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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Advanced Energy Industries Fourth Quarter 2020 Earnings Conference Call. (Operator Instructions)

I would now like to hand today's conference over to your speaker, Edwin Mok, Vice President of Strategic Marketing and Investor Relations. Thank you. Please go ahead.

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

Thank you, operator. Good morning, everyone. Welcome to Advanced Energy's Fourth Quarter 2020 Earnings Call. With me today are Yuval Wasserman, our President and CEO; Paul Oldham, our Executive Vice President, CFO; and Brian Smith, our Director of Investor Relations.

If you have not seen our earnings press release, you can find it on our website at ir.advancedenergy.com. There, you'll also find a slide presentation to follow along our discussion today.

Before I begin, I would like to mention that AE will be participating at several investor conferences in the coming months. As events occur, we will make the announcements.

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 and uncertainties is found in our filings with the SEC. All forward-looking statements are based on management's estimates, projections and assumptions as of today, February 10, 2021, and the company assumes no obligation to update them. Long-term targets presented today, including our aspirational goals and our long-term vision goals, should not be interpreted in any respect as guidance.

On today's call, our financial results will be presented on a non-GAAP financial basis unless otherwise specified. Excluded from non-GAAP results are amortization, stock compensation, integration and transition costs, unrealized foreign exchange gains or losses and restructuring items. Detailed explanation of our non-GAAP financial measures as well as reconciliations between GAAP and non-GAAP measures can be found in our press release today.

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

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

Thank you, Edwin. Good morning, everyone, and thank you for joining us on this call.

Advanced Energy finished last year on a strong note, with Q4 2020 revenue of $371 million, up 10% year-over-year and solidly above our guidance midpoint. Non-GAAP EPS of $1.49 was at the top of our guidance range.

The fourth quarter results were driven by strong demand for our products across most of our markets and good execution in an increasingly dynamic operating environment. Service revenue, again, set a record.

Our Q4 results built on a great year of financial performance despite a global coronavirus pandemic that presented all of us with extraordinary challenges. I'm extremely proud of our organization's response to the constant changes throughout the year, demonstrating AE's agility and operational excellence. Our diversified global operation footprint, nimble supply chain, hub inventory management system and maintaining a healthy and safe workforce enabled AE to effectively meet shifting customer requirements and to deliver a strong 2020 results that outperformed the market.

2020 revenue grew 79% as reported and 18% on a pro forma basis to a record $1.4 billion, with our semiconductor business growing 50% and data center computing growing 46%. Our non-GAAP earnings more than doubled to $5.23 per diluted share. And we generated over $200 million in cash flow from continuing operations. Paul will go into more financial details in his remarks.

Advanced Energy is a clear leader in precision electric power conversion and control. Our power solutions are used in many of the enabling technologies behind the fourth industrial revolution in the data economy. Last year, AE not only capitalized on the accelerating megatrends of these markets but we also introduced 12 new products to help speed up our customers' innovation and expand our addressable market.

Examples of major innovations we brought to the market include eVoS, our beyond RF Power solution that we believe will enable advanced plasma processes for multiple next-generation technology nodes. Additionally, our system-level, 48-volt power shelf will allow data centers to become more power efficient and cost effective. Our intelligent lighting and power control system will help indoor farms to substantially lower power consumption and costs while increasing crop yield.

We now enter 2021 with a richer portfolio of differentiated products that we expect will continue to enable breakthrough innovation by our customers and fuel our continuing growth.

In line with our strategy to accelerate our growth and diversification through strategic acquisitions, at the end of 2020, we completed the acquisition of Versatile Power, expanding our reach in the medical market with its field-proven RF Power supplies. Versatile Power brings to AE well-established experience working in a highly regulated medical market and an 18-year customer relationship with one of the leading medical technology companies. In addition, we expect to integrate Versatile's technology into our enterprise technology road map and to cross-sell current Versatile solutions across our market verticals. This is another example of AE using smart acquisitions to grow our scope and leverage our scale.

Our 2020 results affirm the success of the acquisition of Artesyn Embedded Power as we integrated the business into AE-scalable platform. Despite the COVID-related challenges, we exceeded our integration milestones and delivered on our synergy goals. And we believe that we are on track to meet or exceed our long-term cost synergy target in roughly half the time of our original plan.

With a fully integrated functional organization structure, we have the scale and the scope to drive sustainable competitive advantages as a top-tier industrial technology growth company as we continue to pursue our long-term strategic and aspirational goals.

In Q4, we continued our investment in ESG initiatives, launching a new scholarship program to support increased diversity in STEM education. We have tremendous interest with applicants from multiple universities across various technical disciplines. We will continue to enhance our ESG initiatives as part of our commitment to deliver long-term value to all of our global stakeholders.

Now let me comment on our fourth quarter performance across our markets. Our Q4 semiconductor revenue was at the high end of our previously stated second half growth rate of 15% to 20% after an exceptional Q3 driven by robust demand in foundry/logic and strengthening NAND. We expect this healthy market condition to further improve in Q1.

We are extending our leadership in semiconductors as we launch new products, including a new high-power RF generator, the Paramount HFi, and a new remote plasma source, the MAXstream. In addition, we shipped evaluation units of eVoS to a number of strategic customers during the quarter. And we won an RF design for a next-generation PECVD tool at one of the top equipment OEMs.

In Korea, we secured new RF design wins for a leading CVD and ALD platform and for a next-generation etch for NAND application.

In the $300 million semiconductor embedded power market, we secured a new design win in back-end equipment by replacing multiple competitors' DC modules with our integrated solution.

Overall, our success across multiple fronts will allow our semiconductor business to continue to outgrow the market. Driven by increase in the semiconductor industry, we expect our demand to increase in Q1 and to further accelerate in Q2.

Turning to our data center computing market. Demand declined in Q4 as expected, reflecting data center digestion among our hyperscale customers and a generally weak IT spending environment. We expect this market condition to extend into Q1 but we continue to anticipate growth to return later this year.

In hyperscale, we are transforming from being a fast follower to becoming a market leader as we grew our 2020 revenue by over 250%. Although this market could be lumpy, we believe we are still in the early innings of this journey and expect meaningful growth over time.

We continue to make solid progress at new hyperscale customers and reiterate our target to deliver production shipments to additional Tier 1 hyperscale customers this year. We've also started to capture new opportunities created by the transition to 48-volt service. In Q4, an additional hyperscale customer selected our 48-volt power shelf. And we secured a design win for our board-mounted, 48-volt DC-to-DC converter at a Tier 1 customer.

In enterprise computing, we secured another high-performance computing design win for a supercomputing platform at a leading customer as we continue to capitalize on our industry-leading efficiency and power density.

While the high-volume production of these wins may take time, they support our road map of adding over $100 million of annual incremental revenue by 2023.

Industrial and medical revenues grew 8% sequentially, surpassing our expectations. Macro conditions improved in Q4 across several markets as we saw good demand for solar cell manufacturing, flat panel display and hard coatings for consumer devices. We also benefited from growing demand for air filtration systems used in preventing the spread of COVID, which is a win we reported last quarter.

Revenue from medical applications declined sequentially on lower demand for some critical care equipment and elective care applications. During the quarter, we secured several design wins from medical diagnostic applications with our fanless power supplies.

Our strategy for industrial and medical is to enable smart applications through our portfolio of products with advanced digital capabilities. During the quarter, we introduced a multitude of new products across our application set, from pyrometry and industrial heating to indoor farming and medical. While we expect industrial to be seasonally down in Q1 and medical to see further pressure, based on our solid design win pipeline, we are well positioned to grow this vertical for the year as macro conditions improve.

Revenues from telecom and networking applications remained about flat from Q3 and were up 20% year-over-year, reflecting a slightly improved market condition and success of some of our programs. Overall, telecom investment remains constrained and networking is facing the general slowdown in IT infrastructure investment.

With significant 5G investments still ahead, we are focused on winning the key 5G designs. In Q4, we secured an important 5G design win for a small cell radio primarily designed for the U.S. market. In networking, we won a design for a white box switch for a Tier 1 Asian hyperscale customer.

We continue to optimize our portfolio for higher earnings growth. While in aggregate, these actions will impact revenue over the short term, we believe the steps taken will focus our resources on higher value-added opportunities and continue to improve overall margins.

To summarize, Q4 and 2020 results demonstrate our unique position in benefiting from the fourth industrial revolution, our successful growth strategies across our markets and the strength of our team and our culture. Our focus on being a pure-play power leader is enabling us to outperform the markets we serve, gain market share and expand into new and exciting opportunities. We have built a track record of growing earnings faster than our revenue and delivering top-tier return on invested capital.

At the end of 2020, we announced a regular quarterly dividend, demonstrating our ability to generate consistent cash flow and our commitment to regularly return capital to our shareholders while continuing to pursue inorganic growth.

Looking forward, we will continue to invest aggressively in bringing new enabling products and solutions to our markets. Our growing pipeline of design wins reflects our success in converting those investments into tangible results. Despite near-term macro challenges due to the coronavirus, we expect our top and bottom line to continue to grow in 2021. Going forward, AE is well positioned to deliver long-term sustainable growth through our innovation, technologies, products and services.

Before I conclude my comments, this morning, we announced that I will be retiring as President and CEO of Advanced Energy effective March 1. Steve Kelley, who some of you know as the previous CEO of Amkor, will become the President and CEO of Advanced Energy. To ensure a seamless transition, I will remain as an executive adviser to Steve and the Board through March 2022.

I'd like to thank the Board, our shareholders, our customers and, most importantly, our employees for their support over the last few years. It has been an amazing journey as we have grown the company, introduced new products and technologies, delivered record financial results, created shareholder value and transformed AE into an industrial technology growth company. I am proud of our accomplishments and I'm grateful for the relationships I have developed over this time.

My retirement is a result of our standard succession planning process. I have worked closely with the Board of Directors to identify the right person as the next CEO for Advanced Energy. We looked for a proven leader who builds teams, fosters innovation, drives strategic vision and creates shareholder value and we found these attributes in Steve. Together with the leadership team, I'm confident that he will lead AE to the next level of success.

With that, let me turn the call over to Paul.

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

Thank you, Yuval, and good morning, everyone. Before I begin, please note that all financial measures presented today will be on a non-GAAP basis, unless otherwise stated.

This quarter, our non-GAAP results also exclude $5.2 million of restructuring costs primarily related to the previously announced closure of our Shenzhen facility and $3.8 million in noncash unrealized FX losses related to long-term lease and pension liabilities. A reconciliation from GAAP to non-GAAP measures can be found in our press release issued earlier today.

We delivered outstanding financial results in the fourth quarter, with revenue above the midpoint of our guidance and non-GAAP earnings per share at the high end of our guidance range. Despite the challenging environment, our team again executed very well, delivering to strong customer demand primarily in our semiconductor and industrial markets. Combined with synergies and good cost control, we achieved our second-highest quarter ever in operating income and cash flow generation and an annualized return on invested capital of over 20%.

Fourth quarter revenue was $371 million, reflecting nearly 10% growth year-over-year but down 5% sequentially from the record levels in Q3.

Sales in the semiconductor were $166 million, up 32% from last year and almost flat to last quarter. Our full year and second half 2020 growth outperformed the market and industry again as we continue to extend our leadership in semi power.

Our R&D investments during the last downturn are yielding tangible results, with multiple new product introductions and a strong pipeline of design wins.

Looking forward, we expect semi demand to grow sequentially in the first quarter and further accelerate in Q2 on continued strength in foundry/logic and increased demand in 3D NAND applications.

Data center computing revenue was $65 million, down sequentially as expected, as the market digestion that began in Q3 continued into the fourth quarter. Looking forward, we expect cloud digestion to continue to impact our data center computing revenue in the near term, with increased investment and the benefit of new design wins driving higher revenues later in the year.

Revenue from our industrial and medical markets grew 8% sequentially to $94 million. The better-than-expected performance was driven by growth across several applications, including motion control, photonics and thin-film coatings. Medical revenues declined as expected from a strong Q3 due to critical care demand beginning to normalize.

Looking forward, we expect industrial and medical revenues to decline seasonally in Q1 versus Q4 but be well above the revenue level from a year ago. Near term, the impact from COVID will continue to pressure this market. But improved macro conditions should benefit our industrial applications over time.

Telecom and networking revenue was $46 million in the quarter, down slightly from Q3 but up 20% year-over-year. Overall, global 5G investments outside of China are expected to remain relatively muted in the near term. In addition, we expect our portfolio optimization actions to begin impacting revenues in this vertical as we pivot towards higher-value applications.

Non-GAAP gross margin for the quarter was 39.5%, down slightly from 39.8% last quarter on lower volume. Year-over-year, gross margins increased to 360 basis points driven by material cost improvements, product mix and accelerated synergy actions, including portfolio optimization and productivity improvements across our factories.

While we expect gross margin to decline modestly in Q1 due to lower volume and supply chain challenges, our planned synergy actions should further improve gross margins over the next several quarters, enabling us to sustainably achieve or exceed our initial gross margin target of over 40%.

Non-GAAP operating expenses were $76.9 million, down $2 million from last quarter on lower variable expenses and timing of R&D project costs. Our team did a good job of controlling expenses during the quarter. As a result, operating margins for the quarter were 18.7%.

Non-GAAP other expense was $2.3 million, including $1.3 million of interest expense. We expect other expense to remain in the $1.5 million to $2 million range.

Our non-GAAP tax expense was $9.9 million or 14.7%. Looking forward, we expect the GAAP and non-GAAP tax rate to remain in the 15% range.

Non-GAAP earnings for the quarter were $1.49 per share, down from $1.66 last quarter on lower revenue but up 71% from $0.87 a year ago.

Turning to our full year 2020 financial results. Revenue increased by 79% on an as-reported basis to a record $1.42 billion. On a pro forma basis, revenues grew 18% driven by 50% growth in semi and 46% growth in data center computing, partially offset by declines in industrial and telecom markets primarily related to COVID and macro factors.

Our full year 2020 gross margin was 39%, approaching our initial long-term model of 40% after just the first full year of Artesyn integration.

Gross profit dollars increased almost 70% from 2019. Leverage on sales growth and synergies from the Artesyn acquisition resulted in operating income more than doubling to $244 million or 17.2% of sales. As a result, 2020 non-GAAP EPS was a record $5.23 per share, up more than 110% from $2.44 in 2019.

Turning now to the balance sheet. We ended the fourth quarter with cash and marketable securities of $483 million, up $51 million from Q3. Inventory declined by $35 million and turns increased to 4.1x due in part to timing and actions taken to structurally improve our inventory management. This improvement was largely offset by a reduction in accounts payable on lower purchases and associated DPO of 50 days. We expect both inventory and payables to increase in Q1 largely to manage supply chain constraints.

Receivables decreased on lower sales and DSO rose slightly to 57 days. Total days of net working capital were 95, up 2 days from last quarter.

Operating cash flow from continuing operations was $67.1 million, just below the record level we generated last quarter. Full year operating cash flow was a record for the company at $202 million.

Free cash flow from continuing operations was $56 million in Q4 and $166 million for the full year.

Capital expenditures for the quarter were $11.3 million and depreciation was $7.3 million. We continue to expect capital expenditures to be about 2% to 3% of sales.

During the quarter, we also repaid $4.4 million of principal amortization on our debt, ending with total bank debt of $322 million and net cash of $161 million. Our trailing 12-month gross debt leverage decreased to 1.2x.

During the quarter, we did not repurchase any stock.

Finally, as announced last week, we declared a quarterly dividend of $0.10 per share, which will be paid to shareholders of record as of February 22.

Now let me turn to guidance. Overall, we expect Q1 demand to remain strong with sequential growth in semiconductor partially offsetting seasonal declines in industrial and medical and the impact of portfolio optimization in telecom and networking. Data center computing revenues are expected to be at similar levels as Q4.

On a year-over-year basis, we expect solid growth across all our market verticals, except data center computing, due to the market digestion following a strong ramp last year.

While we see strong demand for our products, the ongoing risks related to COVID-19, combined with global supply constraints in the electronics industry, could impact our ability to fully meet this demand in the near term. Factoring these risks into our forecast, we are guiding Q1 revenue to be $350 million, plus or minus $15 million.

Based on lower volume and higher supply chain costs, we expect non-GAAP gross margins to be 38% to 39%. Operating expenses are expected to be up slightly on increased R&D investment.

As a result, we expect non-GAAP earnings to be $1.25 per share, plus or minus $0.15.

Before I open for questions, I would like to share some of my perspective on our business. As our 2020 revenue growth demonstrated, Advanced Energy is well positioned to benefit from the secular growth trends across our markets while also gaining market share and expanding into new market opportunities. The doubling of our earnings reflects solid execution by our team, our ability to deliver on our synergy plans and the operating leverage in our model.

Looking forward, we are as excited as ever about the demand prospects for our business as we should have tailwinds across our markets in 2021. Although the impacts of COVID and challenges in the global electronics supply chain may impact us over the next couple of quarters, we remain confident in both delivering growth in 2021 and in meeting our new 3-year aspirational goals of $1.65 billion in revenue and $7.50 in non-GAAP EPS and in achieving our long-term vision of $2.5 billion in revenue and $12 earnings per share over time.

Finally, I would like to extend my personal thanks to Yuval for his vision, leadership and commitment to Advanced Energy as he led the transformation and success of the company. I have personally enjoyed working with Yuval immensely over these last few years and wish him well on his new chapter of his life. I equally look forward to working with Steve Kelley and I'm confident in his ability to lead Advanced Energy to the next level of success.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question is from the line of Mehdi Hosseini.

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

Yes. Best of luck to you, Yuval. I have one question for Yuval. And I want to better understand what instigated the change in the CEO role. I understand the succession plan but I'm kind of surprised given your aspirational goal. So if you could provide us with some color will be great.

And then in terms of your report, how should I think about your traction in Japan? You talked about continued share gain especially in semi cap. And I want to see how you're tracking with the share gains specifically in the Japan region.

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

Thank you, Mehdi. Regarding my decision to retire, it is really part of our standard succession planning process. Full disclosure, I will be turning 67 years old this year. And my plan is to spend more time with my family, friends and pursue some of my personal interests. I've been working very closely with the Board to identify the person that will have the right profile and attributes to continue to lead the company and pursue the strategy that we put together.

And as I said earlier, we found these attributes with Steve Kelley. We're excited about Steve joining the company. We believe that he has all the capabilities, skills, experience and track record to do just that.

Now regarding our market share gains, as you know, 2020 was an amazing year for us. We introduced tremendous amount of products, I think more than any other company in our space in 2020 while managing the company through COVID-19. Some of these products are enabling and, especially in the semi industry, some of these products will enable the next-generation technology nodes, especially eVoS, MAXstream, the RFPS. We continue to gain traction. We continue to gain share.

And one area that is a really unique strength of Advanced Energy is our RF matching networks. We are the world leader in RF matching, which is really critical for the ability to deliver effectively RF powering to the plasma. This is another area that we continue to grow, get traction and gain share.

Specifically regarding Asia, we continue to have good design wins in Asia as I reported. Specifically to Japan, we are an increasing player in Japan with higher level of traction in very advanced applications. And beyond that, I cannot share any more information.

Operator

Your next question is from the line of Scott Graham with Rosenblatt Securities.

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

Yes. Yuval, congratulations. I know we've only known each other for a short while but obviously, the track record here has been terrific, and you've really transformed this company. So congratulations and best of luck.

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

Thank you so much. Thank you very much.

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

Sure. So I wanted to maybe talk about the 3-year goals as well and maybe kind of piggyback on to the prior question. So why would we be putting these out now in front of the change at the top particularly since, if I may, the EPS growth target, which I assume is for 2023, is a pretty healthy target? Could you talk through why we would be releasing this today rather than maybe waiting a quarter for Steve to have full input?

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

So a really good question. So as I said earlier, the hiring of Steve was driven by a process that is a standard succession planning process. When we talked to the Street about updated aspirational goals 3 years out, we at that point did not conclude on a successor. So in terms of timing, our decision to onboard Steve to the company came after our announcement of the aspirational goals. So there's nothing shifty or tricky about it.

The decision about my timing of retirement was driven by identifying the right successor, right? And if we didn't identify the right successor, I probably will stay here for a longer period of time. So the timing of my retirement was driven by identifying Steve. Does that answer your question?

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

Yes. Yes, it does. Yes, for the most part. If I could just sneak maybe one more in here. Again, you're hearing me not ask questions about the results, which I think are very straightforward. You had a nice quarter and all of that. The guidance is very clear.

Again, maybe one on the longer term. So you're way ahead of plan on the integration of Artesyn. And your balance sheet is kind of back to the -- on a net leverage basis, really being liquid. Does this change from you to Steve slow down potentially the M&A process? As Steve kind of gets his head around everything, do you think there's a potential slowdown here? I guess I was thinking that 2021 would be a big year for M&A for you guys again. What is your thoughts there?

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

Yes. Good question. So let me give you a little bit of background, right? Board -- the Board has approved our strategic plan. The Board has approved our long-term goals. The Board has approved the transition of CEO. And me and the Board together decided on hiring Steve and bringing Steve to the company.

Steve had a great opportunity to review the company's strategy, to review our strategic goals, to review our aspirational goals both for 3 years out and the 7 years out and after doing that, excitedly decided to accept our offer and join the company.

I do not expect to see any major deviation from our strategy going forward. Our business model, our financial model, our operational model have proven themselves over the last 6 years to be extremely capable, yielding results normally ahead of plan. And yes, we are very acquisitive and we do have a very healthy balance sheet with a dry powder that will allow us to continue to pursue inorganic growth.

Steve has a great experience in his previous position at Amkor to go and pursue inorganic growth, acquiring companies, effectively integrating them, increasing value and delivering a really strong shareholder value. So from my vantage point and after talking to Steve during the process of hiring him, Steve is fully aligned with our long-term strategy and our long-term aspirational goals and, again, supported by the Board.

Last comment. Steve and the management team compensation plan is linked directly to our long-term growth and objectives.

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

That's very clear. Yuval, again, congratulations. Thank you for the answer and great job in transforming this company.

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

Thank you very much. I really appreciate that.

Operator

Your next question is from the line of Tom Diffely of D.A. Davidson.

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

Yes. Congratulations from me as well, Yuval. Clearly...

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

Thank you, Tom.

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

(inaudible) both a nice turnaround at the beginning of the story and then a really impressive growth in recent years. So job well done.

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

Thank you for (inaudible).

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

My pleasure. Looking at the end markets, it sounds like dropped off a bit in industrial and medical. Is that purely just seasonality? Or is there anything beyond that?

And then adding to that, on the telecom networking side, it sounds like you're trimming your portfolio a bit. Any more color on that would be helpful.

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

Sure. So yes, indeed, the medical, industrial, definitely seasonality. And also, our medical business was really strongly affected by COVID-19. As you recall last year, we saw a burst of demand coming from critical care equipment that required our power supplies when the whole world was chasing ventilators and critical equipment. At the same time, we saw a decline in elective procedures. That was a little bit of a headwind.

Just to remind everybody, 3 years ago, our medical business was 0, right? So we have entered the medical industry just a few years ago and started growing and expanding and it's is part of our strategy. Going forward, we expect to see continuing growth in the medical space driven by design wins and entrants into new applications, just like the one we announced about entering into more diagnostic -- very, very sophisticated diagnostic equipment.

And also, I'm very excited about the acquisition of Versatile Power. As you recall, in our Analyst Day about 18 months ago, we talked about an area in medical that we are going to pursue, which is RF Power supplies for medical applications. Versatile Power brings to us deep knowledge, experience and capabilities in RF Power supplies that are used for highly invasive procedures.

The reason we acquired Versatile Power was to accelerate our time to market. They are a bona fide player, supplying RF power supplies for one of the leading companies in the world in these procedures. And now as a result of this acquisition, they brought us the scope and we bring them the scale to accelerate the growth and to leverage on the global infrastructure that AE has.

In general, industrial, you should expect to see our business operating and growing at GDP plus. As we said earlier, we are pursuing a portfolio optimization strategy that is a combination of, in some areas, terminating end-of-lifing products; in some other areas, increase prices; in some other areas, shifting the focus to higher value-add products so that the mix will result in shifting of the gross margin bell curve to the right. And we are making great progress.

The area that we mentioned earlier today in telecom and networking is an area that is more of a focus area in 2021, although our strategy is to go across the board implementing a classical 80/20 process to weed out the -- as I call, the not very healthy products and continue to shift to higher-value solutions.

Did I miss anything, Tom?

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

No. That's helpful. And maybe just as a quick follow-up. Paul, can you give us a feeling for how much lingering costs there is from COVID, both in your OpEx and maybe even in your supply chain?

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

Yes. We've talked about that kind of running in the 50 basis points range. And it bounces around a little bit more, a little bit less. As I mentioned in our prepared remarks, we are seeing some headwinds on supply chain costs specifically related to some of the logistics and shortages, in part due to higher global demand and in part due to the fact that COVID still has many suppliers running below full capacity. So it is -- continues to be a bit of a headwind for us in that range.

Operator

Your next question is from the line of Quinn Bolton of Needham & Company.

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

Yuval, congratulations on your retirement and thanks for your leadership over the past several years.

Paul, I wanted to start with you on your comments about the costs in the supply chain, potentially some shortages. Wondering if those component shortages are limiting your ability to meet demand in the first quarter. Or is your operations team able to get all of the semiconductor components you need for the power supplies to meet customer demand? And then I've got a follow-up question.

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

Yes. I think when we talked about the guidance, we tried to be pretty open that demand continues to be strong. But we do see risks in the operations around the supply chain just getting enough parts. Obviously, that's something you're always dealing with and we continue to deal with. It's a daily battle. But we tried to have our guidance reflect the environment we're operating in, which -- it's not us. It's the broad -- there's a broad problem across the microelectronics industry and electronics industry. And in the near term, we think that will impact our ability to ship product. And that's contemplated in the numbers we put out.

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

So the forecast and the guidance are risk adjusted to reflect that, Quinn. And we have the benefit of reporting later in the month. So we have, I think, a better visibility in what's happening in the market.

And it's not across everything in the supply chain. It's really a few components, just a few components, IC components that affect us, the automotive industry and other industries. Obviously, you need all the bond to be able to build a product.

So the good news, we have really strong demand. And as I said earlier, our semi demand is growing in Q1 and we expect it to accelerate in Q2. Short term, our guidance reflects the risk adjustment related to shortage in ICs.

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

Great. Just a follow-up on that. Just wondering in your conversations with the supply chain, how long do you think that they will be capacity constrained? I think it takes probably 6 to 9 months sometimes to bring on additional wafer supply. So I'm wondering if you think it could be an issue you're facing for most of the year.

And then my second question was going to be just around, Yuval, the update on the 48-volt power shelf business. It sounds like you're securing some additional design wins. But just wondered if you could give some more color on the 48-volt power shelf opportunity and sort of design win status.

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

Yes. It's a good question, Quinn. Obviously, it's a difficult one to answer. But clearly, everybody, top to bottom, in the supply chain is working together to get in more parts. And of course, the demand continues to grow, as Yuval said. So we -- this isn't going to be solved in a week but we don't see it as a long-term issue either. So we'll be monitoring it closely.

We saw something a little similar last year with COVID onset there. It took us a couple of quarters to catch up, if you will, in the factory to the demand. So we'll see how it goes but clearly, that's a big area of focus for us and I think the whole industry.

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

Quinn, regarding the 48 volts, these are 2 separate wins. Number one is a new hyperscale customer for our 48-volt power shelf. And as you recall, the power shelf is really a power supply that goes in the rack and support multiple servers, right the second design win is a board-mounted 48 volts that converts from 48 volts to 12 volts DC-to-DC converter. And this one is designed into the server itself, not in the shelf. So these are 2 -- in a way, you can look at that as 2 different application spaces.

We have been designing 48 modules in the past in the telecom and networking space for many years. And for that reason, we have the expertise, the technologies and the experience that we can put that very quickly into data center application space.

It takes time to go to mass production. But these wins really prove our technology and support our long-term targets of adding an annualized revenue of over $100 million incremental by 2023.

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

Excellent. Congratulations again, Yuval.

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

Thank you, Quinn.

Operator

Your next question is from the line of Krish Sankar of Cowen & Company.

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

Yuval, congrats on a solid term at AE. I had 2 questions. First one is on semis. You spoke about sequential growth in Q1 and Q2. Is that mainly a function of NAND spending moving through the system? Or are you seeing like other aspects of WFE giving you that strength in Q1 and Q2?

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

I think it's the same market drivers that you all see in terms of both NAND and foundry. But at the same time, we see a few -- we have a few unique drivers that drive our business in semi. As you know, we have grown our RF matching business faster than the market. We have new products that we launched to the market. We expect to see growth. And also, we continue to gain share in cross-selling the embedded power supplies into the $300 million SAM of the embedded power application space in the semi industry.

So we have multiple drivers that will grow our business. But I can tell you that from our vantage point, right, and the information we gather, demand is going to be, I mean, strong in Q1 and accelerating in Q2. And obviously, as I mentioned earlier, everybody's challenge right now is going to be based on can we all get the IC components to deliver those products on time to market? But the demand is strong. I'm very excited.

We expect 2021, as we said earlier, in general, to be a growth year for us. Obviously, what we see right now in the semi space is an accelerated growth in demand.

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

Got it. Very helpful, Yuval. And then a quick follow-up. You gave some color on data center and the dilution that you're seeing there. I think you mentioned in your prepared comments it should pick up later this year.

I'm kind of curious where -- what is the catalyst or leading indicator you're looking for? Is it more like IT enterprise budget improving? Or what are the key drivers for data center to recover in the second half?

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

Well, the industry is launching new microprocessors and adopting new microprocessors. So a lot of the buying demand in data centers is driven by the microprocessors or the GPUs that are being launched to the industry.

Now we are in a very unique position, Krish. We came from 0 just 2 years ago and have grown the business. As you saw, our growth rate in 2020 was 250%. As we came from nothing to becoming a viable bona fide leading player, displacing incumbents and gaining market share, we are -- as a laggard, we do not have the presence among all the hyperscalers, the Tier 1 and Tier 2 hyperscalers. And for that reason, we saw this surge in growth in 2020. But at the same time, as the industry goes through digestion, our presence is still small, right?

So we expect the industry to grow later this year. And we expect our growth rate to continue a few years out as we transition our design wins into mass production and to growth. And as we reported, we have additional design wins at top-tier hyperscalers that we expect to convert to revenue later this year.

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

Got it. Yuval, congrats again for everything you've done for AE.

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

Thank you, Krish. Appreciate it.

Operator

Your next question is from the line of Amanda Scarnati of Citi.

Amanda Marie Scarnati - *Citigroup Inc., Research Division - VP & Semiconductor Consumable Analyst*

First off, Yuval, congratulations and enjoy your retirement.

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

Thank you, Amanda.

Amanda Marie Scarnati - *Citigroup Inc., Research Division - VP & Semiconductor Consumable Analyst*

You're welcome. I just want to follow up on that DC digestion topic that you were just talking about. Should we think about this as sort of similar to semis, where we see a big step-up in inventory build in data centers followed by a large period of digestion? Or is this really just a matter of you're still early on in building out this market and it's going to be [multi] going forward? So which way should we look at this, cyclicality or just lumpiness in getting started?

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

Yes. It's a good question, Amanda. I think it's both. There is definitely a digestion in the market. As you heard from Edwin, I think last time we talked publicly, the timing of Intel -- transition to Intel's new technology affected the whole market. The transition to new microprocessors affected buying decisions. And also, these are very large investments, capital investments. And they tend to have this very (inaudible) behavior of large investment digestion followed by large investment digestion.

Now if we were -- in our case, if we were present in all the players today, right, we will see less fluctuations because not all of them are lumpy at the same time. The fact that we have only 1/3 of the market and growing make us a little bit more susceptible to the expansion and contraction. As we continue to grow, as we continue to migrate our design wins into mass production, obviously, we will be more diversified and less susceptible to the lumpiness.

Amanda Marie Scarnati - *Citigroup Inc., Research Division - VP & Semiconductor Consumable Analyst*

Great. And then switching over to the semi side. Can you talk about any sort of pull-ins that you might be seeing or unusual demand on the OEM side and how, if at all, you're handicapping SMIC and China generally in your guidance?

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

I don't think that we saw any abnormal behavior in the semi business. The way we operate with our key customers in semi is based on just in time. They pull our product from a hub when they need them. They give us demand signals and indicators going forward. And what we see right now, as I said earlier, is real demand growth, real demand growth that is right now, on a short term, affected by the availability of IC components that we all need, including the automotive industry. We all need to build products.

Regarding SMIC, honestly, right now, as we look at SMIC, we cannot comment on SMIC. And I think everybody, including our customer, is trying to get license to ship product at SMIC. So I don't think that at this stage we can comment on that.

Operator

Your next question is from the line of Pavel Molchanov of Raymond James.

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

Yes. So one of the things that's obviously happened since the last earnings call is the Biden inauguration and the prospect of trade normalization between the U.S. and China. To the extent that you have faced any regulatory or other pressure in the Chinese market as a U.S. company, I'm curious what kind of change would be meaningful from AE's perspective specifically?

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

Thanks, Pavel. So I don't think that you're going to see any change in AE as a result of the change in administration. The one thing that we are really proud about is our decision 2.5, 3 years ago to diversify our operation around the world with a focus on business continuity strategy that led us to build our factory in Malaysia way before even everybody talked about elections. And the whole idea was to ensure that we have the agility and the nimbleness to address geopolitical changes, political changes, IP risks, et cetera.

So the fact that we have our global footprint, the way we have it today, allows us to be extremely flexible and to make a decision together with our customers where to build our product and where to ship it. So you can imagine, we can ship -- we can make in China to ship to China. We can make outside of China to ship to outside of China. And it's all in full alignment with our customers and obviously with an alignment, full alignment with local regulatory requirements.

So one of the reasons that we have done so well last year through the challenges of COVID-19 was this ability to be nimble and flexible and agile. So right now, we're not freaking out about the change in administration. We also believe it's going to take time for any decision to take effect. And if it does, we have the agility to respond to it.

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

Okay. That's helpful. Follow-up question on the dividend. At the time that you guys were setting the rate, $0.10 a quarter, obviously, the stock was quite a bit lower than it is today. So the yield now is barely 0.3%. Are you ready at this stage to commit to a progressive dividend policy? You don't need to say how big the increases will be. But just will there be a plan to raise the dividend with earnings or at some kind of annual road map over time?

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

Yes. It's a good question. Obviously, that's a decision that we would revisit over time and the Board will revisit. But when we introduced the program, we actually said that there's room for that to grow. So obviously, there's no specifics around that but there's certainly room for that to grow over time.

Operator

Your next question is from the line of Paretosh Misra of BCM.

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

So I just wanted to circle back on this news flow about chip shortage. And I was just wondering if there's any role Advanced Energy can play in terms of helping customers increase production. So anything basically that can be done from the power supply side that can boost their productivity.

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

Well, obviously, if customers decide -- if end-use customers decide to add capacity to manage the demand, the increase in demand for IC devices, we will be benefiting from that because we -- our power supplies enable the semiconductor processing tools and technologies. We cannot influence the market but we can respond to the market quickly.

We were monitoring -- look, over the last 38 years that I've been in the semi industry, we've been there before when the market entered into a shortage of components. And in general, what you see is an increase in effort and sometimes in costs of getting components through various channels. And at the same time, increasing capacity growth, where with some companies that are able to respond quickly and increase capacity really gear up, get equipment and increase the capacity of the fab.

So it's a very dynamic environment. We've been there before. We have a very nimble and sophisticated supply chain management team and processes that will allow us to recover.

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

And I guess a follow-up for Paul. For modeling purposes, any changes to income statement items like depreciation, SG&A, attach rate relative to Q4 that you think is worth flagging as we think about Q1 and beyond?

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

Yes. We tried to comment on that in the prepared remarks but I should -- I'll say, generally speaking, not a lot of change. We talked about OpEx up slightly. We talked about the tax rate staying in the 15% range. So no big changes in those various line items.

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

Again, congrats, Yuval, for all that you achieved in your career and all the best for the next phase in your life.

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

Thank you very much, Paretosh.

Operator

Our next question comes from the line of Weston Twigg of KeyBanc Capital Markets.

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

Real quickly. The semi cap demand sounds extraordinarily strong in the first half of the year. You said it's accelerating in Q2. And I'm just wondering -- I don't know what your visibility is. I know it's typically not more than a quarter or 2. But regarding the second half, do you think that acceleration continues? Or do you see any signs of moderation from your customers?

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

Wes, I don't think we are -- we have that visibility and I cannot comment on the second half. In general, as you heard from our partners and end customers, the expectation in general, the consensus, is 2021 is going to be a growth year, an exciting year in semi. We agree with that. We support that.

The one thing that became clear to us, as we speak, is that this demand in Q1 will accelerate in Q2. And we have enough demand signals that allow us to state that. The demand is strong in Q1, growing in Q2. And as I said earlier, it's all about the ability to deliver on time on this demand. And it has to do with the shortage we talked about.

I can't comment on the second half. I can tell you again, 2020 year -- 2021 will be a growth year for the industry and will be a growth year for Advanced Energy.

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

Okay. That's helpful. And then just finally, Vertical Power. Can you tell us how much of a revenue contributor that is?

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

It's -- Wes, it's very small. The acquisition was an example of a tuck-in acquisition of unique technology, unique product with unique capabilities that brings a very special relationship with one of the leading surgical equipment companies in the world. And from that point on, we expect to see growth due to our scale and footprint and market outreach.

Operator

And that does conclude the Q&A portion of today's call. I will now turn the call back over to Yuval Wasserman for any closing remarks.

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

So I'd like to thank everybody for your support and engagement and partnership over the last 6 years or 6.5 years. It's been a pleasure to get to know you all and working with you.

I'm excited about the future of the company. I'm excited about Steve Kelley joining us. He brings all the attributes to be a great successor, to take the company to the next level while I'm fading away and pursuing my personal interests. I will remain in the company until March 2022 to support the Board and Steve.

Thank you again, and have a nice day.

Operator

Thank you. This does conclude today's conference call. You may now disconnect.