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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for joining us for this Advanced Energy First Quarter 2022 Earnings Conference Call. (Operator Instructions) Also, please be aware that today's meeting is being recorded.

To get us started with opening remarks and introductions, I am pleased to turn the floor over to Vice President of Strategic Marketing and Investor Relations, Mr. Edwin Mok.

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

Thank you, operator. Good afternoon, everyone. Welcome to Advanced Energy's first quarter 2022 earnings conference call. With me today are Steve Kelley, our President and CEO; and Paul Oldham, our Executive Vice President and CFO.

If you have not seen our earnings press release, you can find it on our website at ir.advancedenergy.com. There, you also find our earnings slide presentation.

Before I begin, I'd like to mention that we will be participating at several investor conferences in the coming months.

Let me remind you that today's call contains forward-looking statements that 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 can be found in our SEC filings. All forward-looking statements are based on management's estimates as of today, May 4, 2022, and the company assume no obligation to update them. Medium-term targets and long-term aspirational goals presented today should not be interpreted as guidance.

On today's call, our financial results are presented on a non-GAAP financial basis, unless otherwise specified. Excluded from non-GAAP results are stock compensation, amortization, acquisition-related costs, restructuring expenses and unrealized foreign exchange gains or losses. 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. Good afternoon, everyone and thanks for joining the call. First quarter revenue and earnings per share exceeded guidance, largely due to good manufacturing execution and our ability to secure additional key components. Our shipments into the semiconductor market were particularly strong. Demand is robust across all of our target markets, and our order book is at an all-time high.

To mitigate the impact of a dynamic supply environment, we will continue to maintain full staffing levels at all of our factories, so that we can react quickly when scarce components become available. We will also continue to purchase components on the open market at a premium, when we can't find those components through normal channels. And finally, we will continue to address intractable supply issues through alternative sourcing and redesigns.

This aggressive approach to staffing, procurement and component qualification is paying off in the form of higher shipments to our customers over the last 6 months. There are significant incremental costs associated with our mitigation efforts. But we think our approach makes sense for Advanced Energy and for our customers. And I would like to thank our customers for partnering with us to absorb some of those incremental costs.

Although we spend a lot of time talking about parts shortages, let me assure you that our primary focus continues to be the development of new technologies and products which provide value to our customers. These technologies and products are critical to our future revenue growth and financial performance.

In the first quarter, we launched differentiated products into multiple markets, grew our opportunity funnel and won designs in many proprietary applications. In addition, we recently completed the acquisition of SL Power Electronics, expanding our product portfolio and broadening our customer base in the medical and industrial markets.

Now I'll provide more color on the operating environment. In the first quarter, we overcame a number of COVID-related manufacturing challenges, including an Omicron wave in Malaysia and the regional shutdown in Shenzhen. The operations team's quick response to the changing environment allowed us to exceed our quarterly production goal despite the COVID headwinds.

To mitigate supply issues, we continue to qualify alternative ICs and more necessary, redesign entire circuit boards. Customers are partnering with us in these efforts and we are grateful to their support.

I would also like to note that most of our suppliers are keeping up with our demand despite the challenging supply environment and their performance is much appreciated.

Now I'll provide further color for each of our target markets. In the first quarter, revenue from semiconductor customers exceeded $200 million, a new milestone for the company. We expect sales into the semiconductor market to grow sequentially in the second quarter and to continue growing in the second half of the year. Given that outlook, we are confident that AE can grow semiconductor sales faster than the overall wafer fab equipment market in 2022.

We are making good progress developing technologies and products for applications such as dielectric etch, remote plasma source and panel-level packaging. These efforts represent upside opportunity for Advanced Energy and will help drive long-term revenue and market share growth for the company.

In the industrial medical market, first quarter revenue grew year-on-year. Demand is strong and our order book increased in the first quarter. We secured a number of important industrial and medical design slots in the first quarter with notable wins in electro surgery, life science, test and measurement and vehicle charging applications.

During the first quarter, we launched the LCM4000, a high-efficiency, high-density power delivery system, particularly well-suited for indoor farming and large-scale commercial lighting applications. This highly differentiated solution will enable our customers to reduce both installation costs and operating costs. Key customer interest in the LCM4000 has already resulted in several large orders.

Now I'd like to touch on our recent acquisition of SL Power, which we believe makes Advanced Energy a top tier player in the medical power market. We like the medical market because it offers steady secular growth, long product life cycles and sticky proprietary designs. Medical customers demand highly reliable solutions built on certified lines with customer features. SL Power is a well-known supplier of customized power solutions for leading medical device and equipment makers. Roughly 75% of their revenue is derived from sole sourced products. And its portfolio of low power medical products dovetails nicely with Advanced Energy's high-power solutions. With almost no product overlap, we see a lot of opportunity for cross-selling.

Concluding the market commentary, our revenues in the data center computing, telecom and networking markets were up year-on-year. We see continued strong demand in all of these markets.

In summary, as demonstrated over the last 6 months, we are gaining momentum as a company. Our operating tempo is good. Our new products are gaining traction and our team is energized.

With a strong focus on innovation, new product development and customer satisfaction, Advanced Energy is well positioned to deliver sustained profitable growth in the coming years.

Paul will now review our financial results and provide detailed guidance.

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

Thank you, Steve, and good afternoon, everyone. We delivered first quarter revenue and EPS above the high end of our guidance ranges. The results reflect good execution, our ability to secure additional key components, increased factory output and partial recovery of material cost premiums. Demand continues to be strong and our backlog grew another 9% to a little over $1 billion. However, the supply chain continues to pace our revenue and earnings performance. As a result, we will continue to plan prudently, but we remain optimistic that we are on track to deliver our annualized earnings target of over $6 per share as we exit the fiscal year.

Now let me go over our financial results. First quarter revenue of $397 million grew 13% year-over-year and it was up slightly from our fourth quarter. Revenue from the semiconductor market was a record $203 million, growing 12% from last year and 13% sequentially. Strong demand and our ability to recover after significant COVID impacts in Malaysia and Shenzhen allowed us to deliver upside to our initial target.

Looking forward, we anticipate semiconductor revenue to grow sequentially in the second quarter and in the second half of the year. In addition, we are investing in further capacity and production flexibility. This should enable our throughput and capacity in Malaysia to continue to increase every quarter, and we have extended our Shenzhen plant closure to the end of the calendar year.

Overall, we expect to significantly increase our semiconductor capacity over the next few quarters, which should allow us to meet our customers' long-term demand as the supply chain improves.

For the first quarter, demand in our other markets was also strong and overall backlog increased. However, revenue was paced by supply of critical components as expected. Sales into the industrial and medical market were $83 million, up 6% from a year ago, but down 16% from our record Q4. Data center computing revenue grew 29% year-over-year to $76 million, but declined 5% sequentially; and telecom and networking revenue was $35 million, up 6% from last year, but down 9% from the fourth quarter.

First quarter gross margin was 36.6%, up 110 basis points from last quarter on slightly better mix and higher factory output. Compared to last year, gross margins declined 310 basis points, primarily due to higher material costs and factory inefficiency in the current environment.

Premium recoveries, which reflect costs that we've been able to pass onto our customers but at 0 margin alone accounted for 180 basis point impact to gross margin. We expect the higher material costs and related premium recoveries will continue to negatively impact our results in the second quarter. However, we believe that these costs will gradually come down in the second half of the year based on our mitigating actions and some normalization of the supply chain.

Operating expenses were $87.6 million, up approximately 2% from last quarter. The sequential increase was due to investments in R&D, partially offset by lower SG&A expense. Operating margin for the quarter was 14.5%. Depreciation for the quarter was $8.4 million and our adjusted EBITDA was $66 million, up from $63 million last quarter.

Non-GAAP other expense was $2.1 million, including $1.3 million of interest expense and $500,000 of foreign exchange losses. We continue to expect non-GAAP other expense to be in the $2 million range going forward.

Our non-GAAP tax rate was 16%, slightly above our target of 15%. The increase was due to a change in U.S. tax rules, effective at the beginning of the year, partially offset by a favorable tax credit. Looking forward, we now expect our GAAP and non-GAAP tax rate to be approximately 19%. Compared to our prior target, this will impact our quarterly earnings by approximately $0.05 per share.

Earnings for the quarter were $1.24 per share. This compares to fourth quarter EPS of $1.36, which included a large year-end discrete tax benefit. Excluding this benefit, last quarter earnings would have been $1.21 per share.

Turning now to the balance sheet. We ended the fourth quarter with total cash, including marketable securities of $524 million and the net cash of $136 million. Cash flow from continuing operations was $10 million. The lower operating cash flow was due to higher net working capital, which increased to 120 days.

Inventory on a dollar basis increased 7% sequentially and turns were 2.8x. We continue to expect some upward pressure on inventory in the near-term as we prioritize meeting customer demand while pursuing shortages of critical parts. However, inventory turns should normalize as the supply chain improves and shipments increase. Days payable declined slightly to 65 days and DSO increased to 56 days, largely due to timing.

During the first quarter, we invested $13.1 million into CapEx, made debt principal payments to $5 million and paid $3.8 million in dividends. In addition, we repurchased $6.6 million of common stock at $80 per share as part of our opportunistic share repurchase program.

Before I talk about guidance, I want to provide some financial details on the SL Power acquisition. As we announced, last week we completed the acquisition of SL Power Electronics for $145 million on a cash free, debt free basis, using the cash we have on our balance sheet.

SL Power adds approximately $65 million of pro forma revenue on an annualized basis. It is a profitable business with operating margins in the mid-teens and we expect to realize approximately $4 million of cost synergies once we fully integrate the operations. With the highly complementary product portfolio and customers, we believe there are meaningful cross-selling synergies which will accelerate our growth in the medical and industrial markets.

Now let me turn to guidance. Our second quarter results will continue to be paced by availability of critical parts, including additional risk from the ongoing COVID lockdowns in China. As a result, we expect Q2 revenue to be approximately $395 million, plus or minus $25 million. Our Q2 guidance assumes semiconductor revenue will continue to grow sequentially and it includes a partial quarter revenue contribution from SL Power.

As we guided previously, we expect Q2 gross margin to be approximately flat to Q1 with similar mix and material cost premiums. We expect operating expenses to be in the $93 million to $95 million range on annual salary increases, continued R&D investment and the addition of SL Power, which adds $3 million to $4 million to our OpEx for the quarter. Including the higher tax rate of approximately 19%, we expect Q2 non-GAAP earnings per share to be $1.05, plus or minus $0.30.

Before I open it up for questions, let me make some additional comments beyond the current quarter. As I mentioned, the operating and supply chain environments remain challenging, and our revenue and financial results are being paced by supply of critical components. However, we are executing well and are making progress in our supply mitigation efforts. Demand and our backlog position are strong and we are investing in further capacity and flexibility to increase output as the supply chain improves. As a result, we continue to believe that we are on track to deliver annualized EPS of greater than $6 per share by Q4 with higher earnings potential in 2023.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll hear first from Quinn Bolton at Needham & Company.

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

Congratulations on the nice results. March was the second quarter where you guys were nicely above guidance on your ability to get component supply. And I'm wondering if you could just give us your updated thoughts on component availability or things starting to loosen up or have some of your efforts to go out secure components on the open market really been the source of upside in the near-term, just kind of thinking about when do you think component availability starts to get more predictable?

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

Yes. Quinn, this is Steve. Good question. I think it's a daily battle essentially. We get upsides, we get downsides literally every day from our critical IC suppliers. We've been fighting this battle for more than a year. So I think we're getting a bit better at it. So you've seen some of the results of our efforts as we do various channels and brokers, I think that's part of it.

The other part is, we've been working pretty hard on alternative qualifications as well as board redesigns to get around some of the more intractable supply issues and our customers have been working very closely with us to qualify those solutions quickly, and so that's also played a part in our success in the last 2 quarters, and we see that these alternative solutions will play a bigger role moving forward in 2022. That's why we're optimistic about the second half.

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

My second question really for Paul. It sounds like you're reiterating your guidance for $6 of annualized EPS. And I think in past quarters, that was sort of on our revenue run rate of something a little bit north of $400 million. I guess my question is your backlogs up now to over $1 billion. It certainly seems like if you can get component supply that the natural run rate of revenue would be well above that $400 million level. I want to ask you to say when that might happen, but am I right to think that when you're no longer paced by component issues, the revenue could be nicely ahead of $400 million on a quarterly basis for several quarters?

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

Yes, I think that's exactly right, Quinn, and it really comes down to how available the materials are, and also what we have to pay for them. We have a little higher revenues now, but part of that is these premium recoveries where we have more revenue, but it's essentially at a pass through costs. So over time, I'd expect that would decrease, the actual product revenue will increase and that's where you get some of the lift in gross margin as sales improve as well. But you're exactly right, it will be paced by the availability of parts and we're doing everything inside the company to put ourselves in a position to get as many parts as we can, as well as be prepared as those parts become available to deliver quickly to our customers.

Operator

Next, we'll hear from Mehdi Hosseini at SIG.

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

When I look at your reported March revenue moving forward to include or exclude the impact of SL Power, you were still able to have north of $20 million of revenue. And I'm just curious how should I think about that upside driven by our ability to procure components in the open market versus other factors, if you can help us to discuss other factors? And I have a follow-up.

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

Yes, Mehdi, let me just make a comment there. I think there are 2 main factors that helped us in Q1. The first was indeed our ability to source more components and to put some work around into play. But the second was our ability to react quickly to the COVID slowdown in Malaysia and the COVID shutdown in Shenzhen. And so the factories recovered very quickly and actually exited the quarter at a very high operating tempo. So the combination of good execution, factories and improved procurement of parts really allowed us to hit the number in Q1.

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

Yes. And I appreciate the execution, operational execution, but what is interesting is that it seems like the component's availability is there if you're willing to pay a premium, especially if you were going in the open market?

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

Yes, I think that's true at some level. There is a lot of components that we go after that we don't actually get. So it does come down to both what's available and as Steve said, I think we've gotten pretty adept at trying to get what's out there, but really that's the limiting factor. And of course, that's very hard to predict because the shortages are also dynamic. We think you're covered in some cases, and then there should be commit or something and you're having to find parts quickly. So it continues to be a dynamic environment. I think again that we were able to do better this quarter in getting parts, and our factories were then able to quickly turn those into product despite the COVID headwinds.

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

Sure. Okay. And as my follow-up, now that you're on track to head north of $400 million of the quarterly revenue and exiting the year at annualized earnings of $6 and with more than $10 of your cash per share, why not become aggressive with capital return?

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

Last year, we did buy quite a lot of stock back. You'll see we did buy some stock back this last quarter and our opportunistic share repurchase plan continues to be one of the tools that we have. And as every quarter, we'll assess on a variety of factors to determine how aggressive we should be with that repurchase program.

Operator

Our next question today comes from Steve Barger at KeyBanc Capital Markets.

Robert Stephen Barger - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

I just want to make sure I understand the guidance. The midpoint of the revenue guide, would you put you back at record levels like 4Q and 1Q? And in those quarters, non-GAAP EPS averaged about $1.30 per quarter. You're guiding to $1.05 at the midpoint. I hear you on tax rate that could be an echo, but what are the other factors that will drive operating margin lower sequentially on higher revenue?

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

Yes, I think there is a couple of factors, Steve. The first is that in that roughly flat revenue or slightly higher, does include partial quarter of SL Power. So that's revenue that helps us in Q2, but as you know, it comes with full cost structure. So it's not leveraged revenue, if you will. So if you exclude that, our product revenue, it's actually we're projecting it a little bit lower in Q2 than we got in Q1. I think that's the biggest thing. So you're just getting a little bit of headline benefit of the acquisition.

Now over time, as our organic revenues increase because there is more parts and of course we'd expect that fall through to occur, but that's the biggest factor.

Robert Stephen Barger - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Got it, okay. And order rates for specialty industrial equipment were strong through 1Q, just broadly speaking, and all the commentary from the companies that have reported suggested trends remain strong in April and really no cracks in demand. So understanding that we're going to layer in SL Power into industrial and medical, just how are you thinking about organic growth in that segment for 2Q or the year, if you could?

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

Yes, Steve. The organic growth in I&M is quite impressive. The only thing holding us back right now are critical parts. And I think some of the shortages we have in I&M are more acute than what we've seen in semiconductor. So there has been a real focus on trying to procure parts for the industrial medical business and we're very sensitized to it, but there's a lot of pent-up revenue and profit and our current backlog for the industrial medical markets.

Robert Stephen Barger - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

I guess if you could explain on the supply side, can you talk about what the order rates were year-over-year in I&M?

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

I can say that our backlog went up in the first quarter. So we continue to receive orders in excess of what we could ship.

Operator

Our next question today comes from the line of Paretosh Misra with Berenberg. I do hope I said your name correctly.

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

Yes, that was perfect. Can you talk about the mix in your backlog a bit? Is the mix similar to your revenue mix or it's heavier on your semiconductor business?

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

Yes. In general, I'd say it's a very healthy mix. Broadly speaking, I'd say it's more healthy than our average revenue mix. Broadly I'd say over 80% is either semiconductor or industrial medical products.

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

Got it. And then how should we think about the output at your Shenzhen facility between now and the end of the year given your current plan?

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

Yes. So we -- as a reminder, we decided to keep open the Shenzhen plant through the end of this year. And so, the reason we did that is because we need the capacity and I can say that today the Shenzhen plant is doing an excellent job with output. In fact, it's the highest we've seen output in many quarters.

So we expect that they're going to be a solid contributor over the course of 2022. And at the same time, we're bringing up our production in Malaysia. So we're setting new output records every month at our Shenzhen facility and we're getting more efficient and increasing output on a regular basis. So we think we're in good shape on the semiconductor production side.

Operator

(Operator Instructions) We'll hear next from the line of Krish Sankar at Cowen & Company.

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

I had a couple of them, actually. Paul, did you mention in your guide of $395 million, how much is SL Power contributing?

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

We did mention it specifically, but it's about $65 million to $66 million annualized if you look at last year's results and we close the transaction in the last week of April. So you can kind of roughly do the math to get an estimate of the contribution.

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

Got it. All right. And then on your June guidance, you clearly said that semi should grow sequentially. And if I layer in the fact that SL will help and then is it fair to assume that semi and I&M growth sequentially while telecom and data centers down in June?

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

Yes, let me comment here, Krish. Our guide is substantially better than what we guide in Q1, but it's less than what we actually delivered in Q1. And really what's going on is there are couple key uncertainties that we deal with every quarter. One of the critical IC decommits an upside. So it's very difficult to predict.

The second one we have that we're dealing with this quarter are the COVID lockdowns in China. And it's really hard to precisely quantify the impact of these lockdowns. We know they are impacting various parts of our supply chain. They're not impacting our factories, but they are impacting our suppliers. And so we did take a bit of a cautious approach to our Q2 guidance.

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

Got it. Super helpful. And then just a final question. Steve, you mentioned in the past I think it's been almost the good part of the last 6 months or so about dealing within paying a premium or a massive premium with the third-party broker, I'm just kind of curious when I look over the last month or 2 months or 3 months, would you say that the amount you paid to those brokers, has it been going up or has it been flat or do you think it's actually rolling over from what you paid like a few months ago?

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

It's a good question. As Steve said, it's sort of the day-to-day battle. So I think we're a little cautious about trying to find trends. But in generally, I'd say there is indications that the incoming rate of those is getting better, maybe not what's coming in the door, but what we see out there is maybe trending better and that's part of what leads us to conclude that we are on track to what we said earlier that towards the latter part of the year, we should see these things coming down. So I don't want to get ahead of myself too much just because it's a dynamic environment.

Steve already commented on the China, COVID lockdowns and the impact on the supply chain. So -- but we're cautiously optimistic perhaps that those are starting to improve.

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

Well, I mean maybe if I can squeeze one lastly, Paul. Based on what you just said in your comments that Q4 exit run rate for our EPS should be over $6 plus annualized. But in the past you said that gross margins shouldn't check In the second half. Should we still assume it or do you think gross margin inflection is more Q4 story rather than a Q3?

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

Yes, it's a good question. I think, as we thought about that gross margins in total will be up in the second half, but you should really think of it as a more of a Q4 than in Q3, maybe some modest improvement in Q3, and then more in Q4. But look, you're hitting on exactly the key issue. To the degree that these premiums can subside, that's going to help us. And the question is, is that sooner or later. And our best view is when we get the most benefit of that is closer to Q4, but we are seeing some signs that it could be modestly improving.

Operator

Hans Chung with Balyasny (sic) [D.A. Davidson].

Mon-Han Chung - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

This is Hans Chung from D.A. Davidson. So I think my first question is, it's very encouraging like regarding your commentary on the semiconductor business to go to outpace the WFE outlook this year. So can you kind of elaborate like what's the underlying driver is more like the share gain totally or it's more like we have the component critical parts to be available, so we're able to ship and we're going to ship that to fill the -- ship to backlog, or it's just maybe new part rents and something like that, just anything there would be helpful?

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

Yes. Let me just answer your question in 2 parts, Hans. So your immediate question is what's driving our optimism for this year in our growth story as we go through the remaining quarters of 2022. And that's simply tied to 2 things. The first is, we're expecting improved parts availability based on our activities and the second is our factories operating tempo is quite good and we expect to sustain that for the remainder of the year. So I think that's really going to drive our growth as we accelerate through the course of 2022.

But when it comes to market share, in our business in semiconductor, it tends to be over years that we measure market share because we are trying to win design slots in new equipment from the major equipment makers. And then if we win the slot, we hit that business for many years afterwards. So the share really doesn't shift that much on a monthly or quarterly basis. It shifts over the course of years. And so what we're doing there is we're defending our current position in conductor etch, which is our strongest area, has been for quite some time. But we're also planting seeds in new markets. So we have new products that we've launched into the dielectric etch market, into the remote plasma source market, into the flat panel market. So we think that by doing this, we can increase our served market essentially and really drive our growth in 2023 and '24.

Mon-Han Chung - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Got it. That's helpful. So and the next question, just can you provide some colors around the end market in industrial medical or the data center to account? It seems like they imply same quarter guidance basically, these combine will decline sequentially. And I just want to know like, are all these going to decline sequentially or -- ?

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

I think the only way to thinking about this, Hans, is that it's all a function of supply. We have huge pent-up demand in all the markets you just mentioned, whether it's industrial medical, data center and telecom networking, you name it. We have a very solid order book in all of those markets. And so, as we get parts, we will be able to maximize our output, but this has nothing to do with demand. It's all about supply right now.

Hans? Operator, we're ready for the next question.

Operator

Gentlemen, apologies for the delay. Once again, Mr. Chung, please re-signal to complete your question. We'll move forward to Graham Price with Raymond James.

Graham Frederick Price - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

I guess, just quickly on the SL Power acquisitions. You've highlighted the cross-selling and integration synergies there. Just wondering kind of how quickly you see those playing out? And then just more broadly, how the margins for the acquired business compare to the legacy business?

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

Yes. So let me just make a comment about the integration and how we intend to exploit the sale synergies. So first, we've taken a very strong approach to integration, immediately the factories of SL Power reporting directly into our Chief Operating Officer and their sales force is reporting directly to our Chief Sales Officer. And then the remaining people at SL Power, the engineering, marketing and support people are reporting to the former President, Russell, who now has responsibility for all of the medical power products that AE makes, not just the SL Power products, but also the Advanced Energy products. And together, we think the unconstrained demand there this year is well over $100 million. So it's a good size business for us and it makes us to top tier player.

Like I said in my script, we think the medical market is a good space for us, it's high mix, it's low volume. It's mostly sole source business and that's right in our wheelhouse essentially. So what we're going to do moving forward is we're basically training our sales force. The SL Power sales force to sell AE products and the AE sales force to sell SL Power products, and we have a particular focus on medical accounts and the secondary focus on select industrial accounts. And we think together, we could do a very good job cross-selling. Because SL Power was strong at accounts where we weren't, and we're strong at accounts were SL Power wasn't. So we think it's a very good match. And I actually visited there Friday last week, went down to Calabasas and welcomed the SL Power team to Advanced Energy and -- there's a lot of energy, a lot of positive energy from the team down there. I think it's going to be a very good match between Advanced Energy and SL Power.

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

Yes. Maybe just to comment on the business model, I'd say the financial profile coming out of the gate is very similar to Advanced Energy. They've built pretty similar products, they are in differentiated markets and still you look generally we already mentioned operating margins are in the mid-teens. It's pretty similar to AE today. Gross margins are around 40%, so again pretty similar. And as we combine the organizations, as Steve said, there's a lot of opportunity to grow the business. And with that and the other integration actions, there's opportunity to grow, I'll say, the bottom line or earnings, probably faster even in the top line. So I think it's a very natural fit and a lot of opportunity for us to grow in the medical market as we go forward.

Graham Frederick Price - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Got it. And then for my second one just kind of a housekeeping one. You mentioned the income tax rate going forward will be 19%, which looks like just not the highest than it's been in a few years. So I'm just trying to get a little clarity on what's causing that?

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

Yes. There was a change in the U.S. tax law that was effective at the beginning of the year that essentially requires companies to capitalize their R&D expenses rather than to expense them. This was something that was put in place back in 2017 as part of the Tax Cut and Jobs Act. That became effective. Obviously, it didn't impact us as much in the first quarter because we had some other benefits. But looking forward, it's about a 400 basis point impact.

You can probably do some reading about it, it's affecting all companies particularly technology companies, and I think there is some hope overtime that or maybe even expectation that that will get rolled back or repealed. But at this point, that's the current tax law, so that's what reflected going forward.

Operator

(Operator Instructions) Mr. Chung, apologies for the audio issue earlier. Please go ahead, Your line is open once again, sir.

Mon-Han Chung - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Okay. Yes, just quick one. So can you give us some sense about the gross margin impact from the high premium paid for the second quarter? I know you gave the 180 basis point for first quarter, but what about second quarter?

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

Yes. We didn't guide to that specifically, but in my prepared remarks, we said that we expected those premiums, the premiums and related recoveries to be about the same as it was in Q1, the level of those things.

Operator

And we have no further signals from the audience at this time. I am pleased to turn the floor back over to Mr. Steve Kelley for any additional or closing remarks.

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

Thank you, operator. And I'd just like to recap our key messages. First, demand for our products is very strong. Second, we are on track to deliver solid operating results in the second quarter and even better results in the second half. And finally, we are squarely focused on developing innovative technologies and products for our customers. And thanks for joining the call today.

Operator

Ladies and gentlemen, this does conclude today's Advanced Energy first quarter 2022 earnings call. We thank you all for your participation. You may now disconnect your lines. Have a great day.
