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<<N. Quinn Bolton, Analyst, Needham & Co.>>

[Call Starts Abruptly] conference. My name is Quinn Bolton. I cover the semiconductor and semiconductor capital equipment stocks for Needham. Thank you for joining us. It's my pleasure to host this fireside chat with Advanced Energy. The company is a leading supplier of power conversion systems for the Semiconductor, Industrial, Medical, Data Center, and Telecom, and Networking markets.

Joining me from the company are Steve Kelley, President and CEO; Paul Oldham, EVP and CFO; and we also have Edwin Mok, Vice President of Strategic Marketing and Investor Relations here in the audience.

Before I start with my questions, I'm going to hand it over to Paul for a quick Reg FD disclosure.

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Great. Thanks, Quinn, and welcome, everybody. We appreciate your interest in Advanced Energy. Just want to remind everybody that any forward-looking statements we make today are subject to number of risk factors and encourage you to have a look at our filings with the SEC for further discussions with those.

Also, we've finished our fiscal year on January 1, so we're clearly in our quiet period, and so we won't be making any comments about our current period results. We're not providing any updates to guidance today.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Great. Okay. We'll go ahead and get started. I guess to begin the company's significantly beat expectations the past four quarters. When you look back, what have been the main factors that have enabled you to outperform over the past year?

<<Steve Kelley, President and Chief Executive Officer>>

Yeah. Quinn, I think 2022 was really a tale of supply chain management and operational execution. What happened was that we were able to get more parts than we expected in each quarter. This was very difficult going into each quarter, because the commitments from our suppliers, particularly the IC suppliers, were pretty uncertain.

So we adopted a conservative posture, and we forecasted each quarter. And we were able to beat it consistently. So that was good for our customers, and I think it's good for the investor community.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

And you sort of touched on the supply constraints and some of the uncertainty, the decommits being some of the factors that have limited just near-term growth. Is securing parts still the number one issue for the company as you're looking at calendar 2023?

<<Steve Kelley, President and Chief Executive Officer>>

Unfortunately, I think it is. You would think two years into it that the parts shortage would be behind us, but they're not. I would say the list of problem parts has certainly narrowed, but some of the remaining problems are pretty difficult to resolve. And so you may recall from our Q3 earnings call, we talked about record revenue, but we also had record what we call price premium variance (PPV), this is the premium that we paid to brokers to procure these scarce parts.

And so we continue to run into problems and it's all older node ICs, so it's analog chips, it's micro controllers, and to a lesser extent some MOSFETs. So we're still chasing chips. It's still a big issue, still constraining revenue, particularly on the non-semiconductor side of our business.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

And how about the price premiums? Are those constrained parts still very expensive? Are you starting to see any reductions in price out of the broker chain?

<<Steve Kelley, President and Chief Executive Officer>>

I think they're still pretty expensive from what I've seen. But again, because there are less of the products on the list, I think overall we're spending a little bit less than we have in past quarters. We expect that to decrease. But for the remaining problem parts, we're paying a lot of money.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Okay. I know some of the actions the company's taken to try to avoid those bring them pricing is to either qualify new suppliers or just do outright new board designs. Can you give us an update on sort of where you stand with those efforts and are those continuing?

<<Steve Kelley, President and Chief Executive Officer>>

Yeah. We started doing board redesigns and qualifying alternative suppliers back in the spring of 2021. So we've been at it a while. And it paid off in a big way for us last year. It had a material impact on our revenue and our profitability. So our ability to procure these other parts and deal with better suppliers was very important to us. We're continuing to do it. We are looking for ways to design around some of the remaining intractable problems. And I think we're showing some progress there.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

And for the non-critical components, are you holding what you feel are adequate buffer inventories? It sounds like that the critical parts may move or shift from one quarter to the next. And so maybe this is a tough question to answer but…

<<Steve Kelley, President and Chief Executive Officer>>

I think most of our parts are non-critical. So if you look at our inventory, it's pretty high. And those are basically piece parts. These are all the non-critical parts that we have no problem procuring. So we have plenty of those. And so the trick is to stop buying the non-critical parts. It doesn't come naturally, particularly at the lead times are very long, even for the non-critical parts.

So we're having to go in and manually adjust some of our demand pulls. But you do what you have to to keep things under control. It's still an interesting environment given long lead times throughout the supply chain.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

The – you touched on that the frame of recovery is kind of a 300 basis point headwind between that higher material costs in the September quarter. When do you think some of that begins to normalize? Is that this year or could it extend into calendar 2024?

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Yeah. It's difficult to project. A year ago, we thought we would be largely through this over the course of this last year, but it's clear that we're not. And on our last earnings call, we talked about how we expect this environment to persist into the second half of next year. After that, we'll see, it's very hard to see in the second half.

It seems at some point you kind of reach a tipping point and more of these parts ought to become available, but we haven't seen that yet. So we're obviously monitoring it. I think once that does start to tip, that will provide a tailwind to gross margins for the company. And so we'll obviously – are focused a lot on in the meantime getting the parts that we need. So we continue to ship to our customers. But we think that's going to persist at least for another couple quarters.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

The other gross margin headwind I think you identified in the earnings call was a 50 basis points to 100 basis point headwind from inefficiencies on the factories. Can you provide an update here and your sort of thoughts on moving forward with both Shenzhen and the shutdown there also with the ramp of Malaysia?

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Sure. So we were fortunate during this last upcycle to be able to keep our Shenzhen factory open. And that allowed us to have kind of burst capacity and when we got parts to be able to ship more, and clearly, we made the most of that. Our third quarter was by far record for the company in semi, and industrial medical was a record from a profitability perspective.

So our being aggressive on the supply chain and giving ourselves flexibility in operations, we think it's really paid off. Having said that, we've kind of come to the end of the rope, if you will, or the end of the rainbow for Shenzhen. And we said last quarter, we would close that by the end of the year end, and we've done that. So that factory is essentially closed.

At this point, there's some mop up activities that need to occur. And that's a good thing. I mean, the fact that we're heading into a softer period or lower semi being able to actually close a factory is good. And we'll be looking for other opportunities where we can move some of our products, from some of our smaller boutique factories into our larger factories to continue to optimize our footprint going forward.

Now that factory's been – we've been bringing it down over time. So we will see a little bit of benefit now that we finally close it. We've talked about that being in the 50 basis point range, the same time volumes are coming down. So we've got fixed costs that's sort of counterbalancing that a little bit.

But our goal as we go into 2023 is to optimize our factory footprint, given the fact inclusions and there's opportunities to continue to move some of our products into the larger more scaled factories.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

I wanted to shift to backlog. If I remember, I think your backlog at the end of 2000 was something like $280 million. It's increased to about $1.1 billion. So obviously a pretty meaningful uptick. In September, I think you had said it was down 6% quarter-on-quarter, but still a very healthy level relative to normal levels. How durable is that backlog? Is it largely in your semiconductor and industrial, medical, the higher margin markets?

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Yeah. It's – if you look at our last call, we said the 80% of it was between semiconductor and industrial and medical. So it's – we think of it is very high quality backlog. The margin in the backlog would be higher than the company average. So that's all positive. It's also scheduled – largely scheduled for near-term deliveries.

In Q3, we said that two-thirds of it should ship by the end of Q1. So we're partly through – partly along that timeframe. So it's pretty short-term backlog. There's delinquencies in there frankly, that we'd like to ship. And our backlog, while it's – we're very – it's great to have $1 billion plus a backlog, it's too high. It represents the fact that we're not getting products to our customers.

We'd like that number to be in the $400 million to $500 million range. And one of our goals is to bring that down over the course of the next several quarters. It also provides a little bit of a buffer or runway to maybe dampen the impact of a slower demand environment. Now, we don't know exactly what that looks like, because this is kind of uncharted territory for us.

As you said, we've never had a large backlog in the past. But we believe if demand comes down that will either provide a runway to ship more and mitigate that or if demand stays higher, could provide some upside as we're able to get critical parts. But our goal is to work that backlog down over the next several quarters.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

I think a lot of that product is sole sourced. Have you seen cancellations or rescheduling activities starting to affect the backlog? Or is it held relatively intact and it's really just your availability or your ability to get parts shift revenue is how you're going to work that down?

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Yeah. Broadly speaking, it's held pretty intact. Demand has stayed pretty strong as we talked about in Q3 across our markets. We do see reschedules of it mostly as customers try to match their own golden screws. So there's some things that move in and move out. So it's pretty dynamic, but on balance, it's stayed pretty intact.

One note that I will make as we talked about in our call is that in the $1.1 billion roughly we had at the end of Q3, there's about $90 million related to shipments – export shipments to China, which we said we would address that during this quarter. So I would expect to see the backlog come down for that. Not that that demand's going away, we just don't have a clear path to ship it right now. So until we're able to identify that, we'll probably move – at least move that portion out of backlog.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Okay. Okay. Lastly, and understanding you're late in the quiet period, but any thoughts on just sort of the current demand environment that you're seeing across end markets? Or is that something you wanted to further the earnings call?

<<Steve Kelley, President and Chief Executive Officer>>

I could speak generally about it. Obviously, if you look at our business about half goes into semiconductor equipment and the other half goes into other applications. On semi equipment, we said on the call that we expect 2023 to be a down year. And so there's a consensus emerging about WFE for this year.

We think we could do a little bit better than that. But again, the semiconductor equipment will be down. On the other half of the business though, we see a flattish environment. Right now we have not seen any significant changes in the backlog or in the demand patterns. So we sell into industrial, we sell into medical, we sell into computing data center, telecom and networking applications. And that business is pretty steady, pretty stable.

And so what we expect this year is that business will stay pretty stable. We're going to go through the normal down cycle in semiconductor, but overall, I think you'll see that Advanced Energy is going to weather this cycle better than we have in the past when we were more dependent on semi equipment.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

It sounds like the diversification benefits of the Artesyn transaction are going to start to show through in 2023?

<<Steve Kelley, President and Chief Executive Officer>>

Yes. So we acquired Artesyn in 2019, so a little more than three years ago. And Artesyn brought in industrial medical business, a really good piece of business there. They also brought in the hyperscaler and telecom and networking businesses. So the industrial medical combined with some of the industrial medical, we already had in the company has become a key focus area for Advanced Energy.

Firstly, because it averages up the company. The margins are good. Almost all the products are sole sourced. And so we've put a lot of effort into increasing our design wins, increasing the sales people calling on industrial medical accounts. So it's full speed ahead in industrial medical. On the data center side, we've changed our strategy a bit because there's a fair amount of competition in some of the high volume areas of the data center and long-term that wasn't going to work out well from a margin standpoint for us.

So we took the engineers, our development engineers and pointed them towards sole sourced projects. And so what we're seeing now is an improvement in our gross margins in the data center, computing, telecom, and networking business, and that's by design. So we're trying to get the bottom line up in those high volume businesses. And we don't care so much about growth there. All the growth we see is going to come from industrial, medical and semiconductor equipment.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Thank you. Moving to the semiconductor business, obviously there're a number of cross currents. You've had some of the large OEMs, Lam and KLA call for WFE be down as much as 20% next year. I think you've had ASML on the other hand saying, hey, we think we can grow.

Based on their backlog, I think ion implant is another segment where Axcelis said they're going to grow. So do you have a view on where you think WFE shakes out? I know you think you can do a little bit better than WFE, but it feels like there's a pretty wide range of estimates depending on which company you speak to.

<<Steve Kelley, President and Chief Executive Officer>>

So we've always refrained from giving specific dollar numbers. We think there are other people who are smarter than we are when it comes to WFE. So I'll continue that tradition. But what I will say is when I think about the market, I think about the semi market in three buckets. One is memory, the second is advanced logic. So this is the leading edge logic from TSMC and Samsung, primarily and Intel.

And then the third bucket, which is a pretty big bucket is the older stuff, it's analog, trailing edge logic and discretes. And in each of those markets there's different dynamics, memory, obviously going through a cycle, but this is not the first time memory has gone through a cycle. This is just how the market is. So we're going through the down cycle of memory, that market's driven primarily by phones and computing applications.

The second market, which is logic – advanced logic is down a little bit, but not dramatically down. And that the big driver there is going to be smartphones. And the last market I mentioned, which is pretty large is the trailing edge nodes. And that market's not down at all. And you could tell that from some of the shortages that we continue to deal with, right? There's still a lot of demand for products on trailing edges, the so called good enough nodes, right? For industrial, automotive, all sorts of different applications.

And so I think it's a long-winded answer to your question, but I think there's still a fair amount of demand out there in semiconductor, but you can't escape the downdraft in memory into a lesser extent leading edge logic.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

I think where you're positioned now in terms of your dependency on memory versus the last cycle, that mix shift to foundry logic, your strength in conductor etch, it feels like you may be a little bit better positioned into this down cycle, however deep it may be than the 2018 cycle.

<<Steve Kelley, President and Chief Executive Officer>>

Yeah. We think that we're better positioned because we're more biased towards logic applications than memory applications because the nature of our product. We also think that our service business will grow because of the larger installed base, we have Advanced Energy generators and matches in the fabs. So we think there's some counterbalancing factors that should help us not reduce our sales to the same extent as WFE.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

And maybe spend a minute, just your view of AE inventories at OEM customers, whether it's at the customer or in the JIT bins and some of your larger customers. I assume those are still pretty lame given how constrained the industry has been until fairly recently.

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Yeah. You talked a little bit about that. We can't be specific about it obviously because this isn't public data. But I think it's fair to say that our inventories at our customers are much lower than they would be historically at this point in the cycle. So one of the reasons we think we can perform maybe a little better than WFE this cycle whereas historically we would perform worse than WFE is because we don't have as much of that inventory headwind that we would typically have.

Normally our customers in these JIT bins, they build up this inventory as their volumes increase because they're turning product, et cetera. And therefore, when the down cycle comes, they can bleed that down and lower the size of the bins. This year, we don't have that big build. There's certainly some inventory, but relative to historical levels, it's much lower and therefore we don't see as much of that headwind.

And in some cases, we may have to actually fill those bins a little bit over some amount of time. So I think that's a key factor for us. That should be another one of those things that helps bumper us a little bit against the just the downdrafts that we'll see in semi.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Are there any sort of major design wins that ramp in 2023 that can also help offset the downdraft in overall WFE?

<<Steve Kelley, President and Chief Executive Officer>>

Yeah. I mean let me make a few comments there. Yeah. We did have some significant design wins last year. And many of those will take time to develop into revenue. So we'll see some revenue this year from those design wins, but most of it, at least in the semi segment, it takes two years or three years, maybe longer to develop into meaningful revenue.

One of the things we've done as a company in the past couple of years is really focus on our product development cycle time. And we've gotten a lot better at it. And we'll be launching a couple new platforms here this year in semiconductor, which really extends our technology leadership, really sets the table for us to grow revenues from probably 2025 onward.

So that's typically the cycle in these major design wins. It takes a while first to develop the platform, then to adapt it to the customers application and then for it to actually go into production.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

I guess maybe related question, how do you feel about the remote plasma and efforts to gain share in dielectric etch?

<<Steve Kelley, President and Chief Executive Officer>>

I feel really good, because I mentioned the two platforms. One of those platforms is our entree into dielectric etch. And I think when you're entering a segment where you don't have much market share, you need to have a significant technology advantage to gain a foothold essentially and I think we have that.

And so I'm very excited about our ability to gain a foothold in dielectric and to offer customers a choice both in dielectric as well as in remote plasma source, the RPS. We've got a good technology there as well. It's been in evaluation for some number of months now, getting good feedback. So I think for those two applications, dielectric and RPS, it's all upside for us essentially. The area where we have commanding share is in semiconductor etch, so we're defending that part of the business, but we see dielectric and RPS as ways to improve our revenue and expand our SAM.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

And just sort of speaking of relative share, your main competitor MKS previously reported pretty strong growth in calendar 2021, looks like you grew faster in calendar 2022. How do you see share between the two companies in the broader power conversion markets trending over the next couple of years?

<<Steve Kelley, President and Chief Executive Officer>>

Yeah. So when I think of share, I think of two things, tactical market share and strategic market share. Tactical market share ebbs and flows depending primarily on supply chain issues and also how successful your particular customer base is, it's hard to predict. But over time, you'll see a trend and that's more strategic share. And that's really about your ability to win new designs with your technology and with your platforms. And so that's why we put so much focus on that part of our business is to really make sure we're first with the best and our experience is if you have the best technology, the semiconductor equipment customers will find a way to get you designed in.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Switching to the industrial and medical markets, previously you sort of said that non-semiconductor markets were sort of holding more steady in 2023. Can you just talk about some of the longer term or both near-term and longer term growth drivers within first the industrial side and then we'll touch on medical.

<<Steve Kelley, President and Chief Executive Officer>>

Yeah. So industrial is an interesting market. It's made up of a lot of different sub-segments and quite frankly, we've underserved the market over the past year and a half. And that's – if you look at our backlog, a lot of our delinquent backlog is for industrial medical customers. And so we're working hard to reduce that delinquent backlog. So I think there's a lot of pent-up demand in industrial for these solutions which we have not been able to ship. And I think it's a common refrain right now, that’s probably the area of the market that’s still suffering the most from parts of shortages.

Looking farther in the future, we moved a lot of engineering talent into industrial medical about a year and a half ago, we changed how we pay our sales force to encourage industrial medical design wins and revenue. And that’s having a huge impact on our design win pipeline. And we think our revenue is going to follow here shortly in industrial medical. So we’re very pleased with how things are going in industrial in particular.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Where are the design cycle times in industrial? I hear industrial and think sort of just – that’s probably a longer design in to revenue cycle, but don’t know if that’s a good assumption.

<<Steve Kelley, President and Chief Executive Officer>>

Yeah, speaking generally, the longest cycle is probably semiconductor equipment, because of the different qualifications you need to go through. Second longest is medical, because of various certifications. And then industrial is probably the quickest, but again, it could vary anywhere from six months to two years depending on the application. But you get some fast turnarounds in industrial.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Moving to the medical market, how do you try to differentiate AE from other power conversion systems in that market? And what are you doing to sort of grow that business?

<<Steve Kelley, President and Chief Executive Officer>>

I think in medical, there’s some key differentiators. First is, of course, your technology. And we’ve always been strong in high power medical, that’s why we acquired SL Power last year, last April, because they were very strong in low power. So the portfolios were complimentary and that’s worked out very well, because SL Power brought in some customers that were not on our radar screen and vice versa. So there’s a lot of cross-selling going on there. So product is important for the customer.

The second thing that characterizes the medical space is fragmentation. There are a lot of different suppliers in medical and many of them are underfunded and not investing at the appropriate rate. And so when Advanced Energy shows up at a medical customer and we show them what we make and we show them our balance sheet and how many people we have working on this, it’s a pretty good proposition for the customer.

And so we’re talking about long-term viability, our focus and our dedication to the medical market, that’s important for medical customers, because they tend to buy for a very long period of time, the same product. So that’s I think how we differentiate first two product, but then I think we’re a good value proposition for purchasing people who want to make sure that we’re going to deliver on time and we’re going to be there 10 years from now when they still need the product.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

And is it – do you target certain applications? Do you target different medical equipment more by their power needs? I mean, is it – hey, we’re now good with SL Power, the low voltage, low power level. And so we’re going to go after certain types of equipment. I mean, are there any kind of medical equipment segments that you see particularly strong growth or is it…

<<Steve Kelley, President and Chief Executive Officer>>

Yeah, there’s some – I think there’s certain parts of the market that really require precision power. MRI for instance, electrosurgery, a lot of people have their knees done. They’re using a product from Advanced Energy. And so there are a lot of new treatments that require the delivery of precision power and that’s where we excel, but it tends to be higher tech type products.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Okay. Shifting to the data center and telecom market, it does feel like there’s been some softening in the data center market. Some of that might just be the deceleration from 25% plus growth in CapEx to maybe a flattish outlook in 2023. But what are you seeing in sort of the data center market specifically?

<<Steve Kelley, President and Chief Executive Officer>>

In data center, we’re seeing demand hold up. And that’s a question I ask every month, are we seeing any dip in data center? And the answer is no. And when you look inside a data center power box, it’s extremely complicated. We have up to a 1,000 electronic components in each one of these boxes we deliver to the hyperscalers. And so it’s particularly prone to parts shortages and all it takes is one part and we can’t ship it. And our competitors have the same issue. So I believe in data center, what you’re seeing is that the industry is not supplying what the data center customers need right now. So there’s a continued pull for more product. And so we could ship everything we make into data center and we’ll keep following it, but so far so good.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

How many hyperscalers are you currently shipping into, right?

<<Steve Kelley, President and Chief Executive Officer>>

We formally announced that we are shipping into four, but we have added other accounts that you might not think of as the Tier 1 accounts as some of this technology is proliferated to other areas.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

So you continue to…

<<Steve Kelley, President and Chief Executive Officer>>

We continue to add. That's right.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Base even though, they're sort of a more focus on the higher margin…

<<Steve Kelley, President and Chief Executive Officer>>

It's a more selective strategy from a product and solution perspective, but that – those solutions can be used across multiple customers. So there are some offsets to, I'll say a more, a higher focus on differentiation is, there is still a little bit of an underpenetrated market for us even at that.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

And when you say higher value sort of applications and data centers, that's sort of like the titanium plus drive.

<<Steve Kelley, President and Chief Executive Officer>>

This will be higher efficiency, high power density things with more complicated control solutions. Those would be areas where we would have advantages.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Any updates on sort of how you're penetrating the 48 Volt power supply market in data centers? Is that becoming a meaningful percentage of the business?

<<Steve Kelley, President and Chief Executive Officer>>

I think we're still a leader in 48 Volt. So I think we're on the print and they're starting to buy from us. I think it'll be rolled out in the coming two years and we're positioned well there. But again, our focus is going to be on sole source differentiated opportunities in data center and in computing. And so I think we'll have participation in 48 Volt, but we're not trying to be the sales leader there long-term.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Okay. Paul, sort of moving to sort of the financial model in 2022, the company surpassed its three term – three-year revenue goal of $1.65 billion, but EPS was well sort of the $7.50 target, obviously margins right now, gross margins are depressed, but if I were to sort of set the gross margin at the 41% target, it still feels like OpEx. The EPS is closer $6 rather than $7.50. And so can you talk about what you need to do with OpEx to get to that $7.50 EPS target?

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Yeah, so a couple comments. You're right. We have seen better revenues for sure. Certainly, we've had an upcycle in semi. Frankly, in 2022, we had north of $80 million of premium recoveries, which is revenue with no gross margin in it. So that's a little bit of a headwind that'll come back. It won't affect earnings or margin, gross margin dollars, but it will affect the model somewhat. We've also absorbed a higher tax rate, obviously this year we had the capitalization of R&D came in, that wasn't in our model. And we've included in that two or three acquisitions, the largest of those in the last year and a half was the SL Power. So those things have impacted us relative to a model perspective. Having said that, if you annualized the last two quarters we're actually roughly at that $7.50.

So we kind of got there a little bit different way. With revenues coming down, our focus is going to be on number one, continuing to work to get margins up above 40%. We should get a tailwind from the material costs as you referenced over time there. I still think there's some time – there's some opportunities to bring some more efficiencies out of manufacturing. We have an opportunity to work on that this year over the course of the year with, again, optimizing our footprint.

And look our goal on expenses is to kind of keep those sort of in this flattish area despite inflation, despite fact that we're going to continue to invest in R&D in key programs. (31:42) So there's actions that we'll take to kind of keep that in check. In the long run, our goal is to grow spending about half the rate of revenue growth, and I think we're on track to that. Setting aside, M&A which adds revenue and then brings some costs with it. So the things we'll focus on is getting gross margins above 40%, kind of maintaining operating expenses. So we get leverage on sales growth from that and we still continue to feel good that we'll be able to drive to those goals and hire over time.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Any updated thoughts on sort of M&A strategy? You've got a pretty strong balance sheet with $400 million-ish in cash. M&A has been a big part of the strategy. Do you feel like targets are open to having conversations in this choppier environment? Does that actually help you or are they more – are they started tightened up and waiting for the markets to get better so they get a higher price?

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Well, first let me comment on the SL Power acquisition, which we did in April. We're pleased with how that went. We're pleased with the integration process and how customers have reacted to it and it just was a successful acquisition. So moving forward, we want to look like – we want to look for other companies that add to our position in semiconductor industrial medical, and that’s what SL Power did. There are other companies like that out there. We think this is a good time to be a strategic acquirer, and I think there’s a little less competition from private equity given the current interest rate environment.

So we’re ready. We expect valuation three reasonable this year, but we’ll have to see how open people are to selling these assets in 2023. But we’re certainly on the hunter side of the equation, we’re looking for good acquisitions. And I think we’ve got a good playbook now for integrating these acquisitions.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Sounds like Edwin may be busy this year. How about any just thoughts on share repurchases will you be more opportunistic this year?

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Sure. We’ve had an opportunistic share repurchase plan in place, frankly, over the last 18 months. We’ve been able to buy back quite a lot of stock at well below kind of average market value, because of the way we’ve approached. In fact, I think last quarter we bought back some stock in the 60s amazingly enough. So we’ll continue to be opportunistic in that regard. We have plenty of capacity in the summer. Our board authorized back up to $200 million. There’s no expiration on that. But as Steve alluded to earlier, our primary goal is to grow the company. And so that’s where we’ll focus a lot of our energy and resources and if the market plays out so that we get a chance to buy back some more stock, then we’ll take advantage of that as well.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Last question for me before I open it up. What’s the impact of rising rates on your debt?

<<Paul Oldham, Executive Vice President and Chief Financial Officer>>

Yeah. It’s probably a little more muted than you would think. We do have about $380 million worth of debt. It’s at a pretty attractive rate. It’s at LIBOR are now moving towards SOFR plus 75 basis points. So we don’t have a big premium on that. And about two years ago, we were able to put a swap in place and for two-thirds of that lock that in at 1.25%. So about two-thirds is fixed, about 1.25%, the balance will float with the interest rate environment. So definitely, there’s upward pressure on interest expense, but it’s a little bit muted and frankly we’re in a net cash position, so we’re also earning a little bit more on our cash, which is helping to offset that.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Great. We’ve got about four minutes left. Questions?

Q&A

<Q>: [Question Inaudible]

<A – Steve Kelley>: So in data center, the primary competitors would be Delta, Lite-On, so they're pretty big companies in Taiwan. I think the components and shortage are micro controllers, various types of analog devices and to a lesser extent discrete components.

<Q>: [Question Inaudible]

<A – Steve Kelley>: I'm the wrong guy to ask that question, because I've been predicting next quarter for the last three quarters. So I would've thought those imbalances would've been corrected by now, quite frankly. So I'm surprised that they haven't been. I think it's going to happen sometime this year. It's my best guess.

<Q>: [Question Inaudible]

<A – Paul Oldham>: So if you look across the industry, you'll notice inventory's way out for most companies, including us, including Advanced Energy. And the reason that is, is because we have this warehouse full of components. I'm waiting for those so-called golden screws. And so at some point you stop buying this other stuff, which should create capacity to build the golden screws, right? That's the theory. And so at some point that's going to happen and it's going to happen quick. These things correct very quickly. So I'm hopeful, it corrects soon. Yeah. Robert?

<Q>: [Question Inaudible]

<A – Paul Oldham>: Yeah, I think it's difficult to comment on current quarter activity. Obviously, Robert, I mean, we're all reading the same news about what's happening in the industry. We'll, again, I think our view is that we've tried to account for those trends. We expect to be lower relative to semi for the things we've talked about. And but we expect to perform a little better than the market. I think that's the best I can give you. As it relates to any charges, look, Steve said we have lots of inventory, but that inventory's all been bought to current demand. And so these aren't parts that are going to get stranded. It might take us longer to use them depending on how deep and how long the downturn might be. But in the end, these – this is we don't anticipate that there's inventory that's stranded in the long run, because we bought – we've been buying to all very current demand.

<Q>: [Question Inaudible]

<A – Steve Kelley>: Well, I'm not sure. I would say that there's a different sensitivity to supply issues. And so for most of our customers, I think the bias is towards keeping more inventory, not less. Because they don't want to be caught like they were over the past year and a half. So I think when the smoke clears, you're going to find customers want to keep probably a little bit healthier levels of inventory, so when demand picks up, they're not dealing with long lead times and shortages.

<<N. Quinn Bolton, Analyst, Needham & Co.>>

Any other questions? All right, Steve, Paul, thank you very much.

<<Steve Kelley, President and Chief Executive Officer>>

Thanks. Thanks, Quinn.