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PRESENTATION

Operator

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

(technical difficulty)

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

Thank you, operator. Good morning, everyone. Welcome to Advanced Energy's Third 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, the 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 also find a slide presentation to follow along our discussion today.

Before I begin, I would like to mention that AE will be hosting a virtual investor event on Monday, December 14. We welcome all of you to join us at this event. In addition, we will be participating at multiple investor conferences in the coming months. As events occur, we will make the announcement.

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 for future performance. Information concerning these risks and uncertainties is found in our filings with the SEC. All forward-looking statements are based on management's estimates, projections and assumptions as of today, November 5, 2020. And the company assumes no obligation to update them. Long-term targets present today, which include our aspirational goals and the integration targets should not be interpreted as guidance.

On today's call, our financial results will represent on a non-GAAP financial basis unless otherwise specified. An explanation of our non-GAAP financial measures as well as reconciliations between GAAP and non-GAAP measures can be found in today's press release.

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

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

Thank you, Edwin. Good morning, everyone, and thank you for joining us on this call. Overall, this was an standing quarter for Advanced Energy with record revenues, earnings and operating cash flow. We delivered sequential revenue growth across all of our market verticals, and recorded new quarterly highs in semiconductor, data center computing and service. Good operating leverage and continued execution on our synergy goals, resulted in gross margins approaching 40% and non-GAAP earnings per share, up over 3x from last year, validating our financial model and demonstrating our ability to accelerate earnings growth.

Overall, demand for our products continue to be strong, driven by ongoing investments in technologies associated with the data economy, great execution by our operations and supply chain teams enabled us to catch up on COVID-related delays and respond to the first of demand. During the quarter, we continued to ramp our Malaysia factory, which is next to one of our leading customers, as we integrate and optimize our global operational footprint.

It provides us with business continuity and resiliency in meeting our customers' demand in a dynamic operating environment. In addition, we continue to execute on our integration plans, delivering synergies and record accretion from our Artisan acquisition. We expect additional synergies to be realized through 2021, as we execute structural changes in our manufacturing and supply chain. Beyond cost synergies, we have started to secure new cross-selling design wins across both semiconductor and industrial end markets, and we expect those means to drive incremental revenues in 2021. We continue to invest aggressively in R&D, which enable us to win multiple design wins across all markets and to launch 6 new products across different portfolios during the quarter.

These new wins and new offerings are expected to generate continued growth for AE going forward. Turning now to our products and performance by market. As I mentioned, semi revenue was a quarterly record, growing nearly 15% sequentially and over 70% from last year as we continue to meaningfully outperform the market and our semi peers. Service revenue also reached record high, driven by improved fab utilization across multiple reasons and strong demand for upgrades and retrofits.

We believe process power has become one of the fastest-growing subsystem segments within the semi equipment supply chain. As the market leader with the broadest product portfolio, end market and customer exposure, we are gaining market share with design wins for many critical processes. The combination of strong market growth and our share gains are driving our semi revenue to grow faster than all of our semi peers in 2020. For example, our advanced RF matching technologies are getting adopted in multiple advanced edge and deposition process tools, resulting in revenues growing over 120% year-over-year in Q3 after doubling in Q2.

Our remote plasma sources revenue grew again this quarter and is on track to double in 2020, resulting in double-digit millions of dollars of incremental revenue. In Q3, we have secured a dielectric etch design win at one of the leading OEM suppliers. And in Korea, we won several designs for memory and advanced packaging deposition applications. We believe our continuing investment in product development will enable us to capture an expanded pipeline of opportunities in new and exciting areas, including additional wins in dielectric etch.

Looking forward, we expect semi revenue in Q4 to remain strong. Long term, with our design wins, growing power content and a favorable market trend, we believe we are well-positioned to continue to outgrow the market. Revenue from our industrial and medical markets increased by nearly 23% sequentially, driven by increased factory output to deliver on strong backlog and general improvement in the industrial markets. For example, in industrial, demand for consumer electronics coating and motion control applications improved.

Revenues from medical applications remained strong, driven by continuing demand for critical care applications. Noncritical care applications also began to improve, but remained well below pre-COVID levels. This quarter, we secured multiple design wins across a wide range of medical diagnostic, imaging and therapeutic applications. Of note, we won a sole source position for a next-generation diagnostic blog analyzer at one of our leading medical customers, and our power solution was designed into new air filtration system for preventing the spread of COVID.

As we look forward, we expect the industrial and medical markets to continue their modest recovery with revenue around current levels in Q4. Our data center computing revenue hit another quarterly record in Q3, up 5% sequentially and 91% year-over-year. Despite industry headwinds of data center dejection, and a generally weak IT spending environment, new design wins and growing share have enabled us to meaningfully outgrow the market.

In hyperscale, revenue was down slightly from a record quarter in Q2 but jumped 380% from last year. Revenue from a third hyperscale customer helped to offset initial digestion from our earlier wins and we made good progress in winning new businesses from additional hyperscalers that should contribute to revenue next year. Although revenues in this market to be lumpy quarter-to-quarter, we remain confident in the long-term market growth and our ability to outgrow the market. Demand from enterprise OEM customers recovered in Q3, partially due to our ability to deliver to customer needs and capture market share.

In addition, one of our prior design wins into high-performance computing platform started to way. We expect HBC to be a secular driver for our business going forward, given that our industry-leading product power density is the ideal solution for meeting the high power, high-density requirements for those server racks. Looking forward, our data center computing revenue is expected to remain at elevated levels and well above last year's run rate. However, we anticipate digestion in the data center market to impact our revenue in Q4.

We expect growth to return likely in 2021, driven by additional investment in data center with the releases of new CPUs and accelerated by our share gains. Telecom and networking revenue grew over 18% sequentially as the market improved modestly from the trough levels in the first half of 2020. Q3 revenues also benefited from some catch-up shipment from our backlog and incremental share gains. Data center networking remains a bright spot in this market as data traffic shifts from enterprises to the cloud due to remote working trends. In addition, during the quarter, we secured a critical design win in a next-generation cloud networking platform that will support revenue growth as the industry migrates to 400-gig networks.

In the telecom market, overall investment remained limited, although our mix of products sold into 5G applications has risen considerably in 2020, large-scale infrastructure investment in 5G outside of China continue to be delayed. Looking forward, Q4 revenues are expected to come in around these levels as market signals remain mixed. Long-term, our efforts in winning 5G and next-generation networking designs prepare us to capture the market's recovery as global 5G infrastructure investment accelerates.

In summary, our Q3 results serves a clear validation of our strategy and our business model. This strategy has enabled us to deliver industry leadership, revenue growth, innovation, synergies and earnings. I'm extremely proud of our global team who have responded to the myriad challenges this year to deliver outstanding financial and operational results while ensuring a safe environment for employees. I would also like to welcome our new -- 2 new board members and Anne DelSanto and Lanesha Minnix, who add complementary industrial market knowledge, experience and capability to our Board.

As we continue to deliver on our strategic goals, we are realizing our vision of being a leading industrial growth company with a diversified revenue base, strong growth drivers and top-tier financial results. As we look forward, near term, we see increased risks due to the new waves of coronavirus, but longer term, we see 2021 setting up to be a growth year for AE.

Although we see some variations quarter-to-quarter, we expect to continue to grow our earnings, driven by our momentum in semi, share gains in hyperscale and macro recovery in industrial markets and global 5G investments, combined with our continuing efficiency gain, portfolio optimization and synergies. We are planning an investor briefing in December to discuss our progress to date, a deeper dive into our newer markets and an update to our aspirational goals. I'd like to thank our customers, shareholders

(technical difficulty)

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

Thank you, Yuval, and good morning. Before I begin, please note that all financial measures presented today will be on a non-GAAP basis, unless otherwise stated. Excluded from non-GAAP results are amortization, stock compensation, integration and transition costs, unrealized foreign exchange gains and losses and restructuring items.

This quarter, we recorded $5.6 million of acquisition-related costs related to the Artesyn acquisition and transition. We also recorded $3.5 million in noncash, unrealized FX losses related to long-term lease and pension liabilities. A full reconciliation from GAAP to non-GAAP measures can be found in our press release issued earlier today. As Yuval mentioned, this was an exceptional quarter as we delivered record results across a wide range of financial metrics.

Strong execution by our team to meet our customer requirements and increased demand for our products enabled revenue and EPS to surpass the high end of our guidance ranges. In addition, we achieved an annualized return on invested capital of over 25%, and our cash balance increased by over $48 million.

Perhaps most significantly, our financial performance validates our business model and demonstrates the leverage in our operation as we execute our strategy to accelerate earnings growth. Third quarter revenue was a record $390 million, up 15% from $340 million last quarter and 122% from a year ago.

We saw sequentially stronger demand across all our markets and a burst of order activity at the end of the quarter that we were able to deliver to our customers' short lead time requirements. In addition, we were able to ship backlog created during early 2020 due to capacity supply constraints, reflecting roughly half of the upside to our guidance in the quarter. On a pro forma basis, including a full quarter of Artesyn revenue in prior periods, Q3 revenue grew 35% year-over-year. Excluding Artesyn, organic revenue grew 12% sequentially and 50% year-over-year to $201 million.

Turning to revenue by market. Sales in the semiconductor in Q3 were $167 million, up nearly 15% from a strong second quarter and up 73% year-over-year with good demand across foundry, logic and memory. Revenues were up 70% on a pro forma basis. Both semi product and service revenues were a quarterly record. Overall, we are growing faster than our peers and the overall market, with sales in both RF matches and RPS more than doubling year-over-year.

Revenue from our industrial and medical markets was $87 million, up 23% sequentially as a result of modest market improvement and catch-up of backlog. On a pro forma basis, revenue declined 11% year-over-year as a result of ongoing general weakness in several of our industrial sectors, exacerbated by the COVID-19 crisis.

Data center computing revenue was $88 million, up 5% from the second quarter. On a pro forma basis, sales were up 91% year-over-year, another quarterly record for the company. Hyperscale revenues declined slightly from record levels in Q2 as cloud digestion began, but was still up almost 5x from last year.

Enterprise OEM revenues grew both sequentially and year-over-year, driven by share gains and increased demand from prior design wins. Telecom and networking revenue was $48 million, up over 18% sequentially. On a pro forma basis, revenues were nearly flat year-over-year. Non-GAAP gross margin for the quarter increased by over 100 basis points sequentially to 39.8%. Margins benefited primarily from better fixed cost absorption on higher volume, partially offset by increased other cost of sales following a favorable quarter in Q2.

Importantly, we are beginning to see the benefits of our synergy actions, including portfolio optimization and cost improvements shine through as volumes increase, validating our business model. Although gross margin is expected to decline slightly on lower volume in the coming quarters, we continue to make great progress on our goal to improve sustainable gross margins to greater than 40% as we complete our synergy and consolidation plans over the next year. Non-GAAP operating expenses were $78.9 million, up $1.1 million from last quarter, primarily due to ongoing investment in strategic R&D programs and innovation.

Expense as a percentage of sales decreased by over 250 basis points versus Q2 to just over 20% of revenue and in the top quartile of our peers. Overall, we achieved 19.5% operating margin, reflecting 45% incremental margins or operating leverage from last quarter. As a result, non-GAAP operating income improved to $76 million, up 41% sequentially and another record for the company. Non-GAAP other expense was $2.4 million, including $1.1 million of interest expense. We expect total other expense to be in the $1.5 to $2 million range going forward. Our non-GAAP tax expense was $9.8 million or 13.3%, primarily as a result of favorable mix of foreign earnings and the integration of Artesyn into our tax structure on a year-to-date basis. Looking forward, we now expect the GAAP and non-GAAP tax rate to be in the 15% range.

Non-GAAP earnings for the quarter were a record $1.66 per share, up 41% from $1.18 last quarter on higher revenue margins. Earnings per share was up over 200% from $0.54, 1 year ago, demonstrating our goal of accelerating earnings growth. The Artesyn acquisition contributed meaningfully to our financial results. To date, we have achieved annualized synergies of over $30 million and earnings accretion over the past 4 quarters of over $1 per share. In addition to achieving our Phase 1 synergy targets ahead of schedule, we continue to find new opportunities for efficiency improvement as we integrate into a combined functional organization. Phase 2 of our synergy plan is well on its way, and we remain confident in meeting or exceeding our long-term targets of over $40 million of annualized synergies and over $1.50 per share in annual EPS accretion.

Turning now to the balance sheet. We ended the quarter with cash and marketable securities of $431.6 million, up $48 million from Q2. Receivables increased slightly on higher sales. The DSO improved 7 days to 55 days on fairly linear shipments during the quarter. Inventory decreased by $3 million and turns were 3.7x. Payables were $159 million, representing 61 days of DPO. Total days of net working capital were 93, down 4 days from last quarter.

The business continues to deliver excellent cash generation. Operating cash flow from continuing operations was $67.5 million, our highest level ever. Free cash flow from continuing operations was $56 million in Q3 and year-to-date free cash flow was $110 million. Capital expenditures for the quarter were $11.8 million, and depreciation was $7.2 million. The higher than normal CapEx in this quarter was due to a onetime investment in facilities to support expanded capacity in our Philippine operation.

Overall, we expect capital expenditures to remain about 2% to 3% of sales in line with historical levels for Advanced Energy. During the quarter, we repaid $4.4 million of principal amortization on our debt, ending with total bank debt of $326.3 million. Our trailing 12-month gross debt leverage decreased to 1.34x, well within our target range of 1 to 2x. During the quarter, we also repurchased approximately $4.3 million of stock at an average price of $59.70 per share.

Now let me turn to guidance. Overall, in the fourth quarter, we expect demand to continue to be solid across our vertical markets. We expect semiconductor revenues to remain strong, with second half of 2020 growing 15% to 20% above first half levels. Revenue for data center computing applications is expected to be lower in Q4 as we see overall market and customer-specific digestion, following several strong quarters and share gains. We expect demand and revenue in industrial and medical and telecom markets to remain relatively stable.

Factoring in the limited visibility and ongoing operating and macroeconomic risks related to COVID, we are guiding Q4 at $360 million, plus or minus $20 million. Based on anticipated volume, mix and ongoing COVID-related costs, we expect non-GAAP gross margins to be in the 38% to 39% range. Operating expenses are expected to be about flat. As a result, we expect non-GAAP earnings to be $1.30 per share, plus or minus $0.20.

In summary, we expect that 2020 will be a very strong year for Advanced Energy, as we have grown both organically and achieved our integration and financial performance goals related to the Artesyn acquisition ahead of schedule. Based on the midpoint of our guidance, second half 2020 revenue growth would be nearly 15% over first half of 2020, and full year revenue would be up 17% from 2019 on a pro forma basis. Earnings per share would be up 42% from the first half and more than double for the full year, demonstrating our goal of accelerated earnings growth.

In addition, our financial performance in the third quarter illustrates that our long-term financial targets of over 40% gross margins, and over 20% operating margins are achievable. Our strategy of being a pure-play power provider to industrial growth markets is enabling key competitive advantages and our continued focus on improving our operations to drive further revenue growth and profitability. Looking forward, while timing of orders and market dynamics may drive some quarter-to-quarter variation, we believe overall demand for our products remains solid. And 2021 is setting up to be a good growth year for AE with multiple drivers across our verticals.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Scott Graham with Rosenblat Securities.

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

So I have a couple. Could you evolve -- talk a little bit more about the high-performance computing and calling that a secular driver, this is a ramp of a win/how -- even if you could just give us some type of parameter for how big that is within data center computing and I guess it's important enough where you listed it on this page. So if you can maybe give us more color on that?

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

So I think it's a trend right now as we see migration to high-performance computing, driven by increased focus on AI, aptitudinal intelligence, machine learning and more focused on edge computing. These applications are requiring significant amount of power, their power hogs. And we are well-positioned, and specifically in this area because of our high-efficiency of power conversion, power density and our solutions provide a competitive advantage when it comes to the actual total cost of ownership of the asset. Now I cannot comment on the size of the market. I'll ask maybe, Edwin, if you have any information about the size of this market, but it's definitely a trend that will continue to grow, and we are well positioned to benefit from this growth. Edwin?

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

Yes. So this particular one, we won this design on enterprise OEM who has a high-performance (inaudible) platform that they are rolling out, right? But I think the whole idea is that as things move forward, there are more AI or machine learning applications being adopted and you hear from module company talk about high-performance computing as an area that will grow, right?

And as I grow, as you all suggested, those server and those systems typically come of substantially higher power, which then higher power density becomes a more critical primer as important for this. And that's an area that we believe we have an advantage. That's why we're winning this all.

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

Got it. That's very helpful. Paul, one question for you. You talked about a sort of a onetime or expected nonrecurring benefit in the third quarter to gross margin. And you said something about -- I'm sorry for missing this, that half of your upside in the quarter was due to something, end of quarter shipment or something along those lines. Could you clarify both the gross margin and all of that comment as well?

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

Yes. Sure, Scott. So on the revenue obviously we had an outstanding quarter, even above our guidance range that we gave before. What we said on the call is about half of that upside came from catching up backlog from earlier in the year, that essentially was a result of operational supply constraints related to COVID. So that was better than we thought we could do. So we had a really good quarter, and that's why we wanted to call that out. In particular, to catch-up on that backlog. Now if you look at our backlog numbers, they were still quite strong because we were able to fill some of that in at the very end of the quarter due to the strong demand we saw.

The second comment on gross margin, what we said is the sequential improvement from last quarter was largely the result of higher volume. And what it illustrates, though, is that some of the underlying improvements we've made in portfolio, rationalization as well as cost are really shining through. As you saw this quarter on a non-GAAP basis, margins are almost 40%, which is close to our goal. Even though we haven't completed kind of our Phase 2 structural changes for -- around cost to sales and supply chain and some material cost savings that we think we can achieve over the next year or so.

So it wasn't really any onetime item in gross margin, it's more the benefit of volume, but we're seeing the actions we're taking underneath that really, really starting to come through, which gives us a lot of confidence about our ability to get to 40% gross margins over the long run as we see good volumes in the business.

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

One comment about the quarter is our ability to respond very quickly to changes in volume and mix, and that allows us to deliver to customers when they need it and addresses various demand in Q3.

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

Yes. One last quick one, if you don't mind. Could you just briefly talk about -- you're saying that the telecom and networking market, you're expecting that to get better. I thought you said late in '21. Is that simply a pushout of your customers of their 5G spending? Is that what that is tied to that comment?

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

I think we said later in 2021, not late in '21. We basically -- basically talking about data center computing, will recover in late in 2021. Telecom networking, we came from a trough, and we see some recovery, although because of the geopolitical situation, and delay in some investments in 5G infrastructure, we see some pushout into next year.

However, we are very excited about 5G. And to make sure that people don't misunderstand us, 5G drives growth in all of our verticals, not only in telecom network and the networking. Telecom networking at the 5G products we sell in telecom networking go to the base stations and the radio towers. However, 5G in general drives increase in semiconductor devices, which drive increase in the need for semiconductor processing tools. It accelerates the migration to Industrial 4.0, that also increased the need for some of our advanced solutions for medical, for industrial, for automation, et cetera. So we are extremely excited about 5G. And we believe that the world is just the beginning of the adoption of 5G, and that will continue to drive secular growth for us for all of our verticals, not only the power supplies that go into the infrastructure.

Operator

Your next question comes from the line of Paretosh Misra with Berenberg.

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

Great. What is the medical component? How much is that within the industrial and medical business? And how are you looking for growth potential add for the medical part of that business?

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

Yes. Overall, we said last quarter that our medical is about $75 million, and it's been growing. This is an area we're excited about. If you go back 3 or 4 years ago, we had virtually no presence in this market, and we've been able to grow that both through products we've acquired and organic growth. So it's an area that we see of growth going forward.

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

And the growth phase, driven both by, I would say, short-term need, a burst of need for critical care applications like ventilators, and also some life science equipment that goes into a gene sequencing, vaccine development and testing.

Long term, we expect to see a continuation of the growth coming from the noncritical applications. And we mentioned just a few examples, and we became a social supplier for a blood analyzer and additional applications that go to diagnostic, imaging and also therapeutic applications.

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

Interesting. And then within the industrial part of that business, are there any specific end markets that you think have been a drag on growth? And any thoughts on when those slower growing or not growing end markets might recover?

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

So the beauty about the industrial market, the non-medical part, right, the industrial market, it's highly diversified. And that's the exciting thing about it because if you look at every application in the world, they could be lumpy and they could have cycles of investment because these are capital investments. So in this specific market, we see growth coming from a consumer electronic product coking, and these are a tribological coking or optical coking. We see increasing need for automation and motion control. And again, very broad. And I -- you should expect to see that product mix, market mix and application mix changes dynamically. But in aggregate, we expect to see this part of our business continues to grow at GDP plus.

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

Understood. And maybe if I could ask just last quick one for Paul. And just on your balance sheet and capital allocation philosophy, given where you ended up at the end of this quarter. Just any thoughts on how are you looking to deploy cash in the quarters ahead.

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

Yes. Clearly, our primary goal in cash deployment is to continue to grow the company. We've stated that, broadly speaking, we'd like to deploy roughly 70% of our capital to smart M&A to continue to build out our strategy as a pure-play power provider. And the balance we would look at as available to return to shareholders. We've done that historically and continue to do that through an opportunistic share repurchase program. It doesn't mean we're buying every quarter, but we're looking for opportunities that make sense to be in the market. And we did buy additional shares this quarter, as you saw stock dipped away with -- and to pick up a few shares. I think year-to-date, we've purchased something like $12 million or $13 million of stock through the first 3 quarters of this year. And that will vary by year, but that's our goal is roughly 70-30 split.

Operator

Next question comes from the line of Quinn Bolton with Needham & Company.

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

Congratulations on the results. I wanted to just come back to the semiconductor business and your comments about growing faster than peers. I think MKS talked about growing its power business over 100%, both in the quarter and I think year-to-date, which sounds perhaps faster than your overall semiconductor business. So wondering if you might be looking at apples and oranges here? Or just can you clarify your comments about your belief you're growing faster than peers? And then I've got a couple of follow-ups.

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

Sure. Thank you for the question, Quinn. I think you're not looking at apples-to-apples. I think you need to really take a deep dive and look at the definition of power. Now if you look at growth, I'm saying right now, categorically, categorically, we are growing faster than MKS. Q3 year-over-year, year-to-date, half -- second half versus first half and year-over-year.

And we'll be able to talk to you later, but show you some numbers. So we are growing faster than MKS in every category of growth comparison you look at. I don't know how they define power. The area that we compete with them categorically, we're growing more than they do, and we're gaining market share that drives that growth.

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

Okay. Paul, second question for you. You talked about catching up on backlog built earlier this year due to COVID supply constraints and for half of the upside in the third quarter. As you come into the fourth quarter, do you expect to catch up on additional demand? Or do you think with the third quarter upside, you're largely back now and all of that catch-up is behind you?

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

I think we're largely caught up from things that were delayed due to the supplier constraints and some of our operational challenges, particularly out of the Philippines. And most of that came out of the I&M and telecom side for embedded power type products. So we think we're largely caught up. Having said that, we continue to have a very strong backlog position because we continue to see good demand across our other markets. So we think that, that helps the quarter certainly. But we wouldn't expect to see that catch-up or a big backlog drawdown necessarily as we look forward.

Operator

And your next question comes from Mehdi Hosseini with Susquehanna.

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

Yes. I have a couple of follow-ups. And one as a follow-up to Quinn's question. I think it would be very helpful if you could give us an update on how you're increasing market share or presence in Japan, especially as it relates to semi cap. And I have a few follow-ups.

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

Well, maybe obviously we need to be very careful, very careful about customer information and our business size and activities of customers sites. We are definitely gaining share in Asia, including Japan and the areas that we are gaining share are related to etch and deposition. We see dramatic growth in general in our RF matching technology. And as you know, RF matching is sort of the glue between the power supply and the process. And it's an area that is extremely critical, especially as multiple frequencies are being used to drive advanced processes. We are the leader in technology in RF matching and our RF matches continue to be adopted across the board as an enabler for next-generation technology.

And that's the reason, if you go back to our prepared remarks, you can look at the growth rate we exhibit in the RF matching area, which is a phenomenal. Another area that we openly talked about is key to our strategy in semi first is remote plasma source technology. And our remote plasma source product line continued to grow significantly, and we expect the business to continue to generate incremental revenue for the future as we continue to gain share, both in Asia and also in other locations around the world. I hope that answered your question, Mehdi.

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

Absolutely. And I want to go back to some of your targets. You have highlighted consistently your desired goal of exceeding revenue target of $1.5 billion and cash EPS of $650 million. Your Q3 results despite the onetime adjustment to backlog from earlier this year, puts you above that run rate. And as you look into the future -- and I understand you're going to provide us an update on December 14, but as you look into the future, do you think that you're going to continue to exceed your targets organically? Or is this going to be a mix of organic growth and selective and opportunistic acquisition?

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

Yes. Those long-term targets that we talked about, Mehdi, do not include acquisitions. So that's our organic growth targets. To the degree we get additional acquisitions, we would see that as incremental to achieving those numbers. So obviously we're pleased with the progress we've made to date. I think we're ahead of schedule. And at the same time, there's more to do.

Certainly, around -- I'll say, the structural part of gross margin improvement. And we've always talked about Phase 2. It's well underway, and we expect to make really good progress on over the next year, which will continue to supplement our efforts to improve gross margin. But I think the encouraging thing or exciting thing for us is that with these higher volumes and the changes we've already made, you can see kind of a glimpse of the future. I mean we're approaching those numbers right before we've completed all the opportunities to drive improvements in the business.

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

Right, Mehdi, to maybe reemphasize 2 points here. Q3 is kind of a peak into the future, even before we completed all these synergies that will be realized in the integration of Artesyn and future synergies that will come after that. In addition to that, to the point that Paul made, we remain acquisitive. And the plan that we basically described to you when we put together our aspirational goals does not include acquisitions.

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

I just want to highlight that now, just one more -- one quick question regarding the momentum. You talked about how you see the different business units trending. But do you -- you can answer qualitatively or quantitatively, was your book-to-bill above 1.0, is it in Q3?

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

Yes. It's a tough question to answer because, as you know, our book-to-bill, we don't really have a book since a lot of our products, especially in semi, and to some degree, even the embedded power they're pulled. There's no order for them. They just get pulled from a jit, den or from a hub right, but on balance, I would say we feel our -- outside of maybe the catch-up in backlog. Certainly, our book-to-bill is at least 1.0 higher.

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

And again, Mehdi...

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

Qualitative, qualitatively.

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

Right. And Mehdi, as you know, significant portion of our business is based on long-term purchasing agreements. And not purchase orders that are being placed every week or every day. So these are long term, and it's a demand flow of technology, our customers pull our products from hubs when they need them.

Operator

Your next question is from Tom Diffely with D.A. Davidson.

Thomas Robert Diffely - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Yuval, I was hoping you could talk a little bit more about the cross-selling opportunities. It sounds like you've had a little success now. And if you could highlight where that's coming from and what's the opportunity is, that would be great.

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

Thank you, Tom. Yes, cross-selling, as we mentioned earlier in previous quarters, started to realize itself faster than we predicted. And we see an increase in number of applications that we can serve with our embedded power products, and we have launched a unique product called IHP at SEMICON West that goes into multiple platforms in the semi industry and in this case, Tom, it's auxillary power, it's not process power.

Now it doesn't, mean that it's not important. These power supplies, if they do not operate, then the whole machine doesn't move. So these are really important power supplies with unique capabilities that serve the global platform, not only inside the fab, but also outside of the fab in the back end of the process, testing and packaging.

So this is an area that we continue to drive in semi, but we also see additional growth coming to industrial applications as we start moving products from different product lines that basically belong to either native AE or native Artesyn. We're now cross-selling them to different markets. So it's an area of significant potential incremental growth and drives a lot of excitement. What we bring to the table in some of these applications, our global footprint, our global manufacturing capabilities and support infrastructure around the world with our high-density and high-efficiency of conversion plays well into those who start looking into efficiency of power and performance locally around the world. So we're very excited about that. And we view that as one of the no -- revenue synergies associated with the recent acquisition.

Thomas Robert Diffely - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Okay. Are these situations where you have to catch the product release cycle, so it takes a few years before this gets fully integrated into the opportunity?

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

Well, in some of these cases, I would say, yes, it's similar design cycle. However, we had a few cases when we were asked to step in and help a customer to displace an incumbent that could not perform. An incumbent that could not perform either because of COVID-19 or could not perform because of issues related to their operational supply chain, at that point, our resiliency allows us to very quickly derivatize products to our customers' needs and will come back with a plug-and-play solution to help our customers.

Thomas Robert Diffely - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Great. Okay. And then as a follow-up, Paul, I'm wondering on the capacity side of your business, with a couple of segments reaching record levels, do you have the capacity to already handle, call it, a double-digit growth in Semicap next year or adding a couple of new hyperscale customers? Or would you have to add capacity?

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

No. It's a good question, Tom. We believe we do have capacity to things that have constrained us this year have been, I'll say, COVID-related restraints, just the ability to get people into the factories. As well as supplier constraints. And that's been the challenge. We certainly have physical capacity to continue to grow both in semi and data center across the board.

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

Yes. It's a great question, Tom. We expect our industry to continue to have -- to continue to grow, but we may see quarter-to-quarter variations driven by our customers' demand profile. So we have designed a plan for managing bursts. And we have the capacity, we have the test equipment, we have the fixed cost in place already and variable costs will vary with the volume. So we expect not only to be able to address the capacity increase, but also to do it in a very efficient way financially.

Operator

Your next question is from Pavel Molchanov with Raymond James.

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

Obviously the election results are still a little fluid by let's assume for the sake of argument that there will be a change in administration. And in that context, a different approach to trade with China specifically. What impact, if any, would the ending of the trade war have on your business?

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

It's a good question, Pavel. Obviously that's -- it's a difficult one to answer because there's a lot of dynamics. But look, broadly, I think the effects of the trade and tariff for so far have had not a lot of effect on our business directly. Because we have a global footprint, we are global customers, we haven't seen a big impact.

Speculatively, with a change in trade policies, improved overall economic growth and trade in that regard. And I think that's probably good broadly for the economies in general and for our industry probably as well.

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

Yes. Our global footprint, Pavel, allows us to deliver to our customers globally and manufacture close to where our customers are. So in that sense, we haven't seen dramatic impact thus far on our business with restrictions. And for that reason, we expect to see -- unless there is an increase in geopolitical landscape that will increase GDP across the board, which will benefit us, we don't expect to see dramatic changes.

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

Understood. Let me turn to the service revenue. In a certain sense, you're kind of a victim of your own success. You have so much product sales now that service as a slice of the revenue mix is now less than 10%. I know you've talked in the past about kind of building up your recurring revenue stream. And in that context, is that something that would be relevant to vis-à-vis M&A, acquiring any kinds of service or perhaps software businesses if that's relevant to create or...

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

Yes. So Pavel, let me make a comment and maybe clarify something for you relative to the comment you made about our declining service as a percent of total revenue. Significant portion of our service revenue comes from our process power business from what we call the advanced power or native AE, if you may.

And the reason for that these are extremely sophisticated and extremely expensive products. And when they need treatment or repair or calibration, normally, they're being shipped back to us to our labs around the world, and we take care of them and ship them back to our customers because the value of the asset is so high.

In the embedded power business that came through the acquisition, many of these power supplies are not being repaired when they fail, they're being replaced. So it doesn't generate service revenue, which generates product revenue. And it's just a matter of category. Our native service business continues to grow with our installed base, and we expect the business to continue to grow, and we accelerate the growth of this business by offering service products like upgrades, retrofits, refurbishments, et cetera. So that will continue to grow, but the decline in percentage of sales total revenue is a result of the product mix.

Now going to the outlook. We launched our power insight offering. We're making an investment and progress in providing software products to our customers that are adjacent to our core products and provide our customers with unique capabilities like big data analytics, predictive maintenance and process diagnostics. That will continue, and our aim is to continue to grow this business and to offer that, these software products to the market first, in semi, but later in industrial and telecom networking as well.

Operator

And your next question is from Krish Sankar with Cowen and Company.

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

I had two of them. First one, Yuval, when I look at your semi cap revenues or shipments compared with your peers and contrasted to your customers like Lam, it clearly looks like your growth rate is much higher than theirs. And I understand that your customers are also building some buffer inventory because of COVID, but do you worry that at some point next year, this should normalize and your semi cap growth rate could slow down, especially as your shipments catch up with your customers?

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

Do you want to answer that, Paul?

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

So look at -- we anticipate -- I'm trying to be careful not to predict the market for you. I'm not trying to be a market analyst. But we are prepared and have the capability to manage and respond to changes in volume and mix. And we believe that we are going to see over the long-range of the industry growth we're not going to have every quarter up into the right in the industry. We're prepared for that.

Now the other thing that I believe that happened, especially in Q3, we had a burst of demand. It was really a demand to deliver faster and quicker. And we have the capacity, we have, the operation -- operational excellence to be able to respond to this demand.

Now I'm sure that scoring your question, you're asking about inventory building in the industry. And I can tell you that there is some of that -- some of that inventory building in the industry that some of it was driven by the -- I would say, the trade war and the restrictions of shipments. But it's not significant to the point that it will impact us dramatically going forward.

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

Got it. Yuval, that's very helpful. And then just as a follow-up on the data center side of the business, you spoke a lot about the hyperscale segment and your traction there. I'm kind of curious to see on the other part of the data center, which is the enterprise spending. How do you see that business trending looks like it budgets are down this year? And how do you expect enterprise to trend into next year?

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

So let me address the hyperscale first. We are -- we believe that we are in the third inning of our journey in basically designing our products into the top hyperscalers, right? And if you look, based on the information we have shared with you earlier over the last 3 quarters, we have recently got set at the ramp of our product shipments into a third hyperscaler.

At the same time, we're making great progress in designing our products into additional hyperscalers. Now if you look at right now where we are in a journey, we're still highly concentrated in just a few hyperscalers. Now we believe that in the short term, we're going to see digestion in the hyperscale, a market as some of the hyperscalers basically use the inventory that they acquired.

And as we look at the market, and I think in our prepared remarks, we said we expect to see resumption of growth coming in 2021. We expect when a market recovers to do better than the market because we continue to gain market share. And we continue to gain market share as a fast follower because of our unique product offering with very competitive energy conversion efficiency and power density.

On the enterprise area, right now, we see IT spending is still slow, but high-performance computing will become a driver for the enterprise computing space, and that's why we highlighted this area. We are excited about it because we see more investment in the high-performance computing. New CPUs from Intel and AMD, we believe, will also be a catalyst to a cycle of investment in 2021, and we're looking forward to participate in this recovery.

Operator

And your final question comes from Weston Twigg with KeyBanc Capital Market.

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

I just wanted to follow-up on the burst of order activity that you mentioned at the end of the quarter and just mentioned in the last comment. Why doesn't this burst in demand carry through to Q4 guidance? In other words, why is Q4 were down if order activities picking up -- was picking up at the end of Q3. I'm just kind of wondering if you add some color there, like which kinds of customers we're doing it. Why it's sort of temporary?

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

Yes. It's a good question, Wes. To clarify, when we look at that surgical as we saw, we think that was largely prepositioning of inventory to kind of get ahead of seasonal shipment patterns and some of the geopolitical near-term geopolitical items that you've all just talked about by some customers, not all but by few. Overall, we -- despite that, we expect semi to still stay strong. That's what we said in our comments in Q4.

So that's not necessarily what's driving our guidance. We also said that we don't expect this kind of catch-up from backlog that we got through earlier in the year to repeat in Q4. And that helped Q3 quite a bit. And then secondly, we also said the data center is going to be lower based on customer-specific and industry digestion.

So those are the primary drivers. Obviously, there's risks around COVID and other environmental things that continue on. We've largely managed those. But the 2 big items that lead to lower guidance is just, we don't expect that backlog catch up to repeat. And we'll see lower impact, lower on data center. That's the digestion in the data center market that's behind a lot of that.

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

Okay. That helps. And then the other follow-up question I have is just gross margin. The guidance is quite good, 38% to 39%. But you talked about growth in industrial, medical, telecom over the next few years. And I'm just wondering if the semi -- part of the semi demand growth this year was inventory restocking and you see the other segments grow nicely next year. Do you have a gross margin headwind in 2021 that might drive it below that 38%, 39% range? Or could we -- could you see that maybe staying in that range or getting better through the year next year?

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

Yes. Obviously mix can have some impact. But look, if you look at this year, semi is up, but so as our embedded power products are up and our gross margins are up in both areas. The impacts that we're making from a synergy perspective and consolidation perspective, are having -- they're having the desired effect. And as we look into next year, we'll see some more improvements.

So on balance, I'd say the answer to your question is no. We think we can continue to drive gross margins. But there could certainly be some mix impact if you saw big swings in the relative 2 markets.

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

So just to clarify, you think gross margin could trend up through the year, generally speaking, but with some mix variation?

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

Yes. Generally speaking, yes.

Operator

I would now like to turn the call over to Yuval Wasserman for closing remarks.

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

So thanks, everybody, for joining us today. Obviously we're extremely excited with the progress the company is making. We're extremely excited about our future projections and the future of this company. Both -- we have 4 areas of excitement, semi, data center, medical and 5G. And we expect those to drive continuous growth for the future for the company in the future.

We're gaining share, and we are continuing to expand our presence, invest in new products that allow us to accelerate our penetration to new applications and markets. I'm looking forward to seeing many of you in December when we will provide you a deeper dive analysis of the growth trajectories, the applications, targets we serve and update on our aspirational goals. Thank you very much.

Operator

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