it was. We also commented that this kind of form is how the new baseline should go forward. We'll see some growth from here. There'll be some kind of quarters can be a little higher, a little lower, but fundamentally beat this sort of establishes a new baseline post those actions. Most of the actions really took effect in late 2020, which had the effect of accelerating some business in 2020. And as we go forward, we think this is a reasonable baseline level.

Scott Graham - *Rosenblatt Securities Inc., Research Division - MD & Senior Equity Industrial Technology Analyst*

Okay. I was also hoping for a little bit more color on some of the supply shortages logistics issues and what have you. Certainly, everyone is feeling it. We understand that. Could you kind of tell us which segments are being sort of affected? Maybe sort of list them worst to least if that's possible.

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Sure. Be happy to comment on that. Obviously, the biggest issue we have is in semiconductor chips and microcontrollers, other IT's that we buy. Second would be ceramics, and ceramic substrates, and other forms of ceramic. Probably the third are passive. Some passive components are very short supply. And so we're spending a lot of time with our key suppliers. We have almost the entire management team involved in expediting the calls every week. That includes me. We're going out and bringing on new second sources where we can find them. We've signed a number of long-term agreements with our key suppliers.

We did that in Q1 as we saw lean time stretch. Until we think that it's going to start benefiting us in Q3. And we've secured our position as a preferred customer, essentially with most working suppliers. We're also taking some actions in our factories. We're building some buffer capacities, some (inaudible) capacity. And the reason we're doing that is because there's a tendency for some of these scarce components to be delivered and in the batch fashion towards the end of the quarter. We want to be able to take advantage of that. That requires some additional for capacity.

Scott Graham - *Rosenblatt Securities Inc., Research Division - MD & Senior Equity Industrial Technology Analyst*

That's very helpful. I guess the last question is around, so we're funding a little bit more R&D. We have these supply chain issues, if you will. We have higher materials and, I guess, I was just wondering maybe is there going to be a renewed focus on managing SGNA down a little bit to prop up the earnings while we're going through this sort of transition period into the second half. And frankly, also in the second half, because I think as you said, Paul, that the second half the sales guidance sort of up 5%-10%. Sequentially as the previous question pointed out was kind of what I think we were all expecting anyway. This does look like it moves maybe into 2022. How do we handle SGNA during these next 3 quarters to try to keep our earnings propped up?

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

That's a good question. As you look from the numbers, we've pretty much been able to hold or reduce SGNA over the last 4 or 5 quarters, even despite other kind of pressures that would normally increase SGNA. We expect to continue to do that. We continue to want to drive a lot of leverage. And in fact, we expect to see SGNA as a percentage go down over the course of the year. That is something that we're working on. Clearly, our investments in R&D we think will drive future growth. We're committed to those. Some of the other headwinds are seeing the need for transitory. They're going to last in a period of time. And as we continue to execute our synergy plans, both [in OpEx] as well as the heavylift that we have felt complete by the end of the year. And in manufacturing, we think broadly speaking, we're back on our target model of growth. Even as we exit this year and going into early next year.

Operator

Your next question is from Pavel Molchanov with Raymond James.

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

In the context of the industry-wide supply tightness, I'm curious if that broadens the potential target list for acquisitions, given that some of the smaller players, especially in the industrial vertical, might be suffering particularly in this current climate.

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

No, I really haven't thought about it that way, but I guess that would be the synergy, right? That we can come in and buy a smaller company and exercise are leveraging in the supply chain. But just the general comment, we continue to be opportunistic, we continue to look for companies to acquire. And so I think you'll see us stay active in that area, looking for companies that have strong technology, strong technical teams, sticky products intended to be proprietary. We'll be looking for companies that are exposed to semiconductor industrial and medical opportunities.

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

More kind of thematically, is there anything in the Biden infrastructure proposal that would be directly relevant, impactful to your business that you can see?

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

I think the most interesting part for us is the additional investment semiconductors. So you see that happening basically trying to establish a stronger USB battery base. And if that happens, then obviously that creates even more demand for something that can process power solutions. So yes, we're very enthusiastic about that part.

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

Right. And maybe some of the industrial verticals, you've sold into metallurgy and sort of glass and other things that could benefit from a more active industrial policy.

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Yes. I'm not really familiar with the details. That'd be on someone else at this point, but I hope you're correct.

Operator

(Operator Instructions) Your next question is from Paretosh Misra with Berenberg.

Paretosh Misra - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Steve, as you look at the cost structure at advanced energy, especially your manufacturing footprint at the different facilities that you have. And I know you haven't had that much opportunity to look at that, but do you see the opportunities for further optimization or cost cut that could drive a market expansion?

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Yes, so basically we have 3 centers of excellence in the company for manufactory: one's in China, one's in Malaysia and one's in the Philippines And we are in the process of consolidating our Chinese factories into one location. So we'll be exiting Chengde by the end of this year, I think. You're probably familiar with that process. I think moving forward, we're very comfortable, having China, Malaysian and the Philippines in place and our approach to there will be to try to fully utilize each of those factories. And the good news is if we get to that point, we have the ability to expand our operations in each of those sites. So I think we're pretty well positioned.

Paretosh Misra - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Understood. And maybe as a follow-up, if you could talk a bit more about your industrial medical segments as to what you're seeing. In other words, the rich of the 2 sub-segments, industrial versus metal, you're seeing faster growth, any sense on revenue or any particular end market are you seeing strong orders and strong revenue growth?

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

I'll make some general comments about industrial medical. The reason I like those 2 markets so much is they tend to be, smaller or medium-sized companies, smaller or medium size opportunities, but each opportunity typically wants something a little bit different. So we start with our standard products or configurable products, and then we tune them to the customer's need. And that creates a very good relationship between AEM and the customer. It creates a very sticky product situation. So typically these applications are very long life cycle applications. And so once we get those ideas to share for many years, so we're going to continue to scour the market and look for more of those types of opportunities.

Operator

Your next question is from Weston Twigg with KeyBanc Capital Markets.

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

First, I just wanted to start with gross margin, last quarter I think you said it would exceed 40% for the year. You're gutting it down a little for Q2 and you didn't mention that again. So I just wanted to get your thoughts on the gross margin in the back half of the year and if you still think you can hit that 40% target equity in a year.

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Yes, I think what we said was that as we executed our manufacturing consolidation that we believed we could exit the year sort of at that 40%, but it was out of reach. That's still I'd say bodily our goal, but certainly, in terms of logistics and some of the supply chain constraints that's a headwind that we didn't see a quarter or 2 ago. We think that transitory is not going to last and how long it's going to last is less clear. So we think that those headwinds are maybe 100 to 200 basis points. I mean, I would say that more than even what we spent last June with COVID, reimbursement and other things with COVID. Supply chains are very full and logistic channels are very full. So in the interim, we're going to face these headwinds but, put those aside, and as we finish our manufacturing consolidation. We feel confident we'll be able to be on that target model.

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

Okay. Yes, that makes sense. And then just when you talk about revenue growth in the second half, can you help us understand which are the stronger growth segments relative to the first half? So is it semi? Is a data center, et cetera? If you could help us understand which ones are growing a little faster in the second half and driving that upside, that would be helpful.

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Yes. The good news is we've seen strong growth in all sectors, quite frankly. So we see semiconductors full speed head, essentially. The customers we have in many sectors are very bullish about demand in the second half into 2022. So our challenge there is just going to be keeping up with their demand. Obviously, I've come in on data center, you see that coming back strong in the second half. Industrial medical is going through a recovery phase and we think that's going to be very strong. I think the only market where we may not see as far a growth is probably telecom and networking; I think will stay steady there. Again, as we focus on 5G designs, I think most of that revenue would probably come in 2022-2023.

Operator

I see no further questions at this time. I turn the call back to Steve Kelley for closing remarks.

Stephen D. Kelley - *Advanced Energy Industries, Inc. - President, CEO & Director*

Thank you very much for joining us on the call today. You see increasing demands across all of our target markets for the rest of 2021. And although supply issues are limiting our size in the second quarter, we see increased commitments from our suppliers in the second half. That by hopes that we can enter the year at very high velocity. Thank you very much.

Operator

This concludes this conference. You may now disconnect.
