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Advanced Energy Industries, Inc. (AEIS)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Advanced Energy Fourth Quarter 2024 Earnings Call. At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. [Operator Instructions] And as a reminder, this conference is being recorded.

It is now my pleasure to introduce to you, Edwin Mok, the Vice President of Strategic Marketing and Investor Relations. Thank you, sir. You may begin.

Edwin Mok

Vice President-Strategic Marketing & Investor Relations, Advanced Energy Industries, Inc.

Thank you, operator. Good afternoon, everyone. Welcome to Advanced Energy fourth quarter and full year 2024 earnings conference call. With me today are Steve Kelley, our President and CEO; and Paul Oldham, our Executive Vice President and CFO. You can find today's earnings press release and presentation on our website at ir.advancedenergy.com.

Before we begin, 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, February 12, 2025 and the company assumes no obligation to update them. Any targets beyond the current quarter 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 our non-GAAP results are stock compensation, amortization, acquisition-related costs, facility expansion and relocation costs, restructuring and asset impairment charges and unrealized foreign exchange gains or loss. Please refer to a detailed reconciliation between GAAP and non-GAAP result in our press release today.

With that, let me pass the call to our President and CEO, Steve Kelley.

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

Thanks, Edwin. Good afternoon, everyone, and thanks for joining the call. Today, Paul and I will discuss our fourth quarter performance, highlights from 2024, our first quarter outlook and our 2025 priorities. We delivered strong financial results in the fourth quarter. Revenue of \$415 million exceeded the high end of our guidance range and returned the company to year-over-year growth. Pockets of higher demand in Semiconductor as well as strength in Data Center Computing drove the outperformance.

Fourth quarter gross margin was 38%, our best performance in three years. We benefited from higher volume as well as improved factory efficiency. Fourth quarter earnings of \$1.30 per share were above our guidance and grew year on year. Before providing more details on the fourth quarter, I'd like to review our 2024 performance.

From a financial standpoint, we hit a low point in the first quarter of 2024 due largely to soft market conditions. From that point forward, our revenue improved every quarter. Data Center Computing rebounded strongly in the second quarter as our design wins ramped to volume spurred by demand for AI compute capability. Data center demand continued to increase in the second half and remains very strong.

Semiconductor revenue also grew over the course of the year as we capitalized on a variety of upside opportunities. The Industrial and Medical, Telecom and Networking markets were headwinds to revenue in 2024. The I&M market underperformed due to lackluster demand as well as elevated inventory levels at both distributors and end customers. As expected, Telecom and Networking revenue reverted to more normal levels after a very strong 2023.

In 2024, we made major strides on the new product and design win fronts. We launched 35 new platform products in 2024. In addition, we developed many custom and modified standard products in close cooperation with our customers. In Semiconductor, we continued to experience strong customer pull for our best-in-class eVoS, eVerest and NavX products. We shipped more than 250 qualification units by the end of last year and are experiencing continued strong demand this year.

In 2024, we began to reap the benefits of our move to a modular architecture. The typical development cycle time for new derivative products has been compressed from roughly 18 months to less than 4 months, which is enabling our customers to deliver solutions faster than ever before. Another benefit is that shorter development cycle times are allowing us to engage in more opportunities. In Industrial and Medical, our momentum on the design win front continued to build fueled by a healthy stream of new products and an improved go-to-market strategy.

Our new customer friendly website is generating more opportunities and helping us to convert more of those opportunities into wins. In the Data Center Computing market, we accelerated our technology roadmap in 2024 and will continue to do so in 2025. This acceleration is tied to the increasing rack power requirements of each new

generation of AI data centers. We are working more closely with customers to develop technology which meets not just the needs of their next generation of products, but also the generation after that.

Key factors in our data center success are the ability to move fast as well as deep expertise in the design and manufacturing of highly reliable products with industry-leading power density and efficiency. In operations, we made significant progress on our 15 to 5 factory consolidation plan, a key part of our goal to move gross margin above 40%. On the M&A front, we acquired Airity, which brought critical GaN based high voltage power technology and expertise to AE. We are delighted with the acquisition and have already integrated Airity technology into some of our flagship products.

Now, I'll provide more color on the fourth quarter. In Semiconductor, fourth quarter revenue increased 15% sequentially, well ahead of plan as we experienced stronger yearend demand across multiple customers. New product shipments were strong, driven by evaluation and qualification activity for eVoS, eVerest and NavX products. At SEMICON Korea next week, we will launch another leadership product, a match-less RF delivery system based on the eVerest modular architecture. This new product called eVolve offers millisecond tuning, multilevel pulsing, a small footprint and no moving parts. We shipped eVolve qualification units in December and expect the technology to drive further gains for AE in both deposition and etch.

In Data Center Computing, fourth quarter revenue grew 10% sequentially driven by strength in hyperscale. This was a record quarter for Data Center Computing product revenue, and we see continued strong demand moving into 2025.

Fourth quarter Industrial and Medical revenue was sequentially flat as customers and distributors continued to work down inventories. Industrial and Medical new product and design win activity was robust. We launched 12 new I&M products, including a number of configurable power supplies. We won new designs in test and measurement, industrial production, electrosurgery and aerospace and defense. In the fourth quarter, we launched a new program with Sager, one of our largest distributors, to ensure speedy delivery of fully configured prototypes.

Now, I'd like to touch on our outlook for 2025. We expect first half 2025 demand to be roughly equal to second half 2024 demand. We believe that our full year 2025 Semiconductor revenue will grow faster than market due largely to initial new product ramps in the second half. We expect data center demand to remain robust in 2025 based on projected AI investments as well as customer adoption of our high-value solutions. In the Industrial and Medical market, we believe that we are close to a bottom and expect to begin growing again as early as the second quarter of this year.

I'd like to close by touching on our 2025 priorities. First, we will maintain our strong new product and design win momentum. We continue to invest heavily in R&D and go-to-market initiatives and expect those investments to drive increased share as market conditions improve. Second, we will largely complete our factory consolidation plan, which will give us a much better foundation to move gross margin above 40%. Finally, we plan to use our strong balance sheet to pursue strategic acquisitions, which will accelerate our growth in Industrial and Medical and broaden our technology portfolio.

At our recent Analyst Day event, we outlined a 2030 target model which calls for doubling our revenue, increasing earnings by 4 times and expanding gross margin to 43%. With a diverse set of attractive end markets, strong customer relationships, best-in-class technology and a highly capable factory network, we have high confidence in our ability to achieve those long term goals.

Paul will now provide more detailed financial information.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

Thank you, Steve. Good afternoon, everyone. In the fourth quarter, we executed well, delivered both revenue and earnings above our guidance. Upside in the Semiconductor and Data Center Computing markets more than offset ongoing sluggishness in Industrial and Medical. We continued to execute our manufacturing cost improvement initiatives and delivered gross margin at 38%, the third consecutive quarter of sequential increase. Lastly, cash flow from operations was \$83 million, just below last year's record Q4. Overall, despite a challenging start to 2024 and an ongoing inventory correction in the Industrial and Medical market, we finished the year on a strong note, delivering Q4 year-over-year growth in revenue, gross margin and earnings.

Now, let's review our financial results in more detail. Fourth quarter total revenue of \$415 million increased 11% sequentially and 3% year-over-year. Semiconductor revenue was \$227 million, up 15% from Q3 and 19% from last year with growth across products and service. We were pleased with our ability to respond quickly and capture additional yearend upside.

Industrial and Medical revenue of \$77 million was about flat quarter over quarter and down year over year. Channel inventories continued to be above target levels as market conditions remained soft. Data Center Computing revenue was \$89 million, up 10% sequentially and 41% year over year. Demand strengthened again as we started production ramps of new high power products. Excluding the revenue from premium recoveries during the supply chain crisis, data center product revenue reached a new record. Telecom and Networking revenue was \$23 million, down year over year, but up 20% sequentially as we ramped production of a new program that was pushed out from Q3.

Fourth quarter gross margin was 38%, up 170 basis points sequentially due to higher volume, favorable product mix and improved manufacturing efficiency. Gross margins in Q4 2024 were roughly 200 basis points higher than 2023 levels at a similar revenue run rate, as we are seeing the initial benefits of our gross margin improvement initiatives and improved mix take effect.

Operating expenses were \$102 million, up 5% from last quarter, driven largely by higher sales and incentive-related expenses and timing of a few items that we do not expect to repeat in Q1. Operating margin for the quarter was 13.5%, up 300 basis points from last quarter and 120 basis points from last year, demonstrating the margin leverage of our model. Depreciation for the quarter was \$11 million and our adjusted EBITDA was \$67 million. Other income was \$1.5 million, down as expected from Q3 on lower cash balances and interest earnings following the prepayment of our \$345 million term loan in late Q3.

Our non-GAAP tax rate for the quarter was 14.3% on favorable yearend discrete items. As a result, fourth quarter earnings were \$1.30 per share, up from \$0.98 per share in the previous quarter and a \$1.24 a year ago.

Turning now to the balance sheet, total cash increased by \$65 million to \$722 million with net cash of \$157 million. In the fourth quarter, we delivered close to record cash flow from continuing operations of \$83 million. Inventory days came down to 126 days in Q4 from 143 days in Q3. And inventory turns improved to 2.9 times. DSO decreased to 57 days from 62 days, largely due to timing of revenue and DPO remained flat at 50 days. As a result, net working capital decreased sequentially from 155 days to 133 days. During the quarter, we invested \$13 million in CapEx and paid \$4 million in dividends.

Before I move on to guidance, let me briefly review our full year results. In 2024, we delivered revenue of \$1.48 billion, down 10% year over year in a challenging market environment. The decline was driven by lower revenue in both the Industrial and Medical and Telecom and Networking markets, which were down 33% and 53% respectively. These results came after record years in 2023, followed by unprecedented industrywide inventory corrections in 2024. On the other hand, Semiconductor revenue grew 7% from the trough in 2023 and achieved its highest level in two years in the fourth quarter. In addition, data center revenues grew 14% and reached record product revenue levels exiting the year.

During 2024, we focused on positioning ourselves for faster earnings growth as markets recover. We reduced both fixed and variable costs and accelerated actions to optimize our manufacturing footprint. As a result, despite lower revenues in 2024, our non-GAAP gross margin was up 20 basis points year over year and we exited the year at the highest gross margin since Q2 of 2021. Our increased investment in R&D delivered significant wave of new platforms which have the potential to drive significant growth in revenue and market share over the next several years. This investment was more than offset by lower SG&A as we drove actions to improve efficiency and scale.

As a result, full year 2024 non-GAAP earnings were \$3.71 per share and our adjusted EBITDA was \$193 million. 2024 CapEx was \$57 million or 3.8% of revenue. We expect 2025 CapEx to run at or above these levels as we invest in ramping several new platforms and execute our plan to scale the company to support long-term growth. However, longer term, CapEx should normalize back to historical levels as we complete these investments.

Turning now to our guidance. We expect Q1 revenue to be approximately \$392 million plus or minus \$20 million. The sequential change is mostly driven by the outperformance in semiconductor and data center in Q4 as well as seasonal factors that we discussed on our last call. While lower than Q4, our Q1 guidance is substantially above last year and higher than previous expectations. We expect Q1 gross margin to be approximately 37% to 37.5%, down slightly quarter over quarter on lower volume. We're pleased with our improvement in gross margin over the past several quarters and expect to see additional improvements in the second half as we complete the product transfer process and close our China factory by midyear.

We expect operating expenses to come down to \$98 million to \$100 million on sequentially lower sales related costs and timing of expenses from yearend, partially offset by ongoing investments in R&D and other critical programs. We expect Q1 other income to remain in the \$1 million to \$2 million range. As a reminder, our tax rate is expected to increase to around the 19% range beginning in Q1 due to the Pillar 2 global minimum tax regime. As a result, we expect Q1 non-GAAP earnings to be \$1.03 per share plus or minus \$0.25.

Let me provide some concluding comments. Looking back at 2024, we're encouraged by the progress we made in executing our strategy, including delivering a record number of new products, capturing new design wins across our markets, improving gross margins and growing our cash position. Looking forward to 2025, we're excited about the opportunities ahead. While the market environment continues to be mixed with limited visibility to the second half, we believe ongoing progress on our strategic initiatives will define our future and position us for outsized growth in revenue and earnings over time.

We're driving adoption of our next generation semiconductor platforms to grow share, leveraging design wins and channel investment to capitalize as the Industrial and Medical market recovers and maximizing high end opportunities in AI-driven, high power data center applications. Executing our factory consolidation plan will allow us to further lower manufacturing cost, enable scale and achieve our gross margin goals. Finally, our strong balance sheet and cash flow give us ample capacity to make strategic acquisitions to add scope and expand our market position.

With that, operator, we will take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question and answer session. [Operator Instructions] And the first question comes from the line of Brian Chin with Stifel. Please proceed with your question.

Brian Chin

Analyst, Stifel

Q

Hi, there. Good afternoon. Thanks – congratulations and thanks for letting us ask a few questions. Maybe, first question, thinking about sort of the first half versus second half last year commentary, I think that might semi equipment maybe in the vicinity of sort of 10% year-over-year growth. And I know you talked about the potential to outgrow WFE, I recall, from earlier in the prepared remarks. And so, is that 10% year-over-year, even with an acceleration in the back half, as you suggested – is that maybe the right frame of reference in terms of the outperformance?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Hey, Brian, this is Steve. What we said basically is we were able to take advantage of opportunities in Q4 to really maximize the revenue in semiconductor. So, there were two real highlights in Q4. One was the semiconductor revenue. And the second was the data center revenue. As we move into Q1, we're seeing the semiconductor demand moderate a bit. And again, that's after a record Q4. As we move forward in the year of 2025, we haven't given a specific guidance, but we think the second half is better than the first half, largely because many of our new products are beginning to ramp to volume in the second half. And that's what's driving our confidence in our ability to outperform the market in 2025.

Brian Chin

Analyst, Stifel

Q

Okay. Maybe just to drill down one level. Clearly, some of your new design wins for eVoS and other next-gen supplies and matches should layer in over time tied to future technology transitions and equipment platforms. But can you clarify or confirm whether some of your early designs are closely aligned with the NAND market, where there clearly is some pickup in upgrade activity that's very etch and deposition focused? How do you see that contributing maybe to your equipment outlook this year?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

It's interesting because what we're finding is we've shipped over 250 of these evaluation units in eVerest, eVoS and NavX and that was through December of last year, and obviously, the demand continues into this year. But they're finding homes across all leading edge processes. The issue is customers using the older technology just can't get the job done, right. They're losing throughput and they're losing yield based on old technologies. So, that's forcing them to move to our new technologies and that's the same challenge whether you're talking about NAND, DRAM or leading-edge logic. So, we're seeing equal interest from all segments in those technologies.

Brian Chin

Analyst, Stifel

Q

Okay. Got it. So, maybe if I could just ask one more question, it's actually kind of financial related. There's clearly been a lot of talk and reporting about broader weakness in industrial. This isn't so much on your revenue side, but actually in terms of gross margins. I think semi-cap companies tend to be classified as industrial market for chip companies. And so, do you actually feel pretty good about the cost point and availability of chips you buy and integrate into your power subsystems? Are there opportunities to actually lock in favorable pricing and supply that supports your gross margin expansion targets?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

That's a great question. It's an issue we deal with everyday practically. And I would say it's hard to give a general answer. I think looking back over the last three or four years, we've divided our suppliers into two camps. One are the suppliers that supported us well during the shortages and the other camp is the suppliers that didn't support us very well at all. And I think we've basically focused more business with suppliers who have shown the degree of support we're going to need over time. Now, when it comes to pricing, I think there are market forces at work. And certainly, speaking generally, we see prices coming down. But the willingness to engage in price discussions varies from supplier to supplier. But obviously, it's a positive for us if the supplier is willing to move on price to keep us more competitive.

Brian Chin

Analyst, Stifel

Q

Okay, great. Thank you.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah, Brian, I just add on to that. I think at this point it's a little too early as we think about our gross margins plan to count on, I'll say, material improvements. As Steve said, there's a lot of discussions. And as you know, material costs are up, excluding premiums they're up from where they've been historically. So, this is an area we're working on and could potentially be a tailwind to gross margins over the year, but I think it's a little early to bake that in.

Brian Chin

Analyst, Stifel

Q

Okay. Thanks, Paul.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yup.

Operator: And the next question comes from the line of Krish Sankar with TD Cowen. Please proceed with your question.

Krish Sankar

Analyst, Cowen and Company

Q

Yeah, hi. Thanks for taking my question. Steve, first, on the traction you're seeing on eVoS and eVerest. I'm curious like you said it's across all markets, specifically on the etch side, where're you seeing more traction? Is it on the conductor etch or is it more on the dielectric etch where you're seeing more traction? And then I have a follow up.

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah, we're seeing traction in both areas because you have similar challenges where – I mean, the basic challenge we're seeing, whether it's conductor or dielectric, is the ability to drill deep holes with minimum damage to the wafer. So, it gets to throughput and yield. And so, what these technologies allow our customers to do is to increase their etch rate and to lower the defect rate as they implement these new leading edge processes. And so, I would say in general, we've seen strong interest from both conductor etch and dielectric etch applications.

Krish Sankar

Analyst, Cowen and Company

Q

I mean, is one better than the other or they kind of similar between conductor and dielectric?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

No, I think the difference really is power levels, so when the conductor etch doesn't require the same power level we see in dielectric, but it's the same basic technique that we bring to our customers.

Krish Sankar

Analyst, Cowen and Company

Q

Got you. And then as a quick follow-up, you kind of mentioned about strength in the second half in semis. I'm kind of curious what gives you the confidence, is it more – I mean, I'm assuming you don't have the visibility, but is it more just a design win traction pipeline or something else that's going on?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah, Krish, it's really design wins. We've had so much activity across our customer base over the last year and a half that we think some of this is going to start bubbling up into revenue in the second half this year. So, that's what gives us the confidence. I think the only statement we've made is we think we can grow faster than market. We don't know exactly what the market's going to be in the second half. But what gives us that confidence is our new products plus the fact that the etch and dep intensity for these leading edge processes continues to increase.

Krish Sankar

Analyst, Cowen and Company

Q

Fair enough. Thanks to that, Steve. Thank you very much.

Operator: And the next question comes from the line of Rob Mason with Baird. Please proceed with your question. Hello, Rob, your line is now live. Okay. The next question comes from the line of Scott Graham with Seaport Research. Please proceed with your question.

Scott Graham

Analyst, Seaport Global Securities LLC

Q

Hey, good afternoon. Congratulations on a terrific quarter.

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Thanks, Scott.

Scott Graham

Analyst, Seaport Global Securities LLC

Q

We wanted to understand your thinking around the share gains, you've spelled out the whys, the three big products, I'm just curious is – if you're thinking kind of like more second half oriented, which I think the entire market is on semi, would the share gains be more pronounced in the second half than the first as a result?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah, I think you're referring to semiconductor in particular, right, on the share gains?

Scott Graham

Analyst, Seaport Global Securities LLC

Q

Yeah. I thought I said that, oh, I didn't, yes.

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah. Okay. So, I think when it comes to market share in semiconductor, that takes time, right. Because there's a lot of puts and takes as you go through a year. And I think we commented on initial ramps of our new products in the second half and that's really what gives us confidence that we can grow second half versus the first half in semiconductor. I think what you'll see is our market share will increase over the coming three to five years across the board in plasma processors for semiconductor based on the strength that these eVoS and eVerest technologies. But it's going to take some time to materialize. That's just the nature of market share in semiconductor.

Scott Graham

Analyst, Seaport Global Securities LLC

Q

Understood. Thank you. I've got two other questions, if I may. The Industrial and Medical, that has been a very difficult business for you throughout the year, it looked like it didn't improve that much in the fourth quarter. I mean, I think I asked this question last time. If you were to pull out what your best guess was on the destocking aspect in both of those markets, kind of what would the year-over-year revenue would look like if you know?

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah, it's kind of a tough question to answer because we don't have perfect visibility. But I think one way to think about it is if you look at the Industrial and Medical market historically, you don't see the magnitude of change we've seen this year. And it might be more in the 5% to 10% range depending on the economic conditions or what's happening. We've seen much bigger gyrations than that. And if you listen to us and many of our peers and customers, you could say it's down 30% to 50% depending on who you are. We're probably on the better side of that.

But I think you can attribute that delta largely to the inventory situation which was caused by the supply chain shortage, which extended lead times and caused people to buy inventory based on those lead times. Now that those lead times have collapsed, they're working through that inventory. So, it's hard to handicap, but I think you can look at some historical levels to get some perspective on it.

Scott Graham

Analyst, Seaport Global Securities LLC

Okay.

Q

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

Yeah and maybe just a few more comments. We think we're just about through the correction because this is our sixth quarter of correction in Industrial and Medical. And so, what we've done over the past year and a half is redouble our efforts in that area to increase our design win funnel and to really set us up to gain market share as the Industrial and Medical market recovers. And we think that's going to happen – start happening this year. And we think when we come out into 2026, we're going to have a higher market share than we did last year in Industrial and Medical.

A

Scott Graham

Analyst, Seaport Global Securities LLC

Okay. Just the last one, I hope you don't mind my sneaking in. We've been waiting on an acquisition in I&M for some time as you went to the debt markets almost I guess it was like five quarters ago. And I think you've been waiting on an opportunity as well. Is it that those businesses just need more critical mass? I'm thinking that the answer to that is no because you're in so many different areas. But what is your perspective on that? Is it a critical mass thing? Because I know you're saying that your peers are down 30% to 50%. I'm not seeing those numbers. So, I was just kind of wondering from that perspective, is it possibly also critical mass thing?

Q

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

Yeah, mainly, just comment on the Industrial and Medical market because I think I'll answer your question maybe in an indirect way. Industrial and Medical market basically is very sticky. And so, right now it's a very fragmented and sticky market. And so, we can win an outsized number of new designs and still not move the needle as much as we would like. So, that's why we're pursuing M&A in the industrial medical space. It's to build out further critical mass, become more important to our customers essentially.

A

Now, the only hurdle to buying companies right now is valuation. So, we're clearly in the hunting mode. We've got a good pipeline of candidates. And I think with the passage of time, I think some of our targets should become more realistic on valuation, and at that point, we could do a deal.

Scott Graham

Analyst, Seaport Global Securities LLC

It's great. Thanks a lot for your time.

Q

Scott Graham

Analyst, Seaport Global Securities LLC

Q

You're welcome.

Operator: And the next question comes from the line of James Ricchiuti with Needham and Company. Please proceed with your question.

James Ricchiuti

Analyst, Needham & Co. LLC

Q

Hi, thanks. Paul, you may have mentioned this, but on the sequential improvement in gross margin, were you able to – or did you attribute, quantify how much of that came from the facilities consolidation actions? Or maybe you could just give us a sense as to how much of an impact that might have had? It sounds like it was mix mainly, but...

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah, I actually think it's a combination. Obviously, we saw improvement in Q3 from the facility. We saw further improvement on the facility side from – in Q4. We also benefited from volumes as you've seen and we got a little bit of help from mix. So, I think if you look at how we think about the contributors to gross margin improvement, of course, the one that's most in our control is the facility cost reduction. We believe we're on track there. And we talked about 200 basis points to 250 basis points of improvement related to that. I think broadly speaking, we've achieved at least half of that already to date, maybe a little bit more. And the next leg of improvement comes in the second half of this year as we complete our closure of our China facility. So, I think we're well on the way and we feel very good about our progress there.

I think mix is helping us a little bit. Obviously, we had just some better product mix this last quarter, but one of the elements of mix that's helping us is that our mix in data center is actually better. We've talked about continuing to improve gross margins in that market as we focused on more differentiated solutions. And so, while that market's performing well, it's not nearly the drag it's been historically. And on a year-over-year basis, we certainly saw, I'll say, net improvement in margins, which we would attribute to mix in that regard.

And then lastly, we're pleased that the improvement from margin is tracking right on our model of roughly 100 basis points of improvement for every \$50 million of quarterly revenue. So, everything seems to be coming together. Obviously, as our new products start to have a bigger impact that will contribute to the mix as we exit this year and more pronounced perhaps in 2026, but we feel very about the gross margin progress across the key elements.

James Ricchiuti

Analyst, Needham & Co. LLC

Q

Got it. And if I follow up just on the two areas of the non-semi business that I think you guys have been focusing on, you guys do sound a little bit more optimistic about the continuing strength in data center. Is that a fair way to characterize it? And in terms of your line of sight, when you talk about demand remaining fairly robust through the year, is that – how much of a change is that versus a few months ago based on what you're talking and talking to customers?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah, I think you're right, Jim. We have changed our position on data center. We've become more positive since the last earnings call based on what's in front of us, what we're hearing from our customers and also what they're

saying in public. I think there's going to be a lot of money spent on data center this year into next. And we're in a very good position to continue to grow that business over the course of 2025.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah. And Jim, maybe I'll add, if you kind of look at our guidance and the comments earlier, we are more optimistic on 2025. We would expect the data center market to grow and for us to grow with that. When you look at what we've said across our other markets within semi, we will grow faster than the market. The market we think is – our operating assumption is flattish if you look at WFE. So, new products will help us grow faster than that. And Industrial and Medical, while we think we're bottoming right now, there will clearly be some recovery in that market this year as early as the end of Q2. When you put that all together, we think the full year is going to be up high-single digits. And obviously data center is a part of that.

James Ricchiuti

Analyst, Needham & Co. LLC

Q

Got it. That's helpful. Thank you.

Operator: And the next question comes from the line of Rob Mason with Baird. Please proceed.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Yes, good afternoon. Can you hear me?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Hey, Rob.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah, sorry about earlier. Just wanted to – Steve, I mean could you talk about any – is there any distinction between what you're seeing in industrial versus medical, just in terms of the underlying demand and maybe the willingness or rate, pace at which some of these design wins that you've locked down can start to move into production?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

I think most of my comments apply equally to Industrial and Medical. I would say the big difference between the two is that medical – our medical revenue tends to be concentrated in some large customers. And those large customers, many of them are working through inventory issues. But the demand in medical, the inputs we're getting from our customers, demand is picking up and that's encouraging for their ability to eat through the inventories they currently have and to start placing orders again.

I think in industrial, it's a wide variety of customers, some big ones, some small ones, lot of medium sized customers. And so, it's a very broad market, thousands of customers, literally. So, I think the ability for that market to recover is probably a little bit better just because it's so broad.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah, okay. As a follow-up, I don't think this has come up yet, but it was just – could you address your manufacturing footprint with respect to potential tariffs, Mexico, and obviously you're exiting China. But my understanding in within Mexico, a lot of those products don't necessarily ship directly to the US. They may go elsewhere, maybe stay within Mexico. But to the extent your customers have to deal with that, are you seeing any need to move where you ship and hence maybe where you produce? Is that part of the conversation?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah, let me make a few general comments on that and then turn over to Paul to make some other additional comments. But I think there are basically two areas that we look at. One is our manufacturing footprint and the second is our supply chain. So, from a footprint standpoint, we started pivoting out of China several years ago and will be out of China from a manufacturing standpoint by June of this year, so that's a checkmark.

The second issue is Mexicali. So, the first thing to understand about Mexicali is it represents less than 10% of our revenue. And you're right, most shipments are to non-US locations. That said, we still have shipments coming into the US. So, we're looking for ways to mitigate any potential tariffs, and ultimately, if we can't mitigate it, then we could build these products in other factories in Southeast Asia. So, there's nothing magical about that.

From a supply chain standpoint, we've had a multi-year effort to reduce dependence on Chinese suppliers and that's also motivated by some of our customers making that request. And so, at this point, we have very limited imports from China into the US. It's primarily for engineering builds and spare parts for our service centers.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah, the only thing I'd add to that is it's a pretty fluid situation. So, as Steve said, I think we have mitigating strategies relative to supply chain and logistics and quite possibly pricing. So, we'll monitor the situation. Obviously, we're learning more about it. To be clear, there is nothing embedded in our guidance related to tariffs at this point given that it's a pretty new and fluid issue. But again, I think on balance, it shouldn't be a large impact and there's a variety of strategies to mitigate that impact for us.

Robert W. Mason

Analyst, Robert W. Baird & Co., Inc.

Q

Understood. Thank you.

Operator: And the next question comes from the line of Joe Quatrochi with Wells Fargo. Please proceed with your question.

Joe Quatrochi

Analyst, Wells Fargo Securities LLC

Q

Yeah, thanks for taking the questions. On the semi side, just trying to understand the commentary for 2025. Your base case is kind of thinking that the WFE is relatively flat and you should outgrow that just given the new product launches in second half. I guess, are you seeing customers add any sort of kind of additional inventory after kind of working down the wafer inventory over the last several quarters? And then, I guess, can you remind us on the

new products that you're launching? Is there any sort of ASP dynamic that we should think about relative to the prior generation products?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah, this is Steve. I'll make a few comments and Paul will chime in. It's hard to make comments about what our customers are doing. They don't always tell us exactly where the products are going. We don't know. But all we know is that demand was good. We saw growth last year and Q4 was our best quarter since Q4 of 2022, so we're pretty happy with that. We think we're at a point now where the purchases from our customer are pretty close to what they need near term. So, I don't think we're dealing with that many inventory issues.

Well, what was your second question? I'm sorry.

Joe Quatrochi

Analyst, Wells Fargo Securities LLC

Q

Yeah, just trying to understand as you think about the growth drivers, the ASP dynamic for eVoS, eVerest, et cetera. Just is that a higher ASP than the prior generation products? You think about embedding that in your line of sight to revenue growth?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yes. In general, the new products bring more value to the customer and more capable and they have a higher price tag.

Joe Quatrochi

Analyst, Wells Fargo Securities LLC

Q

Okay. On the Industrial and Medical side, I think last quarter you talked about normalizing channel late 4Q, early this quarter. It sounds like maybe that's kind of pushed out. Is that the right way to think about it? And then what gives you confidence that we are at the bottom?

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah. I think what we said was there's a potential for us to start recovering in Q2 of this year. So, yes, I think our statement moved out a quarter. What gives us confidence in that is that we've seen the deceleration in the business slowdown. And so, when you look at what happened in 2024, basically every quarter, Industrial and Medical was down from the previous quarter until Q4. In Q4, it was basically flat to Q3. And so, that's why Paul said we think we're bottoming. And at some point, we think we're going to start recovering that business.

The other part, it's important, is to realize that half of our business in Industrial and Medical goes through distribution. And so, we've had three quarters now where the sell into distribution has been less than the sell-through. And so, that's brought our inventory down steadily in the distribution channel. And I think that's one of the better indicators we have that we're about to turn upward again, but it's always difficult to time it precisely.

Joe Quatrochi

Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you.

Operator: And the next question comes from the line of Steve Barger with KeyBanc Capital Markets. Please proceed with your question.

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

Thanks. Good evening.

Q

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

Hey, Steve.

A

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

Steve, thinking about getting to outgrow through share gains, back in October you talked about a 30% conversion rate from funnel to design wins. Does it feel like there's been any change in either the rate of additions to the funnel or maybe your win rate post election or post inauguration?

Q

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

Yeah, I think our win rate is going up and that's because we've seen our pipeline increase. So, over the course of 2024, the pipeline increased by about 20% in dollar terms and our conversion rate is still strong, 30% to 35%. That's the right ballpark. I think probably where we're falling short is the conversion of design wins into revenue. And so, I think that's probably a function of the market. Our customers working through inventory before they focus on some of the new products. So, I think, with time those wins will turn into revenue. And that's why I think as the market turns, we're going to gain in an outsized way as the market recovers in Industrial and Medical.

A

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

So, when you have a design win, do you basically consider that in the bank and it's just timing until that does convert or do you ever have a design win go stale essentially?

Q

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

Oh, yeah. Yeah, we have a lot of design wins that go stale, but then we have some that outperform and some where the timing either gets pulled in or pushed out. And so, what we do to qualify design win, we need significant order from the customer and not just a statement that they've designed us in. So, I think the design wins are legitimate, but sometimes, the customer may not be successful in their market or there may be some other extraneous factors that constrain the win from turning into revenue.

A

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

Got it. And Paul, when you were answering data center question earlier, I think you said you expect full year revenue for the company to be up high single digit. So, first, did I hear that correctly? And then if I did, when you

Q

think about that growth in the context of your own margin initiatives, how are you thinking about operating leverage for the year?

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah, first, I did, that is what I said, is if you take the sum of our comments by market, it implies high single digit growth for the company. So, you did hear that correctly.

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah, yeah.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

And I think what you're poking at, if data center is growing fast or faster than the other markets, how does that imply our margins implications? The way we've looked at and I think I commented on this in the past is that we've been able to close the gap in data center relative to the company average. So, it doesn't average the company up, but the gap is lower. And as we've done our modeling, we've kind of said that mix in any given quarter can impact, as you know, up to 50 basis points.

When we look at what's in the hopper relative to manufacturing cost takedown, the mix within data center, the product improvements there, volumes and these other things that we're driving, we believe we can still get to our gross margin objectives even if data center is stronger than the other markets in the coming year.

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

Q

Got it. That's great color. Well and I guess to that point, I mean, you've always talked about incremental operating contribution margin in the, I think, 40%, mid-40s, like, so you would expect the same?

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah, that's right. Our long term model for operating margins is 35% to 45%.

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

And so, yeah, we're saying in this window that we would expect to see that same level of operating margin leverage.

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

Q

Great. And if I can just sneak in a quick modeling question. From your comments, it sounds like you expect another year-over-year decline for Industrial and Medical in 1Q. But do you think revenue could be up sequentially from kind of the \$78 million you've averaged over the last three quarters?

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah, I don't think we were that specific. I think we said it's bottoming. So, we would characterize it as bouncing along the bottom here. And we said that we could see revenue growth as early as Q2. So, again, that's a little hard to handicap, but that's how we think about it. And I think that would imply a stronger second half than the first half in any regard in Industrial and Medical.

Steve Barger

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Thanks.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yup.

Operator: [Operator Instructions] And the next question comes from the line of Mehdi Hosseini with Susquehanna. Please proceed.

Q

Hi, this is Mahwish Mahbub asking on behalf of Mehdi Hosseini. Thank you for taking my questions. My first question is regarding OpEx. Can you offer some color on your OpEx growth for 2025 relative to your anticipated revenue growth for the year as well as against your 2024 OpEx? And second, is the pickup in your semi business reflecting an inventory refresh by your OEM customers? Or is it more a reflection of material growth across the OEMs in anticipation of their own revenue growth? And then I have a quick follow up.

Paul R. Oldham

Chief Financial Officer & Executive Vice President, Advanced Energy Industries, Inc.

A

Yeah. Thanks for asking the question. On OpEx, OpEx was up a little bit in the fourth quarter basically on higher volumes and incentive related costs. So, we expect that to revert back in the first quarter down into the \$98 million to \$100 million range. As you look forward into the year, we do expect to see that number grow sequentially over time. We've talked about it growing kind of in the \$1.5 million to \$2 million range per quarter as we implement salary changes, there's inflation, clearly we're going to continue invest in all these new product launches and we see some timing of program expenses affect that. But if you look at the full year, we would expect to grow operating expenses less than half of the revenue growth rate and that's the best way to look at the annual number.

Q

Great. And then regarding the semi business, do you see that more – do you see that reflecting more the inventory refresh from your OEMs? Or is that just more growth across OEMs' anticipation of their own revenue growth? Just any color there would be really appreciated.

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah, we really don't know. I think there's a variety of reasons we outperformed in fourth quarter. Some customers I'm sure were refreshing the inventory, but we think most of demand was there to match the demand from our customers. So, we think we've reached an equilibrium point in semiconductor after a couple of years of adjustment. So, we're pretty happy where we're at from a demand standpoint. Again, this is the best quarter we've had in semi since Q4 of 2022. So, yeah, I think we're well positioned.

Q

Great. Thank you. That's very helpful. And lastly, just any color you can offer on trends you're seeing within your networking business? Thank you.

Stephen Douglas Kelley

President, Chief Executive Officer & Director, Advanced Energy Industries, Inc.

A

Yeah, our networking business, we call it the Telecom and Networking business. We've really sharpened our focus there in the past few years. And we've pruned a lot of the business because it wasn't reaching our margin targets. And so, what we see there today is it's a pretty flat business for us now. We don't see a lot of growth moving forward. So, most of the action today is going to be in Semiconductor and Data Center and in Industrial and Medical and Telecom and Networking is fine, but it's not a growth business for us.

Q

Got it. Thank you.

Operator: And ladies and gentlemen, that does conclude the question-and-answer session and that also concludes today's teleconference. We thank you for your participation. You may disconnect your lines at this time.

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