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<<James Ricchiuti, Analyst, Needham & Company>>

Good morning. Thanks for joining us today, first session of the 26th Annual Needham Growth Conference. We're pleased to be sitting down with a discussion with the CEO of Advanced Energy, Steve Kelley, and CFO, Paul Oldham. We also have with us today here in the audience, Edwin Mok, VP, Strategic Marketing and Investor Relations, a familiar face at this conference.

My name is Jim Ricchiuti, Senior Analyst in the Equity Research department at Needham, covering companies in the advanced industrial technology space. I think – so I think most people in the audience are familiar with the core semiconductor business at AE, but the company in recent years has significantly diversified its precision power solutions business into a variety of other markets.

So Steve, maybe to start off, why don't you give us a brief snapshot of the company today.

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

Thanks, Jim. So for those of you, who may be new to the company, we're roughly a \$1.85 billion revenue company, headquartered in Denver. As Jim referred to, we were formed about 42 years ago and we were focused on the semiconductor market for many, many years exclusively. And we're specialists in RF power for plasma chambers. Our biggest customers are Applied Materials and Lam. Over the years, we've made many acquisitions and through acquisition, we've become strong in other markets.

So today, we're roughly 50% semiconductor related power solutions and 50% industrial, medical, telecom and networking, as well as data center computing. But the common theme throughout is looking for sole source, highly engineered solutions. So whether it's semiconductor, industrial or medical, generally speaking, our solutions are sole source solutions.

So roughly 70% of our revenue comes from sole source products. So that's a good mix. We like semiconductor, industrial, medical in particular, because the applications tend to be long lifecycle applications, very sticky, and it's a good foundational business for us.

So our focus over the past few years has been creating more new products for these markets, launching them faster, and working hard to get design wins so that we can continue to grow the company organically. In addition, we're on the hunt for new acquisitions, particularly in the industrial medical space.

<<James Ricchiuti, Analyst, Needham & Company>>

Good, thank you. And we're going to dig into some of these non-semi markets. But I want to start with the semi business. It's obviously always a topic near and dear to people at this

conference. You have the company historically and continues to have a strong position with some key OEMs.

I'm just wondering, has the view of the semi-market changed relative to maybe the way you were thinking about it earlier in 2023? Just wondering as you went through Q3, you've seen some of the recent commentary from some of the OEMs. Just your sense on that.

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

Yeah, maybe I'll take a cut at that one. And maybe before I jump in I'll dispense with the formalities, which is just a reminder that our statements are subject to a number of risk factors. And we gave guidance in our last earnings release at the end of October. And we're not updating any guidance today. But if we look back at where we've come this year in the semi market, we all know that it's been a difficult market.

But I think for us, there's been some things that have been different this year. We entered the year with some fair amount of backlog and many of our customers still needing to fill inventory positions. We've benefited from having a broad semi footprint addressing a large portion of the market, foundry logic and trailing-edge that certainly benefited us this year.

We've had products in other parts of the market like high voltage for things like iron implant and others which have actually grown this year. So despite a pretty significant memory downturn this year, maybe as big as ever, we've performed relatively well. We think we've performed sort of at or better than the market, which is unusual because typically a subsystem company like us would perform much worse than the market as you move into these semiconductor cycles.

So because we've had a broader footprint and we've been able to execute well in some of these other areas, we think we've performed based on our guidance, sort of at or in line with the overall market. So we think that's very different than in previous cycles. And I think going forward, look, the market is going to continue to bounce around.

We've said that we always expected this to be a longer, not a V-shape cycle, but a longer cycle. And we said in our last earnings call, we expected semi to kind of bounce around the levels we've seen as we look forward here.

Having said that, I think there's some pretty exciting things happening in semi around some of our new products and activities. And maybe, Steve, you want to talk a little bit about that?

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

Yeah, maybe just to comment too. We manage the company in two ways, one is financially, and Paul just told you about our view of what's happening in the market, but also we understand that our ability to forecast is pretty limited as an industry, right. So operationally, we are ready for an upturn because they typically come fast and furious. And so to that end, we have staffed our factories probably a little bit higher than we could because we know this business is lumpy and we need to be quick. And the second is, as we came out of this supply situation, the COVID supply issues, we were able to identify the most troublesome parts of our supply chain where we haven't been able to change suppliers.

We've gone and built some strategic inventory that will allow us to respond quickly to uptakes in demand. But going back to Paul's question, 2023 was really an outstanding year for the company because we launched some really exciting new products, particularly in semiconductor, what we call eVerest and eVoS. But these are probably the most significant technology products that we've introduced in more than 10 years.

What these products are, they're enablers for the sub 2-nanometer processes and they give our customers the flexibility that they did not have before. And the performance, which we think is differentiated relative to our competitors. And everything we're doing is focused on two areas. One is increasing the throughput, that our customers have in these processes through their chambers, and the second is improving yield. So the big challenge in these advanced process is these high aspect ratio contacts. They're trying to drill these very narrow holes in a very efficient way and our solutions help them to do that.

<<James Ricchiuti, Analyst, Needham & Company>>

I want to talk about the new products, Steve. It's early days, but I'm just kind of curious what's been the market reaction so far?

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

Yeah, we launched these new products officially in July of last year at SEMICON West in San Francisco. And we have started sampling those products in April of last year and we continue to send beta units out to the customers.

The response has been extremely enthusiastic. So we've received more orders for these products than we typically do with new products by a significant factor. So we're working closely. The way these things work is we launch the platforms and then the customers are able to put the platforms on their system and then we work with the customers to customize the performance of our units to meet the needs of their particular customers. So that's the part that we're in today. So we expect to confirm a number of design wins in the coming months.

<<James Ricchiuti, Analyst, Needham & Company>>

And that being the case, design wins potentially in the next few months as far as this revenue contribution from that, are we two years, a year?

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

Yeah. I think in this business its long lifecycle. So we don't expect significant revenue from these new products till 2025 at the earliest, probably second half of 2025, but it will last a long time. So we think this drives growth through the 2020s into 2030s.

<<James Ricchiuti, Analyst, Needham & Company>>

And you guys have both been around the semi market and every cycle seems to be different. I'm just wondering, Steve, just in broad strokes, as you think about the next upturn, what are you – how are you thinking about it?

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

You're right. I've been in the semi industry my whole career, so been through quite a few of these cycles. And like I said before, we're not very good at predicting the cycles, the downturns or the upturns. So that's why we're preparing for an upturn, because we don't know exactly when it's going to happen, but we know when it happens, it happens quickly, right? The way we think about the selling market is so big now, you have to think about it in parts.

Obviously, there's the memory market and you've got two parts, NAND and DRAM. You've got the advanced logic market, which is driven by smartphones and advanced computing. Then you get everything else, what we call trailing edge. And so the good news is we have good participation in each of these markets, but today, they operate a little bit differently. They depend on different end markets.

And so it's hard to predict exactly what's going to happen. But I think most customers think that the DRAM market will pick up mid-year. The NAND flash market should pick up towards the end of this year. I think the advanced logic market, I think a lot of that volume depends on smartphones, on the success of smartphone makers, differentiating their product and stimulating demand.

And then the biggest market, which is everything else still seems to be pretty healthy. So this is power, analog, microcontrollers, you name it. But anything doesn't need a leading edge process. That's the biggest part of the market and that's the source of a lot of revenue for us just not only for new products, but also for service business.

<<James Ricchiuti, Analyst, Needham & Company>>

And we're going to transition into the non-semi business. Paul, I want to go back to a comment you made about backlog. You've talked also about backlog normalizing. Is most of the bulk of the backlog is semi related, fair to say.

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

I think it's about evenly split between Semi and Industrial and Medical. And then we have some backlog in the higher volume areas, but we tend to get orders more as you go in that market, which can be a bit lumpy. But over 80% of our backlog is the combination of Semi and Industrial and Medical.

<<James Ricchiuti, Analyst, Needham & Company>>

And when you've talked about backlogs coming down, is that mainly more so in the semi?

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

I'd say it's both areas and there's two things that are happening, well, three maybe. The first is that we saw our backlog a couple of years ago increase to really unprecedented levels. We got to over \$1 billion of backlog. That was really driven by challenges in the supply chain where lead times had extended significantly and customers really needed to put orders in place to ensure even getting product a few quarters down the road.

So we saw that backlog go up dramatically. We think that was sort of the temporary feature of that environment. Normally as a company, we would carry less than one quarter of backlog. And there's a couple of reasons for that. If you think about Industrial and Medical, products these tend to have pretty short lead times, sort of in the 8 to 12-week lead time. And on the semiconductor side, many of our customers typically don't give us orders. We supply to them on a just in time basis.

So they maintain bins. We keep the bins at certain targeted levels and you have revenue but no orders. So it's pretty typical before this time of the supply chain crisis that we would run two-thirds of a quarter in backlog is all. So it's much more of a build to forecast, either a customer forecast or our own forecast model.

And the good news is that we're getting back into that mode again. And we've seen our backlog sort of steadily trend down as parts have gotten better. Last quarter was a little over \$500 million. We said in normalized times we would get into the \$400 million to \$500 million range. We expect that to happen in the fourth quarter because customers are both – now have shorter lead times. They don't have to give us these long lead time orders. And many of those that were giving us orders in the interim are transitioning back to this sort of just in time model. So we do expect that to normalize during the fourth quarter of last year.

<<James Ricchiuti, Analyst, Needham & Company>>

The non-semi business, this is probably not necessarily the right way to ask the question because it's going to be dependent on the cycle. But how do you see that business as a percent of revenues? It's been roughly around half of revenue. But longer-term, Steve, these are – how would you see that profile of the business changing?

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

We don't see it changing dramatically. I think on Industrial and Medical, we put a lot of focus there internally with the re-incentivization of our sales force. So we split off half our salesforce and they're paid exclusively on Industrial and Medical revenue and design wins. So that's inspiring a lot of activity there.

And we supported that with a new website which we launched in August, and we'll have e-commerce available later this quarter. So that gives us a lot more reach into markets that we haven't touched before. And it's going to be difficult to get to some of these customers, because there are thousands of Industrial and Medical customers.

So we think organically we can grow a lot in I&M is how we refer to it. But in addition, you look at our inorganic strategy, most of the opportunities of any size are in the Industrial and Medical space. I think you'll see us grow there with acquisitions as well as organically.

In semiconductor, it's all about the technology. So that's why I'm so enthusiastic about these new products, the eVerest and eVoS platforms, because it really gives us a growth engine for the next 5 to 10 years. In addition, we have other products, we have a service business that all contribute to the growth in semiconductor.

<<James Ricchiuti, Analyst, Needham & Company>>

I want to spend a moment on next few questions on a medical business, and that's both an organic and an inorganic story. What does medical represent roughly in its most I&M [ph]?

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

It's about 25%. So medical business is about 25% of the Industrial and Medical business as a whole. With the acquisition of SL Power in April of 2022, and some growth over the past couple of years, we've been able to attain the number two position in medical power. And we think number one is in sight.

So that was a very good acquisition for us, because we are very complementary companies. They were strong at customers where we were weak and vice versa. And so the customers have been very happy with the total portfolio and our ability to service it, because Advanced Energy has very good factories, not just in Asia, but also in Mexico.

So part of what we got with SL Power was a factory in Mexicali. And in the medical market, onshore manufacturing matters. And so that's an important part of our growth story to medical accounts. And as an aside, we've invested quite a bit in that Mexicali factory. We've quadrupled the floor space and we expect the business will quadruple or quintuple in Mexicali over the next two years. So it's not just medical, it's also industrial, it's also other high volume customers who want to build in North America.

<<James Ricchiuti, Analyst, Needham & Company>>

Line of sight in medical, how would you characterize that? And the reason I'm asking the question is we're hearing some mixed news, some of the – at least from some of the companies that I follow that have exposure to medical. And just curious, what have you seen?

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

Well, first of all, it's important to realize that medical is a very long lifecycle or design cycle business, so similar to semiconductor. So it takes us a long time from the first samples to respectable volume. So what we've seen is a lot of activity on the design side. When that goes to volume, anybody's guess, but we think from the design standpoint, we're in really good shape. I think if you're asking about the ups and downs in medical market, it varies a lot by customer. So I have a hard time making a really intelligent comment on the medical market beyond what has already been written.

<<James Ricchiuti, Analyst, Needham & Company>>

You alluded to the manufacturing footprint in Mexicali. Also hearing from companies about the wage pressure that we're starting to see in Mexico. Paul, maybe it's a question for you. Is this something that has been a challenge for you guys?

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

I think wages – wage growth and inflation in general have been a pressure on a lot of companies, and we're no exception to that. At the same time, we've continued to take actions to optimize our footprints, particularly in manufacturing across the globe, as well as in our own structure. I think anytime you're in markets that can be cyclical, and certainly we've

been in a down semi market, argue the data center market is also in quite a down market. You mentioned medical is mixed, same with a little bit industrial and medical, the industrial market as time goes on. So what we've tried to do is focus on things that we can manage and control.

And in that respect, we focus a lot on how do we shore up our gross margins, a lot of that's about factory optimization strategies, how do we manage our cost structure. So we've actually been able to bring our actual spending down from a year ago rate despite inflationary environment, because we've been able to drive efficiencies in the organization. And that's how we've been trying to manage these cost pressures and other challenges.

<<James Ricchiuti, Analyst, Needham & Company>>

Yeah.

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

Yeah. And we're actually transferring more of our headcount to Mexico and to the Philippines as a considered effort over the past 18 months. And so I think that's helping the company, it's helping our performance in OpEx, and ultimately, our retention in these low cost areas is also very good. So that's the other part of the equation. You could look at the labor costs, but also the cost of recruiting and training and so forth is significant. So we focused on staying competitive and really trying to be best in class when it comes to retention.

<<James Ricchiuti, Analyst, Needham & Company>>

Yeah. As diverse as the medical businesses, but the industrial portion of I&M is really quite diverse. And that's sometimes a challenge, I think, for investors. And help us think about how should investors be thinking about that part of the market?

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

I think on industrial, it's a highly diversified market and it's a very broad term, right? Encompasses a lot of things. Think about advanced test systems, think about aerospace and defense, think about burn in chambers, think about any application where reliability and performance is important. And that's where we play. And there's many, many applications there. Talk about robotics, process automation, you name it. And so how we operate there is first we've refocused the salesforce, improved our website, but then as we start to win designs, we try to replicate.

So we say this is a burn in customer. How many other burn in oven customers do we have? So let's use that same value proposition. And that's how we are able to carve out new niches and then expand our ability to grow the revenue in industrial. So it's hard to generalize, but within the company, we have roughly ten segments where we're focusing today. But that's going to change because we're going to keep adding as we find good applications. The other thing we do in industrial is we customize it.

So we've launched a number of new platforms over the past year and a half, which have inspired a lot of interest from customers. But they all want something different. I want a

different color, I want a different knob, I want different output, different input. We have a team of people in the Philippines who basically customize these products for customers. It only takes two to six weeks, and once we do that, we've got a custom design win that's probably going to generate revenue for the next 10 to 15 years.

<<James Ricchiuti, Analyst, Needham & Company>>

Given the changes you've made in some of the go to market in that area, in I&M, particularly in industrial, are there some segments of the market that you think investors should be paying closer attention to in terms of that could move the needle, the more attractive areas that you see over the next couple of years?

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

Yeah, I think it's really the industrial automation and it's basically the high cost machinery and high cost processes. And that's where we play and that's where customers can't afford downtime and they can't afford systems that malfunction. And so that's our value proposition is, we'll provide highly engineered solutions that don't break down, essentially, and that's how we differentiate from many of our competitors.

<<James Ricchiuti, Analyst, Needham & Company>>

Any sense, and again, it's tough to answer this one, possibly, because of the diversity of the business, but overall market position in some of these markets in the industry, and the opportunity to, as in medical, where you gain some share, some of that's through acquisitions.

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

Yeah. So I think when you think of an industrial and medical, it's a very fragmented market. We have single digit market share and we're still one of the top players. And so that's why we think through M&A, we could become number one in relatively short order in the next couple of years. But still we're not going to be a 50% player. We could be a 15% or 20% player and be quite significant industrial and medical.

Now my ability to measure my success in each of these submarkets is kind of limited, because it's hard to get the TAM data. The way we look at that is, we look at a market, let's say, test systems, and we know who the players are and we know how we're doing on each player. And then we'll tally it up. The sockets we've won and the sockets we have to win in the future. And then there's the sockets that have been won by somebody else in the past. And the only way we get to that is with M&A.

<<James Ricchiuti, Analyst, Needham & Company>>

Are there some opportunities in industrial similar to what we saw with SL, I mean, that...

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

SL Power, yeah.



<<James Ricchiuti, Analyst, Needham & Company>>

That turned out to be a really nice acquisition. Or is it a different market in industrial as it relates to that business in medical?

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

I think there are other significant players in industrial medical. I can't go into details, but they're basically target companies in our pipeline, which we think would be complementary to our current business.

<<James Ricchiuti, Analyst, Needham & Company>>

And just relating to the comments you've made. And this goes back to the last couple of calls where you've talked about the changes in the way the sales force and I&M is being compensated. Any metrics you might be able to share with us that give us a sense as to the progress you're making in that area.

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

I could tell you what we measure. We haven't gone into great detail, but the biggest one is our design win pipeline. So what's the size of our funnel essentially? In industrial medical, we're at least 2x to 3x where we were two years ago as far as the number of design, the value of the designs in the pipeline. So that's an important metric for us. And so we do that in each of the regions of the world. Some regions we're stronger than others and so we adapt our strategies in each region depending on where we're at.

<<James Ricchiuti, Analyst, Needham & Company>>

Semi portion of the business is characterized by very sticky relationships. I think you said medical as well.

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

Yeah.

<<James Ricchiuti, Analyst, Needham & Company>>

In general, I&M, are these relationships sticky? And that could be also an opportunity for you to take share if there's an opportunity where you can get in with some of these newer customers.

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

Yeah, I think I&M is a little bit different than semiconductor for two reasons. One is the customer base is more diverse, and the second is the supplier base is more diverse. And so that's part of the strategy longer-term as we consolidate some of the market, the supply base under AE, then we become more important to our customers, and that's when our relationship goes to another level. But today, I think there's a lot of work to be done as far as customer relationships and industrial medical. That's what we're working on.

<<James Ricchiuti, Analyst, Needham & Company>>

We haven't touched on the data center and telecom portion of the business, small parts of the business, just any color you can provide on what you're seeing in those markets.

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

Yeah. So shortly after I joined the company, we took a look at those businesses and decided to become more selective because in many of the high volume businesses like data center, there are a lot of low margin opportunities. They're high revenue, but low margin. We said we don't want those, right? So we're going to focus on sole source opportunities with higher margin, and then we're going to shift some of the engineering resource over to industrial medical to accelerate our pipeline and our revenue there.

So what we've seen on the data center computing side is transition to better margin business. The focus there has been growing the bottom line faster than top line. We've been very successful in doing that. Telecom and networking, I think there's probably less excitement because the big driver was 5G that appears to have peaked, right? So we don't see a lot of growth in telecom and networking moving forward.

<<James Ricchiuti, Analyst, Needham & Company>>

You mentioned margins, and Paul, I think it's a good opportunity to segue to some discussion on gross margins. Like a lot of companies, AE has been impacted by component premiums, material premiums. You've seen improvement. You saw improvement, I think most recently in Q3. As we look at it 2024 that becomes a bigger tailwind, doesn't it?

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

It does continue to become a tailwind for us. And look, gross margin is probably the single most important financial measure that we're focused on as a company. Our goal is to be at 40% or better. And frankly, over the last two or three years, that's proved a little bit elusive for different reasons. The biggest one is during the supply chain crisis, we paid substantial amount for parts that we had to buy from third-parties, brokers, dealers or other parts of the market because we just couldn't get parts. And that was a conscious decision.

It actually paid off really well for the company because we got good revenue growth. We're able to meet our customer needs. But it was very expensive. So fortunately, that environment is getting better. And we said we'll be largely out of that paying those premiums by the first half of 2024. And in fact, by our third quarter, we said that that had come down to being only 100 to 150 basis point impact on margins, where in the prior year was over 300 basis points. So certainly that's been positive for us.

I think the flip side is, during that same time, we went from sort of a peak revenue now to where the semiconductor is in the middle of a down cycle, and similarly with data center. And so there's been some volume offsets that have sort of clouded the tailwind from that. As we look forward, there's three things that we think will drive gross margins in the future.

One is we'll continue to get the benefit of that last 100 plus basis points of improvement in just material costs that should come naturally over, like we said, by first half of 2024. Secondly, we're putting a lot of effort into our factory optimization. During the supply chain crisis COVID, you're doing everything you can just to get product out the door, particularly during the upcycle that was in. So there's a lot of opportunities for us to consolidate our footprint. We announced at our Q3 earnings release, we expected to close two factories in fourth quarter. We had already closed a large one the prior year. And we have a plan over the course of the next year to continue to consolidate from our smaller boutique factories into our larger factories.

We think that adds another 100, 150 basis points of gross margin improvement, because we're fundamentally improving our cost structure in cost of sales. Put those two things together, and one of the things we said in Q3 was that if we had sort of a flattish year in 2024, we could actually see better overall gross profit, and therefore potentially a little bit better earnings on a flattish year. So those are the things that are right in our control, that we're really focused on driving efficiency, obviously, working with our supply chain, improving our cost of quality and things like that.

Finally, volumes should need to recover a little bit, and that's the last leg. If we can get volumes back into the mid to high \$400 million range, then we think that adds another 100 plus, 150 basis points of margin, and that gets us to our 40% target, or maybe plus or minus.

Now, in the long run we would like to be at 40% in good markets and bad markets. And I think a fair internal goal or aspirational goal is that after the markets recover and go into the next downturn that our troughs wouldn't be in the sort of this mid-30s plus, they'd be more like around 40. And so the last leg to that is continuing to optimize our product portfolio. The new products we're bringing out focus on industrial and medical. We've talked about our selective strategy and our high volume markets. All those things we think can add another 100 to 200 basis points because of the mix of products that we have – capabilities we have.

Part of that we'll be increasing our sole-source content from 70% to 80%. Those are sort of the supporting metrics that we think get us there. So this is a big area of focus for the company. We personally or I personally think, and I think we collectively feel like there's a lot of earnings potential still in the company as we're able to improve our gross margins. It's the one area of our model that we're not satisfied that we've been able to really accomplish yet. But it's clearly on our radar and I think we have a clear roadmap of how to get there.

<<James Ricchiuti, Analyst, Needham & Company>>

Also it sounds like there are multiple levers.

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

Multiple levers, that's right.

<<James Ricchiuti, Analyst, Needham & Company>>

I guess from your standpoint that gives you a little bit more comfort in terms of that, right?

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

Yeah, that's exactly right.

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

Yeah. And I think one positive of a downturn it gives you a lot more freedom to make these factory consolidation moves, right. So we've been doing those fast and furious over the past year, and as long as the market stays relatively low, right, we're going to continue to make these moves. So coming out of this downturn, our fixed cost base is going to be in much better shape.

<<James Ricchiuti, Analyst, Needham & Company>>

Three years ago at your last Investor Day, the company identified what I think you described as three main pillars of the growth strategy: market share gains, product innovation and some of these newer opportunities. I mean, it sounds like we're seeing that not necessarily a fair question for you, Steve, you came in shortly after the Analyst Day, but as you're thinking about the business and thinking about going forward, the business continuing to evolve, driving stronger growth. What do you see as the big opportunities?

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

I think on the semi side it's about the technology. If we can secure these wins on eVerest and eVoS it looks like we can. That's going to be very beneficial for the company because it drives revenue growth and it drives margin growth. I think on the industrial medical side, we see the same thing where it's new products plus acquisitions. Those are key drivers of growth as well as margin. And underlying all of it is what Paul talked about is, do we have an industrial base that's efficient, and there is a big opportunity to make changes there, and we're doing that as we speak.

<<James Ricchiuti, Analyst, Needham & Company>>

Before I move to my final questions on capital allocation, I just want to throw this out to anyone in the audience, any questions out here? Let's turn to that. You raised approximately, what, 480 million in September in a convertible senior notes offering. Talk about the rationale for that capital raise?

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

Yeah, it's a good question. As Steve has mentioned M&A is an important part of our strategy because we live in this very fragmented market, and there's a lot of opportunity to stay within our lane of advanced power applications and acquire complementary products, channels customers through M&A. And we want to make sure we're in a position to do M&A. We also said that we prefer to do larger sizes. We've done SL; we would kind of put in the medium size. We've done one large one with Artesyn, and we've done lots of little ones.

And as we looked at the market in the summer, what we found is there was an opportunity to raise capital, we thought was very attractive rates that would support our M&A strategy. And given the uncertainty of the financing market and the higher cost, we decided to take advantage of that and raise the funds. Now, first use of those funds is clearly to drive the

opportunity for M&A, and we didn't want to get into potentially a larger M&A scenario and then be trying to secure financing at the same time, that always creates some risk. So this sort of took that risk off the table.

Secondly, we're prudent about how we come about M&A. I think we have a good track record there. We make sure that the targets fit within our strategy. There's a good cultural fit, and that financially it makes sense. And so we're not in a rush to go out and do something. And so we felt like if we're going to raise money, we need to make sure there's other purposes for it. And I'd say the second purpose is we do have a tranche of debt coming in September where the cost of that debt is going to increase because we were able to put a swap in place and keep that cost low for quite a long time. So there's a natural window that we could actually optimize our debt structure a little bit and use those funds to do that.

And the third thing is there's opportunity in these cyclical markets to buy back our own stock. And we've done that over time. We have an opportunistic share repurchase plans. We don't buy stock every quarter, but we are able to take advantage of market cycles and then be able to buy back our own stock at attractive rates. And we've actually reduced the share count in our company because of our share repurchases over the last two or three years.

So that's how we think about its opportunistic. We were able to raise money at a time that we felt was relatively low cost of capital, and it positions us well to execute our strategy.

<<James Ricchiuti, Analyst, Needham & Company>>

How does the M&A pipeline look in the intermediate? How active the pipeline is? It sounds like you're looking at a variety of things, but we know, I think, the two key areas that you're focused on, but in terms of size and the types of acquisitions that are out there and your criteria?

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

Yeah. We have, I think a healthy pipeline. And so the way we approach this is we try to develop relationships with these target accounts so that when they're ready for a transaction we're first in line, essentially. I think there's still in many cases a disconnect on valuation. So I think as time goes by the disconnects become less pronounced. So we hope that this year is going to be a good year for M&A, but we're going to make sure whatever we do makes financial sense for the company.

<<James Ricchiuti, Analyst, Needham & Company>>

Are you focused more, Steve, on customer relationships or getting deeper into certain segments of these verticals?

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

I think in general what we see is good opportunity, industrial, medical. So it's going to be more product fit. Do they have a complementary product set? Are they efficient? Do they have good cost structure? Are they going to average us up from a margin standpoint?

<<James Ricchiuti, Analyst, Needham & Company>>

Good. I think we're going to wind it up there. I want to thank you both for doing this.

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

Thanks very much.

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

Thanks, Jim.

<<James Ricchiuti, Analyst, Needham & Company>>

Yeah.

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

Thanks all for joining us.